



CAPITAL

**“What,
Why,
Where,
How, and
How Much”**




Philadelphia
September 18, 2014

Command Global Capital



About your Presenter




Industry Experience

- Veterinary Medicine
- Manufacturing
- Assisted Living
- Multifamily Housing
- Technology

David Bovée, CM&AA
Managing Principal

- Certified Merger & Acquisitions Advisor
- MBA - Pepperdine University
- B.S. Biochemistry – University of Denver
- Economic Development:
 - Bonds
 - Tax-Exempt Bonds
 - Tax Credits
 - Loan Guarantees (SBA, USDA, HUD)
 - Immigration-linked programs (EB-5)
- Closed \$300 Million
- Affiliations: NIC, IIUSA, CDFA, AM&AA, ALFA and ACG

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Today's Session

Capital - What, Why, Where, How, and How Much

Learning Objectives

1. Enumerate and understand the various forms of capital
2. Learn and understand, for the various forms of capital and structures:
 - applicability
 - cost of capital
 - process and timing
3. Valuation
4. Tools
 - Simple Payback
 - ROI
 - Cash-on-cash
 - Risk analysis
5. A case study for your own organization - propose a financing plan that provides capital for a stated strategy
6. Glossary

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CAPITAL IN BROADEST SENSE

Various Forms of Capital

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Zenith CAPITAL Capital in the Broadest Sense

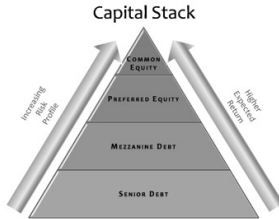
- Capital is different from money
 - Money is used simply to purchase goods and services for consumption
- Capital is the cash, value of business assets, debt, and equity
 - E.g. Feb 2014 Facebook acquires WhatsApp for \$16 billion – paid in both cash (\$4B) and stock + \$3 billion bonus to founders in restricted stock



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Zenith CAPITAL Capital Stack, Concept

- The top of the stack is higher risk, higher reward
 - Ownership
- Senior debt = collateral (SAFE)



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Zenith CAPITAL Capital Worlds

- Shareholder
- Private
- Institutional
- Regulated lenders
- Government




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Zenith CAPITAL Equity, Defined

- The ownership structure of a company
 - Applied: The sale of an ownership interest to raise funds for business purposes

Characteristics in Financing

- First in
- Highest risk
- No protection in liquidation (unsecured)
- Upside potential



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Debt, Defined

- Capital for working capital or capital expenditures, raised by:
 - entering into a promissory note
 - issuing bonds
- In return the lender becomes a creditor and receives a promise that the principal and interest on the debt will be repaid

Characteristics

- Secured
 - serial or pair passu
 - Bankruptcy rights
- Often requires guarantees
- Covenants
- Low cost, low risk (Hx CF coverage)



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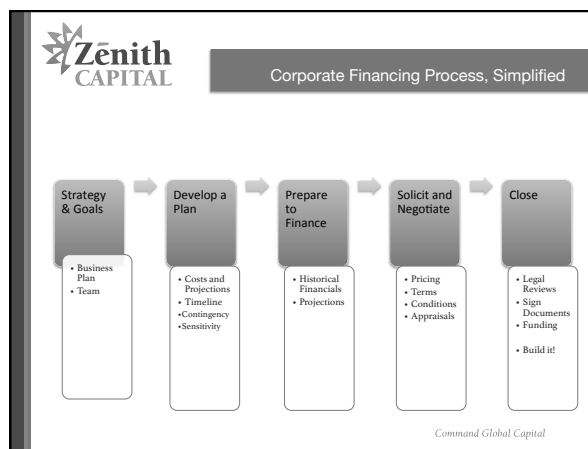
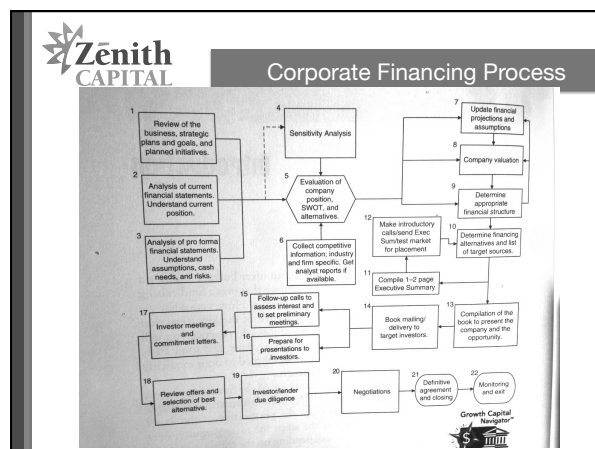
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MIDDLE-MARKET CORPORATE FINANCE

