4 FINANCING THE TRANSFER PROJECT

Financing set-ups for business transfers differ from one business to another, and, contrary to popular belief, there is no universal magic bullet.

Accordingly, Desjardins offers advantageous consulting services for the financing of your business transfer or acquisition, at very attractive rates.

Our advisors will rigorously assess your financial and business needs, and propose appropriate financing strategies and financial products.

FINANCING STEPS

1. Document the transfer project and draft the business plan

You are the architect of the transfer; therefore, it is up to you to design the plans. Preparing a solid business plan helps you ensure that the various factors required for a successful transfer are in place.

Owning a business involves teamwork. You will need the support of financial experts, partners, government advisors and/or suppliers. Your business plan will help you to accurately describe your vision to each stakeholder.

Before meeting with your Desjardins advisor, be sure to fill out your application and draft your business plan. You must also consult the legislation regarding business start-ups.

2. Generate the financial statements

To complete your business plan, you must generate the financial statements for your business or the one you are acquiring. These financial statements must reflect any planned or ongoing business projects.

You must also prepare the following documents:

- your personal balance sheet;
- your curriculum vitæ, summarizing your main achievements;
- the cost and financing of your project;
- an opening balance sheet;
- the cash budget forecast (two years);
- projected income statement according to various scenarios (three years);
- budgeted balance sheet (three years).

3. Prepare the financing set-up

The financing of your transfer must cover every aspect of your business operations: working capital, current expenses, tools, equipment, buildings, patents, etc.

Once your needs have been determined, you should identify the possible sources of financing to meet them. This financing set-up is often presented in the form of a table, and it is essential that each transfer-related need be met.

EXAMPLE OF A FINANCING SET-UP

COST OF THE TRANSFER PROJECT	
Land and buildings	$600,000
Furniture and equipment	$250,000
Inventory	$75,000
Accounts receivable	$250,000
Goodwill	$245,000
Other start-up costs (accounting, taxes and permits, insurance, rent, supplies, etc.)	$80,000
Total	$1,500,000

FINANCING THE TRANSFER PROJECT	
Capital funding	$150,000
Mortgage loan	$450,000
Term loan on equipment	$150,000
Line of credit	$225,000
Balance of sale	$250,000
Mezzanine capital	$275,000
Total	$1,500,000

4. Prepare your financing application

You have identified your needs and determined which financial tools will enable you to meet them. You have also created a network of resources (other entrepreneurs, mentor, account manager, financial advisors, members of the board of trade or business associations, etc.) that you can consult as needed. The next step is to prepare your financing application.

Fill out your application

Your financing application will complete your business plan.

The application should include:

- the nature of the transfer project to be financed;
- the amount of financing required;
- the financial spin-offs of the project (which will enable the business to continue to grow while meeting its financial commitments);
- the benefits of your transfer for the investor.

Present your application

Before meeting with your investor, be sure to provide your financing application and your business plan so that he can review it.

Prepare for this meeting by:

- specifying the length of the meeting and adhering to it;
- preparing a brief presentation that covers the key points;
- anticipating the lender's objections and making note of points that require further explanations;
- inviting an expert (accountant, attorney or other) to accompany you in order to provide more details on points related to his field of expertise;
- being attentive to the lender's comments and reactions during the meeting;
- offering your availability in case he wishes to obtain more information;
- asking the lender what the next steps are.

Review of your application

If the lender approves your financing application, you will have to agree on the terms of the contract.

If your application is declined, take the opportunity to improve your file. It would be wise to ask your lender what prompted his decision. This will provide you with valuable information about your business plan or your approach, since it is likely that you will have to submit a new application to that institution.

Six criteria to evaluate in a financing application

In general, financing applications are evaluated based on the following six criteria:

1. Quality of the leadership

The transferor and the buyer are the driving forces behind a business transfer project. Their vision, energy and efforts will determine the success of the business transfer.

2. Risks associated with the business environment

The lenders will ensure that your activity sector does not present a risk for them. The anticipated lifting of a tariff barrier, use of a process that is harmful to the environment or a downturn in the economic sector in which the business operates are just some of the factors that cause investors to be overly cautious. The business must also have adequate insurance coverage that is tailored to the nature of its activities.

