Reckoning due for businesses reliant on capital injections

Todd Gammel (left) and Simon Cathro

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Amid a changing market outlook, businesses reliant on capital injects may need to re-think their balances sheets, according to a pair of insolvency experts.

The dire warning comes at a time with digital advice provider a.i. entering voluntary administration and licensee balance sheets being challenged, but the principles apply to any business in the financial advice space including practices themselves.

Simon Cathro, founder and managing partner of restructuring and insolvency specialist Cathro & Partners, says his general view on advice tech providers is they are often too heavily reliant on capital injections because they're not cashflow positive.

"What we're seeing at the moment – and it's not just that industry specifically but genuinely any business or industry that's heavily reliant on capital injections – the investor appetite is they're expecting a quicker turnaround into profitability," Cathro tells *Professional Planner*.

"These days, the importance of profitability is significantly greater so there's some pretty tough decisions being made in the businesses that are heavily reliant on cash or capital injections."

HLB Mann Judd restructuring and risk advisory partner Todd Gammel specialises in working with hedge funds and venture capital around trying to find financial solutions outside of the formal process.

When it comes to investors pulling money, he says the overarching theme is where the business is in its lifecycle and how close it is to being self-sustainable. However, if the business is a long way from being profitable and too speculative – even if there is a potential upside – it will still be a challenge to find further funding.

"Then you run into the current owners/investors and anyone wanting to come in around pricing," he says, adding this can further lead to an impasse that doesn't solve the issue.

Pressure pushing down

The future model of licensees is still under pressure with licensees covering all market segments dealing with margin constraints.

The two major players – Insignia Financial and AMP – have worked since the Hayne royal commission to return their advice licensee businesses to profitability.

The two CEOs, Alexis George and Renato Mota for AMP and Insignia respectively, will also be at the *Professional Planner* Licensee Summit to discuss the status of the licensee businesses.

For the most part, Gammel says there is largely only information provided by publicly listed licensees to go off, but there is "scuttlebutt", as in rumour or gossip, being driven by pressure.

"Those entities generally derive more income when markets rise and when a market is going down it can become more difficult," Gammel says.

"It can become more difficult when the markets go down, particularly when you have clientele requirements that aren't getting the return they expect. Then there's obvious pressure around pricing and value."

Shifting winds

Cathro says investor appetite has shifted towards a conservate approach which can be attributed to a variety of macroeconomic factors.

"What you're seeing now is what I would call a return to a more traditional approach around investment where people are placing the importance of profit right at the top," Cathro says.

Cathro & Partners were appointed liquidators of Metigy last September. Founded in 2015, Metigy used AI to provide small businesses with potential customer insights to inform marketing strategies.

Cathro drew on this recent experience as an example of the danger of a valuation not reaching expectations – he says the company grew to a $1 billion valuation but never drew a profit.

"Whilst there were other issues that caused the downfall of [Metigy], once you dug into the business and looked at the cash flow and the expected revenue from that, it wasn't that strong," he says.

In the current economic environment, Cathro says the cost of business has gone up significantly and businesses are concerned about the implications of wage growth.

"We will see a pickup in unemployment rate because people will really start to cut heads to reduce their cost base, because other parts of the cost base are growing," Cathro says.

"On the revenue side of things, if revenue is quite reliant on discretionary spend whether it's business or an individual's discretionary spend, then there's a lot more risk associated with that revenue because the cost of living, interests and the cost of doing business has increased."

The main advice Cathro has for businesses in any space is prioritising revenue generation and cashflow, and making sure the entity is working as efficiently as possible.

"If there's businesses or divisions or revenue streams in the business that are not performing sufficiently, then they need to think very closely around whether they should continue to operate in that space," Cathro says.

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