



ALP LTD. VALUATION SERVICES PRESENTS:

Unlocking Small Business Financing in Canada:

A Guide for Loan, Mortgage
and Business Brokers

 (506) 804-4430

 CMEA@ALPAtlantic.com

 www.BusinessAndAssetValues.com



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Advantage Liquidity Partners (ALP) Ltd. Valuation Services Presents:

Unlocking Small Business Financing in Canada:

A Guide for Loan and Business Brokers

Executive Summary

This guide serves as an essential introduction to small business acquisition financing in Canada, tailored specifically for professionals assisting clients in securing loans. Unlike asset-based loans for cars or real estate, business acquisition financing is complex due to the intangible nature of businesses, requiring a specialized understanding of how different business components are valued and financed.

The guide provides a clear breakdown of business financing components, beginning with tangible assets, such as machinery and inventory, which are eligible for secured loans often backed by government programs like the *Canada Small Business Financing Act*. It also introduces the concept of goodwill—the value above tangible assets—illustrating how buyers pay a premium for profitable businesses and how lenders typically fund only the collateralized portion.

The financing landscape for business acquisitions is outlined in detail, covering senior secured debt for fixed assets, subordinated debt, operating capital financed through lines of credit or trade credit, cash flow lending such as BDC products and seller financing arrangements, which may be subordinated to senior loans. An essential aspect of business acquisition financing, buyer equity, is explained with emphasis on debt-to-equity ratios, which ensure the business maintains a healthy financial structure post-acquisition.

The report then guides readers through the acquisition financing process, from offer submission through loan approval and appraisal engagement. Key steps, including when and why to conduct a certified machinery and equipment appraisal, are outlined to support transparent valuation and ensure financing readiness. The report concludes with criteria for when an appraisal is required, such as non-arm's length purchases, out-of-country acquisitions, or after major repairs.

To ensure smooth transactions, ALP Ltd. offers a Lender Acceptance Guarantee, committing to appraisals that meet lender specifications and offering adjustments or refunds if the report fails to satisfy requirements, minimizing uncertainty for clients.

This comprehensive guide equips professionals with the knowledge to navigate the nuances of small business acquisition financing in Canada, supporting informed decision-making and fostering successful loan transactions.

President's Message



Hi there and Welcome!

My name is David Barnett, and I founded Advantage Liquidity Partners Ltd. in 2008 and introduced Certified Machinery & Equipment appraisals in 2009.

Thanks for taking the time to download this report.

Our goal is to help you get your deal done and if you work with entrepreneurs, we want to help make you a better advisor to them.

If you received this report as a gift from someone, please take a moment to add yourself to our email list so that you can receive our monthly newsletter with short updates and educational clips about the world of appraisal and trends in capital equipment values.

Sign up at www.CMEAEmails.com or scan this QR code to open the signup form on your phone.



Over the years, I've had the pleasure of working with hundreds of entrepreneurs and their advisors and their brokers and have helped them get deals done.

If you have questions or have encountered a 'non-standard' scenario and are looking for advice, please don't hesitate to contact us.

Thank you

A handwritten signature in blue ink, which appears to read 'D. Barnett', is placed below the 'Thank you' text.