3. Credibility of the transfer

Lenders expect competitive returns when they decide to invest in your transfer; therefore, they will ensure that your forecasts are realistic and based on verifiable facts.

4. The business's ability to pay and its financial structure

You must prove to the investors that your business is able to meet its financial commitments. The financial structure of the business therefore must show a healthy balance between assets and liabilities.

5. Financial history of the buyers

In your investor's eyes, the past predicts the future. It is highly likely that a credit check will be done for each buyer. The investors will ensure that the buyers have met their past commitments. A bankruptcy or outstanding loan negatively affects a buyer's credibility.

6. Securities

Loan financing is granted in exchange for securities. These securities must be available in sufficient quantities to enable your investor to cover his risks.

TYPES OF FINANCING

You can finance your business through loans, equity and/or government programs.

A. LOAN FINANCING	Used to finance accounts receivable, inventory, equipment or commercial property (including renovations).
B. EQUITY FINANCING	Provided, in part, by the buyer. Private investors and/or investment companies are also potential sources of equity. During the start-up phase, they help finance working capital requirements and start-up costs. During the growth phase, they enable business acquisitions and the development of new markets.
C. GOVERNMENT PROGRAMS	Various subsidies are offered by the federal and provincial governments to help businesses succeed and to promote entrepreneurship.

A. LOAN FINANCING

You can finance a part of your transfer with loans. They are used to finance accounts receivable, inventory, equipment and commercial property (including renovations).

Commercial term loan	To finance equipment or miscellaneous projects.
Business mortgage loan	To finance the purchase, construction or expansion of a building, or the purchase of a parcel of land.
Operating line of credit	To meet cash flow needs.
Bridge financing	Loan that meets your temporary cash flow needs while awaiting an influx of cash or a pending loan disbursement.
Investment credit (revolving credit)	Provides the funds needed to invest in your business: purchase of equipment, machinery or production inputs, or repairs/renovations to property.

Here is a brief description of the most common financing loans available at Desjardins:

Commercial term loan

To buy supplies and equipment required for business operations or to improve the financial structure.

Features:

- amortization according to the useful life of the purchased supplies;
- fixed or variable interest rate;
- flexible repayment terms;
- available in Canadian or U.S. currency.

Benefits:

- enables you to finance capital projects without significantly affecting working capital;
- improves or consolidates the business's financial structure to enable the continued growth of the business;
- possibility of reborrowing a portion or all of the repaid capital without incurring new fees (Multiproject Option).

Business mortgage loan

For capital needs, such as the purchase of land, the construction or expansion of a plant, or any other major project.

The terms of credit (term, amortization period, rates and repayment terms) are tailored to the needs of the business.

Features:

- amortization up to 20 years;
- fixed or variable interest rate;
- available in Canadian or U.S. currency.

Benefits:

- Repayment terms based on the business's activity sector or financial results;
- possibility of reborrowing a portion or all of the repaid capital without incurring new fees (Multiproject Option).

B. TYPE OF EQUITY FINANCING

Equity financing is provided, in part, by the buyer. Private investors and/or investment companies are also potential sources of equity. These funds improve the business's capital without reducing its room to manoeuvre with respect to its creditors.

SOURCES OF EQUITY	
The buyers	The buyers must provide a portion of the amount required to finance the transfer (personal savings, home, pension fund, RRSP, balance of sale, etc.).
Development capital	In the form of financing with acquisition of shares in the business.
Mezzanine capital	Combines the features of a loan and equity financing. In terms of the business's financial structure, mezzanine capital falls between a senior debt and a net asset.
Management buy-out	Acquisition of controlling interest in the business.
Cooperative financing (CTA)	Cooperative financing is achieved when the unionized and non-unionized employees of a corporation jointly purchase shares in order to benefit from the growth of the business.
Angel investors	This type of investor is often a former business owner/manager who has the necessary investment capital. Angel investors inject money in projects with high chances of success. Accordingly, they become business partners and are often involved in running and growing the business.

