Mining Sources of Capital for Growth by Acquisition

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If you're ready to buy a printing company, banks and other lenders are ready to provide the funding. But, don't plan on one-stop-shopping for the resources you'll need.

As we never hesitate to remind our clients, anyone who owns a printing company today is an owner who should be planning either to sell it or to grow it. Today, the straightest path to growth is through mergers and acquisitions in a market that remains very receptive to these transactions. We see four reasons why the M&A climate continues to be as healthy as it is:

• The economy as a whole is in good shape, thanks in part to federal tax cuts that began to go into effect this year.

• Despite recent actions by the Federal Reserve, interest rates are still at historic lows.

• After years of blacklisting printing companies, banks are willing and even eager to lend money for acquisitions within the industry. In some cases, they'll offer up to three and a half times EBITDA for the right deals (and even more when packaging companies are involved).

• The industry is highly fragmented, and fragmented industries inevitably consolidate through M&As once strategic buyers and private equity investors sense opportunity in them.

The third point will be of special interest to owners who are ready to grow by acquisition. The money you'll need is out there – but there are points to remember about gathering capital for the deal you have in mind.

The first is that unless you have sufficient funds to pay all cash at closing (the arrangement sellers naturally prefer), you will have to borrow money in order to finance the purchase price. The all-cash transactions that the industry's big consolidators are known for won't be feasible for most small to medium sized acquirers.

When planning to borrow, don't count on being able to raise 100% of the purchase price from a single lender. Think about building a package of capital consisting of funds from some if not all of the following sources:

• *Banks.* These mainstream institutions provide senior debt – secured debt the borrower typically is required to repay before settling any other obligations – at interest rates that are lower than those available from other lenders.

• *Asset-based lending*. A company offering this type of financing makes loans based on the value of assets pledged as collateral: for example, inventory, accounts receivable, machinery and equipment. If the loan is not repaid, the pledged assets are taken by the lender. Interest rates on asset-based loans are higher than rates on bank loans.

• *Mezzanine financing*. Here, the borrower agrees to give the lender an equity stake in the borrower's company in the event of a default on the loan. Interest rates on these loans are higher than in any other type of financing, but there can be tax and other financial advantages to the borrower in a mezzanine arrangement.

• *Publicly underwritten funding*. Borrowers shouldn't overlook loans backed by the federal Small Business Administration (SBA); or, if they qualify for them, industrial revenue bonds (formerly known as industrial development bonds) issued by local governments wishing to encourage business growth and job creation.

The right borrowing strategy is to build up to the needed amount with as much senior debt as can be obtained from the bank. Then, fill in the gap with financing from the other lenders as well as cash contributed by family members, friends, and other personal backers.

If the total amount you were able to raise doesn't cover the entire purchase price, seller financing, also known as owner financing, may be the way to make up the last bit of difference. It consists of the amount still payable to the seller at closing, which the seller in effect lends to the buyer upon the buyer's promise of eventual repayment.

The risk to the seller in this type of financing will be reflected in the interest charged. On the other hand, it can be an attractive option for sellers who want to "keep skin in the game" after closing.

Each source of capital has its own application process and its own rules for determining creditworthiness. Some will require more documentation than others; some may insist on getting the borrower's personal guarantee.

When approaching banks, be prepared to show financial statements for the company you are acquiring as well as for your own. Equipment appraisals, the collectability of accounts receivable, and debt repayment histories will be looked at. Banks may also want to see post-transaction financial modeling for the combined entity.

If real estate is to be part of the acquisition, it may help with the financing aspect – banks like to put money into deals involving land and property that can be collateralized. It's important to make a distinction between the value of the company and the value of the real estate, which the parties may or may not decide to include in the final transaction. The seller, for example, might prefer to put building and grounds into a REIT (real estate investment trust) that would then lease the property to the buyer.

It should go without saying that raising capital is a task in which borrowers will find professional guidance extremely helpful. Although shaking money loose still takes some expertise, funding definitely is available to print company owners who are ready to grow by acquisition. The fact that we can say this now after a long period when it wasn't the case tells us that it's a great time to be a seller – and just as good a time to be a buyer.

New Direction Partners is an investment banking and financial advisory services formed by Peter Schaefer, Paul Reilly, Jim Russell and Tom Williams to serve the printing and related industries. Services include merger advisory services through the representation of selling shareholders as well as buy side representation, valuation services, financing and refinancing efforts, turnaround and restructuring services, and temporary/interim management consulting. To learn more about New Direction Partners, visit New Direction Partners' website at www.newdirectionpartners.com.