David C Barnett
www.BusinessAndAssetValues.com

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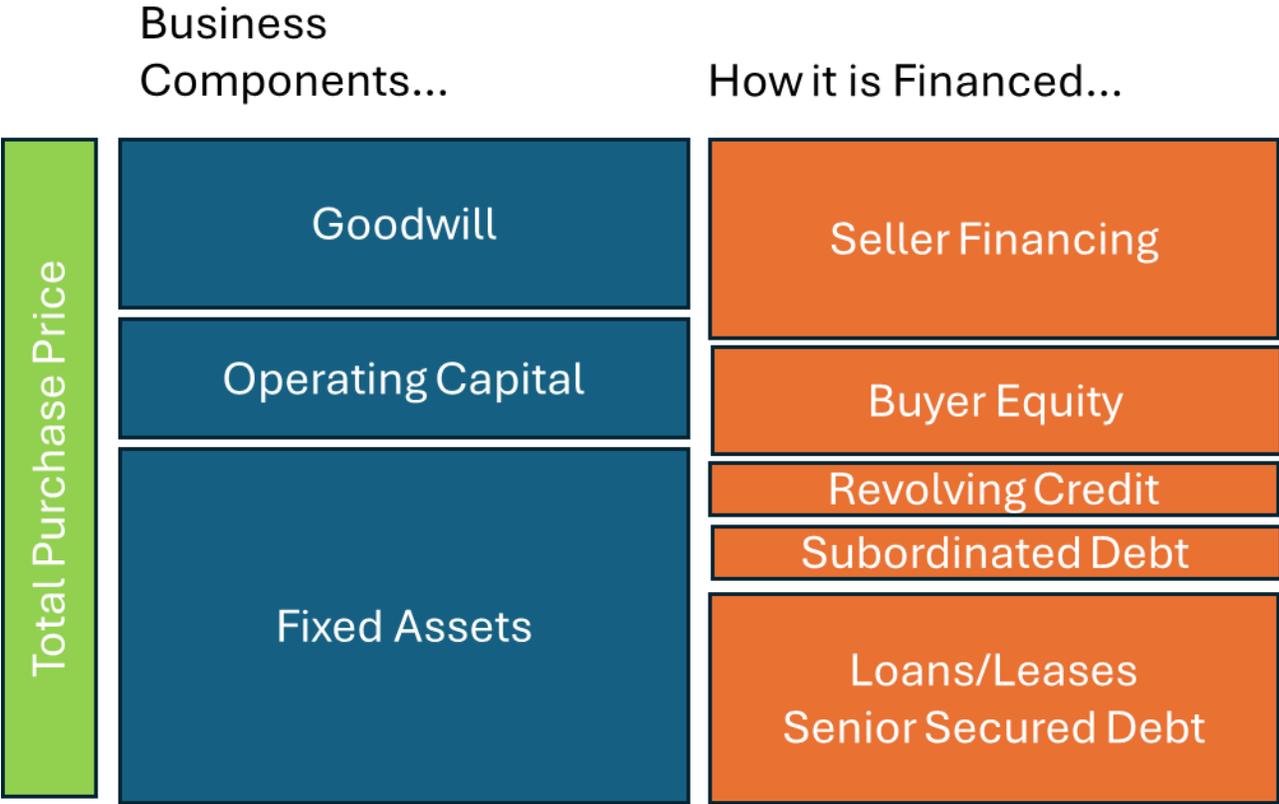
Introduction to Small Business Acquisition Financing in Canada.

Welcome to our guide on understanding business acquisition financing in Canada. If you're new to helping clients, get loans for business acquisition, this guide is for you.

Unlike the sale of a car or a building, a business is not a single tangible item, as such, lenders do not make loans against the purchase price of a business or on the transaction value.

Rather, lenders often begin by financing the tangible assets of a business or operating capital assets that can be converted into cash such as inventory or accounts receivable. In some cases, additional financing may also be available based on the cash flow of the business or for certain eligible intangible assets.

Components and Financing for a Business Purchase



If a business is profitable, buyers will be willing to pay a price for the business that could be more than the value of the tangible assets within the business. For example, a pizzeria that is profitable may find a buyer willing to buy it for \$500,000. If the pizzeria comes with \$300,000 of equipment and furniture (fixed assets) and \$50,000 of inventory (part of the operating capital) then there is a 'gap' of \$150,000. This gap is referred to as the *goodwill* of the business.

Fixed assets are the substantial pieces of equipment, vehicles or furnishings that represent collateral for a lender such as a bank. These loans are therefore referred to as *senior secured debt*. These are the assets that are appraised during a machinery and equipment appraisal and are financed by loans or leases. Typically, in most small business scenarios, lenders will use the *Canada Small Business Financing Act* program from Industry Canada. The act allows lenders to access a loan guarantee from the federal government and requires items such as a qualified appraisal for the lender's file. The amount of value of the fixed assets that the bank may lend could range and is typically between 50-90% of the item's value.

Any other loan that might be found for the business acquisition that is not secured against the assets would be referred to as subordinated or junior debt in reference to the fact that they will have a lower claim on any collateral than the bank loan.

Operating capital would be inventory and money for financing accounts receivables or simply money in a cash register used to make change for customers. Operating capital can be financed with lines of credit, credit cards and trade credit offered by suppliers.

The last available piece of debt financing comes from the seller of the business. This seller financing or *vendor take back* financing is typically subordinated to the bank loan and sometimes may be subject to conditions from the senior lender such as waiting for a period of time to pass before principal payments may commence. This situation is referred to as 'being on standby.'

