

Student 4: High Achieved

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Sanford Ltd wants to purchase a second-hand fishing vessel costing \$4,200,000 to allow the company to remain competitive and meet demand from an increasing trade market. This purchase will be a capital expenditure.

Although Sanford has a current net asset value of \$575,836,000 there is not enough cash on hand to purchase the vessel outright, so the company is looking at financing options.

Sanford wants to pay off its loan in six years or less and is considering three different financing methods to purchase the vessel. This report will compare the options of using vendor financing, increasing their borrowings with BNZ, and using crowdfunding.

The first option is **vendor financing** from the seller of the vessel. **It is like hire purchase. Sanford will get possession of the trawler once the contract has been signed but ownership of it would not transfer from the vendor/seller until the final repayment has been made.** There would be a one-off \$2,000 establishment fee to set up the contract, but the first 12 months would be interest-free. Despite the interest free period, using vendor finance is risky as the interest rate is higher and often floating. Using the AA loan calculator as a point of reference, interest rates can vary from 9.95% to 15.95% or higher.

Changes in a floating interest rate can result in a higher or lower rate of interest which can be difficult for Sanford to predict and budget for. The chart below uses a 12.45% interest rate to calculate repayments over a six-year loan period. Over the five years that interest is charged, a total of \$845,373.50 would be paid in interest.

Year	Interest rate	Interest repayment	Principal repayment	Total paid (rounded)	Total owing
1	0%	0	702,000	\$702,000	\$3,500,000
2	12.45%	\$281,124	700,000	\$1,683,124	\$2,800,000
3	12.45%	\$224,899	700,000	\$2,608,024	\$2,100,000
4	12.45%	\$168,674	700,000	\$3,476,698	\$1,400,000
5	12.45%	\$112,449	700,000	\$4,289,148	\$700,000
6	12.45%	\$56,224	700,000	\$5,045,373	0

Another funding option is a **bank loan**. The 2017 interim report shows that Sanford has \$206,282 in secured loans with BNZ. The interest rate being charged for BNZ loans ranges from 2.62% to 3.06%. By increasing their current loans Sanford would be able to receive lower interest rates than for vendor financing, resulting in much less interest being payable. Also, **due to Sanford's existing relationship with their bank, they might be able to negotiate to refinance their current loan, allowing them to remain flexible and potentially able to extend the term of the loan if required.** The bank will require the fishing vessel to be used as security for the loan. If Sanford defaults on the loan the bank can sell the vessel to recover the money they are still owed. The table below shows the hypothetical repayments for a BNZ loan calculated on a hypothetical change to the interest rate each year.

Year	Interest rate (floating)	Interest repayment	Principal repayment	Total paid (rounded)	Total owing
1	2.62%	\$16,030	700,000	\$716,030	\$3,500,000
2	2.72%	\$12,868	700,000	\$1,428,898	\$2,800,000
3	2.82%	\$9,929	700,000	\$2,138,827	\$2,100,000
4	2.92%	\$7,447	700,000	\$2,846,274	\$1,400,000
5	2.72%	\$5,147	700,000	\$3,551,421	\$700,000
6	3.06%	\$2,288	700,000	\$4,253,709	0

Crowdfunding is defined by the Merriam-Webster dictionary as “the practice of obtaining needed funding, as for a new business, by soliciting contributions from many people from the online community”. Sanford Ltd is already a well-established business and, if it were to use crowdfunding, it would have the most favourable outcome by crowdfunding from its shareholders rather than the public.

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Due to the large amount of money needed (\$4,200,000) and Sanford's financial position, there is a very small chance that Sanford will get financed via crowdfunding, and an even smaller chance the boat will get funded within the six-year period that Sanford intends to repay the shipping vessel in. If Sanford did use crowdfunding, they would not need to pay interest on money received. However, there is no certainty over whether they would be able to raise the funds required to buy the vessel. Crowdfunding is most successful when contributors get something in return. For example, the most successful crowdfunding campaign was the Pebble Time smartwatch which raised \$US20,338,986 for its production, with contributors (pledgers) receiving gifts, such as a discount on the watch, in return for the money they gave. Unless Sanford can offer contributors some type of benefit or reward to encourage them to provide funding for their shipping vessel, they are unlikely to gain traction in interesting potential contributors.

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CONCLUSION

The best option for Sanford to use to fund their shipping vessel is to increase their borrowings with their current bank, BNZ. This is because Sanford already has loans with the bank and could have the option to refinance their loan as required.

If unable to increase borrowings from BNZ, Sanford could also use vendor financing, although they would be required to pay much higher interest rates.

The odds that Sanford would be able to successfully finance their new boat through crowdfunding is so low that it shouldn't be seriously considered.

With the loan and vendor financing, cash is guaranteed to be received over a medium-term period (5-10 years).