Client Group: Gary's Furniture

Submission Prepared By: Pearl Financial Services

Date Submitted: January 2010

Information contained in this memorandum has been provided by Gary's Furniture Pty Ltd for the purposes of obtaining credit. Pearl Financial Services Pty Ltd understands all the information contained here to be correct at time of writing, but takes no responsibility for information on which lenders rely. Lenders should make their own independent enquiries on all matters upon which they rely in making a lending decision.

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1 Application Summary

1.1 The Transaction

- Our client, Gary's Furniture, is looking to purchase a competitor's Operation and to borrow the full amount required for the purchase (not including Government costs). The reason for the desire to purchase is business efficiency based, as the current operation incurs greater costs and reduced capacity where as the target business will see these inefficiencies removed. This benefit is estimated to reduce COGs by as much as 10% for the existing operation.

- The expected interest costs for the new business are expected to essentially equal to the current cost base thereby demonstrating to the business that the cost of the purchase can be easily covered by the future performance of the business.

- The business is finalising negotiations with the target and a preapproved limit is required to provide the company with comfort in completing the deal in the near future.

- The company is indifferent regarding their existing banking relationship and hence is prepared to move all facilities for the right future relationship.

1.2 Facilities Required:

The following table details the existing facilities and new facilities required by our client.

Bank Product	Limit required	Current Limit	Proposed Term	Borrowing entity	Security	Purpose
Overdraft (Vic Business)	$1.2m	$0.8m	Annual Review	Gary's Furniture Pty Ltd	A, B, C	Working Capital for Vic operation
Commercial Bill **(New)**	$2.0m	$0	Annual Review	Gary's Furniture Pty Ltd	A, C, E	Business Acquisition
Commercial Bill / Term facility	$0.6m	$0.6m	15 years	Gary's Furniture Pty Ltd	A, B, C, D, E	Original land purchase
Commercial Bill / Term facility	$2.5m	$2.5m	15 years	Gary's Furniture Pty Ltd	A, B, C, D, E	Business premises construstion
Leasing Line	$1.3m	$1.3m	Annual Review	Gary's Furniture Pty Ltd	A, C, E	Equipment purchases
Commercial Bill	$0.8m	$0.8m	Annual Review	Mr Michael Smith	A, C, E	Financing of personal investments
Total	$8.4m	$6.0m				

1.2.1 Security Detail (refer Key above)

A. 1st Registered Mortgage Debenture over Gary's Furniture Pty Ltd in its own right and in its capacity as partnership manager of the Gary's Furniture Partnership, Smith Pty Ltd (atf The Smith Property Trust and atf The Smith Family Trust), GARY'S Plant and Equipment Pty Ltd and DEF Plant and Equipment
B. Limited Guarantee provided by Michael Smith
C. 1st Registered Mortgage over the Victorian business premises in Toorak Rd, Sunshine, estimated by directors to be valued at $4.5m
D. 1st Registered Mortgage over the business to be purchased and 1st Mortgage over the premises of the new business
E. Debt and Interest interlocking Guarantee between Gary's Furniture Pty Ltd, Smith Pty Ltd (atf The Smith Property Trust and atf The Smith Family Trust), Gary's Plant and Equipment Pty Ltd and DEF Plant and Equipment and the new entity

1.3 Security Cover

The company requires $8.4m in facilities per above. In return for these funds, the business will provide security as follows:

Property Security Available

Estimated Value of Toorak Rd Premises		$4.5m (estimate given by Directors)
Value of new property		$5m (assumed based on purchase value)
Extension value @	*65%*	*$6.175m*

Note the director's estimate is based on the fact that the new premises are essentially a mirror image of the Victorian premises and hence the purchase price of the new premises should indicate a similar value.