The Buyer's Equity or Down Payment.

The last component of the financing puzzle is the buyer equity. This can be from an individual buying a business or money found from investors. Lenders typically may place restrictions on payments to investors until specified loan covenants have been achieved. Many lenders have an absolute requirement on the amount of buyer equity that is present in the deal and often give guidance in the form of a debt-to-equity ratio.

For example, a debt-to-equity minimum ratio of 3:1 would mean that the bank doesn't want to see the total financing solution for the business exceed three dollars of debt for every one dollar of equity. This amounts to a maximum amount of debt equal to 75% of the total business acquisition or 'opening balance sheet'.

The opening balance sheet is the projected balance sheet of the business once the deal is done and any additional debts or assets required beyond what the seller has supplied have been applied to the business. A common example of this is when a business is purchased in an asset sale and no operating capital is conveyed. The buyer will have to bring their own operating capital, and this will affect the opening balance sheet, making it different from the assets acquired from the seller.

Banks will have these equity requirements even though they likely will not be lending, for example, 75% of the purchase price. It is a risk-management policy to ensure the business is not overburdened with debt service payments. The financial strength of the business ensures the ability of the business to pay the bank loan.

Other guarantees and assurances such as personal guarantees or collateral liens are secondary to the success of the business in assuring the lender of their ability to collect their investment.

Cash Flow Loans and Other Financing Based on Business Performance

In the previous section we discussed the buyer's equity and how lenders want to ensure that the business is not overburdened with debt service payments. This leads to another important concept in business acquisition financing which is cash flow lending.

A cash flow loan is a loan made primarily on the strength of the business's ability to make the payments rather than on the liquidation value of specific pieces of collateral. In other words, instead of relying mainly on equipment, vehicles, leaseholds or real estate, the lender is looking at the historic and expected future cash flow of the business and deciding whether that cash flow is dependable enough to support the debt.

This type of lending is important because many profitable businesses sell for more than the value of their fixed assets and inventory. That gap is often referred to as goodwill. In some cases, there may not be enough tangible collateral in the business to support the full purchase price with conventional senior secured lending alone. This is where cash flow lending or subordinated lending may become part of the financing solution. The existing report already explains that junior or subordinated debt may be found for the part of the purchase that is not secured against assets. A cash flow loan is one example of how that can happen in practice.

In Canada, BDC is one of the clearest examples of a lender offering this kind of financing while other charter banks have been known to do them on an industry or size-specific basis. BDC currently describes cash flow financing for business acquisition projects where the target company has demonstrated a consistent track record of positive and strong cash flow. BDC also says this type of financing can help bridge the gap between senior debt, vendor take-back financing and buyer equity.

BDC also describes mezzanine financing, also called subordinate financing, as a hybrid of debt and equity that is not secured by specific company assets and is instead based on the historic and expected future cash flows of the business. This is very much in line with the kind of gap financing that often appears in business purchases where the value of the business exceeds the value of the hard assets.

This does not mean that a lender ignores the borrower's own financial strength. In fact, when a loan is not strongly supported by hard collateral, the personal strength of the borrower and the management team often become even more important. BDC says that businesses seeking loans without tangible collateral will generally be required to sign a personal guarantee for certain working capital loans, and depending on the lender's analysis, additional security may also be required. BDC also says that businesses with proven cash flow and strong finances can often obtain certain growth-oriented loans without collateral.

This means that the personal net worth of the borrower may play an important role in determining whether this type of financing is available. A lender may take comfort from knowing that the borrower has financial strength outside the business, the ability to inject additional capital if required, and enough personal resources to stand behind a guarantee. Likewise, the borrower's experience in the same industry or in operating similar businesses can be very important. If the lender believes the buyer has the skill and experience to preserve the future cash flow of the business, then a loan based more on business performance and less on collateral may be easier to justify.

This is especially true in a business purchase where there is a meaningful amount of goodwill. If the lender is being asked to finance value that cannot easily be appraised and sold piece by piece, then they will usually want reassurance in other forms. Those reassurances can include a strong earnings history for the business, reliable financial reporting, a solid management team, relevant borrower experience, and personal financial strength from the principals behind the purchase. BDC's Growth and Transition Capital materials emphasize strong cash flow, strong management and customized repayment terms built around the cash-generating ability of the business.

