
Being Exceptionally Well Prepared Critical for Capital Raise

Successfully attracting investment capital in challenging times



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EXECUTIVE SUMMARY

There is an often quoted but misguided thought... “Businesses are bought, they are not sold.” This implies that investors will simply find your company in the vast ocean of investment opportunities and happily hand over their precious cash simply because it’s needed.

In reality, it takes a great deal of well orchestrated strategic marketing and sales efforts to first, get a company ready to court investors and second, make the presentation and third, close the deal.

The process of attracting investment capital has always been challenging, but given the current market conditions it has become exponentially more difficult. Consequently, the key to success is to be properly positioned and prepared.

Two factors are driving the need for exceptional preparation before approaching an investor– tightening investment criteria and less available capital.

Both lenders and investors have tightened their criteria by which they judge the credit or investment worthiness of a company. Now companies are required to clear higher hurdles due to the downturn in the economy and collapse of the credit market.

At the same time, there is simply less money chasing fewer good deals. This means greater competition for investment capital and lower quality of investment opportunities. Only those who are well positioned and prepared, or extremely lucky, find the money they need.

To be exceptionally prepared, a company must have the following structure in place prior to any outreach efforts to potential investors.

- Assemble a mature, experienced and well-rounded management team
- Demonstrate financial stability through size and exhibited growth
- Draft a well articulated story illustrating how internal management and processes are well aligned with the strategy
- Have internal operations singing and humming
- Write and be ready to defend a concise business plan
- Be fully prepared to engage in a deep and detailed financial conversation
- Prepare in advance a general PE due diligence request form

It is also important to start the process as early as possible. It takes time to prepare the company, to go through the process of attracting investors and to close the deal. In most cases, the process requires at least six months from start to finish.

PRIVATE EQUITY CAPITAL

There are many sources of investment capital, ranging from personal investment, angel and venture capital investment, private equity and bank loans. Each works best at specific stages of a company's life cycle. Two of the most common come in the form of debt financing from a bank or equity investment from a private investment fund. Each form has its own set of advantages and disadvantages. Here we'll focus on the process of attracting private equity (PE) investment capital by established companies that require additional capital to grow, complete an acquisition or expand product lines.

PE groups predominantly focus on growth and profitability when evaluating a company's investment worthiness. Conversely, banks tend to focus more on stability, collateral and then profits. Growth is not a bank's primary motivator for investment and it can, in fact, be viewed as a negative due to the implied associated risk.

Typically, small to medium sized companies are focused on growth and are looking for capital to fund that growth. At this point in a company's development, bank debt is very difficult to qualify for. PE capital is usually the best fit due to the mutual growth and profit goals of both the company and the PE firm.

One of the challenges of PE capital is an inherent time line. PE groups are looking for an intermediate-term return as most investment funds have a finite life. Ten years is typical. Consequently, companies need to show the ability to produce a solid return on investment of typically 20-25% per year over five years. PE groups want to invest, add value with strategic direction, and exit at a maximum valuation by carefully timing and structuring the exit strategy.

PE capital also comes with some measure of control. PE groups don't just provide a company money and disappear for five years. Part of the value-add PE groups offer is forward-looking strategic direction, which usually includes board representation.

THINGS TO DO FIRST BEFORE YOU EVER TALK TO PRIVATE EQUITY GROUPS

It is no secret that today's economic environment is extremely difficult. The process of attracting investment capital has always been challenging, but given today's market conditions it has become exponentially more difficult. Consequently, the key to success is to be exceptionally well prepared.

Two factors are driving the need for exceptional preparation before approaching a PE group – tightening investment criteria and less available capital.

Both lenders and investors have tightened their criteria by which they judge the credit or investment worthiness of a company. Now companies are required to clear higher hurdles due to the downturn in the economy and collapse of the credit market.

At the same time, there is simply less money chasing fewer good deals. This means greater competition for investment capital and lower quality of investment opportunities, both of which keep PE investors up at night. Companies still need to find money to help restructure, reduce cost and recapitalize existing debt. And, they are competing for the same smaller pool of available funds. PE firms state they only close one out of 100 deals often due to poor preparation and risk analysis. Only those who are well positioned and prepared, or extremely lucky, find the money they need.