Here is a brief description of the most common financing loans available at Desjardins:

Development capital

When analyzing the financial needs associated with a transfer, the financing package is often completed with risk capital, in the form of equity or quasi-equity. For the buyer, the aim of the financial structure is to simplify the acquisition of a successful business and ensure its continuity. For the seller, the goal of the transaction is to maximize the income from the sale and minimize the tax implications.

Features:

- sources of additional capital through traditional loan financing;
- financing with the acquisition of shares or in the form of subordinate debt;
- unsecured capital: common or preferred shares, debentures;
- exit/repayment horizon: 5-8 years;
- risk-adjusted returns;
- amounts ranging from $200K to $20M.

Profile of eligible businesses:

- forward-thinking management team;
- realistic and well-developed business plan;
- excellent growth potential;
- competitive edge;
- product for which there is already a major market.

Certain specialized investment funds, such as the *Fonds Relève Québec* intended for buyers, are hybrid in nature, with features of both conventional funds and development capital.

Mezzanine capital

Financial instrument, also known as subordinate financing or quasi-equity, that combines the features of a loan and of equity financing. In terms of the business's financial structure, mezzanine capital falls between a senior debt and a net asset.

Features:

- takes the form of an unsecured loan with a term of 3-5 years;
- the repayment terms are dependent on the business's financial forecasts.

Benefits:

- its subordinate position to that of the lender means it can be considered as a net asset;
- results in minimal dilution for current shareholders;
- helps reduce the tax burden (interest is deductible);
- pre-defined exit strategy;
- a portion of the financing costs are dependent on the success of the business.

Profile of eligible businesses:

- minimum two years' profitability with enough stable and predictable internally generated cash flow to meet the terms of the additional financing;
- a strong and committed management team;
- niche market with growth potential;
- competitive edge;
- maintenance of certain financial ratios.

Buy-outs

Possible scenarios:

- controlling interest with an existing management team that acquires shares (buy-out of the founding shareholder);
- controlling interest with a new management team becoming shareholders (buy-out of the founding shareholder);
- controlling interest through the partial buy-out of shares held by the majority shareholder, who stays on with the business;
- controlling interest through the acquisition of business shares from an industrial group undergoing a spinoff, with the management team becoming shareholders.

Type of businesses sought:

- medium-sized businesses with a strong management team;
- businesses operating in growth sectors or in sectors in which consolidation is both possible and desirable;
- businesses with strong market positioning or that operate in a market that is difficult to penetrate.

Competitive edge afforded by buy-outs:

- membership at Desjardins;
  - assets are kept in Quebec;
  - pride in selling to Quebec's largest financial institution;
  - Desjardins is a major player in the local economy, which is reassuring for managers, employees, and community stakeholders;
  - clients and suppliers are instantly reassured (due to Desjardins' strong financial footing).

C. GOVERNMENT PROGRAMS

To stimulate entrepreneurship, the federal and provincial governments offer various subsidies to help businesses succeed.

Features:

- Some of these programs simplify loan financing, while others, in the form of subsidies, enable an increase in the value of business equity.
- Many of these programs target a specific clientele.
- While others are aimed at a specific type of activity, such as research and development, exportation and marketing.
- Each program offers a different type of support. In certain cases, the support comes in the form of tax credits, while others offer loan security, subsidies or direct loans to finance an aspect of the business.
- Each program has multiple requirements: business size, age of the buyers, sector of activity, etc.

List of main resources:

- *Fonds Relève Québec* (no link yet)
- Business Credit Availability Program (BCAP)
- *Centres locaux de développement* (CLD)
- Community Development Assistance Corporation:
  - Quebec
  - Ontario
  - Canada
- Canada Business Network – Government Services for Entrepreneurs
- Industry Canada
- Canada Mortgage and Housing Corporation (CMHC)
- Export Development Canada
- *Investissement Québec*
- Canada Economic Development
- Canada Small Business Financing Program
- Small Business Enterprise Centres (SBECs) (Ontario)