ASK THE EXPERT

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Growing Pains

Financing for expansion doesn't have to be a painful experience

In order to grow in the food manufacturing business you will, at some point, have to expand your production/processing facilities. That may mean building a new state-of-the-art plant or undertaking a multimillion-dollar expansion of an existing facility. Construction or major expansion is usually the biggest single financial risk a company can take. Think about your own company. How much money would it require to expand your production capacity by 50 per cent? Now consider the cost of building an entirely new manufacturing facility. Depending on the size of your company, the cost could range from $1 million to $50 million or more. That's a lot of risk.

Making these types of financing decisions involves more than just an examination of sales projections and balance sheets. Expansion and risk management are highly complex issues. There are often hidden costs associated with expansion, and there is often a transition period where sales may not keep up with increased production costs. There will also likely be tax implications, and there's always the chance of unexpected events impacting sales.

Ultimately, taking on large-scale debt is a major decision. Fortunately, expansion debt can be managed so that the risks are reduced. It starts with sound professional advice.

Generally, there are two key interrelated issues to address when considering debt financing: cash flow and lender compatibility. Cash flow, which is always important, becomes even more vital after you've taken on debt. For instance, when structuring a financing deal it can be tempting to spend a portion of your company's operating cash on getting the project completed. However, this is a risky move because of events that might occur after expansion, such as higher taxes or unplanned expenses. That's one reason lender compatibility is so essential. While most food manufacturers already have a relationship with a financial institution or bank, these traditional lenders may not be best suited to handle expansion financing. They may not be as familiar, for example, with all of the expenses and contingencies associated with installing modern food production lines. If your loan doesn't cover these unforeseen costs, the money may come out of your operating cash later. Following are a few issues to consider when consulting with a lender:

Loan-to-value ratios – Some lenders will finance only 60 to 80 per cent of a project cost, while others will finance up to 100 per cent of equipment costs and 85 per cent on real estate. A higher loan-to-value ratio means you spend less of your own money on the project and save your operating cash for day-to-day expenses.

Single-source financing – It's generally a good idea to diversify your lending sources between your operating lender and your term debt specialist. During growth periods you will require ample operating lines of credit to meet the daily cash flow needs associated with expansion. Diversifying your lending sources between your operating lender and a term debt funder can preserve important operating lines of credit, while maximizing the funding advance you receive against your fixed assets (equipment and real estate).

Innovative options – Depending on your situation, a lease rather than a traditional loan may be the best financing solution. For example, a "joint election lease" for equipment can be structured as an operating expense on your books, but is considered an owned asset for tax purposes. It provides the tax benefits of owning the equipment but the debt is off your balance sheet for accounting purposes. This is just one of many leasing options an experienced lender can provide.

Industry specialization – Traditional lenders such as banks may not have the deep industry knowledge and experience required to understand the specific needs and cycles of food manufacturers. Working with a lender that specializes in your industry can make a world of difference, ensuring you receive a financing solution tailored to your particular needs.

Lines of credit – A good lending partner can meet all the financial needs associated with your business growth. This includes establishing a line of credit should you need additional funding after expansion. Any lender offering turnkey services should be willing to extend a line of credit if necessary.

While every company targets growth, expansion can be risky if poor financing choices are made. Choosing the right financing partner, one that can help your company navigate a minefield of difficult decisions, can avoid unnecessary growing pains.

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