FEI Canada
2014 Annual Conference

Financing Panel

June 5th, 2014

The Capital Continuum

- Over the course of the past fifteen years, the landscape for Canadian financial services has changed materially with a proliferation of financial instruments aimed at more appropriately pricing financial risk along mid-market Balance Sheets.

Debt

Senior Secured Debt

First Charge Security Ranking
- Operating Line
- Term Debt/Mortgage
- ABL
- Equipment Finance
- Other (i.e., factoring / SR&D / Etc)

Subordinated Debt

Second Charge Security Ranking
- Term debt (can be amortizing or non-amortizing) with interest
- High yield bonds

Subordinated Debt + Participation

Hybrid Instrument
- Second charge security ranking for debt
- No security charge for equity sweetener (i.e., royalty, warrants, etc.) required to meet higher risk/reward hurdle

Convertible Debenture

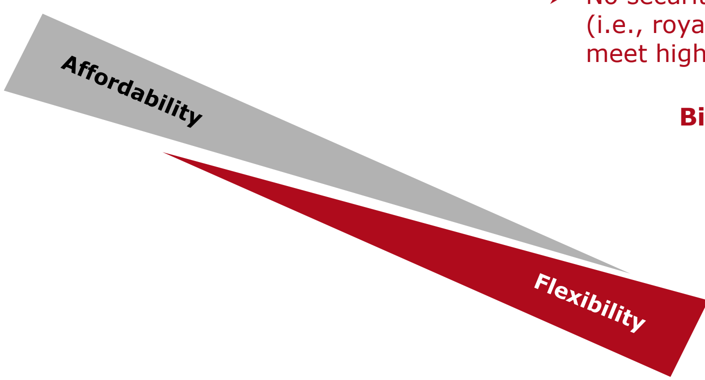
Binary Instrument
- Either Equity or Debt where conversion implies full participation in the equity risk

Preferred Shares

Equity Instrument
- Yield-based, non-participating equity
- Ranks ahead of Common Equity in liquidation

Equity

Common Equity
- Pure equity risk



- Bankers typically rely on one of three key lending disciplines when evaluating financial alternatives

Asset-Based Lending

- Lending values determined by Asset values
- Heightened advance rates and flexibility supported by independent appraisals, in-depth due diligence and increased monitoring
- Collateral value more important than equity value

Traditional Lending

- Lending values determined primarily by Asset values but may also be affected by Enterprise Value
- Proposals are informed by historic and anticipated performance
- Lender value at risk is proportional to Borrower's equity at risk

Leveraged Lending

- Lending values determined by the quality and consistency of the anticipated future cash flow of the business
- Asset values may be an important sweetener
- Lender value at risk is proportional to Borrower's equity at risk

Lending Instruments

Asset-Based Lending	Traditional Lending	Leveraged Lending
• Operating Lines of Credit • May be supported by standalone term debts attached to hard asset value	• Operating Lines of Credit • Often supported by standalone term debts attached to hard asset value where LTV increases as quality of earnings improves	• Operating Line of Credit • Almost always supported by standalone term debts attached to Enterprise Value

	ABL Financing	Traditional Bank Financing
Structure	▲ Revolving working capital loans ▲ Term loans available ▲ Collateral focused	▲ Revolving working capital loans ▲ Term loans ▲ Leverage focused
Borrowing Base	<u>Revolving Loans</u> ▲ 85-90% of eligible AR ▲ Lesser of 60-70% of cost, or 85-90% of the Net Orderly Liquidation Value ("NOLV") of Inventory (no cap) <u>Term Loans</u> ▲ Up to 75-85% of NOLV of M&E ▲ Up to 65% of FMV of Real Estate	<u>Revolving Loans</u> ▲ 75% of eligible AR ▲ 50% of book value of Inventory (subject to a cap) <u>Term Loans</u> ▲ Leverage or collateral based
Term	▲ 3 to 5 year committed facilities	▲ On demand ▲ 3 to 5 year committed facilities are available
Covenants	▲ Fixed Charge Coverage ▲ Springing covenants	▲ Debt / EBITDA, Debt / Equity ▲ Working Capital Ratio ▲ Fixed Charge Coverage
Use of Proceeds	▲ Flexibility based on excess availability	▲ Restrictions in place, particularly for distributions
Pricing	▲ Typically based on excess availability	▲ Based on leverage
Monitoring	▲ Weekly/Monthly Borrowing Base monitoring ▲ Field Audits & Appraisals	▲ Monthly Borrowing Base ▲ Financial covenants reporting

Key Leverage Drivers

- When assessing a new opportunity, lenders will determine leverage levels by focusing on the quality and consistency of cash flows and/or the nature and quality of the asset base:

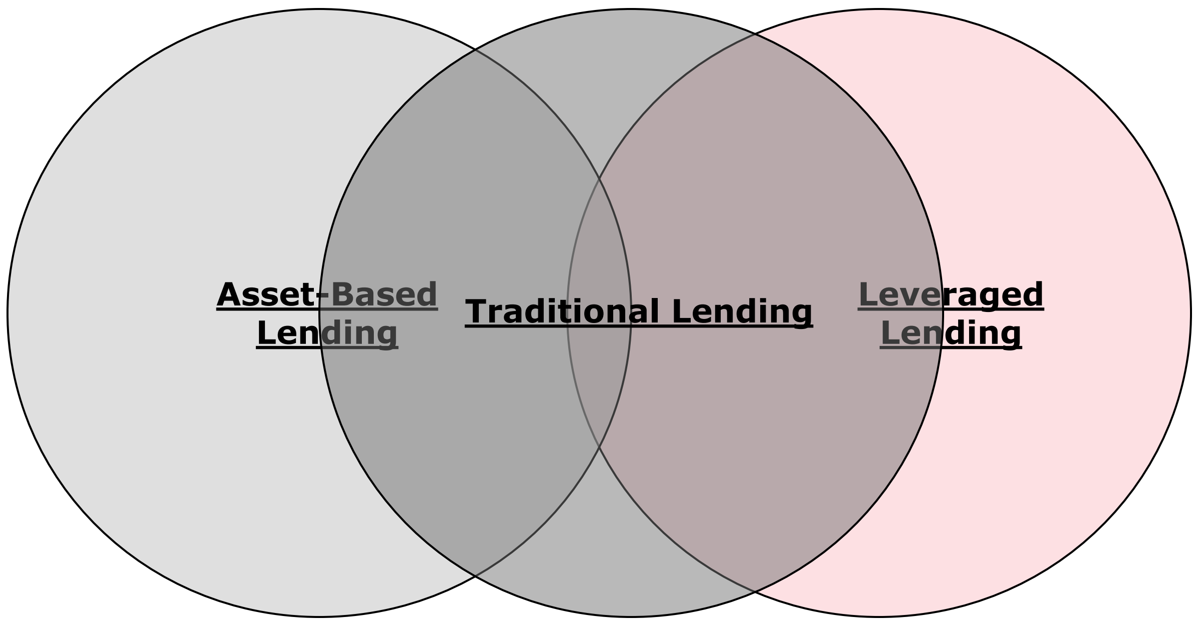
Enterprise Value Loans

- Size & Scope of Borrower’s Operations
- Degree of Customer Concentration (revenue and profit)
- Level of Supplier Concentration
- Degree of industry cyclicality
- Level of input commodity price risk
- Degree of foreign exchange risk
- Capital intensiveness (working capital or capex)
- Seasonality
- Level of Return on Invested Capital
- Proprietary product/service
- Relative value determinable via comparable precedent transactions & publicly traded companies
- Strength of management team

Asset-Focused Loans

- **Physical Assets and Inventory**
  - ✓ Nature of Asset
  - ✓ Predictability of Value
  - ✓ Marketability / Buyer Universe
  - ✓ Cyclicality / Seasonality
  - ✓ Disposal Costs
- **Accounts Receivable**
  - ✓ Quality of AR (concentration, investment grade)
  - ✓ Extent of Ineligibles
  - ✓ Perfection /Collectability
  - ✓ Risk of potential Set-Off
  - ✓ Dilution

- Present market conditions are contributing to a “blurring of the lines” between three distinct types of commercial lending



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Other Financial Products

- A number of other financial products can help enhance cash flow, including documentary letters of credit, A/R & inventory insurance, factoring and supplier financing

Accounts Receivable

- Improve communication with customers, to ensure invoices have been received
- Standardization is key to improving efficiency:
  - Standardize credit approvals for customers, to maintain rigorous lending limits
  - Standardize price lists and proposals, to reduce room for confusion on pricing
  - Standardize collection strategies by customer type and customer value
- Monitor Key Performance Indicators (KPI's) over accounts receivable:
  - Communicate the impact of their daily actions over KPI's, and effects on working capital

Inventory

- Look for opportunities for potential inventory reduction through technology improvements, such as inventory optimization software to manage upstream and downstream inventory levels
- Establish KPI's on inventory levels, and communicate their importance to operations staff
- Make inventory planning a priority, to set target inventory levels needed to support forecast demand

Accounts Payable

- Maintain strong supplier relationships and negotiate payment terms (early payment discounts, volume purchase discounts and frequent purchase discounts)
- Simplify your accounts payable process (reduce the number of cheque runs per month)
- Use technology to your advantage (ensure your accounts payable module is properly set up in your accounting software, so that all payments are accurately flowing through the system)