Business Assets

The financials for the business are not currently audited, hence depending on bank policies regarding extension; it is assumed that most lenders would extend minimal to no value against business assets, as demonstrated in the following estimated valuation based on the values contained in the 2009 Management accounts:

Credit Submission

	Unaudited	Input Data		Extended Value	
Debtors					
Invoice Finance Debtors	80%			-	
Debtors (up to 90 Days)	15%		2,790,391	418,559	
Insured Debtors	25%			-	
Overseas Debtors		-			
Intercompany Debtors		-			
Debtors with right of set off		-			
Debtors with Concentration >30%		-			
Doubtful Debts		-			
Total Debtors					418,559
Inventory					
Raw Materials	50%			-	
WIP	30%			-	
Finished Goods	15%		2,039,791	305,969	
Subject To Romalpa		0			
Perishable, Obsolete and Damaged					
On Consignment					
Market value is lower than cost					
In Transit or Overseas					
Total Inventory					305,969
Plant & Equipment (refer Rapid P & E)					
Non-specialised	15%		461,308	58,685	
Specialised (P&E)	5%		106,638	5,332	
Farm machinery	10%			-	
HP Liability - Non Specialised		70,074			
HP Liability - Specialised					
HP Liability - Farm machinery					
Total Plant & Equipment					64,017
Less Insolvency Costs					
Estimated Employee Entitlements	8,500	per employee	34	289,000	
Receiver/Liquidation Costs					
Current Assets	15%	of extended value	724,527	108,679	
Non-Current Assets	15%	of extended value	64,017	9,603	
Total Insolvency Costs					407,282
					381,263

It should be noted that as a worst case scenario, all inventory held by the business has a market value at Auction based on 50% of book value as confirmed by valuers. This ensures that in a liquidation scenario the controller of the business would obtain 50% of book value for the stock held at this time. As the financials are unaudited a bank does not have third party verification of stock value however assuming the current book value is correct, a further $652k can be added to the security valuation detailed above.

In recognition of a security shortfall the business would expect to undertake a rapid amortisation of the "unsecured" amount (say over 3 years or faster if cash flow allows) to ensure that the facilities be fully secured as soon as practicable.

1.4 Summary Risk of the Business/facilities

- Performance of the commercial property industry is feared to continue a period of contraction, however in FY2009 the business enjoyed year on year revenue growth contrary to generally subdued conditions. The business model was developed during the last recession providing comfort that the model has been tested in depressed market conditions
- The security valuation is less than the facilities, however the valuation held suggests that a far greater recovery amount would be achieved in a liquidation than bank policy currently allows for.
- The business enjoys a unique market proposition of in the design of furniture and th long standing international brand that attaches to this business offering will ensure strong on going sales potential.
- The longevity of the company in its market place ensures that its brand is strong and its client base is long established
- The business is supported by local government due to its local manufacturing content and the importance of employment of local staff
- The business has a long history of successfully integrating newly acquired businesses

