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Vanderbilt financial services: assessing future opportunities

Jessica Welsh wrote this case under the supervision of Professor Ian Dunn solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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It was January 12, 2018, and Jeff Donovan, owner, branch manager, and sole shareholder of a Vanderbilt Financial Services (Vanderbilt) brokerage[[1]](#footnote-1) in London, Ontario, had just finished reviewing his financials from the previous fiscal year (see Exhibits 1 and 2). Donovan had experienced one of his most profitable fiscal years to date, but he was concerned that he had not accomplished as much as he could with his current business strategy. Donovan had been looking into other opportunities to expand or diversify his existing business, and he wondered if now was the time to enter into real estate. To determine if this was a feasible option for the Vanderbilt brokerage, Donovan would need to complete an assessment of the financial-services industry and Vanderbilt’s past financial performance, as well as assess the future financial opportunities of his new plan.

**financial-services industry**

The financial-planning segment of the financial-services industry employed financial advisors whose job was to provide investment, tax, and insurance advice. Financial advisors helped individuals and families maximize their financial assets through a variety of different products, including, but not limited to, mutual funds, life insurance, retirement plans, and education savings plans. A mutual fund was an investment vehicle made up of a pool of funds collected from many investors for the purpose of investing in securities such as stocks, bonds, and money market instruments. These types of funds were managed by a professional and allowed the owners to share in profits through dividends, interest, or investment appreciation.[[2]](#footnote-2) Retirement plans helped individuals plan for a regular income once they had ceased employment. Education plans helped individuals save for their child’s post-secondary education.

Life insurance required policyholders to make regular payments (monthly or annually) to an insurance company so that, in the case of their death, their dependents would be protected against the loss of the policyholder’s income. Policyholders would name a beneficiary who, after the policyholder’s death, would receive the proceeds agreed upon at the inception of the life insurance policy. Insurance companies offered two broad types of insurance products: term insurance and permanent insurance. Term insurance required individuals to pay a regular monthly or annual premium for a set amount of time in order for the beneficiary to be paid an agreed-upon lump sum if the individual died during that time period. Permanent insurance policies were more expensive than term insurance policies. Regular payments were paid on these types of insurance products in the same manner as term insurance, with part of the payment going toward the life insurance premium and the remaining portion going into a separate account, creating forced savings within the policy. Policyholders could withdraw their forced savings, but, in some circumstances, this would result in the cancellation of the policy, leaving the individual without life insurance. When the forced savings reached the agreed-upon lump sum payment to be made upon the death of the life insured, the policy was considered paid up, and no additional premium payments were required. Upon the death of the life-insured individual, the beneficiary would be paid the agreed-upon lump sum. Unless an additional feature was added to the policy at its inception (for an additional fee), the beneficiary would not be paid the forced savings in addition to the agreed-upon lump sum; the forced savings would be surrendered to the insurance company.

Managing one’s own finances was something that many individuals were uncomfortable with; thus, these individuals looked to a trusted advisor for guidance. If a client did not trust their financial advisor, they would not feel comfortable taking investment advice from that individual. As a result, referrals were often one of the most effective advertisement methods for financial advisors to acquire new business.

Financial advisors and financial brokerages earned revenue through commissions and fees on the products sold to their clients. In some instances, similar to a restaurant franchisee paying a portion of revenue to the franchisor, a portion of a financial advisor’s commissions would be distributed to the advisor’s brokerage. The type of fee and/or commission earned could be paid for by the client, mutual fund company, or insurance company, but was dependent on the type of product sold. In any instance, however, the client was made aware of how the financial advisor would be compensated. This transparency helped to build a trusting relationship between the client and advisor.

Recently, the industry had seen the addition of robo-advisors through many new online financial companies. A robo-advisor was an online service that helped customers to invest primarily in exchange-traded funds[[3]](#footnote-3) through the use of specialized software. Robo-advisors tended to charge lower fees than financial advisors, but often were unable to offer real advice to investors.[[4]](#footnote-4) Robo-advisors were not able to assess a client’s full financial picture, nor were they able—without the client instigating it—to adapt a client’s financial plan as their needs changed.

