Funding Options to Support Your Company’s Growth

We wrapped up the year in our previous article by providing you with a number of tips and ideas about closing out the company year and some helpful processes for beginning the New Year. One of the processes we discussed was to schedule a strategy session for the New Year in which opportunities for growth and budget planning is discussed. There may be a number of effective ways to enhance your funding and financial flexibility, or restructure a few things to increase your cash flow…and that could be just the ticket you need.

For example, if your receivables aren’t turning fast enough, you might find that you are not in a position to capitalize on opportunities for expansion. The climate in Middle Market financing has become one that is now extremely advantageous to the borrower since so much focus has shifted to rebuilding the economy and an abundance of lenders are competing vigorously for new business.

In deciding which type of debt financing is most advantageous to you, it is helpful to understand the different types of financing structures and their basic definitions.

- **Cash Flow Loans:** During the economic boom, these loans were common and made based on expected cash flow. There is very little emphasis on collateral value tied to securing these loans, but instead they are based on financial maintenance covenants that must be met on an ongoing basis. These covenants include stipulations such as minimum EBITDA requirements, lev
erage restrictions and fixed charge coverage ratios. These loans are no longer as popular in the lower Middle Market due to the challenges that many smaller companies have had in meeting these types of covenants.
- **Asset-Based Loans (ABL):** Since it has become more difficult for companies to meet the covenant requirements of Cash Flow Loans, the structure of ABL loans has become more appealing. Often, the covenants of these loans only become effective in the case of default or when excess availability falls below a specified amount. These loans are generally secured by collateral representing all the assets of the borrower. The assets include inventory, accounts receivables, intellectual and investment properties (depending on the industry) as well as property, plant and equipment (PP&E). These loans typically require frequent reporting on the composition off assets securing the loan in the form of a borrowing base calculation which monitors collateral levels. This required reporting goes beyond that which is customarily necessitated for other types of loans.
- **Second Lien Loans:** These loans are a form of secured financing where the lender holds a secondary security position in the collateral of a senior lender who maintains a first

security position in all the assets of a borrower. There is still an expectation of timely repayment, however, in the case of default, the security position of a second lien lender ranks behind the senior lender's interest in the collateral. Their right to enforce against the collateral is often restricted by an inter-creditor agreement. These loans are generally offered by finance companies desiring higher yields with some perceived level of protection from the collateral. These loans are generally more expensive than first lien loans, although due to the security provided by the second lien, they tend to have a lower cost than mezzanine loans, equity financing or high yield offerings.

- **Subordinated Debt:** This form of debt is generally unsecured and ranks behind every other debt provider in a company's capital structure and is only ahead of equity capital when determining the order of a borrower's repayment obligations It is generally used to finance the expansion of a company during a significant period of growth. Subordinated debt can incorporate a mix of debt and equity financing and gives senior lenders comfort that are investors that rank below them in a company's capital structure. This form of debt is generally the most expensive type of borrowing and can result in the dilution of existing equity investors if there is an equity component in the transaction and specific milestones are achieved by the company during the term of the loan such as revenue growth and profitability measures, or conversely in the event of a loan default.

There are several other forms of Middle Market financing including Senior-Secured Loans, Term B Loans, High-Yield Offerings, Factoring and Unitranche. In order to best evaluate the needs of your company and your current situation, it may be advantageous to get some outside input. Consider scheduling a complimentary consultation with one of our professionals at PCG, where we specialize in evaluating your debt financing needs and finding the right funding solution for your company.