The Tools and the Process

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Zenith CAPITAL Capital Budgeting

- The business case, or cost-benefit analysis (CBA)
 - No rules
- Simply put – the examination of financial feasibility
 - Quantitative methods typically used
- Computational Methods
 - Payback
 - NPV
 - IRR
 - ROI
 - Cash-on-cash

Handwritten notes on the slide:

$A = P \left(1 + \frac{r}{n}\right)^{nt}$

Labels for the formula:

- P : PRINCIPAL
- r : ANNUAL INTEREST RATE
- n : NUMBER OF YEARS MONEY BORROWED
- t : NUMBER OF TIMES THE INTEREST IS COMPOUNDED PER YEAR

Calculation example:

$A = \$1500 \left(1 + \frac{0.043}{4}\right)^{4 \times 6}$

Result: $A = \$1,938.84$

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Zenith CAPITAL The Tools



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Zenith CAPITAL Net Present Value (NPV)

Net Present Value

- Definition:
 - The present value of cash inflows less (-) the present value of cash outflows
- Used in capital budgeting to analyze the profitability of an investment or project *relative to other options*
 - Build vs. Buy
 - Purchase vs. Rent
- Discount Rate used to “subtract out” alternative return scenarios

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Zenith CAPITAL Internal Rate of Return (IRR)

- Definition
 - The intrinsic rate of return that is expected to be derived from an investment considering the amount and timing of the associated cash flows
- Alternate:
 - That rate which, when applied to a collection of incoming and outgoing cash flows, results in a solution of zero (0%).
- In the context of corporate finance, this is most often used to describe the return potential to investors (including shareholders!)
- The name alone is esoteric, confusing most people. Don't let that happen to you:
 - Rule of thumb: Total profit divided by # of years to achieve it*

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Net Present Value vs. IRR

Net Present Value vs. Internal Rate of Return
Tip: Context and Timing

	Investment	\$(250,000)	\$(250,000)	\$(250,000)	\$(250,000)	\$(250,000)
End of:	Year 1	\$50,000	\$50,000	\$-	\$25,000	\$-
	Year 2	\$50,000	\$50,000	\$25,000	\$50,000	\$100,000
	Year 3	\$50,000	\$50,000	\$75,000	\$100,000	\$250,000
	Year 4	\$50,000	\$50,000	\$125,000	\$200,000	\$500,000
	Year 5	\$50,000	\$300,000	\$275,000	\$400,000	\$750,000
Sum of Cash Flows		\$-	\$250,000	\$250,000	\$525,000	\$1,350,000
Total ROI		0%	20%	20%	42%	108%
IRR		0%	20%	18%	33%	60%
NPV						
discount rate:	5.0%	\$(31,930)	\$154,624	\$148,353	\$365,234	\$1,005,389
	7.5%	\$(44,377)	\$117,613	\$108,985	\$302,700	\$869,389
	10.0%	\$(54,964)	\$86,154	\$75,582	\$249,229	\$752,428

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Questions

ELECTRONICS



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"Can you recommend a GPS device to help me avoid the dead-end streets and locate the shortcuts on the Road to Success?"

- How can I finance my strategy?
- How much money do I need?
- What is the cost of capital?
- How do I compare different bank offers?

