CREATING CAPITAL – LOANS, EQUITY & CONVERTIBLE DEBT

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When you are in need of funding for your business there are basically three options out there: Loans, Equity or Convertible Debt. What is best for your company depends on a number of variables: the size of your business, the industry, how urgent the funds are needed, what stage your company is at, the amount, how you are planning on using it and what are your goals in the short and long run are.

Below we will look at each of the options, how they work and what the pros and cons are:

Loans

Loans are by far the most common form of raising capital. They are also the simplest to understand. You borrow a sum of money and need to pay it back later with interest, over a predetermined period of time. It can be short or long term. The debt is usually secured against the assets of the company, which makes it a bit trickier for businesses without many assets. The lender needs something concrete that it can take from you in the case when you are not able to repay your debt. The more assets you have the more you are likely to be able to borrow.

Possible lenders are banks, credit card companies and financial institutions.

Advantages of a loan

- It is usually faster to go through the process of taking out a loan than getting capital from equity
- Taking out a loan is usually cheaper than financing through equity as a lender will loan money where there is low risk and it is secured by assets.
- The lender does not have any ownership in the company and so the company is not answerable to them in any decisions in the running of the company.

Disadvantages of a loan

- If the company doesn't do as well as expected, it may not be able to pay of its loan. This will leave the company in debt and can lead to a downward spiral
- Keeping up with payment for the loan could become a burden on the business
- A personal guarantee could put assets at stake that are outside of the business
- Once there are problems in repayment the lender is concerned about getting his money back and not about the best for the business

When is a loan a good option?

• When you are looking for a smaller amount of capital, ie less than 50,000 euro
• When you want funds fast
• When you are buying something concrete, like new equipment. In this case it provides the assets that can be used for the debt to be secured against
• When you can't or don't want to go down the equity route and you wish to keep ownership and control

Also note that it is worth looking into credit as another option. This has the advantage of being much faster than going through the process of getting a loan. However, it can, link back to your personal credit and may bring some personal risk into the equation. It would also not work if you haven't got a good track record and poor credit level.

Equity

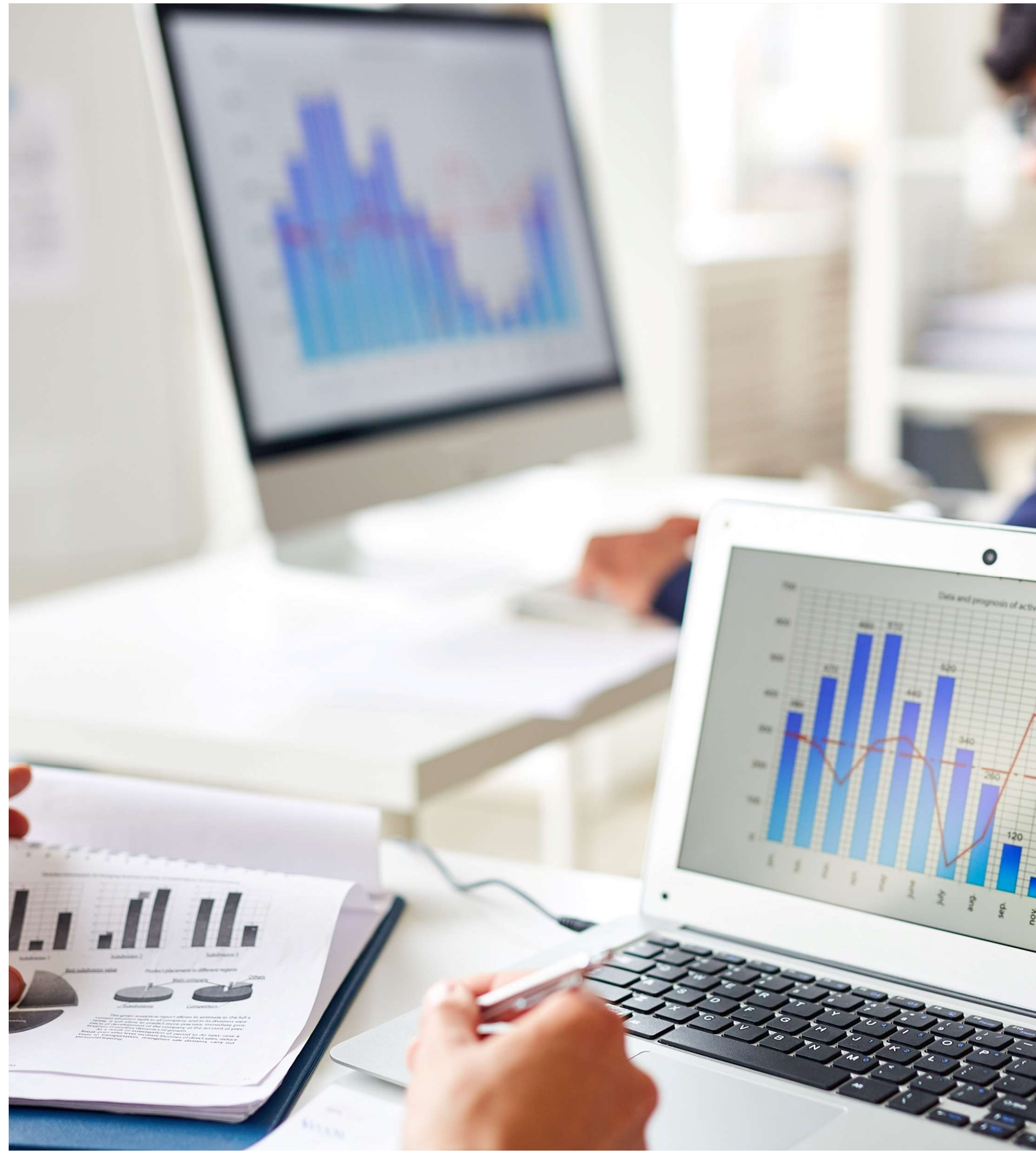
Equity is where an investor puts money into a company in exchange for a part ownership in the company. An evaluation is made of the company at the outset and the amount of ownership they get in the company will be proportional to the amount of money an investor gives. In this way the company raises finances without being in debt and therefore there is no need for keeping up with repayment schedules. This is a real bonus if the company does not have a steady income.

