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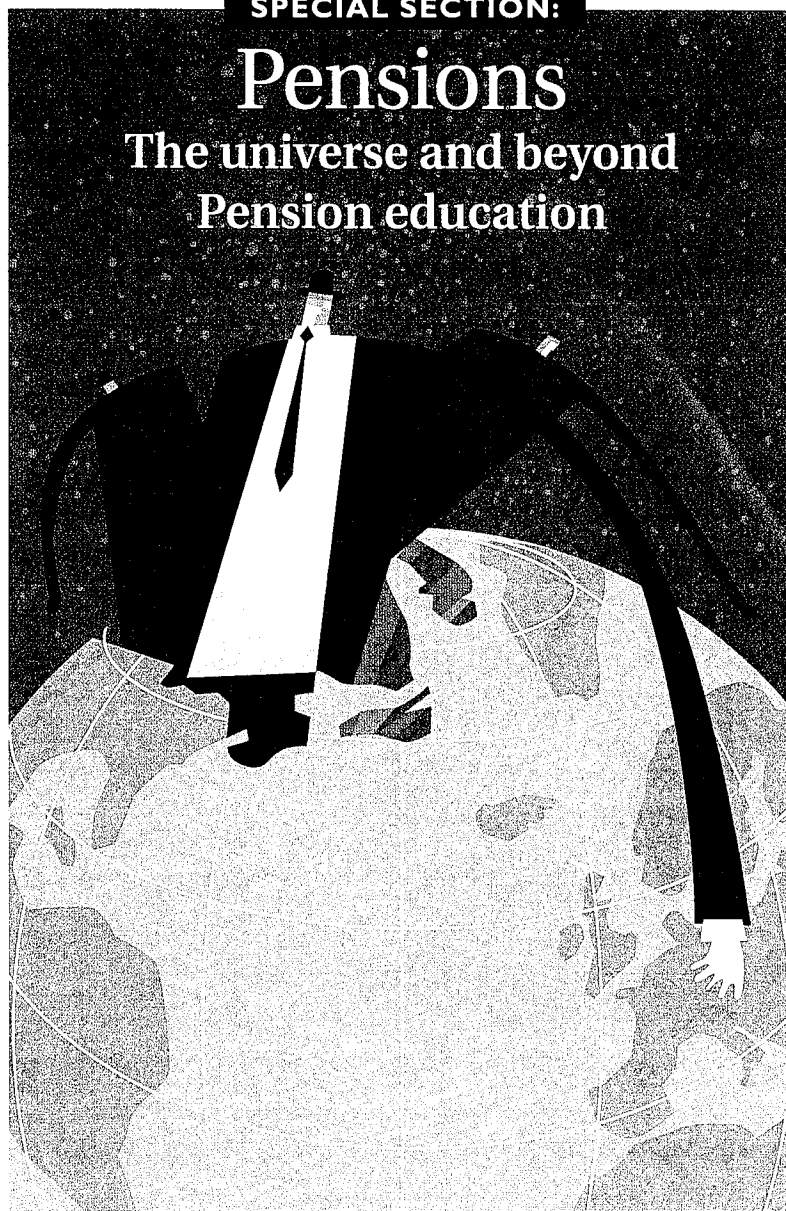
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Playing the financing dating game

It's important to find the right financing partner for your company and its aspirations. Sometimes a matchmaker can help.

by Eric Klein and Andre Kleynhans

TWO PRIMARY WAYS TO GROW A BUSINESS ARE TO ACQUIRE A similar company or to grow organically. Both typically require external funding, but the sources can vary widely depending on myriad quantitative and qualitative criteria. For those of us acting as intermediaries for these and other corporate financing requirements, it is up to us to be the money matchmaker. Bringing the right people together to move a business forward can create financial magic.

Money is available for most situations, but it can be frustrating to find the right investor, with the right money, on the right terms. While banks traditionally figured prominently in any match, more rigorous lending criteria and high administration costs have forced businesses to look beyond this traditional source. As a result many other sources of funding have appeared, establishing niche areas of focus and expertise as they present common alternatives to the banks. As with all relationships, however, it is important to look before you leap.

