



FINANCING AN ACQUISITION

IN A SLOW-GROWTH ECONOMY, SUCH AS WHAT IS ANTICIPATED IN THE UNITED STATES FOR THE FORESEEABLE FUTURE, A GREAT DEAL OF BUSINESS GROWTH TURNS FROM ORGANIC GROWTH TO INORGANIC GROWTH — NAMELY ACQUISITIONS.

While most bankers can put together a workable financing package for acquiring tangible assets such as equipment, many struggle when it comes to working with clients who plan to acquire another company. Having a banker that can respond quickly and accurately to an acquisition financing request is crucial to your success.

Contacting your banker early is an important part of a successful acquisition. Even before you discover a target, meet with your banker to let them know what you will be doing. Get their input on how the structure of the acquisition could be handled. There are tax benefits and drawbacks to specific buyout structures, but before talking about those, it's important to understand whether or not there are other issues, with the target company or your own, that would preclude any bank being able to work with you.

UNDERSTANDING CASH FLOW AND COLLATERAL

Any loan request will be approved at the intersection of collateral and cash flow. The key on cash flow is to make sure that the

debt payment you take on will be covered at least 1.25 times annually by your net income and depreciation, essentially the residual cash flow of the combined companies. The amount you add back for expense amounts must justify the purchase. Add back too much and you have overpaid. Use the wrong discount amount and you could also end up overpaying.

TANGIBLE AND INTANGIBLE ASSETS

Collateral must be supportive of the loan and the loan must be reflective of the business' cash flow. Collateral is tricky in acquisitions. There are typically two aspects to the asset purchase side of an acquisition. The first is the value of tangible assets you are buying. If the seller has fully depreciated the assets on their balance sheet, you will need an appraisal in order to assign a value to them in the transaction. The banker can then use that value for the collateral coverage on the loan. If the assets are considered undervalued and partially depreciated, an appraisal can still boost the loan amount by allowing the banker to use the "off balance sheet value."

continued on the next page

All acquisitions also include intangible, or blue sky, assets. This covers the amount you are paying for the company that is not backed up by core assets. How you handle this amount in the purchase structure will determine how much a banker can help you. While bankers typically avoid unsecured lending, if there are compensating factors, a specified amount might be allowed. However, in some cases it might be best to cover the “blue sky” in a purchase agreement as an incentive bonus to be paid out based on the performance of the company going forward. Or the seller could carry this amount, being paid on a subordinate basis over time. This latter scenario is most often used to retain the seller throughout a transition period to guarantee that the expected performance of the firm is met.



EXPERT ASSISTANCE CRITICAL TO SUCCESS

Getting a banker involved up front with any acquisition is critical to getting the correct financing structure in place. Unfortunately, many people exploring acquisitions may not fully weigh the collateral/cash flow relationships before pursuing a deal, resulting in disappointment for all involved. There are many moving parts in an acquisition and every deal is unique. Likewise, financing options can change quickly, and a company’s specifics can evolve during an acquisition. It’s important to work with a financial institution that can not only provide the expert resources needed to successfully acquire a company, but that can also support your expanded financial requirements after the deal is closed.

WE’RE HERE TO HELP

Alerus has the people, resources, and experience to help you successfully plan and execute your business acquisition. Our professionals would be happy to provide the advice and guidance you deserve at this important moment in the history of your company. Give us a call at **800.279.3200** to get started.

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