CHARTER Capital Partners

M&A Insights

INCREASING LIQUIDITY THROUGH A CAPITAL RAISE

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Raising capital is a strategic move for businesses seeking to enhance their liquidity to fuel growth and can be a critical process for companies aiming to bolster their financial standing and expand their operational horizons. In this white paper, we will explore various sources of capital and highlight the advantages and challenges associated with each, offering insights into how companies can navigate these complexities to achieve their financial objectives. In addition, we'll review three major steps involved in a capital raise process.

The capital markets landscape is complex, and navigating it is not an easy task. Engaging an advisory team familiar with the terrain and the process can increase the likelihood of success. This team is typically led by an investment banker who works closely with your attorney and CPA to manage the process so company management can stay focused on business operations.

Potential Sources of Capital

Traditional Bank Lenders

These depository institutions offer lines of credit and senior debt, usually both asset-backed and cash flow-based. They are the friendliest and cheapest source of capital, and if you have an existing relationship, diligence time can be reduced. However, banks are typically the most conservative source of capital. In addition, many banks may require guarantees or outside collateral.

Private Debt Funds

Private debt funds are nonbank institutions that offer a range of options from senior to subordinated debt, unitranche (both at once) and even small amounts of equity. These firms are highly active with significant capital to deploy. They may take on more risk and lend more than a bank, but depending on how a fund is faring, their appetite for new investments may vary. This type of borrowing is often more expensive than a bank, and there is speculation that large credits have stretched the liquidity of some funds.

Family Offices

Wealthy families that have institutionalized their investing create family offices focused on private markets for allocating a portion of their capital. Many family offices are looking for their "Warren Buffet moment," where they can be helpful to local companies while generating a good return for themselves. Each office is unique and while they have evolved since the last downturn, they may be more volatile than other capital sources.

Mezzanine Funds

Mezz funds offer subordinated and second lien debt, usually in priority behind a senior bank. This type of capital typically offers interest-only payments, a portion of which can be deferred. Mezz funds do not require significant changes in governance, create little or no equity dilution and can usually close quickly. The debt can sit behind a senior lender that will not commit any further capital to a business. However, it is usually the most expensive debt source.

Private Equity

PE firms often make majority control investments but may be open to minority (less than 50% ownership) investments. Firms vary in terms of culture and investment criteria. However, most offer a wealth of operational resources, strategic guidance and management team advisory support that can result in significant upside post-investment. More than a $1 trillion of dry powder has been raised by PE funds across North America and many remain active albeit cautious. On the flip side, PE firms have the highest return expectations, can take the longest to complete diligence and will require changes in governance and equity dilution.

The Capital Raise Process

Raising capital requires a methodical and knowledgeable approach that can be broken into three stages: preparation, marketing and closing.

Preparation

The initial step in any capital raise is an in-depth analysis of the business, including products/services, customers, industry, competitors and the management team. Historical financial statements and forward-looking projections are reviewed to identify liquidity needs and growth opportunities. This analysis, along with your specific business goals, are used to determine how much capital can be serviced and to project an optimal capital structure. Your investment banker will then compile a confidential information memorandum (CIM) highlighting the merits of the business to drive investment interest with prospective capital sources.

Marketing

Marketing begins with reviewing an extensive database of thousands of capital sources to identify those that may be interested based on their investment criteria, target investment amount, debt and equity preferences, and other factors. Investors that are a good match are contacted with a blind teaser and only learn the company name once a confidentiality agreement is signed, after which they receive the CIM. Interested investors are asked to submit a non-binding term sheet. Investors with the most attractive proposals are invited to meet with the management team and provided with access to further diligence materials.

Closing

In the best-run capital raises, the company can “pick their partner” from multiple potential suitors. The closing process varies depending on the type of capital. Transactions with senior lenders are typically the most straightforward, while those with PE firms tend to be more complicated. Utilizing an investment banker’s knowledge of the market and ability to advocate on behalf of the company’s best interest help streamline the process. The final steps include confirmatory diligence, legal documentation and a successful close.

Conclusion

Optimally raising capital is a delicate balance between how much equity dilution ownership will endure, risk tolerance for debt and how much capital can be serviced with cash flow. It is a strategic decision as well as a financial one. Capital providers come in many shapes and sizes and, in most cases, can bring impressive additional resources beyond capital to add value to the business. Most companies are far better positioned with a financial partner than by going it alone. Accessing new sources of capital is a challenging pursuit. An experienced and qualified advisory team can help you navigate through the complexities and reach your goal. While not a simple endeavor, a capital raise can serve as a strong foundation for future success.

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About Charter

Founded in 1989, Charter Capital Partners is a premier investment banking firm headquartered in Grand Rapids, Michigan. We offer a comprehensive range of investment banking advisory services, including buy-side and sell-side M&A, succession planning, business valuation and capital raise.

About the Author

Mike Palm, Partner and Managing Director

Mike Palm has more than 18 years of finance and investing experience. He works on both advisory transactions and investment transactions for Charter.

As an investor, Mike oversees the Charter Growth Capital Fund L.P. as a member of the investment committee, completes fund advisory activities, and helps manage Charter's venture funds and other SPVs. As an advisor, Mike brings his years of private equity experience to help guide clients through M&A processes and the complex private equity landscape. He has partnered with and advised executives on both growth and recapitalization transactions.

Prior to joining Charter Capital Partners, Mike was a Vice President at Driehaus Private Equity, a Chicago-based private equity firm where he identified, reviewed, and executed investments in addition to providing oversight of the fund's portfolio investments. He joined the team as the firm's first employee outside the co-founders and is an advisor to the fund.

Mike spent three years as an Associate at Beecken Petty O'Keefe & Company, a middle market healthcare services investment firm in Chicago, where he focused on investments in the practice management, HCIT, insurance services, and medical products sectors. He began his career in the investment banking division of CRT Capital Group in Stamford, CT where he was a member of the healthcare, TMT, and restructuring teams.

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