



Abstract: You've settled on a price. You've hammered out the legal agreements. Now all that remains is to get the acquisition financing you need. To maximize your chances of acquisition success, it's helpful to put yourself in the shoes of those who would provide that financing. Understanding what a bank or other lender is looking for in a loan proposal can increase the odds that you'll receive what you ask for. This article outlines what lenders look for, what a solid proposal should include and alternate financing sources.

How to attract lenders to your acquisition plans

You've settled on a price. You've hammered out the legal agreements. Now all that remains is to get the acquisition financing you need.

To maximize your chances of success, it's helpful to put yourself in the shoes of those who would provide that financing. Understanding what a bank or other lender is looking for in a loan proposal can increase the odds that you'll receive what you ask for.

What do lenders want?

Lenders' primary motivation is to get back their original principal along with a reasonable return. Thus, any effective loan proposal needs to assure lenders that you represent sound credit. The more information you can provide, and the more professional and organized it is in its presentation, the more favorably your proposal is likely to be viewed.

A good loan proposal will include all of the relevant background information on both the target and your company. Lenders will want to see historical financial statements as well as projected financials for the combined business. To help the lenders put the numbers in context, be sure to explain any one-time aberrations, such as unusually profitable or lean years.

Provide detailed information

Your proposal should include copies of key legal documents pertaining to the acquisition. Also, detailed information should be included about the proposed company structure, including an organization chart.

In addition, lenders will want to see a list of the new company's principals with their ownership stake, information about the employees and data about the business's major shareholders.

The lender will be looking for detailed information about why you intend to combine forces with the target.

This represents your opportunity to "sell" the acquisition by answering questions such as:

- How will the combined company fit into the competitive landscape? What will be your comparative advantages and disadvantages?
- What are the synergies that will make this merger a success?
- Will the combined firm have access to the latest technology to ensure its continued competitiveness? If so, will your employees have the technical skills and expertise they need?
- What is the industry outlook for the combined business?
- Who will the company's suppliers and customers be? Will your supplier and customer base be sufficiently diversified?

Of course, this is only a partial list of what belongs in a loan proposal. Talk to your M&A advisor for more information about what you should mention in the proposal.

Alternate financing sources

If you're not able to get sufficient bank financing for your acquisition project, you may still have other options. Talk to your M&A advisor about your individual situation. In the interim, here are three financing possibilities to consider:

Mezzanine financing. This is a hybrid between a traditional bank loan and a private equity investment. Because most mezzanine loans are unsecured, the cost exceeds that of a commercial loan.

Terms can vary widely. Most arrangements require repayments in three to seven years. During that time, the borrower typically repays the interest while deferring repayment of principal.

In return, the lender usually receives a financial stake in the company — often in the form of warrants or stock options, providing the mezzanine lender with enhanced returns. Generally, the lower the current interest rate, the greater financial stake the lender will require in return.

Companies best suited to mezzanine financing are those that need large capital infusions and are willing to part with a significant ownership stake. Businesses with good growth and earnings potential and a solid financial history also may be good candidates.

Asset-based loans. Unlike traditional commercial loans, which are supported by cash flow, asset-based loans are backed by company assets, such as receivables and inventory.

Attractive candidates for asset-based loans are companies with good management teams, a healthy asset base and strong financial controls.

Often, companies that seek these types of loans have difficulty attracting traditional financing, perhaps because they have irregular cash flows or declining earnings, need more borrowings than their cash flow can currently support or their credit history is too brief.

One advantage of asset-based loans is their flexibility, though it comes at a cost. That's because the lender assumes substantial control over the company's cash flow, which, after expenses, goes directly toward loan repayments. Typically, asset-based loans also require detailed reporting because lenders demand regular statements detailing asset and collateral values.

Private equity groups. Returns required by private equity investors are much higher than returns required by commercial bank loans. Accordingly, this type of financing can be very expensive because of the size and value of the ownership stake that equity investors demand in return for financing.

It can also cause a potential loss of control over business operations. In general, however, the stronger your company's management team and financial statements, the less day-to-day control you may have to relinquish.

As with most lenders, private equity investors will require detailed financial statements and want to conduct thorough due diligence on your operations. They will value a capable management team, a good competitive position, an attractive and achievable business plan, and a predictable and repeatable cash flow.