

Funding to grow

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Mezzanine funding now available in Wisconsin

Success requires growth. Growth requires funding. And funding requires resources.

For existing business owners looking to expand or potential business owners seeking an acquisition, it is a recipe for endless frustration. Well-heeled businesses that are for sale often carry an asking price in excess of the market value of the tangible assets. This premium, often called “blue sky” or the “air ball” in the purchase price, can be difficult for traditional bank financing to fully fund or finance. The seller asks for that premium because the business has a history of profitability as well as a unique product or name recognition in their industry.

Businesses typically sell for some multiple of profitability, plus non-cash expenses (i.e. depreciation) and interest expense that all together is commonly referred to as “cash flow;” it is also known as Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA). Whether you are attempting to purchase a competitor’s company or navigate a transfer of ownership, if the current owner can show a history of solid cash flow, it is very likely that he or she can expect to realize a premium in the price of the business over and above the value of its assets.

For middle-market companies, making such a purchase – at such a premium price – can be difficult. Few middle-market businesses have the resources for major growth through acquisition, expansion or product-line development without the support of a bank, and banks generally limit the available dollars borrowed based upon the value of the tangible assets available as collateral. However, if the purchasing business is a market leader with a solid management team and a strong track record, finding flexible growth funding may be easier than one thinks.

Mezzanine financing – a type of debt aptly named after the balcony between the first and second floors – helps middle-market businesses meet their full financial needs by filling the gap between equity capital and collateral-based debt. It’s a crucial funding resource for thriving companies looking to expand; companies that until recently had very few options for meeting million-dollar investments.

What sounds counterintuitive is actually true: In Wisconsin, like many states, securing \$25 million is often easier for business owners than obtaining \$5 million. That is because smaller, community-based financial institutions rarely offer mezzanine financing, while national providers typically grant such unsecured debt to larger companies in larger denominations. But now some lenders are breaking with tradition.

Dane County’s First Business Bank has partnered with Aldine Capital to provide mezzanine financing for businesses seeking \$2 to \$8 million, a first among Wisconsin-based banks. The collaboration places them at the head of a growing number of progressive financial institutions that recognize mezzanine financing’s flexibility is uniquely suited to help medium-sized enterprises become big ones.

Mezzanine funding focuses on proven track records. Lenders look at a prospective company's long-term performance, market position, earning history and cash-flow consistency. Does the company fill a certain market niche? Is it a part of an industry on the upswing? What are the company's long-term and short-term goals? These common considerations differentiate mezzanine financing from angel investments and venture capital, which are often based upon an idea, concept or business strategy yet to be fully tested or proven.

For that reason, businesses that combine healthy balance sheets with quality management have the advantage in this funding arena, especially when their capital needs are clearly defined. Management buy-outs, acquisitions, expansions, and ownership changes are all customary reasons for a mezzanine capital search.

It is also an attractive alternative for entrepreneurs worried about losing ownership or autonomy. Because smaller amounts of equity are exchanged in mezzanine transactions than in venture capitalization, owners stay securely in charge.

While mezzanine financing is an invaluable capital resource for acquisitions, expansions and product development, middle-market companies may find that their capital comes with an even greater advantage: the investor.

Most mezzanine financiers are sophisticated, strategic investors, people and institutions that can add valuable insight to your company. Plus, mezzanine financiers aren't looking for a fast buck or a quick killing. They're long-haul investors who want to maximize a company's potential over years without taking control. Such an attitude can make them appreciative when things go well, yet flexible when the best laid business plans go awry.

To be successful, entrepreneurs interested in mezzanine funding should seek banks that demonstrate a strong commitment to small businesses in their community. When growing your business depends on gaining a financial partner, working with a bank that supports your business, understands your market and believes in your potential can be the most important thing of all.

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