Working & Growth Capital Alternatives

Four Routes to Raising Capital Today

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In the current economic environment, a number of alternative sources of capital are available to fund a company's working capital needs and growth objectives. In this article, we take a look at the pluses and minuses of a variety of alternative sources of funding available today. A number of elements are compared for each source: cost of funds; level of availability of capital; degree of risk assumed by the lender; level of documentation required; timing of the transaction and term of the loan. Of course, as a company grows and demonstrates success, additional avenues for capital open up.

FACTORING

To say that accounts receivable factoring has not been viewed positively is an understatement, but, in fact, a number of highly reputable and supportive factors provide a valuable service for younger companies and firms in turn-around mode that do not meet standard bank financing requirements.

Factoring involves the assignment of accounts receivable in exchange for immediate cash as high as 85% or more of the face amount of the receivables, depending on A/R quality and size. Factoring typically requires very modest agreement documentation and can be put in place within several weeks.

The quality of a company's customer base and payment history generally dictates the need for any financial covenants or personal guarantees. The trade off for the risk assumed by the factors is the cost of funds, which typically runs in the mid- to upper-twenty percent range, again dictated by the receivable quality and the amount of financing (larger lines typically mean lower rates).

While some companies are concerned about the stigma of factoring assignment, a quality factor will work with a company and its customers to minimize disruption. A number of factors are affiliated with asset-based lenders and banks, providing a pathway to other sources of capital as a company achieves success.

ASSET-BASED LENDING

As the name implies, asset-based lending (ABL) funds provide line of credit financing secured by a company's assets. Typically, advance rates are up to 85% on accounts receivable, up to 50% on inventory and some funds will also advance against the liquidation value of the capital assets, with advance rates governed by asset quality. Utilizing a line of credit structure, funds availability is generally determined on a weekly basis with daily access to funding.

ABL funding sources assume a moderate level of risk but want to see profitability. Some funds will finance turn-arounds where there is a clear path to profitability. Documentation and due diligence (collateral audit, appraisals, etc.) is more involved than with factoring, requiring four to six weeks.

Financial covenants usually are limited to several critical metrics and the loans are generally multi-year with annual renewals. Guarantees are dependent on asset quality and financial performance.

The cost of funds for ABL loans ranges from high single digits to the mid teens, again dictated by asset quality and financial performance. A number of ABL funds are affiliated with banks and mezzanine lenders, which once again, provides pathways to additional funding.

BANK DEBT

The capital most familiar to many of us is line of credit and term lending from commercial banks. Typically banks look for a minimum of a five-year operating history with the most recent years on a profitable level, although there are federal, state and local programs available that offer ways around these requirements.

Although unsecured lending is available to financially strong customers, bank debt usually is secured by all of the assets of the company. Availability under bank lines of credit is formula based, similar to ABL lenders, although generally at a lower advance rate level.

Documentation is fairly involved with a wide variety of financial covenants and guarantees dependent on financial strength. Lines of credit are almost always annual and multi-year term loans are generally reserved for customers with strong track records.

The trade off for companies who qualify for commercial bank debt is the cost of funds. Interest rates can vary from prime to high single digits in today's interest rate environment.

MEZZANINE OR SUBORDINATED DEBT

Mezzanine or subordinated debt is basically cash flow lending without a first lien against the company's assets. "Mezz-debt" is often associated with acquisitions, although it is available for growth capital, often in combination with straight debt and/or equity.

Term lengths are typically five-plus years with interest only payments in the initial years and principal repayment schedules varying from commencing after two years to bullet repayment at the end of the term. Total borrowing levels in today's markets remain below four times cash flow, impacted by the amount of senior, secured debt.

Sub-debt lenders assume a fairly high-risk profile resulting from a reliance on cash flow generation and the lack of security interest. Because of its subordinated nature, banks typically view sub-debt as a form of equity allowing a company to raise significantly higher levels of capital.

The trade off for access to mezz-debt is the cost of funds, which has two components. The first component is the interest rate which is typically a fixed vs. floating rate running in the 11%-13% range in today's environment. The second component is common stock warrants, or a bet on the success of the company. The amount of warrants is negotiated based on the sub-debt lenders expectation of the

future success of the company, generally with an expected combined yield along with the interest somewhere north of twenty percent.

Because sub-debt is more expensive than straight debt but less costly than equity, it is usually utilized in combination with debt and/or equity to balance the overall cost of funds. Because of its nature, mezz-debt documentation and due diligence is fairly involved, taking several months, although covenants are usually less restrictive than standard bank requirements.

A number of sub-debt funds serve the middle market, with lending levels as low as $1 million. Some sub-debt funds also provide equity capital and are affiliated with commercial banks.

The Bottom Line

Raising capital is about alternatives, with an assortment of choices in the marketplace including the four mentioned here as well as other types such as leasing, SBA loans and a host of others.

By leveraging its network of funding sources, **Gryphon Growth Group** has assisted a wide variety of companies in successfully raising additional capital by utilizing resources ranging from growth capital fundings to commercial debt financing to sub-debt, factoring and ABL financing.

Working with **Gryphon Growth Group** enables our clients to achieve three important objectives: (1) management remains focused on day-to-day execution; (2) the company gains access to and credibility with a broad range of funding sources and (3) the company not only obtains better terms but also achieves a better fit with the right capital provider to meet long-term company objectives.

About Gryphon Growth Group Inc.

Gryphon serves small- and mid-sized companies (up to $25 million in revenue) in transition: early stage, rapid growth, mergers & acquisitions, restructuring or refinancing with Management Services, Turnarounds and Capital Resources designed to grow the profits cash flow and value of our clients. With expert guidance and hands-on management from **Gryphon** you can get control of your situation. We can step in at any time, identify and solve problems, and help you guide your company to higher levels of success.

Our approach is simple - we apply our experience with good, old-fashioned *hustle* to help our clients achieve their goals.

To learn more, we invite you to contact us today:

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