Client Details

Borrowing Entity: Gary's Furniture Pty Ltd

ACN: 123 456 789

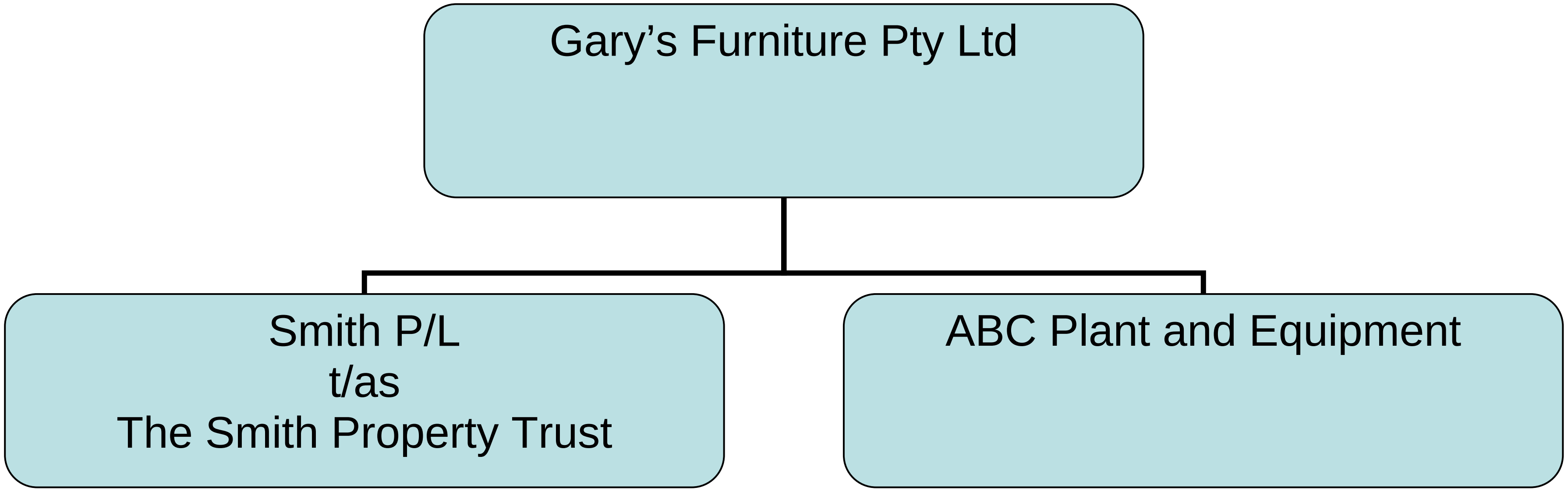
Trading Address: 27 Toorak Rd, Sunshine

Company Website: www.garysfurniture.com.au

Number of Employees: 134 FTE

Year Commenced Trading: 1972

Group Structure: Refer attached Org Chart for the full group structure. The following shows the key trading and asset owning entities in the group



Directors as at 30 September 2008 (ie prior to ownership restructure)

Name	Appointment Date	Background
Michael Smith	**1972**	Founder
Barry Jenkins	**2000**	31 years in the Furniture businesses in CEO and GM positions

Shareholders as at 1 October 2008

NAMES	% OF SHARES HELD
Michael Smith	75%
Barry Jenkins	25%

2 Business Background

2.1 Business Description

Sourcing local timbers and Chinese Metals, Gary's Furniture is a significant manufacturer and distributor of stylised furniture designs to the Australian Architectural and interior design industry. Gary's have manufactured furniture since 1972 and have established themselves as a top of mind player with their target market. The business prides itself on being the most responsive supplier in the market, generally supplying orders within 2 weeks, which provides clients with short order times, reduced working capital consequences and a quality product.

The business predominantly focuses on the commercial furniture industry.

2.2 Industry Outlook

Market commentators continue to portray concern over the prosperity of the commercial property market for the foreseeable future. However Gary's Furniture was started prior to the last major recessions in 1972. The management recognised that supplier competition hots up as there are less construction projects available and property owners look to the best performers to supply them. The slump in new developments is also taken up by a desire to refit properties and this is key to the business growth.

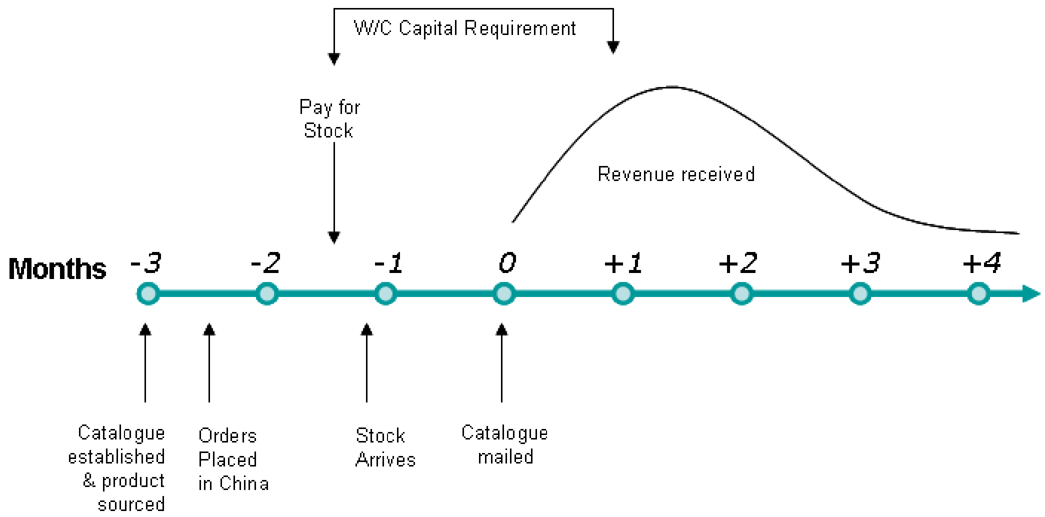
Gary's Furniture's market proposition of 2 week turnaround was developed in 1990 to give it an edge, and whilst this has been key to its success in the good times as well, the reputation it has developed is expected to provide it with above system growth in harder times.

Whilst the industry has seen considerable growth in competition, the commercial property industry respects this business and is inclined to use them is still active, and the pipeline for future sales remains strong. This is evidenced by the fact that the business continued to grow in the 2009 financial year.

