Exploring new global innovations and technologies

Has your company considered all the possibilities?

For any Canadian manufacturer, making a large investment in equipment is a momentous decision given these uncertain times. There has been an accelerated movement among companies to explore new technologies and educate themselves on some of the global innovation taking place to obtain the best possible outcome for the money they spend.

What is significantly different is that in the past, many manufacturers would take the time to review global technologies, select the one they wish to acquire and have that solution supplied by the one foreign supplier.

Today, our manufacturers are innovating by sourcing various technologies from multiple global sources in order to bring them together and create a customized solution with a competitive advantage.

With this trend comes a number of key challenges

- Equipment costs in general have increased globally with a declining CAD
- Currency risk is increasing as Canadian companies source equipment from various foreign suppliers
- Working capital is being squeezed by large first deposits and milestone payment requirements

Most companies have seen the cost of their planned equipment purchases increase in the past couple of years. This has caused many to stall their planned purchases in the past year. At some point, companies will have to take the plunge if they are going to remain competitive.

Matching the right financing structure to the equipment's useful lifespan seems obvious, but there is still a default in the market to move to a five-year financing structure. Why is that? Because many point of sale financing solutions, or term loan offers from large lenders, are modeled so they can be approved or sold to a third party funder quickly. There are options out there that can provide repayment structures longer than five years. Exploring those options can be a worthwhile investment when most equipment prices have increased for Canadian businesses.

On the flip side, there are many businesses that have historically maintained the "we don't like debt – we always pay cash" model. We are seeing a move to leverage the low interest rate environment and finance some of the equipment purchases with terms shorter than the equipment's useful lifespan. Structuring a shorter term allows the company to maintain a cash reserve and reduce their financing costs.

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There is speculation that in the near term a few central banks, like the U.S. Fed, will see a need to increase the overnight lending rates. If you have been a cash purchaser, it may be a good time to consider a financing solution at some of the ultra-low rates still being offered. This will allow you to maintain a cash cushion for potentially higher rate environments ahead. Another thought is that today the ability to be nimble is an advantage, so having cash available to take advantage of an unexpected business opportunity is not a bad strategy.

Currency risk has been a key concern recently, especially for those who have purposely gone overseas in search of new technologies, or have sourced nearly new pieces of equipment from the U.S. This risk is most problematic for the manufacturers who only have a domestic client base and a single CAD revenue stream. There are no offsetting foreign revenue flows to naturally hedge and mitigate the risk. Recently we have also seen the domestic dealer network present invoices to their Canadian customers in foreign currencies as they look to transfer the currency exchange risk directly to their client. There are foreign currency solutions available to support these situations.

Questions to ask yourself when acquiring equipment from a foreign supplier

- How are they establishing their invoiced amount? Is it based on their local currency and have they converted to CAD and provided a CAD amount?
- What rate are they using to convert?
- Would they allow you to pay them in their local currency so that you can control the foreign exchange (FX) rate?
- Will they offer further discounts if they pay in their local currency? Can you achieve a better FX rate than your supplier?

For any significant equipment purchases originating out of foreign jurisdictions, there is an opportunity to speak with your FX specialist and create a better deal for yourself. Knowing how the FX component will impact the final price and having a strategy against it are critical.

FX spot trades and forward contracts are the two most common approaches in the market. A spot trade occurs when you sell one currency to buy another currency in real time. You either have the available cash on hand to buy the other currency at the real-time market rate, or you have access to an FX line that your lender allows you to leverage in order to complete the trade. With either option, you make a commitment to buy the foreign currency at a specific point in time. When it comes to buying equipment, it's all about timing. What if it takes six months to build your machine? What if delivery is delayed? What if you don't receive the equipment?

Risk considerations

- Can you negotiate a penalty on the supplier side in the form of a price discount if they cannot meet the delivery deadline?
- If you have entered into currency exchange contracts to pay their invoice at a future date, can you determine what your potential cost would be if you had to take the currency early, and would you need to borrow funds to do so?
- Have you thought about exercising a currency exchange transaction within set dates to provide some flexibility?
- Does the financing solution provide you with the necessary FX risk mitigation?
- How well do you know this supplier? Will they perform and deliver on time?

Trade finance scenario

Let's assume you have decided on a new piece of technology from a supplier in Europe. This is your first time dealing with them. All reports seem okay, but there is still a part of you that has some uneasiness as you are sending a lot of money overseas for something that has yet to be built.

The good news is most banks have Trade Finance Specialists to work with you to mitigate some of the risks of dealing with offshore suppliers.

For example, assuming you have credit availability, you can have your bank issue a Documentary Letter of Credit (LC) in favour of your supplier. This is attractive to sellers in that the LC guarantees payment, conditional on the equipment being built and shipped in accordance with the terms of the LC. This helps ensure the job is added to the supplier's production schedule and a supplier can often use the LC as security for pre-shipment financing.

From your standpoint, working with your Trade Finance Specialist, you can structure the LC to minimize specific risks or concerns, e.g. the LC can require inspection certificates, for quality, completed by a third party at certain milestones during the manufacturing cycle. Hence, either progress payments, or final payment on delivery, will be dependent on presentation of the certificates in good order. Also, other standard LC terms help ensure the product is delivered by a set date, at a specific price and via agreed upon shipping terms.

At RBC Royal Bank®, we work with over 1,400 correspondent banks in 145 countries. Having a trade-finance specialist to lean on when you are establishing a new supplier relationship is just as important as having them there when you are establishing new buyer segments in foreign countries.

Access to capital

Planning to invest significant dollars requires the ability to fund the investment throughout the building, delivery and commissioning stages. If you have limited cash resources and don't want to stress your day to day working capital lines, you may have the option to structure a progress payment line with some equipment lenders.

These are temporary facilities that are established during the time period between the order date and the acceptance date of the equipment. Once the equipment is accepted by the end user, the line is then converted to the agreed upon repayment structure, whether that be a loan, capital lease or other term. Having the flexibility to meet progress payment demands without impacting your day to day credit lines can keep your operations running smoothly.

The competitive advantage

Kudos to manufacturers who are exploring new technologies from around the world and integrating them into new or existing processes. Continuing to engage your expert advisors early in your planning stages enables you to efficiently allocate capital, mitigate risk and build your competitive advantage.

Your RBC Royal Bank team of industry specialists can help you decide what's right for you. They have access to leasing, equipment financing, trade financing and FX specialists who can answer questions and help structure a lease to suit your situation.

For more information:
www.rbcroyalbank.com/commercial/equipmentpurchaseline

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