**Vanderbilt financial services**

Founded in 1977, Vanderbilt was a financial-services company whose mission was to help families earn more income, be properly protected, and become debt-free and financially independent. Its aim was to provide middle-income families with life insurance protection at an affordable price that allowed them to invest for their future and reduce their debt. By 2010, Vanderbilt had become a publicly traded company on the New York Stock Exchange and was the largest independent financial-services company in North America. Brokerages were operated and often owned by branch managers and employed over 117,000 licensed representatives across North America.

A Vanderbilt client’s goals always came first. Prior to recommending any type of insurance or investment vehicle, agents of Vanderbilt were required to complete an analysis of the client’s financial needs. This analysis would help to determine the types of products most beneficial to the client by looking at the client’s need for debt solutions, retirement income, education funding, and income protection. Each client had different financial needs that were best determined using a holistic approach.

Vanderbilt was a member of the Mutual Fund Dealers Association of Canada (MFDA), a national self-regulatory organization for the distribution side of the Canadian mutual fund industry. The MFDA was established in 1998 to improve investor protection and increase public confidence in the Canadian mutual fund industry by regulating the operations, standards of practice, and business conducts of its members and their representatives.[[5]](#footnote-5)

Donovan started with Vanderbilt in 1991, and by 1992, he had become a provincially licensed life insurance agent. By 1993, Donovan had become licensed to sell mutual funds, allowing him to offer his clients additional financial services. Eager to become his own boss, Donovan completed the provincial licensing required to become a branch manager and opened his own Vanderbilt financial-services brokerage in 1994. Since then, Donovan had opened seven additional brokerages in Ontario, which were operated by Vanderbilt representatives that he had personally hired and trained. In addition to revenue earned through his main brokerage, Donovan earned a portion of all revenue earned at these seven brokerages.

In 2003, Vanderbilt began expanding to the United Kingdom, with plans to continue expanding to Europe. Donovan was selected as one of the company’s founders and opened two offices in Basingstoke between 2003 and 2007. Basingstoke was a town in England approximately 87 kilometres from the country’s capital, London. Until Donovan’s return from England in late 2007, Donovan’s wife, Teresa, managed the business in London, Ontario.

**Consumers**

Financial advisors helped clients maximize their financial assets while looking for ways to mitigate their financial risks. Typically, Vanderbilt helped clients minimize the financial risks associated with dying too soon or living too long. Donovan categorized these consumers into two groups: young clients with many financial responsibilities and older, more established clients with fewer financial responsibilities.

For providing protection against the financial risk of dying too soon, purchasing life insurance was often the solution. Typically, life insurance was a temporary need for younger clients who had many financial responsibilities, such as mortgages and children. These individuals wanted to ensure that their death would not leave their dependents in a position of financial hardship. While these clients were young and less established, Donovan would always recommend that they plan for retirement as early as possible, investing as little as CA$25[[6]](#footnote-6) per month. While this would never accumulate to a sufficient amount to retire with, getting people thinking about retirement early in their career was something Donovan was adamant about. Since term life insurance was the only life insurance product Vanderbilt offered, it allowed these individuals to experience lower life insurance premiums compared to the permanent policies offered by many competitors. This gave clients the ability to invest the money saved on premiums, which resulted in higher returns on their savings and access to their funds, if necessary, without the loss of their life insurance coverage.

Once Donovan addressed his client’s life insurance needs, the relationship began to focus more on preparing the client for retirement. As Donovan’s clients aged, retirement preparation became more of a priority. These clients were encouraged to set up a Registered Retirement Savings Plan (RRSP), if they had not already done so. An RRSP allowed clients to contribute up to 18 per cent of their pre-tax income or $26,010 in 2017,[[7]](#footnote-7) whichever was higher, into a tax-sheltered account. An RRSP was an account that could house a variety of different investment vehicles: for example, stocks, bonds, mutual funds, segregated funds, and guaranteed investment certificates.

Donovan often dealt with clients on the verge of retirement who were unsure of how to proceed once they received their pension. Donovan would help ensure these clients maximized their employer pensions by helping them plan the best withdrawal schedule to minimize tax consequences and invest the remainder in vehicles that would allow for continued growth.