It is also worth noting that the *Canada Small Business Financing Act* program has evolved in recent years. While this program is still mainly associated with asset-backed business lending, the current federal guidelines allow term loan financing to include eligible intangible assets and working capital costs, with up to \$150,000 available for intangible assets and working capital costs within the applicable program limit. This means that in some cases a portion of the non-tangible part of a business purchase may fit within the program rules. However, this does not eliminate the need for buyer equity, other subordinated financing, or a strong underwriting case based on cash flow.

The key point is that business acquisition financing in Canada is not always limited to the value of equipment and inventory alone. For a business with strong, dependable cash flow, some lenders may be prepared to lend against the earning power of the business itself. When this happens, the lender is likely to pay close attention to the quality of the financial statements, the stability of the cash flow, the experience of the buyer and management team, and the personal financial strength of the people standing behind the deal.

When an Appraisal May be Needed for a Used Equipment Purchase.

Throughout this report we've been examining when an appraisal would be required to help facilitate the purchase of an operating business. In most circumstances, if a business simply wants to buy used equipment, no appraisal is necessary.

In circumstances where used equipment is being purchased from an arm's length party or dealer lenders typically use the invoice as the value of the equipment. In some specific situations, however, they may require an appraisal be done by an outside appraiser.

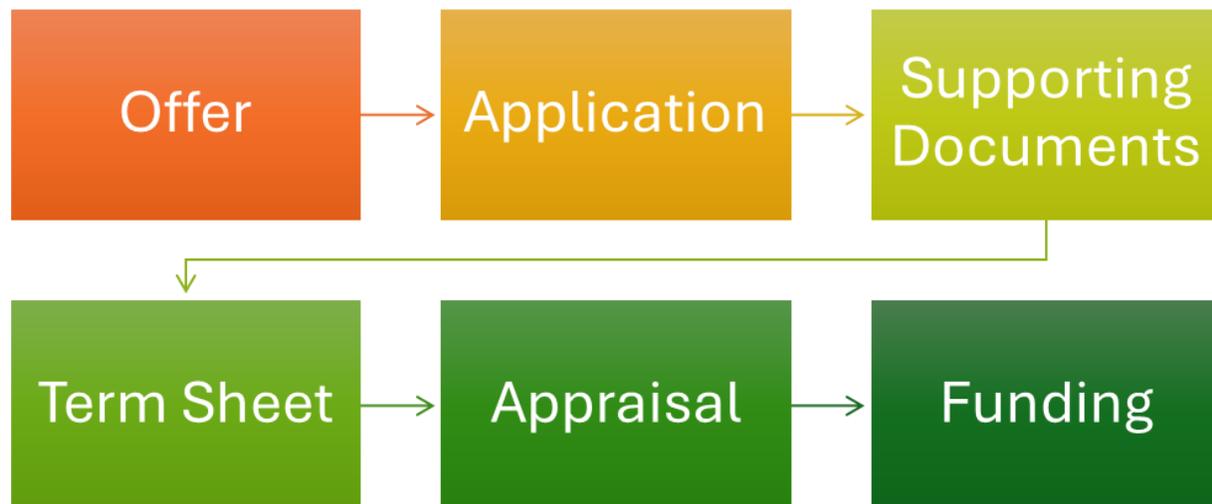
These situations include:

1. When a piece of equipment is being bought outside of Canada,
2. When a piece of equipment is being bought from a non arms length party,
3. Or, for the purchase of equipment after a major repair or restoration of the item in question.

At anytime if you're asked for an appraisal of equipment when trying to arrange financing for a client, please reach out to us and discuss the situation.

The Business Purchase and Financing Process.

Buying a business and obtaining senior secured financing follows these steps:



1. The buyer makes an offer on the business which is accepted by the seller. This offer should be subject to due diligence and financing approval.
2. The buyer takes the offer to the lender or loan broker, this offer becomes the basis for making an application. Often a cash flow forecast and/or a business plan must be made to demonstrate the ability of the business to service the debt into the future.
3. The lender may want to know the value of the equipment in the business; however, this is not yet the time to hire an appraiser. Instead, the seller should furnish a list of equipment and estimate the value of each item. The lender will use this information along with the cash flow forecast to make an underwriting determination as to whether they want to do the loan or not. The personal credit history of the borrower will also be examined at this time.
4. If the loan is approved, the lender will issue a term sheet for acceptance by the business buyer. This term sheet will be subject to several conditions, one of which may be securing a qualified appraisal on the equipment in the business. This is the point at which you engage with ALP Ltd. Valuation Services.
5. ALP Ltd. will create the report and send it directly to the lender.
6. After all final approvals, the bank will communicate instructions for the movement of money and their requirements for registering loan security with the buyer's lawyer. The deal is now on its way to closing.

