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Machinery & Equipment Refinance: Working Capital for Company Acquisition and Organic Growth

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SME M&A Advisors sometimes state that they only work with Buyers that can write a cheque – now that is an enviable position for both the Buyer and Advisor! This speaks to the balance sheet capability of the Buyer but of course does not necessarily mean that the company acquisition will be funded with cash on hand. Maximizing efficient use of the Buyer's corporate finance resources will dictate whether monetary assets on hand are to be deployed or whether debt and/or equity issuance will be required.

TARGET COMPANY FINANCING RESOURCES

But what if the financial resources required to fund a company acquisition are beyond the Buyer's balance sheet capabilities? Vendor financing might be an option if the target company shareholders are willing to accept loans as partial consideration. Working capital to remain with the target company is always subject to negotiation and tends to be a component of purchase price hence not usually a source of acquisition financing. Target company equity issuance could be considered if partners or other stakeholders are funding participants and equity dilution/cost is acceptable. Otherwise, it could be worthwhile to consider the balance sheet components of the company that is to be acquired as there may be significant funding capability that is not readily evident based on balance sheet net equity.

THE NUMBERS

Let's consider a numerical example to demonstrate how the refinancing of Machinery & Equipment purchased by the target company 4 years ago can provide non-dilutive financing to help the Buyer fund the company acquisition:

- $10 million equipment purchase, 30% declining balance amortization = $2.4 million NBV after 4 years
- 80% loan advance rate at time of purchase, 5-year term, straight line amortization = $1.6 million outstanding loan balance after 4 years
- Balance sheet net equity attributable to the Machinery & Equipment = $800K delta between the NBV and loan balance

LONG LIFE ASSETS RETAIN VALUE

But what if the real time depreciation curve was in fact less precipitous than the accounting amortization rate? Applying a 15% depreciation rate, which could make sense for long economic life assets, would result in an appraised value of over $5 million at the end of year 4 which could support Machinery & Equipment loan refinancing of over $4 million. Leaving aside the nuances of Fair Market Value vs Orderly Liquidation Value appraisal definitions, this equation could provide the Buyer with the option to procure significant non-dilutive acquisition funding by refinancing Machinery & Equipment owned by the target company.

ORGANIC GROWTH FINANCING

This numerical example is applicable as well for companies seeking working capital to drive Organic Growth. A true Asset-Based Lender will not restrict uses of working capital generated by Machinery & Equipment refinancing so the cash inflow can be used to fund investments in tangible or intangible assets. Further funding flexibility can be achieved by utilizing the Machinery & Equipment already in place as a downpayment for the procurement of additional gear – this a is cash flow friendly method to grow!

WHO CAN FUND YOUR COMPANY TO ACQUIRE & GROW?

Banks can support some but not all Canadian companies to Acquire and Grow. Alternate Lenders can provide financing for situations that do not fit standard Bank credit requirements. This can include Alternate Lenders acting as a complementary financing source when companies are growing too quickly for Banks to provide full support.

Alternate Lenders can support companies that have lower debt service coverage and require higher financing advance rates and longer terms. Covenant light financing structures and payment flexibility can be key differentiators as well, especially for companies experiencing balance sheet constraints and uneven cash flow.

The cost of financing will vary amongst Alternate Lenders – be sure to work with a reputable, transparent funding source that provides full disclosure of financing terms and interest rates. Asset-based lending tends to be non-dilutive and thus is a cost-effective substitute for additional equity capital investment.

Bottom Line

The key to monetizing Machinery & Equipment value is to work with an Equipment Lender that will focus on collateral value, take time to understand the business and can accommodate the complexities involved in Acquisition & Growth financing.

About the Author

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Anthony is a structured finance professional with over 20-years of experience working with major OEM, commercial finance, and financial advisory firms on a wide range of asset, corporate, and cash flow financing mandates. Anthony is skilled at developing and executing innovative financing structures designed to achieve customer growth, turnaround and restructuring capital requirements.

Anthony joined Dynamic's Commercial Structuring Division in 2022 and focuses on assisting customers achieve working capital, growth capital and financial restructuring requirements. Anthony works closely with industry professionals to identify asset-based loan consolidation, refinance and working capital needs.

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