Only large companies are able to attain public equity capital, so the mid-market business needs to turn to private equity capital. This can be found through business investors or Private Equity Groups (PEGs).

Investors can have a varying amount of involvement in the company. Some will give funding and not have any hand in what the company does, others will want to have a heavier involvement as they want to make sure of a good return. Investments made into a company without some sort of security is high risk, so these investors are definitely looking for a greater return and may in turn put the brakes on further risks the company may want to make.

Advantage of Equity

• No scheduled repayments
• The investors share in the risk and are therefore on your side and will want to help if the company gets into trouble
• Investors can add value and partner in the business
• Makes transitioning out of the business easier
• It is an option even if the company doesn't have many assets
• Lower risk than a loan



Disadvantages of Equity

• Loss of control in running the company
• Usually more expensive than a loan
• Can take way longer to get than a loan
• Can be complex and there is a danger that the valuation is wrongly calculated
• It narrows your options, investors will want to see your company grow
• Can be difficult to get

When is Equity a good option?

• When the investment needs to be long term, for instance some businesses just do need a long time to grow before they start making a profit
• When you don't have many assets
• When it is impossible to start the company from small beginnings
• At the point where you are ready for huge growth and to reach a higher level in your business

Be mindful, whatever you do, that giving up equity only happens once and you can't go back on it. So make sure you are happy with the investors you choose and that you are ready to give up part of your company to move forward.

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Convertible Debt

Convertible debt is a mixture of a loan and equity where money is borrowed and the security in the loan is a share in the company rather than a tangible asset. Often the loan can be converted in the next round of funding. There are many variations to this formula and it can be quite a complex deal. However, given the flexibility, this can be a very good option in many different situations.

Convertible debt is useful in high risk companies or those going through rough waters. It can also be a useful funding option for start ups, when it is too early to determine the value of the business, or when it is likely that the company will soon undergo extortionate growth and you can therefore protect your equity.

In summary, there are 3 main options for the funding of a company. Each has its advantages and disadvantages. In any case you need to take a look at the trade-offs between them and be ready to explain to investors your reasoning for taking the path you choose. The more you know your options the better the position you are in to make the right decision. Most importantly your business needs to show that it will be able to make the return on the funding either secured through assets or through the growth of the business.

Our M&A Process

TARGET APPRAISAL	APPROACH	DUE DILIGENCE	NEGOTIATION & CLOSE	POST MERGER INTEGRATION (PMI)
Key Areas				
▪ Target & market analysis; ▪ Initial assessment of synergies & value drivers; ▪ Indicative valuation; ▪ Go or No-Go decision; ▪ Preparation of transaction documents (NDA – Non-disclosure Agreement/LOI-Letter of Intent); ▪ Select Transaction team; ▪ Appoint advisors; ▪ Consider funding ability.	▪ Initial approach letter; ▪ Signing of NDA; ▪ Prepare & share initial information requests; ▪ Formulation of LOI (Letter of Intent) & possible negotiations; ▪ Initial meeting and Q&A; ▪ Circulate information on the Target to the Transaction team.	▪ Set scope of due diligence; ▪ Set up VDR (virtual data room); ▪ Coordinating of due diligence, further meetings and Q&A sessions; ▪ Consider points relevant to the Post-Merger (PMI) phase;	▪ Revisit indicative valuation & prepare detailed valuation based on due diligence findings; ▪ SPA negotiations with the seller; ▪ Development of final structure (share/asset deal) and final valuation; ▪ Approvals; ▪ Signing of SPA & Close.	▪ Consider the extent of integration; ▪ Development of 100 Day PMI Plan; ▪ Consider short & long term objectives; ▪ Estimate requirements to capture synergies; ▪ Determine resource needs & optimal allocation.
Parties Involved				
▪ CFO; ▪ Head of M&A; ▪ Accountants; ▪ Corporate finance advisors; ▪ Consultants.	▪ Senior management; ▪ CEO, CFO, CTO; ▪ Strategy director; ▪ Head of M&A; ▪ Head of Business Development; ▪ Consultants.		▪ Company general counsel; ▪ Lawyers; ▪ Senior management.	▪ Company general counsel; ▪ Lawyers; ▪ Senior management/HR.


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