PART One

The Financing Process

CHAPTER 1

Introduction

For emphasis, we want to point out that there is no silver bullet in funding a company. As much as we would like you to believe that every fund-raising follows the same consistent process, it is just not true. However, what we will do is provide a view that is fairly representative of the key steps that need to be considered and how to navigate the process. In practice you will find that some steps are conducted concurrently with others, and some steps are conducted rather informally. What we have attempted to do is explicitly show the key steps and provide guidance for each.

With that said, Figure 1.1 provides an overview of the financing process (we call it the Growth Capital Navigator™*; more information available at www.GrowthCapitalNavigator.com) from the perspective of the issuer and is comprehensive in that it indicates the steps for raising equity; debt placement will be a subset of this process depending on the transaction type. In many instances you will see the word *investor* used interchangeably for either an actual investor or a lender; the line of distinction blurs depending on the characteristics of the deal. We have chosen to segment the process into the following categories for discussion. You'll note that this is also the organization of Part One of this handbook.

- Planning and alignment—this includes valuation.
- Acquisitions, recapitalizations, and exits acquisitions.
- Capital structure.
- Sources of capital.
- Equity and debt financings.
- Expert support.
- Closing the deal.

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*The Growth Capital Navigator™ is a business process of High Rock Partners, Inc., used for driving the financing of internal and external growth, turnarounds, special projects, acquisitions, and restructurings.

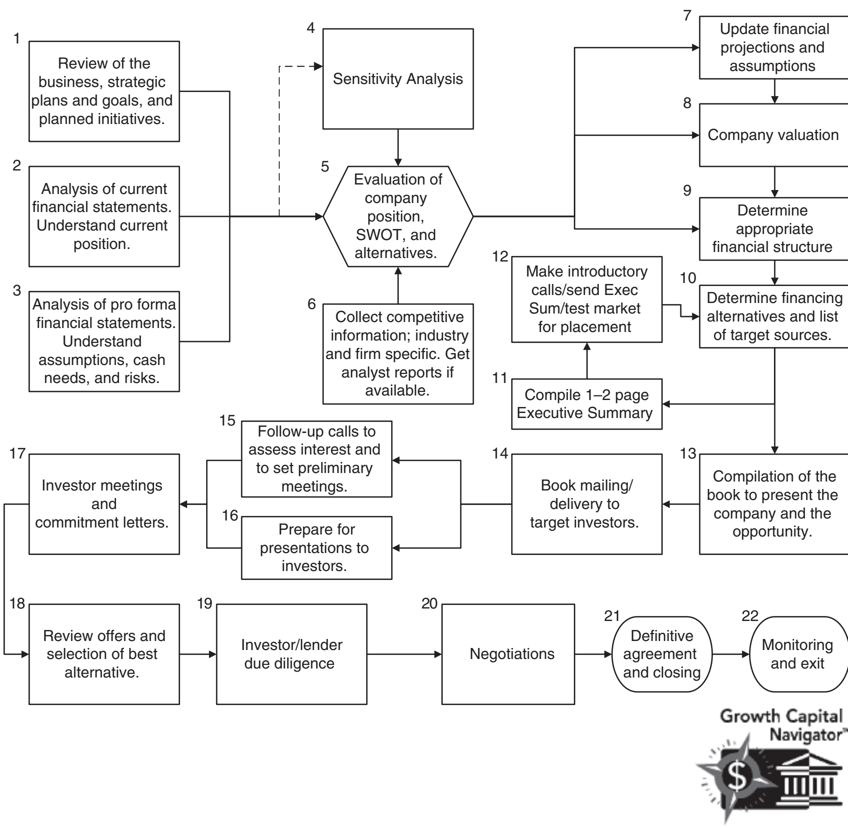

FIGURE 1.1 Financing Process Flow Chart (more information available at www.GrowthCapitalNavigator.com)

Steps 1 through 3 allow us to obtain a view of the current business and management's plans. In step 1 we review the business plan, strategic initiatives, and shareholder goals and objectives. Step 2 is an analytical review of the current financial position of the company. In step 3 we seek to understand the forecasted performance of the company and the underlying assumptions. Combined, we should be able to define and understand:

- The financial position of the company.
- The structure of the current balance sheet.
- The specific use of funds.
- What industry the company operates in.

- The stage of the company.
- The shareholder objectives.
- Management's strengths and weaknesses.
- Management's plans and view of the future.

In many instances shareholder objectives are not well articulated and need clarification, particularly as they relate to funding the business. Given that the focus of this book is start-up through middle-market companies (revenues up to $500 million), many shareholders are also senior managers of the company. Typical objectives include (1) addressing personal risk management issues while growing the business and (2) shareholder liquidity. These two topics have significant impact in answering the classic questions, "What is the right mix of debt and equity?" and "How do I avoid personally guaranteeing the company's debt?" It is critical to understand these issues early in the process.

Steps 4 through 6 focus on comparing the company to its peers and determining variances. Once base information is collected regarding the industry, the stage is set for a discussion with management about the realism and ranges of potential outcomes, and why they may vary compared to other similar businesses. This discussion should result in the ability to analyze multiple scenarios and determine the variability (risk) in achieving management's forecast. In step 7 we update the assumptions and agree on the financial forecast that we will use in the fund-raising process.

Step 8 helps to determine a range of valuations for the business as an entity. This is critical in bringing alignment of expectations among shareholders, directors, management, and supporting advisers.

In step 9, we assimilate all of the prior steps into a target capital structure and some fallback scenarios. In steps 10 through 12 we test the market as a reality check and determine the likelihood for success given our chosen strategy. The company is looking for an indication of interest on the part of potential investors/lenders. This may be an iterative process, the downside being the risk of the market perceiving that you are shopping the company. There is a delicate balance in having sufficient alternative sources without overexposing the company to potential investors/lenders. If this happens, you may not be taken seriously or may be taken seriously by only the less than optimal sources. In Chapter 7 we address the use of experts in the financing process. They can be invaluable in testing the market and potential alternatives, as well as providing an added perspective.

Once the financing strategy has been solidified and initially tested, a so-called book is created to present the company and solicit formal responses; these are steps 13 and 14. In the event that the funding required is solely debt,

P1: a/b P2: c/d QC: e/f T1: g
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and depending on the type of debt, an abbreviated amount of information will be required from a traditional book and then some additional financial detail will be added.

Steps 15 through 17 focus on management's presentation of the company during the financing process. Steps 18 through 22, addressed in Chapter 8, are about negotiating, closing the deal, and managing ongoing investor/lender relationships.