

TouchStone Nugget

FUNDING & FINANCIAL MANAGEMENT

OBSERVATIONS

- Small Business Owners often wait until its too late to solve their financing / funding issues
 - If Financially Healthy, you have more debt capacity now, so be proactive
 - If Start-Up, assess capital needs and alternatives now
 - If Turnaround, restructure business prior to seeking additional funds
 - If Debt is Onerous, have difficulty with monthly payments; refinance, consolidate debts
 - If Growth Capital is Needed - assess capital structure to evaluate debt / equity mix
- Small Business Owners know their business but know nothing or very little about funding
 - What does it take to get investment capital? Seek professional advice.
- Small Business Owners must be able to market the business to investors
 - Assess Risk / Rewards of Debt and Equity Investments
 - Anticipate Investor Concerns
 - Prepare Business Plan and Investment Memorandum

KEY FINANCIAL MEASUREMENTS AND RATIOS

- EBITDA – Earnings Before Interest, Taxes, Depreciation & Amortization
- FREE CASH FLOW – EBITDA Less Capital Expenditures Before Working Capital
- CAPITAL EMPLOYED – Debt Plus Equity
- LEVERAGE TESTS
 - Senior Debt to EBITDA (2.0x to 2.75x)
 - Total Debt to EBITDA (3.0x to 4.0x)
 - Debt to Equity (1:1 to 1.5:1)
 - Debt to Capital Employed (50% to 60%)
- COVERAGE TESTS
 - Debt Service Coverage
 - EBITDA to Debt Service (1.25x to 1.50x)
 - Interest Coverage
 - EBITDA to Interest Expense (1.20x to 1.30x)
 - Fixed Charge Coverage
 - EBITDA Less Capital Expenditures to Debt Service & Rents (1.05x to 1.10x)
- USE FINANCIAL STATEMENTS AS A MANAGEMENT TOOL

FUNDING ALTERNATIVES

- **Traditional Bank Financing** – Mature Companies Only
- **SBA Loans** – Start-Ups, Mature Businesses, Acquisition Capital
- **Mezzanine Capital** – Mature Company with Growth Prospects, Positive Cash Flow, Sound Business Model, Highly Leveraged
- **Equity Investors** – Compelling Business Model, Control Issues
- **Leasing** – Secondary Lenders for Equipment
- **Real Estate Financing** – Leverage Appreciated Market Value
- **Sale/Leaseback Transactions** – Maximize Value of Real Property; establish Exit Strategy to separate value of business from real property
- **Business Brokerage** – Exit Strategy = Cash/Notes, Earn Out

FUNDING ALTERNATIVES EXPANDED CONSIDERATIONS

TRADITIONAL BANK FINANCING

- Senior Secured Loans
 - Business and Personal Assets as Collateral
 - Cash Flow of Business – EBITDA
 - Asset Based Financing – Advance Rates on A/R & Inventory
- Debt Capacity – 2.0 x to 2.75 x EBITDA
- Historical Based Financing for Mature Companies
- No Start-Up's or Turnarounds
- Pricing – Prime and LIBOR Based
- Debt Covenants – Asset Advance Rates, Debt Service Coverage, etc.
- Used For Working Capital Credit Lines & Term Loans To Support Existing Operations, Provide Growth Capital & Refinance Debts
- Most Cost Effective Business Financing

SBA LOANS

- Historical Based Decisions for Mature Companies
- Consideration of Start-Up's & Growth Capital
- Must Market Business / Presentation of Financial Data
- Key Determinants
 - Cash Flow from Operations – EBITDA / Debt Service – Coverage of 1.25x to 1.50x
 - Collateral – Real Estate, Business Assets, Personal Assets, Personal Guarantees
 - Personal Credit Report / Credit Score (675 +)
- Administratively Complex / Time Consuming / Costly for Larger Transactions

UNSECURED SUBORDINATED DEBT (MEZZANINE CAPITAL)

- Willing to be Subordinate to Senior Lenders without Collateral at much Higher Returns
- Targeted Annual Returns 18% to 25%
- Typical Debt Structure
 - 12% to 14% Annual Cash Return
 - 3% to 5% Pay-In-Kind (PIK)
 - 3% to 5% Warrants at a Deeply Discounted Price
 - Principal Due - End of Term
 - Up-Front Commitment Fee
- Must be Mature Company with Growth Prospects in need of Capital
 - Positive Cash Flow / Great Business Model / Established
 - Total Leverage of 3.0 x to 4.0x EBITDA
 - Later Stage Companies – Minimum Revenues of \$10 Million Annually

EQUITY INVESTORS

- For Early Stage Investments
 - Sound Business Model / Opportunity must be Compelling
 - Start-Up's Considered (Minimal Annual Revenues)
 - Requires Substantial Equity Position (Control 50%+ or Non-Control Basis <50%)

ALTERNATIVE SOURCES OF FUNDING

- Consider Divestment - Contact a Business Broker
- Leverage Real Estate To Generate Cash To Support Business and Restructure Debts – 75% To 90% Loan To Value Ratio
- Consider Sale/Leaseback of Owned Facility
 - Proceeds Used to Pay-Off Existing Mortgages, Business Loans, Capital Gains Taxes, Reinvestment or Distribution to Owner
 - Must Enter into a Fixed Non-Cancelable Lease -- 10 YRS +
 - Credit Worthiness of Business Critical to Real Estate Investors

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