ADVICE FROM THE MANUFACTURING TEAM AT
ENSORS CHARTERED ACCOUNTANTS

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MANUFACTURING MATTERS

Bucking the Trend

By **Chris Barrett** – Manufacturing partner

If 2020 was not already going to be an uncertain year in the lead up to our full withdrawal from the European Union, nothing could have prepared us for the outbreak of COVID-19.

Given the pace in which the pandemic took control of us, both personally and in business, it would have been easy to "down tools" and scale back our activities.

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Bucking the Trend

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However, the fluidity of how those in manufacturing adapted to the situation, supported the drive to control the virus and support the NHS was testament to the industry and the ability of our businesses to react quickly.

This was certainly true within the region. I heard of a number of positive stories of businesses supporting the cause and it shows how important our manufacturers are both locally and to the UK.

Recently published data indicates that whilst the East of England has suffered loss of productivity and output during 2020 to date, it is lower when compared to other UK regions. In addition, the region actually saw an increase in employment in Q1 2020 compared to other regions which fell.

Whilst a number of sectors within manufacturing have undoubtedly suffered, the range of sectors the East of England is involved in has led to its figures being more positive than the UK average – showing once again the backbone of manufacturing to the Eastern Region.

Emerging from this pandemic it will be important for businesses to take time to assess current trends and the adaptations that may have been undertaken, ensuring good practices are taken forward to help grow the business in a different world. This will also be the case once we have a clearer picture of Brexit, and if a trade deal is agreed before 2021.

The region remains strong and adaptable. It will be interesting to see which manufacturing types grow in the short term and some that immediately spring to mind are life sciences, pharmaceutical manufacturing and the green economy.

Our latest edition of Manufacturing Matters has been created to remind us of areas which could be considered during this time and beyond.

Tax Partner Robert Leggett has summarised a reminder of the latest tax opportunities available to manufacturing clients. Shelley Minns, Business Services Support Manager, explains the need for strong cashflow management and provides her tips to do this. Finally, Simon Martin, Corporate Finance Director, considers if now is the time to think about exiting your business and the paths available for you to do so.

Let's hope the region continues to buck the trend and remain strong during these times.

Annual Investment Allowance (AIA) update

By **Robert Leggett**

The AIA (currently set at £1m per year), is the amount of capital expenditure on qualifying plant & machinery that a company can claim 100% Capital Allowances on, giving full tax relief in the year of purchase. Expenditure that doesn't qualify for AIA gains relief much more slowly, using writing down allowances at the rate of either 18% or 6% per annum (depending on the type of expenditure) on a reducing balance basis.

The £1m limit was a temporary measure, designed to assist with economic stimulus. Given the virus crisis, it is possible that the Government will choose to extend this, but we will have to wait for the Chancellor's Budget to find out what their plans are.

At the time of writing, the AIA is due to fall to its "normal" level, of £200,000 from 1 January. Businesses may therefore like to consider if there are any plant and machinery purchases that should be brought forward in order to gain full relief.

Businesses without a 31 December year end should bear in mind that they will receive a time apportioned AIA, so a company with a 31 March 2021 year end will receive £800,000 (£1,000,000 x 9/12 plus £200,000 x 3/12). However, the period after 31 December is restricted to the time apportioned part of the £200,000, so be extra careful; in our example, the maximum qualifying expenditure in the period 1 January 2021 to 31 March 2021 would be £50,000 (being £200,000 x 3/12).

AIA may also have to be shared across a group, or with other related companies.

Please speak to **robert.leggett@ensors.co.uk** for more information.

R&D tax relief in a COVID-19 world

By **Robert Leggett**

20 years on from its introduction R&D tax relief remains a highly valuable incentive for innovation. However, the pandemic has focused minds on particular aspects, with other changes coming as well.

Innovation to survive

The pandemic has caused new R&D to be carried out. An obvious example is companies rushing through new designs for ventilators and CPAP machines. However, a more subtle example could be, changing manufacturing processes to comply with social distancing, which leads to scientific or technological advances.

Subsidised expenditure

R&D expenditure that is “subsidised”, rather than funded by the company, is only eligible for R&D Expenditure Credit (RDEC), not the more beneficial SME relief. Where the subsidy is a “notified state aid”, the entire project is disqualified from the SME regime.