**Competition**

**London Life Insurance Company**

London Life Insurance Company (London Life) was an insurance company founded in London, Ontario, in 1874. In 1997, the company was acquired by the Great-West Life Assurance Company (Great-West), but it continued as a separate subsidiary, with its head office remaining in London. London Life offered several different types of financial products, such as individual insurance, wealth management, group benefits, group retirement, savings, and income replacement. London Life offered both term and permanent life insurance.[[8]](#footnote-8)

In April 2017, Great-West announced that 13 per cent of its total workforce, representing 1,500 employees, would be laid off in an effort to save costs. Of these positions, approximately 430 would be from London Life’s head office. London Life employed approximately 3,300 individuals and represented one of London’s largest and most recognizable employers.[[9]](#footnote-9) See Exhibit 3 for select financial ratios of London Life.

**Stevenson & Hunt Insurance Brokers Limited**

Stevenson & Hunt Insurance Brokers Limited (Stevenson & Hunt) was a brokerage-consulting firm founded in 1935. The company’s head office was also in London, Ontario, and the firm had branch offices throughout the province of Ontario. It offered clients insurance and risk-management services including commercial insurance, personal insurance, group-benefit consulting, group-pension consulting, and financial services. Throughout Ontario, Stevenson & Hunt had over 180 full-time employees. In 2015, the company became part of Arthur J. Gallagher Canada Limited, one of the largest global brokers in Canada.[[10]](#footnote-10)

**Manulife Financial**

Manulife Financial was founded in Canada in 1887, with Canada’s first prime minister, Sir John A. Macdonald, serving as the company’s first president. The company operated in Canada, Asia, and the United States and employed over 105,000 people servicing over 22 million clients worldwide. The company offered term and permanent life insurance options, as well as investments, wealth management, banking, group benefits, and group retirement plans.[[11]](#footnote-11)

**Future growth**

Donovan was 47 years old, and while he doubted completely retiring would be on the horizon anytime soon, he wanted to scale back his work week moving forward while still ensuring the growth of the business. Donovan wanted to be able to spend more time with his family, but he also hoped to have created a business that he could leave to one of his children. Within the next five to 10 years, Donovan hoped to have a fully self-sustaining business model that required at most 10 to 15 hours of his time per week. Donovan would also need to ensure that any future business endeavours would still leave adequate time to manage his existing client base.

**Expanding through Real Estate**

One opportunity Donovan had been looking into was entering the real estate market. Up until this point in his career, Donovan had focused solely on the financial-services industry and had always rented office space. Recently, a plot of land near his existing office had come up for sale for $800,000, and he wondered if this would be a good opportunity to enter into a different business stream. The land was large enough to build two 5,000-square-foot office buildings.[[12]](#footnote-12) Donovan intended to use 2,500 square feet for his own office and rent the remainder to local businesses; doing so would allow Donovan to save all rental expenses experienced in fiscal 2017. To furnish the Vanderbilt office space, Donovan would purchase $15,000 of office furnishings, which would be depreciated using the straight-line method, with a useful life of 10 years and no residual value.

After speaking with a local developer, Donovan determined that the buildings could be built for $100 per square foot. New office space in London, Ontario, could be rented for an annual rate of $30 per square foot. On top of this, the City of London would charge a land development fee of $200,000 that would be amortized over the useful life of the building. Tenants would be required to pay their own utilities, while the utilities on the portion of the office buildings occupied by Donovan’s Vanderbilt brokerage would average $300 per month. To draft initial rental agreements, Donovan would incur legal fees of approximately $2,500. If Donovan were to pursue this option, he intended to have construction begin by April 1, 2018.

To finance the project, Donovan would need to secure a bank loan.[[13]](#footnote-13) The loan would be paid in equal monthly instalments over 15 years and charge an interest rate of 5 per cent per annum. Total loan payments for fiscal 2018 and fiscal 2019 including interest would be equal to $126,527 and $189,790, respectively.[[14]](#footnote-14) Prior to the bank granting the loan, Donovan would need to provide the bank with evidence that he had already rented 50 per cent or more of the buildings’ total space. While Donovan would be occupying 25 per cent of the buildings’ space for his own office, he wondered if he would be able to find commitment for the remaining 25 per cent without an actual building to show prospective tenants. As well, Donovan would need to ensure tenants did not need a space immediately, as the building would not be ready for occupancy for approximately eight months from the start of construction. Due to the high demand for new office space in the area, Donovan was confident that the offices would consistently be rented at between 80 and 100 per cent capacity. Donovan would also incur an additional $3,000 in insurance and would allocate $500 of his existing annual advertising budget to this opportunity. Because Donovan would now be the owner of the property, he would incur $66,500 in property taxes annually.