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Sources and Uses Statement

A summary of where the capital used to fund an acquisition will come from (the sources), what this capital will purchase (the uses)

Construction Sources & Uses				
Sources		/Unit	/GSF	% Cost
Sponsor Equity	\$400,000	\$4,255	\$6.33	2%
EB-S Equity	\$6,500,000	\$90,426	\$175.00	40%
Other Equity	\$720,000	\$7,460		4%
Land Contribution	\$280,000	\$2,979		2%
Construction Loan	\$8,604,700	\$93,603		47%
	\$18,604,700	\$197,922	\$294	100%
Uses				
Land	\$2,620,000	\$27,872	\$40.47	14.1%
Construction Hard Costs	\$11,530,756	\$122,455	\$182.18	60.8%
Architectural & Engineering	\$750,000	\$7,979	\$11.87	4.0%
Permits and Fees	\$500,000	\$5,319	\$7.91	2.7%
Dev Fee, Prog Mgmt, and Constr Admin	\$-	\$-	\$-	0.0%
FFE	\$350,000	\$3,723	\$5.54	1.9%
3rd Party Studies	\$25,000	\$2,713	\$4.04	1.4%
Working Capital and Operating Deficits	\$950,000	\$10,106	\$15.04	5.1%
Financing	\$930,800	\$9,802	\$14.73	5.0%
Hard and Soft Cost Contingencies	\$738,174	\$7,853	\$11.68	4.0%
Total Project Cost	\$18,604,700	\$197,922	\$294	100%
Liquidity Reserve	\$1,000,000	\$10,638	\$15.83	5.1%
Total Project Costs and Reserves	\$19,604,700	\$208,561	\$310	

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Sources and Uses Statement

The following sources and uses closely resembles one that may apply in your business transaction.

Sources & Uses		
Sources		% Cost
Cash	\$500,000	8%
New Investors	\$1,000,000	17%
Bank Loan	\$4,500,000	75%
	\$6,000,000	100%
Uses		
Land	\$825,000	13.8%
Construction	\$4,000,000	66.7%
Equipment	\$500,000	8.3%
Working Capital to Breakeven	\$350,000	5.8%
Bank Fees, Reports, Loan Costs	\$60,000	1.0%
Consultants and Advisors	\$90,000	1.5%
Contingency	\$175,000	2.9%
Total Project Cost	\$6,000,000	100%

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A Case Study

- Financing Plan needs to be matched up to a strategy
- Define and articulate the strategy
- Determine the sources and uses of capital
- Propose specific sources of equity and debt
- Estimate the cost of and return on capital

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CAPITAL SOURCES

Various Sources of Capital

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Accessing Capital



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Why Use Debt?



Henry Kravis, KKR 1988

***"Debt
tightens a
company"***

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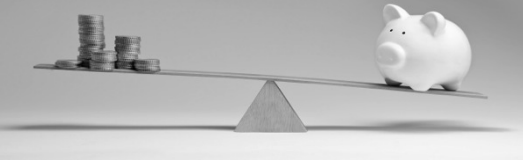
The World of Debt

Traditional

- Banks
- Conduits
- Vendors
- Government (USDA, SBA, Farm Credit)

Non-Traditional

- SBIC / Mezzanine
- Insurance Companies
- Private Equity Funds
- Venture Capital



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How Banks Sell Money

- Evolution of banking 1980's until now
 - Handshakes led to jail sentences
 - Risk framework
 - Now a discipline
 - Emergence of technology
 - risk ratings, etc. (MFA)
- Programmed Sales Force
 - Keywords
 - Low down payment
 - Asset values
 - Environmental contamination → Brownfields

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Bank Lending Process

Solicitation	Prepare Pitchbook	Intro Mtg	Site Tour	Negotiations and Filtering
Underwriting	Financial Package	Modeling	Term Sheet	
Credit Approval	Write-up	Credit Committee	Commitment to Lend	
Closing	Meet Final "conditions precedent"	Documents	Legal Review	Funding (Escrows)

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Preparing the Request

Tee up what you want



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Bank Package

Request

- Business bio
- Business plan
- Hx financials
- Financial Forecast
- Detailed request
 - Ask them for what they want to offer!