New initiatives in the market include changes to upholstering techniques, which Gary's monitors continually.

2.3 Trade Cycle Description

The business currently sources stock from China (35%) and Australia (65%), however international stock is purchased through local Australian distributors, hence the business does not actually deal directly with international parties. All purchases are made in AUD. The business is not invoiced for inventory until it arrives at the business premises, and then typically enjoys 45 days (end of month) to pay for this stock.



All purchases are made to supply existing customer orders, hence there is no obsolescence. Even if the company over ordered, as a worst case all stock can be sold on Auction websites (Grey's online). The business currently receives 50% of book value for such sales.

The business does its own finishing of the purchased stock in accordance with client requirements. This finishing does not affect the inventory value, ie there is no tangible value add applied to inventory between purchase and sale, as represented in the books and records of the business.

When sold, the business includes a retention of title clause in the sale terms and conditions. Standard sale terms are 30 days.

2.4 Competition

The furniture industry is very competitive with no major provider leading pricing in the industry.

2.5 Supply Risk

There are plenty of suppliers both locally and in China, with new approaches of supply being made almost weekly to the business. This large market ensures that no one supplier controls price.

2.6 Demand Risk

The business is not reliant on any one customer and the spread is wide, both in number and in geographical reach. The business continues to gain new customers and extend markets. The business braced itself for a decline in demand following the global financial crisis increasing margin, however the sales performance for 2009 finished 6% up on the previous year.

There exists however 4 key factors that remove concern regarding the risk of a decline in demand at an industry level:
1) The value proposition and key systems and processes were developed prior to the last recession in the early 90s giving comfort that the proposition and the management are capable of riding out adverse conditions
2) Improvement to both process and product range have meant that Gross Margin is up significantly year on year, hence the business is actually turning greater profit this year
3) Geographical diversification has meant that pre Xmas whilst Victorian sales are down 2%, NSW sales are up 35%, so in dollar terms the end result is consistent performance. Since Xmas the market performance has reversed with NSW declining whilst Victoria has increased.
4) Further efficiency and process cost reductions that will come from the purchase of the new business and will enhance the profitability of this business.

In the early 90s smaller competitors ceased to be able to operate and it is expected that the same thing will likely occur again during this period. Hence whilst there is less business available, there are fewer competitors available to gain the work. This will also work for Gary's.

2.7 Geographic Risk

The business continues to diversify the geographical markets that it supplies. This includes a warehouse in Bordertown, sales representation in Canberra, Adelaide and Brisbane, and plants in Melbourne and Sydney. The business does not currently operate in Perth, which should reduce the impacts of any decline in economic environment as NSW is well documented to be suffering more than most states.

2.8 Technology Risks

The business continually monitors the technological environment to ensure that it stays on top of any advancement.

2.9 Credit Risk

Credit assessment processes exist in both Vic and NSW with credit history checks undertaken with Veda Advantage for all new clients, together with reference checks undertaken with 3 existing suppliers for the prospective new client. The business also has strictly monitored credit terms with calls made to late accounts on the 6th of the month and then again on the 15th. If payment is still not forthcoming then supply is stopped.

Trade credit insurance is also taken for Adelaide clients, where the relationships are not as long and the directors are further removed.

2.10 Regulatory Risks

Nil

Business Analysis

2.11 Business Strategy

The company aspires to the position of the largest supplier of commercial furniture on the Eastern Seaboard. The business would like to consolidate its Queensland operation, including setting it up in an owned showroom. Directors see the opportunity to extend growth into new regions through the acquisition of competitors, like the current target and given the market leading gross margins of the business this provides tangible synergies with acquisition prospects.

The business is looking to take on a number of resellers to extend its reach in the target regions as well as broaden reach in new areas. They have recently taken on an agent in the Western District of Victoria, supplied by the Border town distribution centre which has proven very successful for the business. The business will also look to extend its product range, though staying within the commercial furniture market, as a means of growing revenues from existing clients.

2.12 Sustainable Competitive Advantage

The business has two key advantages – its longevity, which new clients find reassuring and existing clients continue to enjoy, and the speed of turnaround, which no other provider can match. This is important to clients as it allows them to fit ordering of supplier more easily into the project plan of the construction.