Business Refinancing

Business Refinancing can also be done for an entrepreneur who owns equipment in the business. The process would begin at Step 3 above.

ALP Ltd. Lender Acceptance Guarantee

Doing a business deal entails risks and costs. We understand that you're trying to do a deal to grow or buy a business and that your plan is that this investment will ultimately yield a positive return for you.

Costs such as obtaining an appraisal for a lender are part of the 'friction' of doing a deal. Deals and business in general, hold many uncertainties.

We want to help make you more certain about the part that we can deliver for you- the appraisal process and report.

Because we've been doing Certified Machinery and Equipment appraisals since 2009, we understand deal making and the needs of our report users at banks and other institutions.

We are therefore comfortable with **guaranteeing** that our report will be accepted by your lender and that you don't need to worry about needing to find an alternative appraiser at the last minute to complete your deal.

We speak to your lender during the engagement phase of the project and confirm with them the definition of value that they desire. We also support the lender in any questions they have about our final delivered document. *If your lender does not accept our report, we will promptly adjust it so that they will, or refund our fee.*

This is not a guarantee that we will determine a specific value or that the lender will approve your loan application.

Appendix A- Definitions of Value

The following values are defined in the publication *Valuing Machinery and Equipment: The Fundamentals of Appraising Machinery & Technical Assets*, Third Edition, by the American Society of Appraisers. This table has been assembled by ALP Ltd. Valuation Services to guide the reader into understanding which values are most pertinent given the different considerations to business profitability and the available timeframe for equipment sales.

Fair Market Value is an opinion expressed in terms of money, at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts, as of a specific date.

Fair Market Value - Removed is an opinion, expressed in terms of money, at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts, considering removal of the property to another location, as of a specific date.

Fair Market Value in Continued Use is an opinion, expressed in terms of money, at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts, as of a specific date and assuming that the business earnings support the value reported, without verification.

Fair Market Value – Installed is an opinion, expressed in terms of money, at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts, considering market conditions for the asset being valued, independent of earnings generated by the business in which the property is or will be installed, as of a specific date.

Orderly Liquidation Value is an opinion of the gross amount, expressed in terms of money that typically could be realized from a liquidation sale, given a reasonable period of time to find a purchaser (or purchasers), with the seller being compelled to sell on an as-is, where-is basis, as of a specific date.

Forced Liquidation Value is an opinion of the gross amount, expressed in terms of money, that typically could be realized from a properly advertised and conducted public auction, with the seller being compelled to sell with a sense of immediacy on an as-is, where-is basis as of a specific date.

Liquidation Value in Place is an opinion of the gross amount, expressed in terms of money, that typically could be realized from a properly advertised transaction, with the seller being compelled to sell, as of a specific date, for a failed, non-operating facility, assuming that the entire facility is sold intact.

Salvage Value is an opinion of the amount, expressed in terms of money that may be expected for the whole property or a component of the whole property that is retired from service for possible use, as of a specific date.

Scrap Value is an opinion of the amount, expressed in terms of money that could be realized for the property if it were sold for its material content, not for a productive use, as of a specific date.

Insurance Cost New is the replacement or reproduction cost new as defined in the insurance policy less the cost new of the items specifically excluded in the policy, as of a specific date.

Appendix B- Frequently Asked Questions

Visit our website to see our currently available videos as well as the top 40 questions that we regularly receive. <https://www.businessandassetvalues.com/faq>

Video#1: Certified Appraisals- How they differ and what they look like.

What does a USPAP-Compliant Certified Machinery and Equipment Appraisal report look like?

What's the difference between a CMEA report and what an equipment dealer might create?

Video#2: Questions for the party ordering the appraisal.

What information do you need to begin?

How much does it cost?

What if we have no equipment list to give you?

Video#3: Questions for the equipment buyer or owner.

Do you need to come and visit the equipment?

Why do I need a Certified Appraisal?

Why is my banker asking for an equipment appraisal for the business I'm going to buy?

Video#4: Understanding small business valuations.

Who needs a small business valuation?

How I complete the valuation exercise.

What the final report document looks like.