Rather than pursuing this venture on his own, Donovan wondered if finding a business partner was a viable option. Donovan had recently met a local business owner who wanted to expand his business and was tired of paying costly rental fees for his existing office space each month. Donovan knew that this individual would require an office space of 2,500 square feet as well, which would satisfy the bank’s lending requirements. If Donovan were to partner on this project, all investments, recurring costs, and rental revenues would be split evenly between the partners. An additional $15,000 of office furniture would be required to furnish the partner’s space. Because there would be two individuals managing the properties and looking for prospective tenants, Donovan predicted that the buildings would be consistently rented at 100 per cent capacity in this scenario.

**Hiring Additional Representatives**

Donovan wondered if building a larger trustworthy and skilled team to help manage and increase the size of the brokerage’s client base would be a better course of action than pursuing the real estate opportunity. While this option would require minimal initial financial investment in comparison, it would be more time-consuming over the next few years. Donovan anticipated that the brokerage’s commissions and fees would increase annually by an average of $20,000 for each additional representative that he hired, trained, and assisted to become a licensed life insurance and mutual fund representative. Donovan planned to hire between eight and 12 representatives by the end of February 2018, with all of their training and licensing completed by September 1, 2018.

To accommodate this larger team, Donovan would need to move to a larger office. Donovan’s current landlord had agreed to rent Donovan 4,000 square feet of office space within the same building.[[15]](#footnote-15) Because this was not a new building, rent was $14 per square foot annually including utilities, the same rate charged for Donovan’s existing office. Rent would continue to be paid on the first day of the month, with a top-up of the deposit for last month’s rent required upon occupancy of the larger office. Donovan’s current office was 1,400 square feet. An additional administrative assistant would need to be hired with a 40-hour work week at a rate of $18 per hour. The administrative assistant’s employment would commence on March 1, 2018.

Furnishings for the new office would total $30,000 and be depreciated using the straight-line method, with no residual value and a useful life of 10 years. As well, laptops would need to be purchased for all new representatives at a cost of $600 each.[[16]](#footnote-16) All additional long-lived assets required would be purchased on February 1, 2018. Expenses for business software would be incurred in the amount of $28 per new representative per month, and expenses for office supplies would increase by $1,200 annually. Telephone and Internet charges would increase by $50 per month. Donovan expected these expenditures to increase with the hiring of additional team members.

**FINANCIAL PROJECTIONS**

Since his new plan would not be implemented until late 2018, Donovan wanted to project a statement of earnings for both fiscal 2018 and fiscal 2019 to assess the potential financial benefits of his decision. He anticipated that his existing revenues would increase each year by 5 per cent, regardless of the decision made. Donovan expected to pay tax of 30 per cent on any profits. All other expenses pertaining to the existing business would remain the same percentage of revenue with the exception of rent, insurance, depreciation, telephone-and-Internet, and wage expenses. Rent, insurance, depreciation, and telephone-and-Internet expenses would remain the same amount as in fiscal 2017 for current operations. Wages would increase by $2,000 per year. Donovan did not think it was necessary to project a statement of financial position.

**what next**

While Donovan knew he had a difficult decision ahead of him, he was excited by the growth potential of these strategic opportunities. He needed to decide which option would best achieve his goal of increasing revenue while giving him the ability to build a self-sustaining business model—building office space to create new rental revenue and reduce monthly rental expenditures, or increasing the size of his team? Donovan had worked diligently for most of his life, often sacrificing time with his family, to build his existing business. As he sat down to begin analyzing his options, he thought to himself, “I’ve earned my 15-hour workweek.”