LOANS

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Negotiating Terms

- Interest Rate
- Type of Interest
- Terms of Default
- Covenants
- Reporting Requirements

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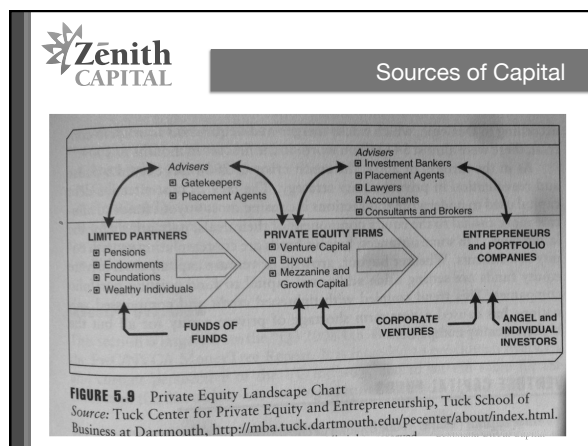
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Getting Thru the Documents

- Lawyer
- I-Banker

- Trust matters, but then again it doesn't
 - FDIC
 - OCC
 - BK Receiver

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Non Bank Sources




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SBA 504




- Provides businesses funding for fixed assets:
 - land, buildings, and machinery
- 50/40/10 → 90% financing
 - ✓ 50% Private lender
 - ✓ 40% SBA loan
 - ✓ 10% Borrower contribution
- Loan Terms
 - ✓ 20-year for commercial property
 - ✓ 10-year for long-term machinery & equipment

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SBA 7(a)



- Loan Specifics
 - ✓ Deficiency guaranty program (75 to 85%)
 - ✓ Collateral requirements (business/personal)
- Borrower Benefits
 - ✓ Maximum loan size of \$5 million
 - ✓ Up to 90% financing
 - ✓ One loan for multiple use of proceeds
 - ✓ Longer term financing
 - 7-10 years: working capital
 - 10-15 years (useful life): machinery & equipment
 - 20-25 years: real estate
- Lender Benefits
 - ✓ Greater loan offering to both existing and prospective clients
 - ✓ Ease of collateral concerns

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USDA Business & Industry (B&I) Loan Guarantee

- Geographies where it applies
- Guarantee's the lender's position, up to 80% of their exposure (at certain LTV)
- Up to 90% of their exposure with lower LTV
- 2% fee
- Processing times
- Federal and delegated State underwriting and administration

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Non Bank Sources




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Farm Credit



- Loan Specifics
 - ✓ Good leverage options (up to ~75%)
 - ✓ Collateral requirements (business/personal)
- Borrower Benefits
 - ✓ Low interest rate!
 - ✓ Direct lenders make decisions
 - ✓ Long term financing
 - Up to 25 years: real estate
- Find a lender
 - ✓ <http://apps.fca.gov/Locator/>

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Vendors

- Loan from one company to another which is used to buy goods from the company providing the loan
- Great for purchasing
 - Product inventory
 - Industrial equipment
- GE Capital

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Asset Backed Finance

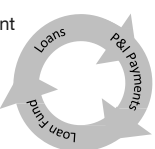
- Also called "Factoring"
- Expensive
- Short-term
- Expect cost of capital 10-15%

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Revolving Loan Fund

- Bridge between the amount the borrower can obtain on the private market and the amount needed to start or sustain a business
- A gap financing measure used for development and expansion of small businesses
- Self-replenishing pool of money, utilizing interest and principal payments on old loans to issue new ones
- May be used in combination with conventional sources



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Hard Money Lenders

- Usually oriented around real estate
- Typically they take bridge positions – term of 1-3 years
- Undeveloped and unentitled ground not good collateral
- Expect to pay:
 - 12-18% per annum on the borrowed funds
 - 5% fee
 - Negative arbitrage

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Export-Import (Ex-IM) Bank

- Strictly trade credit
- Provides working capital guarantees to enable U.S. exporters to obtain loans that facilitate the export of goods or services
- These working capital loans, made by through various programs:
 - ✓ Medical Equipment Initiative (MEI)
 - ✓ Loan Guarantee Program
 - ✓ Finance Lease Guarantees
 - ✓ Export Credit Insurance Program
 - ✓ Environmental Exports Program
 - ✓ Direct Loans

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Insurance / Conduit

- Life Insurance loves to invest in commercial real estate
- Alternative lenders promote this source of long-term debt
- Rates very favorable
- Terms may include defeasance
- Different from Commercial Backed Mortgage Securities (CMBS), now making a comeback from 2008 crash

