

Financing an Acquisition

A Guide for
Middle-Market Companies

THE MERIDIAN GROUP



Types of Acquisition Financing

Characteristics	Debt		Equity	
	<u>Senior</u>	<u>Subordinated</u>	<u>Preferred</u>	<u>Common</u>
Tax deductible Interest Charges	X	X		
Loan Covenants/Restrictions	X	X		
No Required Fixed Payments			X	X
Can be used in Tax-Free Exchange			X	X
Base for Leverage			X	X
Common Equity Convertibility Features		X	X	
Not Subject to Redemption				X
Costs of Financing	Low	Higher	Higher	Highest
Dilution of Ownership		X	X	X



Sources of Acquisition Financing

<u>Investors/Lenders</u>	<u>Instrument</u>	<u>Rate of Return</u>
Government Loans	<i>Senior Debt</i>	<i>Below Prime to Prime +2%</i>
Commercial Banks	<i>Senior Debt</i>	<i>Prime + 1 to 4% (based on security and term)</i>
Commercial Finance Companies	<i>Senior Debt (including factoring)</i>	<i>Prime + 2 to 8%</i>
Insurance Companies and Pension Funds	<i>Long-Term Senior Debt Subordinated Debt Preferred Stock Common Stock</i>	<i>U.S. Treasury Rate + risk premium Composite Compound of 20 to 25%</i>



Sources of Acquisition Financing

<u>Investors/Lenders</u>	<u>Instrument</u>	<u>Rate of Return</u>
Venture Capital Funds	<i>Subordinated Debt (convertible or with warrants) Preferred Stock Common Stock</i>	<i>Composite compound of 35 to 50%</i>
Leveraged Buyout Funds	<i>Common Stock</i>	<i>Minimum 40% compound annual return</i>
Sellers	<i>Earn-outs Subordinated Debt Preferred Stock</i>	<i>Negotiable</i>
ESOPs	<i>Preferred Stock (convertible) Common Stock</i>	<i>Dividend and appreciation appropriate for risk</i>
Management/Buyer	<i>Common Stock</i>	<i>Dividend and appreciation appropriate for risk</i>

Accounts Receivable Advance Rate Calculation



<i>Face Amount of Outstanding Receivables</i>	<i>100%</i>
Less average:	
Returns and allowances	(2%)
Receivables from suppliers for returns	(2%)
Concentration of receivables	(3%)
Consignments sales	(3%)
Discounts	(2%)
Receivables not legally assignable	(1%)
Foreign receivables	(1%)
Historical bad debts	(6%)
<i>Bankable Accounts Receivable</i>	<i>80%</i>
Lender Discount	(10%)
<i>Advance rate</i>	<i>70%</i>



Overall Advance Rates

Accounts Receivables	60 to 80%
Eligible Inventory (raw material and finished goods)	35 to 65%
Eligible Inventory (work-in-process)	20%
Machinery and Equipment	
• Orderly Liquidation Value	40 to 60%
• Forced Liquidation Value	60 to 80%
Real Estate (Market Value)	75 to 90%