

Client Briefing 2

Funding an acquisition or MBO/MBI

Introduction

Funding an acquisition or an MBO/MBI is a large subject but in essence there are four main sources of money to consider:

- **equity**, which will come from a mixture of a venture capitalist (VC) who is backing the purchasing team, or the director's own equity (eg from personal property).
- **grants and soft loans**, of particular relevance in development areas (where it is worth trying www.j4b.co.uk which provides a guide to available grants); and
- **commercial debt** by way of borrowing against the assets being purchased,
- **vendor finance** by way of deferred payment terms or an earn out of their interest (see Vendor finance guarantee bonding - client briefing 9).

It is important to remember that the funding sought needs to cover:

- the purchase price (including clearance of any debt to be satisfied as part of the deal);
- the working capital required post sale to trade the business; and
- any investment required to develop or restructure the business after the purchase.

It is no good buying the business only to find that you do not have the cash with which to run it. You will therefore need to work closely with your advisors to ensure that your financial projections are robust and that you raise sufficient funding to see the business through.

In addition, to borrow against the assets being purchased is normally contrary to the financial assistance rules of section 151 of the Companies Act and you will need to engage accountants to prepare a 'whitewash agreement' in order to allow the borrowing to take place.

Commercial debt

The finance raised by way of loans against assets will comprise a structured finance package of borrowings against:

- property by way of commercial mortgage or sale and leaseback;
- plant and machinery by way of sale and leaseback; and
- debtors and sometimes stock by way of a factoring or invoice discounting facility.

Providers of this type of funding include:

- Banks who will have a range of financing subsidiaries (and don't forget that you will need a trading bank account anyway). Banks are however unlikely to want to fund such deals by way of overdraft facilities.
- Package lenders who are normally invoice discounters who are also able to offer financing against property and/or plant and machinery, as well as in some cases stock. While such funders are key to many successful MBO/MBIs some limit their overall exposure to a certain percentage of debtors (eg 150% of book).

Please reply to

211 Piccadilly, London W1J 9HF

1/3 Bakehouse Hill, Darlington DL1 5QA

- Stand alone independent specialist funders who will finance against any one particular class of asset (such as a factor/invoice discounter to cover debtors, a building society to lend on the property, and an asset financier to cover the plant and machinery). Use of such funders in whole or in part in combination with a package lender can provide greater financing (headroom) than use of a package funder alone which can be important in some cases.

The levels of advance available are generally:

- Property, 70% of OMV by way of a commercial mortgage, or 100% (and in some cases more) by way of a sale and leaseback (reducing the requirement to fund the deposit out of equity, see Commercial property funding – client briefing 3).
- Plant and machinery, from 70% to 100% of the machinery valuation dependent on lender on a 3 to 5 year sale and leaseback basis (see Cash from plant and machinery – client briefing 5).
- Debtors, up to 85% of available debt (of the right type, under 90 days old, up to credit limits etc see Factoring and invoice discounting – client briefing 6).
- Stock will be by way of an increased ability to draw down against debtors (say up to 100% or more) but such borrowings will only be against finished goods stock.

The information Creative Business Finance Ltd needs to establish how much debt funding we should be able to raise for an acquisition is summarised below:

<p>1 The deal</p> <ul style="list-style-type: none"> • Type of sale (share purchase or business and assets) • Purchase price • Expected working capital requirements following sale • Equity, grants, vendor financing (by way of deferred consideration or earn out) or other funding being put in (including details of MBO team's investment in the deal)
<p>2 The business</p> <ul style="list-style-type: none"> • Industry and nature of trade • Trading history covering three years (with last audited and current management accounts) • The business forecasts (with underlying assumptions) • If in difficulty, details of the turnaround plan
<p>3 The management team</p> <ul style="list-style-type: none"> • CVs for all key team members • Personal wealth statements (house values less mortgages, other assets)
<p>4 The assets and liabilities</p> <ul style="list-style-type: none"> • Property: freehold or leasehold, valuation and description, details of any environmental/contamination issues, existing mortgages • Plant and machinery: valuation, (or if not, asset listing with sufficient information regarding machinery make, model, age and condition to allow desktop valuation – client briefing 5), outstanding HP/lease liabilities • Debtors: aged debtors, aged creditors, sample invoice, contract and delivery note • Stock and confirmed orders: list of finished goods stock and confirmed order list

For free initial advice on how much you may be able to borrow please call Creative Business Finance Limited on 0870 420 8317