How does this fit with pandemic support schemes?

Coronavirus Job Retention Scheme (CJRS) and staffing costs
The CJRS is not a notified state aid, so does not disqualify a whole project but, as a subsidy, any salary funded by the CJRS cannot be part of an SME claim. However, as CJRS payments only fund the time furloughed employees are not working, they are not funding qualifying R&D so cannot be claimed under RDEC either. Nor can any top-up payments by the employer to the employee or employer’s NIC, pension contributions etc for the period of furlough.

Extra care is needed when preparing claims for periods covered by furlough, to ensure ineligible amounts are not accidentally included.

Holiday and sick pay
Holiday and sick pay are necessary costs of employees undertaking R&D, even where such payments are made during furlough. However, such costs are subsidised insofar as they are met from a CJRS claim, so to that extent would not be eligible for SME relief (but could be claimed under RDEC).

CBIL / CLBIL / Bounce Back loans
These are notified state aids, so if used to fund an R&D project they disqualify the whole project. Companies should ensure this funding is targeted at non-R&D projects, to avoid inadvertently disqualifying projects.

Cash credit or carried forward losses?

Some loss-making companies carry forward their R&D losses rather than surrender them for the cash credit because they expect to be profitable in future, when the losses could be more valuable. This might change, with the new focus on cashflow meaning the company chooses to take the cash instead for any current claims.

R&D and deferred tax payments

HMRC usually set SME and RDEC payable credits against other tax debts before paying the surplus to the company, but where there is specific tax deferral support for Covid-19 (i.e. automatic VAT quarterly payment deferral), offset will not be made so the claim can be paid in full. However, if the company has deferred taxes as part of a Time to Pay arrangement (TTP), then any R&D claim will be set off against the TTP debt.

PAYE cap

From April 2021 the amount of payable credit a SME can claim above a minimum claim of £20,000 will be restricted to three times the company’s PAYE and NIC payments in that year. Companies that rely heavily on sub-contractors and make large cash claims will be worst affected.

Our R&D experts have a wealth of experience in handling claims and are always happy to have an informal chat to determine if you might be eligible. Please speak to **robert.leggett@ensors.co.uk**

Exiting your Business

By **Simon Martin**

When is the right time for us to sell the business? It is a question which every business owner will ask themselves from time to time. The optimal time to sell is theoretically when profits are close to their peak and business is growing. However, overall risk and the potential decreasing appetite for risk as owners advance in years should also be considered.

Selling a controlling interest in a company can be distilled down to a series of negotiations on a range of matters, from the headline price, right through to the specific warranties offered regarding the past activities of the business. As with any negotiations, elements of brinkmanship are involved throughout. Being in 'last chance saloon' where an immediate sale is vital, does not give the most solid base to achieve the best deal possible.

The most favourable deals are achieved by owners who balance postponing a sale for X years to grow profits against the risk that their businesses landscape may change unfavourably in that time period. Simply put, always waiting until next year does not guarantee a greater return.

The best way is to plan for an exit as far in advance as possible and to prepare the business to increase value. Aside from growing profits, managing working capital so that swings in the bank balance are minimised can make a very big difference to the amount of cash which is agreed as surplus and therefore which ends up in your pocket.

There are a number of routes open to controlling shareholders considering an exit. The four most popular are:

Trade sale – A sale to another company. These types of transactions made up roughly half of our deals in 2019 but have slowed since covid-19. Historically, good prices were achieved if the purchaser had a strategic need for the company for sale.

Management Buy-Out – Selling to a management team is a process that is controllable and is usually a friendlier transaction. MBOs are commonly funded from a mix of the existing resources of the company, new debt raised in the company, deferred consideration and retained equity.

Employee Ownership Trust – an exit strategy of growing popularity. The proceeds of the sale are taxed at 0% and it ensures a lasting legacy. The sellers can also retain a shareholding. A trust is formed which the employees then participate in.

Private equity investment – 'PE' activity in the Eastern region is another growth area. Owners are sometimes sceptical about this option, worrying that 'suits' will take control of their business. Modern PE firms are not like this and look for a friendly rapport with the management teams of their investments.

