Working Capital Financing

Working Capital and Market Trends | 2023

UNLOCKING WORKING CAPITAL POTENTIAL TO FUEL OPERATIONAL GROWTH

capitalmind investec

TORSTEN AUL

Partner, Debt Advisory & Capital Solutions

On working capital financing:

« *Working capital financing has emerged as an easy and flexible solution to fortify the financial stability and enhance operational efficiency. Consequently, working capital financing enables businesses to navigate uncertainty and foster growth during economic recovery.* »

THORSTEN GLADIATOR

Managing Partner, Debt Advisory & Capital Solutions

On working capital financing:

« *Supply chain issues and increasing (raw) material prices lead to higher funding requirements in working capital. A variety of working capital financing products allows for tailor-made solutions.* »

KEY DRIVERS

-0.1% Anticipated contraction in Germany's GDP for the year 2023.

4% Expected peak of ECB interest rates to be reached in September 2023.

6.1% Projected inflation in Germany for the year 2023.

42% Decrease in institutional loan issuance in Europe so far in 2023.

WORKING CAPITAL MANAGEMENT - HELICOPTER VIEW

Amidst the aftermath of the COVID-19 pandemic, geopolitical tensions, and persistent inflation, it is crucial for companies to prioritize efficient working capital management (WCM) in order to navigate near-term uncertainty and foster growth during the economic recovery. We identified four key reasons that make WCM crucial:

1 Economic headwinds are expected to be persistent

Despite the recovery of most advanced economies to pre-pandemic levels of output, growth in 2023 is projected to be sluggish. Recent downward revisions in growth forecasts highlight the challenges that lie ahead. For instance, the GDP growth forecast for the EU has been reduced to around 0.75%, a mere one-fifth of the previous year's growth[1]. The IMF has also predicted that Germany will be the second weakest G7 economy next year, following the UK, with an anticipated GDP contraction of 0.11%[1]. Moreover, recent data reveals that the German economy contracted slightly for two consecutive quarters, by 0.5% in Q4 2022 and 0.3% in Q1 2023[2].

2 Inflationary pressure remains high until at least 2024

The Russian invasion of Ukraine has led to skyrocketing energy and food prices, resulting in persistent inflationary pressures. Additionally, rising material costs and supply chain challenges pose a threat to inventory levels, leaving businesses susceptible to supply shortages and price fluctuations. Although the IMF predicts a decline in inflation in Germany from 8.7% in 2022 to 6.1% in 2023, a return to the 2% target is not expected until at least 2025. Consequently, some companies have turned to forward buying and speculative upstocking. However, this strategy strains working capital and depletes cash reserves.

3 Interest rate peak has probably been reached

Central banks across the world have continued to tighten monetary policy and roll back quantitative easing to defeat red-hot inflation. In Europe, the ECB has raised its key interest rate by 0.25 percentage points to 3.5% in June, marking the eighth consecutive increase since July 2023. This rate-hiking cycle is the fastest in the ECB‘s history. ECB President Christine Lagarde announced further rate hikes in July, indicating an ongoing trend. According to a survey conducted by Bloomberg, it is projected that the peak will be reached at 4% in September 2023. Consequently, financing and working capital is becoming increasingly expensive.

4 Corporate cash flows are coming under increasing pressure

According to PwC, Days Cash on Hand of companies decreased by 10% in 2021. In 2022, the intensified efforts of central banks worldwide to combat inflation by raising interest rates have significantly impacted corporate cash flows. Mounting challenges stem from factors such as cost inflation, supply chain disruptions, and geopolitical events like the war in Ukraine, which have also influenced lender sentiment and global debt markets. In Europe, institutional loan issuance suffered a decline of 42% so far in 2023 compared to the previous year (as of July)[5]. As a result, the management of liquidity and working capital has become increasingly important.

[1] IMF World Economic Outlook Database [2] Statistisches Bundesamt [3] Handelsblatt [4] PwC Working Capital Study 22/23 [5] Bloomberg

WHAT ARE THE BENEFITS FOR YOUR BUSINESS UTILIZING WORKING CAPITAL FINANCING?

