



 Financing



*South Lake Tahoe
May 23, 2018*

Learning Objectives

- Develop awareness of internal fund sources
- Become familiar CoBank
- Become familiar with sources of capital

Special Financing Challenges Facing Cooperatives

- Who will provide Equity Capital?
- Who will provide financing?
- Profits of the Coop?
- Best Price for the Member?
- Who decides financing?

Financial Markets

- Credit is available!!
- Qualification is much more rigorous
- Terms and conditions are tougher
- Interest rates are low
- Elements to qualify the same

Credit Availability/Access to Capital

■ Credit extension criteria:

– 5 C's of credit

- Character
- Conditions
- Capital
- Capacity
- Collateral

Qualifying for Credit

- Understand the 5 C's of credit
- Get your house in order
 - Good accounting records
 - Clean credit report
 - Current on all regulatory and tax filings
- Have a written business plan



Internal Financing Sources

- Rethink left side of balance sheet
- Questions to Consider
- Traditional areas
 - Cash
 - Inventory
 - Accounts Payable
 - Accounts Receivable
- Other areas
 - Lease Assets
 - Sell Assets
 - Subcontract

Internal Financing

Example 1

	Sales	Purchases	Cash Receipts	Cash Outlays	Borrowing
Oct					
Nov		3		(3)	3
Dec		4		(4)	7
Jan		2		(2)	9
Feb		1		(1)	10
Mar	2				10
Apr	4		2		8
May	3		3		5
Jun	4		4		1
Jul	1		1		-
Aug					-
Sep					-
Oct					-
Total	14	10	10	(10)	53
Total borrowing		53	Average monthly		
Average period		12	borrowing		4.42



Internal Financing

Example 2

	Sales	Purchases	Cash Receipts	Cash Outlays	Borrowing
Oct					
Nov					-
Dec					-
Jan					-
Feb		2		(2)	2
Mar	2	3		(3)	5
Apr	3	4	2	(4)	7
May	4	1	3	(1)	5
Jun	1		4		1
Jul			1		-
Aug					-
Sep					-
Oct					-
Total	10	10	10	(10)	20
Total borrowing		20	Average monthly		
Average period		12	borrowing		1.67

Internal Financing

Example 3

	Sales	Purchases	Cash Receipts	Cash Outlays	Borrowing
Oct					
Nov					-
Dec					-
Jan					-
Feb		2		(2)	2
Mar	2	3	1.0	(3)	4
Apr	3	4	2.5	(4)	6
May	4	1	3.5	(1)	3
Jun	1		2.5		1
Jul			0.5		-
Aug					-
Sep					-
Oct					-
Total	10	10	10	(10)	15
Total borrowing		15	Average monthly		
Average period		12	borrowing		1.25



Internal Financing

Example 4

	Sales	Purchases	Cash Receipts	Cash Outlays	Borrowing
Oct					
Nov					-
Dec					-
Jan					-
Feb		2			-
Mar	2	3	1.0	(2)	1
Apr	3	4	2.5	(3)	2
May	4	1	3.5	(4)	2
Jun	1		2.5	(1)	1
Jul			0.5		-
Aug					-
Sep					-
Oct					-
Total	10	10	10	(10)	5
Total borrowing		5	Average monthly		
Average period		12	borrowing		0.42



Cooperative Finance Institutions Serving Cooperatives

- **CoBank, ACB**
- **National Rural Utilities Cooperative Finance Corporation (CFC)**
- **National Cooperative Bank (NCB)**

Cooperative Finance Institutions Serving Cooperatives (continued)

■ CoBank

- \$25 Billion in assets
- Part of Farm Credit System
- Chartered by Congress in 1933
- Serves Ag coops, Ag exporters, Rural Utilities & related entities
- Funding through public sale of Federal Farm Credit System wide debt obligations

Cooperative Finance Institutions Serving Cooperatives (continued)

■ CFC

- \$8 Billion in assets
- Founded in 1969
- Serves rural electric cooperatives and rural telecommunication companies
- Funded through sale of bonds and notes, and issuance of commercial paper to investors