**Exhibit 1: vanderbilt financial services statement of earnings**

**(For the years ending December 31, in ca$)**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **2016** | | |  | **2017** | | |
|  |  |  |  |  |  |  |  |
| Revenue | $337,783 |  | 100.0% |  | $379,532 |  | 100.0% |
|  |  |  |  |  |  |  |  |
| Operating expenses: |  |  |  |  |  |  |  |
| Advertising | 6,333 |  | 1.9% |  | 6,529 |  | 1.7% |
| Meals and entertainment | 17,594 |  | 5.2% |  | 18,138 |  | 4.8% |
| Business insurance | 890 |  | 0.3% |  | 890 |  | 0.2% |
| Interest | 668 |  | 0.2% |  | 689 |  | 0.2% |
| Licensing and business software | 3,753 |  | 1.1% |  | 3,753 |  | 1.0% |
| Rent | 19,600 |  | 5.8% |  | 19,600 |  | 5.2% |
| Office supplies | 3,901 |  | 1.2% |  | 4,022 |  | 1.1% |
| Legal, accounting, and other professional fees | 471 |  | 0.1% |  | 486 |  | 0.1% |
| Wages | 35,541 |  | 10.5% |  | 36,640 |  | 9.7% |
| Travel | 1,218 |  | 0.4% |  | 1,455 |  | 0.4% |
| Telephone and Internet | 5,198 |  | 1.5% |  | 5,359 |  | 1.4% |
| Postage | 639 |  | 0.2% |  | 659 |  | 0.2% |
| Fuel and vehicle maintenance | 14,701 |  | 4.4% |  | 15,156 |  | 4.0% |
| Depreciation | 13,743 |  | 4.1% |  | 13,969 |  | 3.7% |
| Total operating expenses | 124,250 |  | 36.8% |  | 127,345 |  | 33.6% |
|  |  |  |  |  |  |  |  |
| Net income before tax | 213,533 |  | 63.2% |  | 252,187 |  | 66.4% |
| Less: income tax | 71,811 |  | 21.3% |  | 89,653 |  | 23.6% |
| Net income | 141,722 |  | 42.0% |  | 162,534 |  | 42.8% |

Source: Company files.

**Exhibit 2: vanderbilt financial services STATEMENT OF FINANCIAL POSITION**

**(As at December 31, in ca$)**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **2016** | | |  | **2017** | | |
| **Assets** |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| Current assets |  |  |  |  |  |  |  |
| Cash |  |  | $20,911 |  |  |  | $22,639 |
| Trading investments |  |  | 12,563 |  |  |  | 14,930 |
| Prepaid rent |  |  | 1,633 |  |  |  | 1,633 |
| Office supplies |  |  | 250 |  |  |  | 275 |
| Total current assets |  |  | 35,357 |  |  |  | 39,477 |
|  |  |  |  |  |  |  |  |
| Long-lived assets |  |  |  |  |  |  |  |
| Office furniture | 28,432 |  |  |  | 31,779 |  |  |
| Less: accumulated depreciation | 12,359 |  | 16,073 |  | 14,213 |  | 17,566 |
| Office equipment | 12,576 |  |  |  | 16,091 |  |  |
| Less: accumulated depreciation | 7,892 |  | 4,684 |  | 9,313 |  | 6,778 |
| Vehicle | 85,550 |  |  |  | 85,550 |  |  |
| Less: accumulated depreciation | 10,694 |  | 74,856 |  | 21,388 |  | 64,162 |
| Total long-lived assets |  |  | 95,613 |  |  |  | 88,506 |
|  |  |  |  |  |  |  |  |
| Total assets |  |  | 130,970 |  |  |  | 127,983 |
|  |  |  |  |  |  |  |  |
| **Liabilities & shareholders’ equity** |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| Current liabilities |  |  |  |  |  |  |  |
| Accounts payable\* |  |  | 427 |  |  |  | 405 |
| Taxes payable |  |  | 9,465 |  |  |  | 4,308 |
| Operating line of credit |  |  | 2,356 |  |  |  | 2,592 |
| Total current liabilities |  |  | 12,248 |  |  |  | 7,305 |
|  |  |  |  |  |  |  |  |
| Shareholders’ equity |  |  |  |  |  |  |  |
| Common stock |  |  | 105,000 |  |  |  | 105,000 |
| Retained earnings |  |  | 13,722 |  |  |  | 15,678 |
| Total shareholders’ equity |  |  | 118,722 |  |  |  | 120,678 |
|  |  |  |  |  |  |  |  |
| Total liabilities & shareholders’ equity |  |  | 130,970 |  |  |  | 127,983 |

Note: \* Related solely to telephone-and-Internet expenses

Source: Company files.