Increasing liquidity through working capital financing (WCF) provides companies with the financial resources needed to sustain and grow their business operations. It enhances their ability to manage cash flow, respond to market dynamics, and seize opportunities while mitigating risks and maintaining financial stability.

- **Improved cash flow:**
  Working capital financing offers companies the necessary funds to meet short-term obligations, ensuring sufficient liquidity for effective operations and bolstering day-to-day activities. It helps smooth out cash flow fluctuations caused by factors such as seasonality or delayed payments from customers.
- **Non-dilutive to equity holders:**
  Working capital financing is a form of debt financing, preserving full control for business owners without requiring equity transactions, even in dire financing situations.
- **Easy repayment option:**
  Working capital financing offers flexible and easy repayment options, providing convenience to businesses. Additionally, with a fixed interest rate independent from central bank rates, it helps manage risks associated with interest rate fluctuations.
- **Enhanced competitiveness:**
  Working capital finance helps you to maintain a good cash flow for the business. Thus, it turns to result in strengthening the financials and gaining stability in the business whenever there is an unexpected requirement. By having access to the funds, it needs to cover its short-term expenses, a company can maintain a strong financial position and remain competitive.
- **High flexibility:**
  It can be used for a wide range of short-term needs. This flexibility allows companies to adapt to market conditions and pursue new opportunities.
- **Unsecured loans based on balance sheet:**
  Companies can opt for unsecured working capital loans without collateral, eliminating the need to put assets at risk and allowing businesses to flourish in their operations.

WHICH COMPANIES BENEFIT FROM WORKING CAPITAL FINANCING?

In general, working capital is essential for a company to stay in business, as it provides ongoing investment in short-term assets necessary for operations. It ensures a minimum cash balance for day-to-day expenses and unexpected costs. Additionally, working capital is crucial for prepaid expenses, such as licenses and insurance, and for maintaining inventory, from office supplies to large retail stock. Without adequate working capital finance, businesses would be unable to open and operate.

Small Businesses	Small businesses that may not have established credit lines with traditional banks can benefit from working capital financing to bridge short-term gaps and maintain smooth operations.
Seasonal Businesses	Companies with seasonal fluctuations in revenue, such as businesses heavily frequented during holiday periods, can benefit from working capital financing to handle increased demand during peak times.
Start-Ups and Growth-oriented Companies	New or growth-phase companies may require additional capital to explore new markets, introduce new products, or expand their operational capacity.
Companies with Volatile Income	Businesses with fluctuating income, especially those with long-term payment terms with customers, can benefit from working capital financing to cover ongoing expenses while awaiting payment receipts.
Companies making Short-term Investments	When a company wishes to make short-term investments, such as purchasing new machinery or equipment, working capital financing can serve as a bridge until the investments pay off.

WHAT ARE YOUR OPTIONS FOR WORKING CAPITAL FINANCINGS?

When it comes to financing working capital, businesses have a range of options available to them, tailored to their unique needs and circumstances. To make a well-informed decision, it is crucial to thoroughly evaluate your business's specific requirements, cash flow patterns, and eligibility criteria. Seeking advice from financial advisors or lenders can prove beneficial in identifying the most suitable working capital facility that aligns precisely with your business's needs.

Overdraft Facilities

Revolving credit where a business can withdraw funds from its bank account up to a pre-approved limit. Interest is charged only on the amount withdrawn, providing flexibility and immediate access to funds as needed.

Lines of Credit

A flexible revolving credit facility that allows businesses to access funds up to a predetermined credit limit. Interest is charged on the amount utilized, and businesses can borrow and repay funds multiple times within the agreed-upon period.

Trade Financing

Trade financing facilities, such as letters of credit and trade credit, provide capital specifically for purchasing inventory or raw materials. These facilities help businesses manage their supply chain by ensuring timely payments to suppliers and allowing for deferred payment terms.