First, you need to take a hard look at yourself by taking inventory of your needs as well as your personality traits. Take into account the good and the bad. Ask yourself questions such as: How much money do I need and, more importantly, how does that amount compare to my existing balance sheet? How will the money be used? How will it help my business? How long will I need the money for? Will I be able to pay it back in a debt-like manner with its fixed obligations and covenants or will I require more flexibility? What kind

of price (cost of capital) am I willing to pay for the use of that money? Will I then still make a respectable return, taking into account the risk? What will the funding do to my key financial ratios? Are there tangible assets available to secure the funding and what would their realization value be if my business failed? Am I willing to give up equity in my firm to grow quickly, or do I prefer to pursue more conservative growth and retain full ownership? Can I accept increased levels of reporting, planning and accountability? Do I just need money or am I looking for a value-add investor to bring certain business skills to the situation?

Second, you have to consider why an investor would want to let you use his money. What is the size and nature of your business? What are the opportunities and risks associated with your specific industry and firm? What position does your firm hold in its market, and what is its profitability relative to your industry? How and when will the investor get his money back?

The third and perhaps most important factor is the team driving and managing the business. Any investor will want to evaluate the key players in the business. Who is running each area? What is their background and expertise? Don't be surprised, depending on the type of funding you need, when the investor suggests seconding his own business expert to your firm to help move things forward. It gives an investor a great sense of comfort knowing he has someone on the inside who marches to his orders.

Once you identify the appropriate type of investor, the initial chemistry between investor and borrower becomes critical. Deciding what to disclose and when, trying to predict how the other person will react, and making sure you have all the bases covered to create a smooth process can be time-consuming but worth the effort in the end.

Part of the chemistry in a relationship is quantitative and tangible, based on factors such as historic earnings, shareholders' equity, market share, historic rates of growth, return on capital invested, and debt/equity ratios. However, the most important ingredients come from qualitative and more intangible factors such as quality, experience and depth of management, customer and supplier relationships (quite often not contractual in nature), labour relations, and the ability to cope with changing and/or harsh conditions.

External factors can be a critical

You have to consider why an investor would want to let you use his money.

Figure 1: Meeting your match: Forms of financing available and the companies best suited to them.

Type of Funding	Description	Characteristics	Investor Risk / Cost of Capital (Typical range)	Type of Company
Senior Debt	<p>Most secure form of debt. It takes priority of repayment in the event of liquidation. There is not a lot of involvement by the lender.</p> <p>Typically provided by banks, which look primarily for low-risk cash flow and debt serviceability history</p>	<p>Term-debt typically structured over 5 years.</p> <p>Lease financing secured by a specific asset over 3 to 5 years.</p> <p>Short-term operating capital secured by receivables and inventory.</p>	<p>Low</p> <p>Prime to Prime + 2% per annum</p> <p>Fixed or variable rate</p>	<p>Established, profitable, well-capitalized companies qualifying for bank and low-cost lease financing.</p>
Asset-based lending / finance (ABL)	<p>Secured business loan in which the borrower pledges as collateral or sells any assets used in the conduct of his/her business.</p> <p>Financier lends primarily against recovery value of assets.</p>	<p>Short and long-term debt or lease ABL financing secured against assets. Factoring and invoice discounting.</p> <p>Also sale and leasebacks.</p>	<p>Medium to high</p> <p>8% to 25% per annum</p> <p>Fixed or variable rate</p>	<p>Undercapitalized, unprofitable, start-up, turnaround, trading companies whose debt-serviceability risk is high.</p>
Subordinated Debt ("Sub debt")	<p>Debt that is either unsecured or has a lower priority than that of another debt claim on the same asset or property.</p> <p>Also called junior debt.</p>	<p>Term-debt typically structured over 5 years.</p>	<p>Medium</p> <p>10% to 18% per annum</p> <p>Usually fixed rate</p>	<p>Strong cash flow and debt serviceability with secondary or low-quality asset security availability.</p>
Mezzanine Lending	<p>A hybrid of debt/equity – used in similar instances as sub-debt but when more flexibility is required to repay or additional return is required.</p>	<p>Term-debt typically structured over 5 years together with common share participation.</p>	<p>Medium to medium high</p> <p>10% to 15% per annum with equity stake of 5% to 15%</p>	<p>Strong cash flow and debt serviceability but with added risk, e.g. an outsized amount of financing relative to existing capital, etc.</p>
Vendor take-back financing	<p>Portion of purchase consideration funded by vendor of a business.</p> <p>Typically debt or preferred shares.</p>	<p>Typically structured over 2 to 5 years with favourable terms relative to externally raised finance.</p>	<p>Low to Medium</p> <p>5% to 15% per annum</p>	<p>Acquired companies where vendor is confident of continued investment.</p>
Private Equity ("PE")	<p>Equity capital invested in a private company. Many PE firms/funds compete for opportunities, typically with specific industry focuses etc.</p> <p>Usually involvement of financier at least at board level.</p>	<p>Typically secured over common shares sold.</p> <p>Common or preferred shares or structured as debt with equity participation to minimize common share dilution for principals</p>	<p>Medium to high</p> <p>20% to 30% per annum measured upon exit.</p>	<p>Owner retirement, management buy-outs, merger and acquisition transactions in industries with consolidation trends.</p> <p>Companies groomed for going-public or going-private buyouts.</p>

