SUCCESSFULLY SOURCING DEBT FOR GROWTH

nextLevel
BUILDING ENTERPRISE VALUE

Using debt to fund mid-market company growth

Your company is not a start-up, but not yet an entrenched market leader. You are poised for growth, but need financing. Taking on debt can enable you to scale your business to that next tier. But determining an optimal structure is not always easy, and higher financial leverage also presents more risk.

In this edition of *Executive Issues & Insights*, we explore key insights drawn from the extensive C-suite and Board experiences of the NextLevel team on successfully sourcing debt for growth.

NextLevel Case Study

Hotel Chain Acquires New Properties via Cost-Effective and Flexible Financing

A public company in the hotel industry, with annual revenues of about $400 million, needed additional capital to grow its business. The company required the capital largely to finance the acquisition of additional hotel properties. It also had a revolving credit agreement that was maturing and needed to be paid off.

In making its decision on the best way to pay off the existing debt and obtain new capital, the company had to weigh the alternatives to get the necessary financing on reasonable terms against the long-term risk to its business and its shareholders. The timing of the expenditures with the new capital was somewhat unpredictable, due to uncertainty in the deal-making process, which impacted the decision.

The company had access to various types of debt and equity capital, both public and private, since it was profitable and growing

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NextLevel Insights

View capitalization as a strategy

Create a long-range capitalization strategy for your company. A road map of how much debt and how much equity you want at each stage in your growth, and whether or where acquisitions come into play, can keep you from making costly opportunistic mistakes. The road map will never be completely accurate, but it will be a guide to keep you on track.

Understand the costs of growth

Companies often underestimate the cost side of the growth equation. It's easy to assume that economies of scale will offset any costs incurred from moving into new territories, expanding offices, or adding distribution channels. Stress-test those assumptions with different cost levels. Models that worked when your company was smaller may not apply to mid-market accelerated growth.

Plan your financing capacity

Run financial projections with different scenarios to understand the probability that your performance will fall no lower than a certain level. These projections should incorporate the impact of various debt levels within the terms of lender covenants to be certain that even under a worst-case scenario, there is reasonable confidence they can be met. This will help ensure the ultimate debt level secured is manageable.

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significantly. The CFO, now a NextLevel team member, working along with the Treasurer, considered all the alternatives for getting the necessary funding. They chose to enter into a new syndicated revolving loan agreement as the most prudent course of action. With this financing the company was able to pay off the existing debt and have new capital available to it when needed. This was the best combination of capital availability, cost-effective financing costs, and flexibility in new spending.

As a result, the company did not have to use a more expensive or less flexible type of debt. Nor did it have to use equity financing that would have diluted existing shareholders. With this cost-effective, flexible financing, the company was able to acquire new hotel properties and accelerate its growth.

KEYS TO SUCCESSFULLY SOURCING DEBT FOR GROWTH

- **Your capitalization strategy:** Do you have a long-range road map to keep you on track?
- **Your costs:** Do you understand the true costs of your company's growth?
- **Your financing capacity:** Have you run projections to ensure your debt level is manageable?
- **Your management resources:** Do you understand how different types of debt will burden them?
- **Your financing partner:** Will your investor be with you over the long haul?
- **Your debt maturity:** Does it match your anticipated needs?

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Consider the debt management burden

Certain types of debt increase management activity. If you have debt with a lot of covenants on it, you will have an external governor looking over your shoulder. Understand that you may spend time and resources managing in order to meet your covenants at the expense of focus on other aspects of your operations.

Take into consideration your financing partner

A partner that knows and likes your sector and has experience in it is likely to be a good fit. An investor that is just looking to take advantage of a space that is "hot" may not be there for you if your sector falls into disfavor. Focusing only on terms without taking into consideration your financing partner can create more risk in the long run.

Structure duration and terms to match anticipated needs

As tempting as short-term rates might be, if a longer maturity period aligns better with anticipated timing and duration of your capital needs, the trade-off of the higher cost of longer-term debt for greater latitude to manage your business may be well worth it. Likewise, short-term financing of longer-term needs translates into a need to roll over debt at various points. If market conditions have changed unfavorably, new financing may be much costlier, if available at all. Conversely, when arranging long-term debt to fuel anticipated growth, it may be prudent to consider structuring it with staggered maturities. This provides flexibility in case the business fails to grow as planned.

"THE BIGGEST MISTAKE COMPANIES MAKE IS A LACK OF STRATEGY IN THEIR OVERALL CAPITALIZATION PLAN."

Your company's ideal or preferred capital structure will change over time. Your strategy should include flexibility to model the impact of changing business needs.

More Information

To learn more about how NextLevel can help you in successfully sourcing debt for growth, call us at (800) 833-NEXT or email info@nlbev.com.

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