Invoice Financing/Factoring

Invoice financing or factoring facilities enable businesses to receive immediate cash for their outstanding invoices. The lender advances a percentage of the invoice amount, typically around 80-90%, and collects the full payment from the customers directly.

Supply Chain Financing

Supply chain financing programs involve collaboration between businesses, their suppliers, and financial institutions. These programs provide working capital to suppliers based on the creditworthiness of the buyer.

Merchant Cash Advances

Merchant cash advances provide working capital based on a business's future credit card sales. The lender advances a lump sum, and repayment is made by deducting a fixed percentage of daily credit card sales until the advance is repaid, along with fees and interest.

Asset-Based Facilities

Asset-based lending involves using the business's assets. The lender advances funds based on the value of the assets, and repayment is made through regular installments or upon liquidation of the collateral.

Government-Supported Programs

Some governments offer working capital programs specifically designed to support small businesses. These programs may include low-interest loans, grants, or guarantees that provide working capital to businesses facing financial challenges.

FACTORS TO CONSIDER WHEN FINANCING WORKING CAPITAL

Common prerequisites for securing working capital financing vary based on lenders. Thorough assessment and research are crucial before committing to a facility, aligning with your business's needs and goals.

Funding Needs: Specific funding requirements (amount of working capital, duration for financing).

Repayment Terms: This includes the interest rate, repayment period, and any fees or penalties involved.

Eligibility Criteria: Set by the financial institution or lender offering the working capital facility. This may include factors such as credit history, business performance, collateral requirements, and documentation.

Cost of Financing: Assess the overall cost of the working capital facility, including interest charges, fees, and any additional costs.

Flexibility and Terms: Determine if there are any restrictions or limitations on how you can use the funds and evaluate if the terms align with your business needs and growth plans.

Lender Reputation and Support: Research the reputation and track record of the financial institution or lender offering the working capital facility.

Legal and Contractual Obligations: Review the terms and conditions of the working capital facility agreement thoroughly.

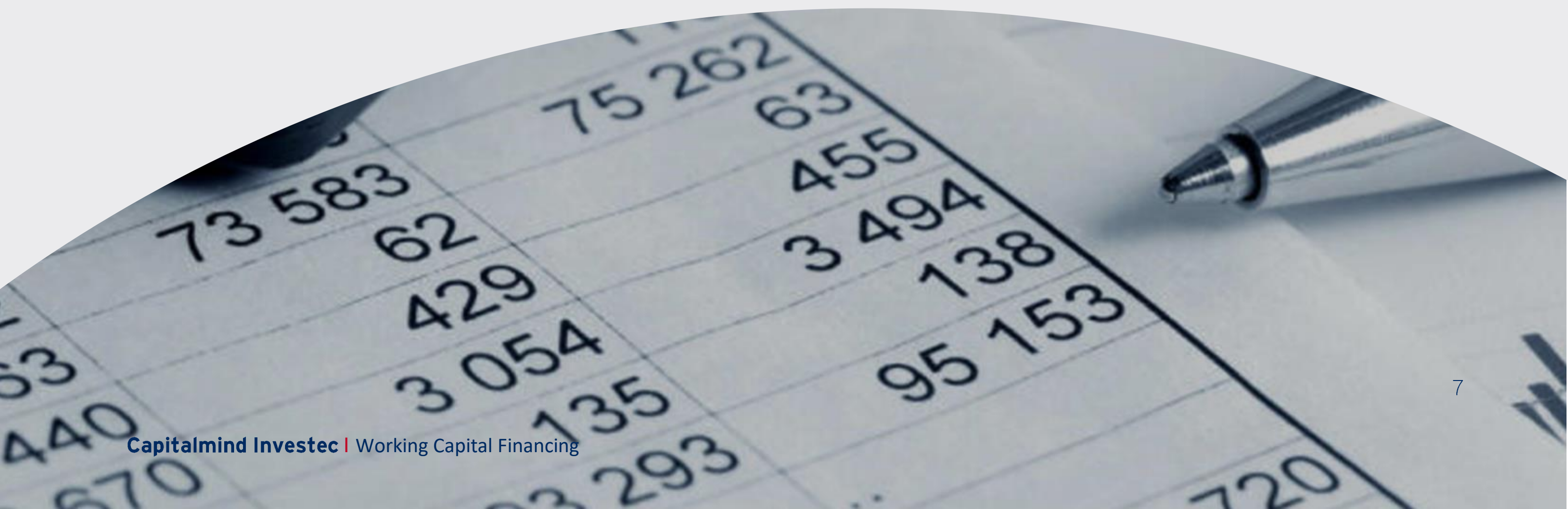
Impact on Credit Rating: Timely repayment and responsible use of the facility can positively impact your credit score, while default or late payments can have adverse effects.