Venture Capital	Funds made available for start-up/early-stage firms and small businesses with exceptional growth potential. Strong involvement of financier at board level and typically in direct operations with managerial/technical expertise.	Common or preferred shares or structured as debt with equity participation to minimize common share dilution for principals.	High 25% to 40%+ per annum measured upon exit.	High-growth, early-stage, newly profitable companies.
Angel Investor	Individuals who provide capital to start-up companies. Usually of high net-worth or have a personal stake in the success of the venture. Typically active involvement of angel.	Non-institutional, more informal investors with industry knowledge & business know-how. Generally more flexible terms. High levels of risk and a potentially large return on investment	High 25% to 40% per annum measured upon exit.	Start-up or very early stage companies.

force as the relationship develops. Factors such as general economic conditions and cycles, political environment, and state of the stock market and money markets can come into play and influence the evolving chemistry between investor and borrower. Your ability to deal with adversity and difficulty in a positive way will increase the odds for long-term success.

For private equity, venture capital and angel investments in particular, the borrower should find out as much about the investor as possible. What other kinds of businesses has the investor supported? What experience and reputation as an investor does he have? Obtain references from companies that are currently working with the investor and from companies with which the investor has had prior experience. Beyond being the investor, how involved has he been with these company's day-to-day affairs? Does he have any experience in your industry? Can he provide additional financing? How simple or cumbersome is his assessment and approval process? What are his reporting requirements? Is he flexible on key terms such as prepayment?

Making sure the investor is right for you is as important as your business being right for the investor.

Once you have that first meeting you will likely know if it is worthwhile proceeding or moving on with someone else. In any event, a professional matchmaker or intermediary can be of great help in avoiding a lot of wasted time with the wrong suitors. By working with an outside corporate finance con-

sultant, you can rely on his expertise to confirm your needs and identify the best match for you based on his network of contacts. Reputable intermediaries also confer a strong degree of credibility on your company, since they conduct their own due-diligence before agreeing to represent you.

The financing relationship will work as long as there are innate values such as mutual trust, respect, honesty and common goals. When you develop your plan and meet with your potential investor, it is critical to be candid about all aspects of the business. If difficult questions are asked, don't try to obscure the truth. It is far more reassuring to an investor that you admit to weaknesses and demonstrate your mettle by addressing how you plan to rectify the problems. Besides, any investor worth his salt will conduct a thorough due-diligence examination to confirm your information before he advances any funds.

Providing regular reporting is also a vital aspect of the relationship with your investor. This keeps the lines of communication open. Never leave your investment partner in the dark. Then, by maintaining an open relationship, if the time should come that you need further funding....who better to call than your Mr. or Ms. Right?

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