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Tips and
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Raising Money without Giving Up Ownership

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Raising Money without Giving Up Ownership

There are many reasons why business owners can often find themselves in a situation where they need to raise new funds but don't want to give up a share in their business. It may be a strategic move to acquire a competitor or there may be a need for additional cash to support operations. It is not uncommon for businesses to find themselves in a situation where a new piece of equipment is needed to facilitate growth but funds are limited as the customer base has not as yet started paying for the added production.

Ken Sweeney is the in-house debt specialist with Growth Equity Partners.

"If the owner of a business decides not to raise 'equity financing' there are two traditional forms of 'debt' that can be utilized - senior and subordinated," says Sweeney. "Senior debt comes in three forms, an operating revolver (also referred to as a line of credit), a term loan or a capital lease. "

Sweeney explains that senior debt means that the lender will have preference on the asset they have security on, over any other lender, including the business owner.

An operating line of credit is set up on the basis of the amount of accounts receivable the business owns which is reassessed monthly. Most commercial lenders will lend between 60-80% of the value of the accounts receivable. This form of debt is usually the cheapest as interest rates are set at prime to prime plus 2%. Another attractive feature to this debt instrument is that there is no defined repayment schedule.

A term loan is similar to an operating line of credit but it takes into account the tangible assets of the business such as buildings, property, inventory, etc., excluding the business' accounts receivable. Most commercial lenders will lend between 40-60% of the value of the tangible assets depending on the condition of the asset. This form of debt usually charges interest at a rate of prime to prime plus 4%. Different than the operating line of credit, the term loan will have defined repayment terms.

Most people are familiar with the purchase of a car or a new piece of equipment and taking a lease out with the manufacturer or a third party leasing company to buy the asset. But what most business owners often neglect is the hidden value of the tangible asset once the lease is paid off and often fully depreciated on the balance sheet. There are companies that lend money as capital leases against assets that have been fully written off but the market value is greater than zero.

"It's what I hear business owners tell me all the time and that is they don't care what the financials say, they feel their assets have more value," says Sweeney.

The interest cost of this debt instrument is similar to a term loan and will usually have a three to five year repayment schedule.

Subordinated debt is a different type of debt instrument. Much like an equity investor, this type of lender often looks at the business as a whole. The lender will consider the value of the assets that are secured and those that are unsecured. They will consider the cash flow the business has generated and should generate in the future. If you have a lender in place with an operating revolver, a subordinated debt lender may be the best option. They will charge more for the loan than the senior lender, in most cases prime plus 8%, to prime plus 10%, but they will postpone their security

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to other lenders. This type of debt instrument has a fixed repayment plan.

In any case, it is important to recognize that the lender will want to be very comfortable with the business' ability to service the debt. The lender will want to see the company's historical performance, understand the business strategy going forward, assess the business plan, and depending on the term of the loan, they may want to see a three to five year plan.

Careful consideration of your business' needs and matching it up with the right form of financing can lead to a very productive outcome. Happy debt hunting!

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