Cooperative Finance Institutions Serving Cooperatives (continued)

■ NCB

- \$700 Million in assets
- Chartered by Congress in 1978
- Serves cooperatives not eligible for other cooperative finance institutions, i.e., consumer, housing, healthcare, and credit unions
- Funded through sale of medium term notes and commercial paper to investors

Bank Loan Characteristics

■ Lines of Credit

- Finance general operating needs, e.g., accounts receivable and inventory on a seasonal basis
- Typically 12 to 24 month maturity
- Secured or unsecured depending on financial strength of borrower
- Pricing indexed to Prime or Libor

Bank Loan Characteristics (continued)

■ Term Loans

- Finance capital expenditures or acquisitions
- Typically mature in 3 to 7 years
- Secured or unsecured depending on financial strength of borrower
- Pricing indexed to Prime or Libor

Lease Characteristics

■ Operating and Capital Leases

- Operating leases typically finance equipment

■ Advantages and Disadvantages

- Reduce initial cash outlay
- Transfer ownership risk to lessor
- Levels cost over life of lease
- Lessee does not own the asset at end of financing

Lease vs. Buy

Assumptions

1. Asset Cost of \$100,000
2. The asset will be held for 3-years, then disposed of
3. Residual value at the end of 3 years = 20%; inflation 5%; Discount @ 15%
4. The asset can be leased for 3 years with monthly payments of \$3,000
5. The company's marginal borrowing rate is 12%

Buy vs. Lease

■ Buy

Present value of :\$100,000 = 100,000

Salvage value of : 20% of asset in 3 years: $100,000 \times (1.05)^{-3}$:
\$23,152.50

Present Value @ 15% = 15,222
Net Present Value \$84,777

■ Lease

Present value of payments = \$90,322

Other Sources of Debt Capital

- **Insurance companies**
 - Private placements and medium term notes
 - Senior debt and notes
- **Asset based lenders**
 - Borrowing base arrangements
 - Sale and leaseback arrangements
- **Commercial paper**

Equity in a Cooperative

■ Risk Capital

- Limited pool of interested investors
 - Only members benefit from patronage
 - Limited transfer rights
- Traditional Sources
 - Purchased
 - Allocated earnings
 - Tax paid retained earnings
- How do you enhance the value?

Equity in a Cooperative (continued)

■ Equity Redemption Programs

- Member expectations
- Current versus former patrons
- Good for growth?

Alternative Capital Sources

Sources of Financing

- **Member Investment Program**
 - Short term
- **Revolverment Policy**
- **Cancellation of Equity**
- **Limited Partnerships**
- **Joint Ventures/Strategic Alliances**
 - Domestic
 - Foreign
 - Brand Leverages
- **Private Placement**
 - Debt
 - Stock
- **Public Offerings**
 - Debt
 - Stock
- **Corporate Restructuring**
 - For-profit subsidiaries
 - Agency in common

Alternative Capital Sources (continued)

Member Investment Program

■ Advantages

- Retain funds from members
- Attractive interest rates
- Easy to administer

■ Disadvantages

- Short-term
- Must be monitored
- Could be considered a security

Alternative Capital Sources (continued)

Member Investment Program (continued)

■ Sources

- Members
- Employees

■ Costs

- Minimal costs for legal and Systems

■ Timing

- 3 to 6 months

Alternative Capital Sources (continued)

Revolvement Policies

■ Advantages

- Retain funds from members
- Easy to modify by extending Revolvement period, changing amount withheld
- Adapt to changed conditions
- Increased capital

■ Disadvantages

- Member relations
- Difficult to increase capital



Alternative Capital Sources (continued)

Revolvement Policies (continued)

■ Sources

- Members

■ Costs

- Minimal

■ Timing

- 1 to 3 months

Alternative Capital Sources (continued)

Discount for Early Redemption of Equity (Cancellation or Equity)

■ Advantages

- Tax advantage to member
- Remove former members
- Link to other capital changes
- Cleans up member accounts