**Exhibit 3: select financial ratios for london life insurance company**

|  |  |  |
| --- | --- | --- |
|  | **2016** | **2015** |
| Net-earnings growth | −1.8% | −3.2% |
| Interest coverage | 68.6 | 69.9 |
| Debt to equity | 23.5 | 22.8 |
| Sales growth | 53.4% | 11.9% |
| Operating-expense growth | 57.3% | 13.5% |
| Return on equity | 14.4% | 15.3% |

Source: Created by the case authors based on London Life Insurance Company, *Annual Report 2016*, 5–9, accessed February 14, 2018, www.londonlife.com/content/dam/ll/Documents/LL-2016-Annual-Report-English-Complete-15-125816LL-150-dpi-FINAL.pdf; London Life Insurance Company, *Annual Report 2015*, 5–7, accessed February 14, 2018, https://pagely.londonlife.com/wp-content/uploads/s7\_035785\_2015-Annual-Report.pdf.

1. A brokerage is a financial institution that facilitates the buying and selling of financial securities between a buyer and a seller. [↑](#footnote-ref-1)
2. “Mutual Fund Definition,” Investopedia, accessed February 13, 2018, www.investopedia.com/terms/m/mutualfund.asp. [↑](#footnote-ref-2)
3. An exchange-traded fund is a marketable security that tracks an index, a commodity, bonds, or a basket of assets like an index fund. [↑](#footnote-ref-3)
4. “Robo-Advisor,” Wealthsimple, accessed February 14, 2018, www.wealthsimple.com/en-ca/investing-101/roboadvisor. [↑](#footnote-ref-4)
5. “About,” Mutual Fund Dealers Association of Canada, accessed February 13, 2018, http://mfda.ca/about/. [↑](#footnote-ref-5)
6. All currency amounts are in Canadian dollars unless specified otherwise. [↑](#footnote-ref-6)
7. Government of Canada, “MP, DB, RRSP, and TFSA Limits and the YMPE,” Canada.ca, December 21, 2018, accessed February 13, 2018, www.canada.ca/en/revenue-agency/services/tax/registered-plans-administrators/pspa/mp-rrsp-dpsp-tfsa-limits-ympe.html. [↑](#footnote-ref-7)
8. “Individual Insurance,” London Life, accessed February 13, 2018, www.londonlife.com/our-products/individual-insurance.html. [↑](#footnote-ref-8)
9. Hank Daniszewski, “Great-West Life Cutting 13% of Workforce, about 1,500 Jobs, Including at London Life,” The London Free Press, April 25, 2017, accessed February 13, 2018, www.lfpress.com/2017/04/25/great-west-life-cutting-13-of-workforce-about-1500-jobs-including-at-london-life-2. [↑](#footnote-ref-9)
10. Stevenson & Hunt, “About Us,” Arthur J. Gallagher Canada Limited, accessed February 13, 2018, www.sthunt.com/about-us/. [↑](#footnote-ref-10)
11. “Products & Services Canada,” Manulife Financial, accessed February 13, 2018, www.manulife.com/Products-Services-Canada. [↑](#footnote-ref-11)
12. The buildings would be depreciated using the straight-line method, with no residual value and a useful life of 40 years. [↑](#footnote-ref-12)
13. The bank loan would be used to cover the cost of purchasing the land, building the offices, and paying the land-development fee. [↑](#footnote-ref-13)
14. The interest portion of the loan repayments was $65,786 in fiscal 2018 and $94,806 in fiscal 2019. [↑](#footnote-ref-14)
15. The new rental agreement would commence on February 1, 2018. [↑](#footnote-ref-15)
16. Laptops would be depreciated using the straight-line method, with no residual value and a useful life of three years. [↑](#footnote-ref-16)