2.13 Business Premises

The business owns its Victorian premises and is looking to acquire further NSW premises through the aquisition. The current rental agreements on all other premises are based on a 5 x5 x5 lease contract with all premises in the first 2 years of the current lease agreements.

2.14 Management and Leadership

Key Management are summarised in the following table:

Name	Position	Commenced	Role Summary, Relevant Experience and Qualifications
Michael Smith	MD	1989	Whilst historical experience as a vetinarian was not particularly relevant, Michael has now worked in and owned the business for 20 years.
Barry Jenkins	General Manager	2002	31 years in the Furniture industry in general management and CEO roles. Barry is responsible for Finance and business operations.
Peter Fredrickson	State Mger, Qld	2005	8-10 years working in the industry and prior to this working with Natuzzi. Peter is responsible for sales and operations of the NSW business

2.15 Succession Planning

The directors believe currently that the business will ultimately be sold rather than expecting existing staff to take over the business operations. However recognising that the business is essentially exposed to sole ownership, Michael as the founder has brought Barry in as GM to broaden management contact and provide protection against the unexpected. Michael currently holds Key Man Insurance.

2.16 Negative Credit History

Nil

2.17 Strengths and Risks

2.17.1 Strengths

- Strong historical financial performance
- Longevity of operation and experience of management
- Unique value proposition
- Funding increase directly impacting on operational efficiency whilst business purchase is cost neutral for the group before principal reductions

2.17.2 Risks and Mitigants

The following key risks are identified in this proposal

Risk	Mitigants
Commercial property market slump	▪ Business model developed pre last recession ▪ Strong brand in market with desirable and uncontested value proposition (speedy turnaround) ▪ Strong Balance Sheet to ride out any market slump
Large Debtor defaults	▪ No debtor accounts for more than 10% of Receivables currently ▪ Stop credit policy at 45 days ensures no debtor can “blow out”
Supplier Concentration	▪ Diverse market allows the business to continually test current suppliers with the competition
Low level of security cover	▪ Strong servicing ▪ Expectation of management to reduce debt to within security cover level within 3 years ▪ Land values in NSW seen to be at a low, ensuring capital appreciation will continue to improve security position

Succession Planning	- Diversified management with Barry Jenkins joining the business 6 years ago - Key Man insurance held by the business - High demand for business from competition would ensure a strong likelihood of the business being sold if required
Occupational Health and Safety	- The business maintains a strong record of health and safety - Detailed health and safety management procedures in place - Use an external consultant to drive policies, procedures and management
Complex Group Structure	- Business to address this with Accountant during the financial year

3 Financial Analysis

3.1 Financial Reports Summary

3.1.1 Gary's Furniture Partnership

The following Financial analysis is undertaken on the Gary's Furniture Partnership as the primary trading entity of the group.

P & L	**31-12-2006**	**31-12-2007**	**31-12-2008**	**Comments**
Revenue	31,500,000	35,000,000	42,000,000	Strong Revenue growth
Revenue Growth %	0	11.11	20.00	
Gross Profit	9,100,000	10,500,000	13,020,000	Strong Gross margin Improvement
Gross Margin %	28.89	30.00	31.00	
Overheads	6,540,000	6,749,990	8,400,000	
Operating Expenses %	20.76	19.29	20.00	Flat performance
EBITDA	2,560,000	3,750,010	4,620,000	Solid growth
EBIT	2,560,000	3,750,010	4,620,000	
Profitability %	8.13	10.71	11.00	
Interest Expense	756,000	1,165,900	1,363,479	
Profit Before Tax	1,804,000	2,584,110	3,256,520	
Net Profit	1,154,560	1,653,830	2,084,172	

Balance Sheet	**31-12-2006**	**31-12-2007**	**31-12-2008**	**Comments**
Cash at Bank	0.00	0.00	0.00	
Acc Receivable	4,315,060	6,712,330	8,630,136	Recoignised to be increasing faster than Revenue and new systems impl.
Inventory	9,084,440	10,336,960	14,291,506	Currently too high and will come down with implementation of inv system
Other CA				
Fixed Assets	7,500,000	8,500,000	9,500,000	
Investments				
Other NCA				
Total Assets	20,899,500	25,549,290	32,421,643	
Short Term Debt	1,761,180	5,019,740	7,279,813	Negative cash flow due to increase in Rec and Inv.