■ Disadvantages

- Reduce NOL/Create taxable income
- Difficult to restrict
- *Adverse* member reaction
- Legal cost

Alternative Capital Sources (continued)

Discount for Early Redemption of Equity (Cancellation or Equity) (continued)

■ Sources

- Members

■ Costs

- Costs for legal and tax advice

■ Timing

- 6 to 12 months

Alternative Capital Sources (continued)

Limited Partnerships

■ Advantages

- Source to fund equipment/facilities
- Possible tax advantage to investors
- Flexible
- Costs are relatively minor

■ Disadvantages

- Can be complex
- Reporting
- May increase leverage
- Could be considered a public offering

Alternative Capital Sources (continued)

Limited Partnerships (continued)

■ Sources

- Members
- Employees
- Outside parties

■ Costs

- Costs for legal, tax, and reporting requirements

■ Timing

- 6 to 18 months

Alternative Capital Sources (continued)

Joint Ventures/Strategic Alliances

■ Advantages

- Flexible
- Leverage brand/know-how/product
- Less capital investment
- Domestic or foreign

■ Disadvantages

- Agreement needs careful structure
- Control/management
- Asset protection

Alternative Capital Sources (continued)

Joint Ventures/Strategic Alliances (continued)

■ Sources

- Customers
- Food companies
- Other

■ Costs

- Could be substantial for search, due diligence, legal, etc.

■ Timing

- 6 to 24 months

Alternative Capital Sources (continued)

Private Placement of Debt/Subordinated Debt

■ Advantages

- Long-term, fixed rate
- Fees and expenses deductible
- No public disclosures
- Flexible structures
- Can be subordinated to other debt

■ Disadvantages

- Restrictive covenants
- Reduced operating flexibility
- Equity give-up

Alternative Capital Sources (continued)

Private Placement of Debt/Subordinated Debt (continued)

■ Sources

- Insurance companies
- Pension funds
- Mezzanine capital pools
- Major customers
- Government entities – private activity bonds

■ Costs

- 1% to 3% of face amount
- Pricing: May be a higher coupon rate – usually with warrants

■ Timing

- 2 to 6 months

Alternative Capital Sources (continued)

Private Sale of Stock

■ Advantages

- Cost – fees and expenses
- No public disclosures
- Timeliness
- Control
- Flexibility in structuring
- Reduces leverage

■ Disadvantages

- Coop can only issue preferred or nonvoting common stock
- Minority discount
- Greater dilution
- Board representation
- Dividends not deductible

Alternative Capital Sources (continued)

Private Sale of Stock (continued)

■ Sources

- Institutional investors
- Private equity pools
- Venture capital firms
- Major customers

■ Costs

- 4% to 5% of amount raised

■ Timing

- 4 to 6 months

Alternative Capital Sources (continued)

Public Offering – Debt

■ Advantages

- Flexibility
- Loose covenant package
- Possibly no amortization/reissue
- Possibly no equity give-up
- Provides liquidity/flexibility
- Overall lowest cost

■ Disadvantages

- Disclosure documents
- Annual reporting
- Costs
- Does not reduce leverage

Alternative Capital Sources (continued)

Public Offering – Debt (continued)

■ Sources

- Public market through underwriter
- Members
- Customers

■ Costs

- 2% to 4% of amount raised

■ Timing

- 2 to 6 months

Alternative Capital Sources (continued)

Public Offering – Stock

■ Advantages

- Less dilutive than private placement
- Current and future liquidity
- Prestige
- Generally unrestricted use of proceeds
- Reduces leverage

■ Disadvantages

- Cooperative can only issue preferred
- Disclosure requirements
- Stock price management
- Upfront and ongoing expense
- Timing considerations
- Dividends not deductible

Alternative Capital Sources (continued)

Public Offering – Stock (continued)

■ Sources

- Public market through underwriter
- Members
- Customers

■ Costs

- 6% to 8% of amount raised
- Pricing: Unknown

■ Timing

- 6 to 12 months

QUESTIONS

NSAC Course on Cooperatives



Introduction to
Cooperatives

END HOUR 1

Enjoy a 10 minute Break