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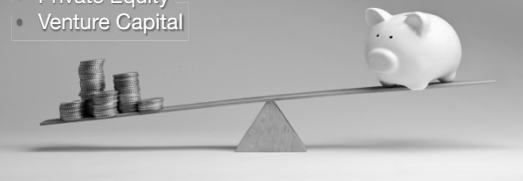
Zenith CAPITAL Equity World

Direct

- Friends & Family
- Angel Capital
- Private Investors
- Private Equity
- Venture Capital

Hybrid

- Mezzanine
- SBIC



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Zenith CAPITAL Angel Capital


- Wealthy individuals with high net worth that make substantial investments in new companies
- Provide private financing for emerging companies that are too small for venture capital
- Angel investors provide about 90% of outside equity for start-ups
- Connect with angel investors:
 - ✓ GUST
 - ✓ Kieretsu Forum
 - ✓ Angel Capital Association



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Zenith CAPITAL Venture Capital

- Long term equity capital invested in expanding enterprise
- Investments have a high expectation of capital gains
- Hands-on role in the management, assist with product development
- Objective is to nurture and grow quickly, then sell in M&A or take public
- Perfect for high-growth industries like:
 - high-tech,
 - biomedical,
 - alternative energy



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Zenith CAPITAL Private Investors

- Friends & Family
- In the rolodex
- Crowd funding is a new, potential source!

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Private Equity

- Investors and funds that make investments directly into private companies
- Private equity is private ownership
- Consists of institutional investors and accredited investors who commit capital for long periods of time.

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Mezzanine and SBIC Lenders

- Gap financing measure for growth-oriented small businesses that may not entirely qualify for loans or investments through traditional lending
- Mid-level financing – Less risky than equity or venture capital but more risky than senior bank debt
- Business may have to cede some management or institutional control or give an ownership position to lender

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Financial vs. Strategic

- Try to identify two (2) strategic investors in your business

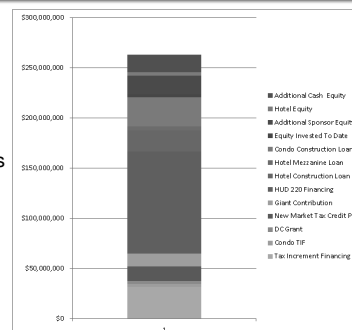
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Capital Stacks

**Total Project Cost
\$260 Million**

- Integrating multiple sources of capital creates a capital stack



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Zenith CAPITAL Investor Package

- Executive Summary w/investor benefits
- PPT
- PPM
- Subscription Materials
 - Operating Agreement
- Cost Payback on PPM / SEC / Regulatory

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Zenith CAPITAL Cost of Capital Discussion

Cost of Capital

- Size
- Complexity
- Risk
 - “RAROC”

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Zenith CAPITAL VC Perspective on Valuation

TABLE 5.13 Valuation by Stage

Financing	Company Stage	Data	Risk/ Uncertainty	Value* (MM)
Seed	Incorporation; early development	Soft data; value proposition, etc.	Extremely high	\$1+
Series A	Development	Validation, time to market	Very high	\$3+
Series B	Shipping product	Preliminary revenue	High	\$7.5+
Series C+	Shipping product	Predictive revenue	Moderate	\$10+
Later-stage/ mezzanine	Shipping product, profitable	Hard data; EBITDA, net income	Lower	\$20–50+

*Based on 2003 market information.
Source: “Understanding Valuation: A Venture Investor’s Perspective,” by A. Dana

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Zenith CAPITAL Negotiating Terms

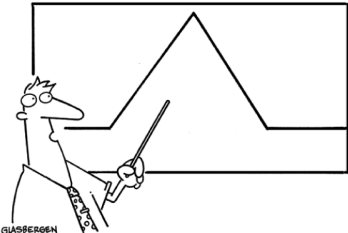
- Capital Stack (Ownership)
- Control
 - Board of Dir
- Detailed Terms
 - Anti-dilution
 - Valuation
- Reporting Requirements

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To
Sum
Things
Up



GLASBERGEN

"When preparation and opportunity collide, it causes a seismic upheaval and that's how mountains of money are made!"

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Conclusion

- Thank you

Call or email with questions



Conclusion

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