Accounts Payable	4,290,000	4,028,550	5,557,808
Other CL			
Long Term Debt	9,000,000	9,000,000	10,000,000
Other NCL			
Total Liabilities	15,051,180	18,048,290	22,837,621
Equity	5,848,320	7,501,000	9,584,022

The business has traded well but recognises that it has performed poorly regarding cash flow. To combat this poor performance the business has implemented a new Accounts receivable process to ensure earlier collection of debts, and a new inventory management system has now been implemented to ensure that inventory management is more tightly managed.

3.1.2 Gary's Furniture Partnership Ratio Analysis

	31/12/2006	31/12/2007	31/12/2008	Comments
	12	12	12	
Coverage Measures				
Interest Cover	3.39	3.22	3.39	
Debt Service Cover	0	-0.94	-0.66	
Efficiency Measures				
Days Receivable	50	70	75	
Days Inventory	148.03	154.00	180.00	
Days Payable	69.90	60.02	70.00	
Working Capital %	28.92	37.20	41.34	
Activity	1.90	1.63	1.56	
Quick Ratio	0.71	0.74	0.67	
Current Ratio	2.21	1.88	1.79	
ROCE %	15.41	17.43	17.20	
Leverage Measures				
Leverage	2.57	2.41	2.38	
Equity / Total Assets	27.98	29.36	29.56	
Debt to Equity	1.84	1.87	1.80	
Bank Debt to Liabs	0.71	0.78	0.76	
Borrowed Funds	10,761,180	14,019,740	17,279,813	
Debt to EBITDA	4.20	3.74	3.74	
Cash Measures				
Change in Net Debt	-10,761,180	-3,258,560	-3,260,073	
Cash After Operations	-6,549,500	-161,230	276,904	
NCAO	-7,198,940	-1,091,510	-895,443	
NCI	-7,954,940	-2,257,410	-2,258,923	
CADA	-7,954,940	-2,257,410	-2,258,923	

3.2 Debt Servicing

Debt servicing is calculated based on the performance of the group in 2008 (refer Group Performance Analysis above) and performance of the Gary's Furniture Partnership alone in 2009 as follows:

	2008	2009
EBITDA	$3,750,010	$4,620,000

Interest Costs included a margin:

Overdraft (Vic Business)	$1.2m	$144,000
Commercial Bill **(New)**	$2.0m	$200,000
Commercial Bill / Term facility	$0.6m	$60,000
Commercial Bill / Term facility	$2.5m	$250,000
Leasing Line	$1.3m	$130,000
Commercial Bill	$0.8m	$80,000
Total Interest		**$864,000**

	2008	2009
Interest Cover	**4.34x**	**5.35x**

The very conservative calculation above demonstrates the group's ability to service the debt.

3.3 Taxation, Insurance and Superannuation Updatedness

All taxes, Insurance and Superannuation liabilities are up to date.

4 Attachment Schedule

The following attachments are provided in support of our client's application

	Michael Smith	Gary's Furniture Pty Ltd	The Smith Property Trust	The Smith Family Trust	Gary's Plant and Equipment Pty Ltd	DEF Plant and Equipment Pty Ltd
Tax returns for 2007	✓	✓	✓	✓	✓	✓
Tax returns for 2008	-	✓	✓	✓	✓	✓
Trust Deeds	N/A	N/A	✓	✓	N/A	N/A
Certificates of Incorporation	N/A	✓	N/A	N/A	✓	-
Tax Agent Portals	-	✓	✓	✓	✓	✓
Statement of Position	✓	N/A	N/A	N/A	N/A	N/A
Aged debtors and creditors listing	N/A	✓	N/A	N/A	N/A	N/A
Management Accounts for 2009	N/A	Vic + Qld	N/A	N/A	N/A	N/A
Business Plan	N/A	-	N/A	N/A	N/A	N/A
3 way Forecast for 2010	N/A	✓	N/A	N/A	N/A	N/A
Loan, Trading Account and Credit Card Statements[1]	N/A	✓	✓	✓	✓	✓

Together with Property Details as follows

	Purchase Contract	Recent Valuations	Recent Rates Notice	Copy of current lease
27 Toorak Rd, Sunshine	N/A	N/A	✓	N/A

[1] Some of the bank statements were collected late 2008 and will need updating prior to letter of offer stage