

**Funding Growth:  
Financing Vehicles  
to Help Grow Your Business**

THE MERIDIAN GROUP



## Funding *Growth*--First Steps

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Identify the company's goal:

- *Purchase another company or product line*
- *Add capacity to existing company---space and equipment*

Prepare 3 to 5 year historical financial statement analysis

Prepare projected financial statements for 3 years including the targeted growth goal

- *Quantify requirements to attain goal*
- *Analyze the company's ability to service new debt and/or provide a return on equity.*



# Write a Business Plan explaining and defining:

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What are the company's objectives

The industry it serves

The market for its product or service

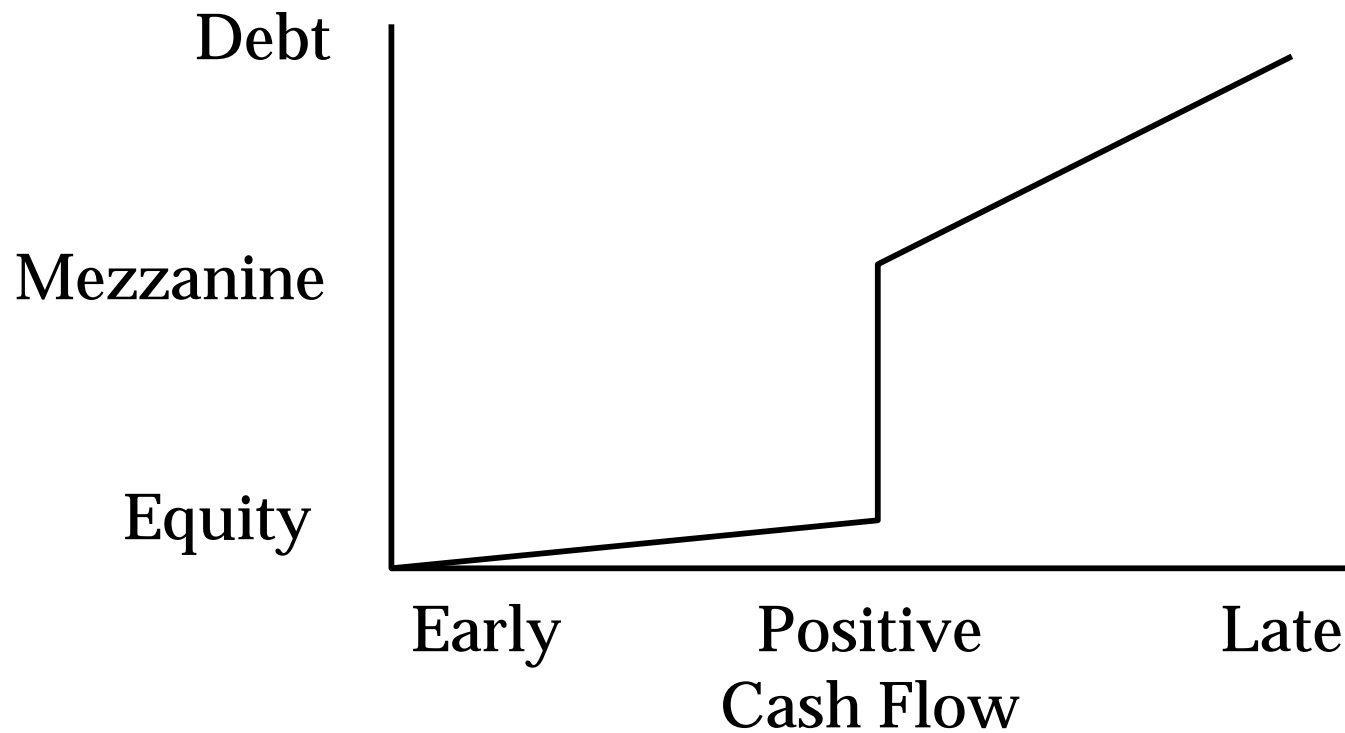
The competition in its industry

The management team and its strengths

A financial analysis of the historical and projected results



# Types of Financing available based on maturity of Balance Sheet





# What an Early Stage Venture Capitalist **Seeks**

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Companies with significant growth potential

Large growing markets --- a key!

Proprietary products

Management experience

Experience in a well-run company

Willingness to be flexible --- open to change



## Late Stage Funding

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A Late Stage Company *has*:

- *At least a five-year history*
- *Positive operating cash flow*
- *Debt to Equity ratio of less than 3.0*



## Types of Lenders

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### Factoring:

- *Small: 1% each 10 days A/R outstanding (APR  $\approx$  30%)*
- *Large: 1% and applicable interest rate*

### Asset based lenders:

- *Small: Prime plus 2% or more plus fees*
- *Large: Rates in the LIBOR + 2% to Prime + range*

### Conventional lenders:

- *Focus on cash flow, collateral, character and personal guarantees*

### Cash Flow lenders:

- *Lend against EBITDA multiples of 2.0x to 5.0x*



## Asset Based and Receivable Financing

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### Factoring:

- *Recourse versus non-recourse*
- *Advances against billed invoices*
- *Factor performs “back office” collection activities*
- *Fees vary from 0.5% to 5% of invoice*
- *Interest rates and advance rates similar to ABL*

### Asset-based financing:

- *70% to 85% for “collectible” accounts receivable (revolver)*
- *40% to 60% for non-WIP inventory (revolver)*
- *60% to 80% of Orderly Liquidation Value of fixed assets (term)*
- *50% of real estate value (term)*



## Conventional Financing

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Financial Institution Equation: Risk versus Return

Cash Flow

Collateral

Secondary Sources of Repayment

Key Measurements:

- Positive Cash Flow

- ✧ *Defined as:*

$$\frac{(Net\ Income + Depreciation + Non-Cash\ Expenses)}{(Principal\ Payments\ on\ Term\ Debt + Unfunded\ Capital\ Expenditures + Distributions)}$$

- Leverage

- ✧ *Defined as: (Total Liabilities / Tangible Net Worth)*

- Tangible Net Worth



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## When does a company need unsecured funding?

First determine what type of financing is available to the company and how much it can reasonably obtain:

- Calculate the conventional financing available from senior secured lenders
  - ✧ *Cash flow-based financing (EBITDA analysis)*
  - ✧ *Asset-based financing (Balance Sheet analysis)*

Financing shortfall requires other funding sources:

Venture Capital Funds  
Family & Friends  
Institutional Investors  
Mezzanine Lenders

Local & Federal Government  
Private Individuals (Angels)  
Private Equity Funds  
Trade Suppliers



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## Sample Financing for Company XYZ

Profile: \$3MM in revenue, 40% market share, fabricated metal products manufacturer.

Purchasing product line to acquire additional 40% market share. Assets purchased are inventory and customer list.

Price for product line is \$1.7 million in cash and \$2.1 million in seller financing, payable over one year.

Company needs to secure financing to:

- complete the transaction
- provide working capital going forward



## Financial Analysis

of Company XYZ

### Balance Sheet Analysis

	Pre-Acq.	Acquired	Post-Acq.	Month 7	Month 7 w Sub-Debt	Year 2
A/R	368		368	1,600	1,600	1,600
Inventory	746	2,800	3,546	3,500	3,500	3,000
PPE - Net	373		373	373	373	371
Customer List	0	1,000	1,000	960	960	860
Total Assets	\$1,201		\$5,287	\$6,433	\$6,433	\$5,831
Seller Fin.	0		2,100	700	700	0
Bank Fin.	295		1,909	3,733	2,933	1,181
Other Liab.	281		281	800	800	850
Total Debt	\$576		\$4,290	\$5,233	\$4,433	\$2,031
Sub-Debt					800	800
Equity	997		997	1,200	1,200	3,000
Tangible Net Worth	997		(3)	240	240	2,140

	Post-Acq.	Month 7	Month 7	Year 2
<u>Debt Available:</u>				
Inventory @50%	1,773	1,750	1,750	1,500
A/R @80%	294	1,280	1,280	1,280
	\$2,067	\$3,030	\$3,030	\$2,400
PP&E @80% Ord. Liq. Val.	600	530	530	360
Total Secured Debt Available	\$2,667	\$3,560	\$3,560	\$2,760
Total Secured Debt Needed	1,909	3,733	2,933	1,181
Excess (Shortage)	\$758	(\$173)	\$627	\$1,579
Cushion=75% A/P		560	560	
Sub-debt Needed/(Cushion)		\$733	(\$67)	
Debt/TNW	0.6 to 1	N/A	21.8 to 1	4.6 to 1
				0.9 to 1



Characteristics of:  
**Mezzanine Debt**

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Required return is lower (making cost lower) than equity because:

- Lender receives current payment
- Secured position on assets lowers risk

Company needs a positive cash flow to service debt.

Exit strategy is clearly defined - (4 to 7 year horizon).

Price is based on projected results. Current return is in the 12% to 13% range. Overall return is in the low to mid-20's range.

Limited numbers of institutional players. Minimum investment for institutional mezzanine debt is \$2 million.

Shareholders may not have to give up equity.

Penalties for not achieving plan are severe and may further dilute shareholders' position.

Usually require position on the Board of Directors.



## Characteristics of Equity

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Required return is much higher than Mezzanine. Better avenue for faster growing companies.  
Overall return is in the mid to high-30's.

Company can have negative cash flow at time of investment.

Valuation is calculated by weighing:

- current market value, and
- projected market value (assuming a 4 to 7 year horizon and an exit strategy based on a financial buyer).

Limited numbers of institutional players but many more private equity sources. Minimum investment for institutional equity is \$3 million.

Shareholders must give up equity.

Penalties for not achieving plan are negotiated up front.

May require position on the Board of Directors.



## Mezzanine **versus** Equity

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Mezzanine is cheaper -- but more of a gamble if you don't meet the projections.

Equity is more expensive -- but shareholders know up front what they are giving up.