For further information on how Ensors can help you please contact **simon.martin@ensors.co.uk**

CASE STUDY VANILLA ELECTRONICS LIMITED

Dan Croft had steered **Vanilla Electronics Limited** to strong growth over a number of years. The company reached the stage where investment to fund acquisitions would be required if growth were to be accelerated further.

Being in his late 30s, Dan was not ready to retire from the business but also did not want to increase his personal risk by introducing more capital to the business. The solution to this was a majority investment from Literacy Capital, a private equity firm, which allowed Dan to sell a controlling stake whilst remaining in control of day to day operations.

This move gave Dan less distractions ensuring that he could better focus on company growth and build up the senior management team. Areas of the business Dan enjoyed and where he could add most value.

Moving forwards, Vanilla now has the funds to make acquisitions to accelerate their growth and, by retaining a sizeable shareholding, Dan will continue to benefit from the growth achieved post transaction.

The importance of Cashflow

By **Shelley Minns**

Cash is King. Cash is what drives your business forward. Cash is what is used to pay overheads, employees, taxes and buy stock. Without cash, your business stalls. To prevent that happening you need to be able to predict your cash position, enabling you to make decisions and take action to prevent you running out!

Cashflows can very quickly become seriously affected for a variety of reasons such as:

- Customers paying late;
- Fluctuating cost of materials;
- Seasonal/fluctuating demand;
- Surplus stocks; and
- Poor tax planning.

Many of these may have affected your business in recent months with your customers struggling for cash themselves and being unable to pay bills on time or even being able to place orders. With any reduction in demand it's important to monitor your purchasing procedures to ensure appropriate stock holdings. You don't want valuable cash tied up in stock.

In the manufacturing sector, where costs are high and margins are low, cashflow issues are more likely to be commonplace. With high transaction volume and low value it's also more difficult to predict what your cash balance is likely to be at any point in the future without a robust bookkeeping system to facilitate cashflow reporting.

TIPS ON HOW TO TAKE THE HEADACHE OUT OF CASH CONTROL

1 Get your record keeping processes straight

You need to have accurate, up-to-date figures. Make sure your bookkeeping processes flow to help keep your records in line. Whatever software you are using there may be modules or features which you can use to help automate processes. Modern features such as bank feeds and invoice scanning can help save time and improve accuracy by removing human error. Efficiencies can buy you time to focus on any cash sensitive areas.

2 Monitor cash inflows

Ensure you have a credit control process that is fit for purpose. At the very least you should be sending out customer statements, reviewing credit terms and actively chasing any overdue payments. There may be a designated module within your software that can offer insights and provide tools to help with chasing debts. Alternatively, there are many cashflow software providers out there which will link to a variety of accounts systems. You could also opt to use credit check solutions to review and assess new and existing customers. These will help limit your risk of bad debts and should highlight accounts where you need to ask for payment in advance or even ask for deposits or stage payments to bring cash in earlier.

3 Manage cash outflows

Make sure you know what you need to pay and when – you don't want any surprises. If possible, you want to keep outflows steady or following the same trend as the money coming in. This is where a cashflow program or forecast will be able to show you what trend line your cash balance is on. Review payment terms or enter into payment plans with suppliers as this will ensure that you are maintaining relationships. And by continuing to make payments you can keep valuable materials coming in to enable production while keeping your cash levels at an appropriate level for you to meet wages and tax demands.

If you would like any support understanding your accounts system and how it can better work for your or, indeed, with any forecasting needs please contact **shelley.minns@ensors.co.uk**

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"Kalsec is an ingredient supplier for the food and beverage industry and have worked with Ensors for the last 20 years. We have found their service and advice professional and efficient, particularly valuing how Ensors know our business and people. We are a private and sustainable business operating in complex financial environments. In recent years, our European trading activities have increased, and we now work under several European jurisdictions. Ensors have provided comprehensive advice on several key areas such as corporation tax planning, joint venture incorporation and VAT compliance. As a thriving UK-based international business with strong capital investment and robust future growth planned, we firmly believe Ensors' continuous support as the independent and dependable financial adviser and auditor plays an important part in our ongoing success."

James Smith – Managing Director, Kalsec Europe Ltd

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