Future Financing Needs: Assess how the working capital facility fits into your overall financing strategy and consider if it aligns with your future funding needs. over time.

WHAT PREREQUISITES MUST BE FULFILLED?

The requirements for obtaining a working capital facility can differ depending on the lender, but there are common prerequisites that businesses usually need to meet. It's essential to consider that prerequisites can vary among lenders due to their risk preferences and assessment criteria. It's recommended to explore various lenders and financing options and compare their requirements before choosing the best-suited working capital facility for your business.

- **Creditworthiness:** Most lenders assess the business creditworthiness to evaluate risk and determine loan terms. A good business creditworthiness increases the chances of approval and better interest rates.
- **Business Performance:** The company's performance, including revenue, profit margins, and cash flow, is often reviewed. Lenders want to ensure that the company can make loan payments and fulfill financial obligations. Strong business results can improve financing opportunities.
- **Business Financing:** Most lenders expect the company to have a stable financial position. This can be demonstrated by providing financial statements, profit and loss statements, revenue forecasts, or other relevant financial documents. A strong financial foundation can increase the likelihood of approval.
- **Nature of the Business:** Certain industries or business types may be perceived as riskier by lenders than others. Some lenders may have restrictions on the industries they provide loans to. It is essential to consider this when seeking working capital financing.
- **Time in Business:** Some lenders have a minimum requirement for the company's operational duration, ranging from a few months to several years. Generally, lenders prefer businesses that have been operating successfully for a certain period to reduce risk.
- **Loan Purpose:** In some cases, lenders may require that the loan to be used for specific purposes, such as covering operating expenses, purchasing inventory, or financing expansion plans.



SELECT TRANSACTIONS ADVISED BY OUR TEAM

Capitalmind Investec has extensive experience in advising deals in the working capital sector. With dedicated financing experts across Europe, we can help you to achieve your strategic ambitions.

Torsten Aul
Partner
+49 173 603 9606
torsten.aul@capitalmind.com

Thorsten Gladiator
Managing Partner
+49 173 706 7706
thorsten.gladiator@capitalmind.com

Michel Degryck
Managing Partner
+33 148 246299
michel.degryck@capitalmind.com

Bart Jonkman
Managing Partner
+31 736 238774
bart.jonkman@capitalmind.com

Markus Decker
Managing Partner
+41 445 752822
markus.decker@capitalmind.com

Callum Bell
Managing Director
+44 207 5974025
callum.bell@investec.co.uk

Currently running several live working capital mandates

Recent debt transactions advised by Capitalmind Investec

Company	Transaction	Sector
MEXXS	Unsecured working capital financing	Beverage
ALEX & GROSS	Unsecured working capital financing	Business Services
BG	Unsecured working capital financing	Real Estate Holding
NOVA GRUPPE	Unsecured working capital financing	Real Estate Holding
EURO PART	Amend-to-extend RCF Financing	Industrials
STERN IMMOBILIEN AG	Unsecured working capital financing	Real Estate Holding
ALUCOM (a portfolio company of LIVIA)	Unsecured working capital facility	Industrials
GROUPE GORGÉ / iXblue / ECA GROUP	€230m investment as minority shareholder €215m bank facilities	Acquisition Financing
FCR Immobilien	Promissory note with a volume of €10m	Real Estate Holding
Deutsche Konsum REIT-AG	€10m tap to €30m corporate bond	Real Estate Holding

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