To be exceptionally well prepared, a company must have the following items in place prior to any outreach efforts to potential investors. A company has one shot to get investors' attention, and if they are missing a critical piece of information or are poorly prepared, they miss that opportunity.

- Assemble a mature, experienced and well-rounded management team that covers the important functions specific to the business. Typically this includes CEO, CFO, VP Sales/Marketing, VP of Product Development, and VP of Engineering or Operations.
- Demonstrate financial stability through size and exhibited growth in revenue and profitability. The company needs to have hit critical mass and have a track record of profitability. Most PE groups will not consider investing in companies with less than \$20 million in revenue. They also require current profitability or a clear and near term path to profitability. Smaller companies are typically a better fit for venture capital investors.
- Draft a well-articulated story illustrating how internal management and processes are well aligned with the strategy. The company's story should make it easy for investors to see how it will meet growth plans and financial goals. The story is told in many forms depending on where the company is in the communication process (see communication plan and materials section of this white paper). Overall, it should explain how the company plans to leverage internal and outsourced resources to increase revenue and profits. And the moral of the story must be how the company has the ability to drive predictable growth in the next three to five years in order to meet the PE group's rate of return expectations and time horizon.

- Have internal operations singing and humming. Be able to show experience and depth in each of the functional areas. This is particularly important in the financial area. The financials need to show strong organization of the business which is often a key point in valuation and interest by PE firms. For example, have clean historic financials at the ready, close books within five business days of month end, and demonstrate solid financial and accounting management through steadily increasing profit margins, lean inventory, and quick collection of receivables.
- Write and be ready to defend a concise business plan. The discipline and planning that goes into writing a business plan is an important part of preparing for a capital raise. The document should quickly and concisely lay out the vision and strategy, define the market, explain the competitive environment, feature company products or services, include financials going three years back and projecting three to five years forward, and so on. Most importantly, it should tell the story with logic and demonstrate the strategy behind the idea, but not be overly detailed. It should answer the question, “How will the company leverage the additional capital to reliably grow the business and provide a strong return?”
- Be fully ready to engage in a deep and detailed financial conversation with the PE group once initial interest is shown. Complete financial modeling facilitates drilling down to a high degree of detail on cost, structure and resources on the balance sheet to support any claims. This type of analysis demonstrates management team strength. Anticipate questions and prepare answers ahead of time.
- Complete in advance a PE due diligence form. Once truly interested, the PE group will provide an exhaustive due diligence request form and expect the company to provide records of all its finances, capitalization, contracts, debts, obligations, employment agreements, intellectual property or patent portfolio, etc. Companies should obtain a generic due diligence request form in advance and maintain a digital (scanned) due diligence binder ready to present to interested PE groups on a day’s notice. In addition to demonstrating a company is on top of its business, compiling the binder as you go is also much more cost effective.

FILLING GAPS WITH EXTERNAL RESOURCES

It is easy for management to be overwhelmed by the process of raising capital. The level of detail and the many moving parts can be difficult to manage. One thing to keep in mind is that PE investors understand and appreciate when a company recognizes that it needs additional resources, expertise and help and then takes the strategic action of outsourcing when and where it is required.

What is seen as a negative is when a company refuses to recognize and/or address gaps in the strategy, management team or functional areas. These types of deficiencies are often very obvious to a savvy outsider but can sometimes be difficult for insiders to identify.

Surround the company with those who do what they do best to allow the management team to do what they do best. The result is the best of the best working on the company's behalf all the way around.

PREPARING & TELLING THE STORY – HOW TO TELL IT AND TO WHOM

There is an often quoted but misguided thought... “Businesses are bought, they are not sold.” This implies that investors will simply find your company in the vast ocean of investment opportunities and happily hand over their precious cash simply because it's needed.

In reality, it takes a great deal of well orchestrated strategic marketing and sales efforts to first, get a company ready to court investors and second, make the presentation and third, close the deal.

A large part of being exceptionally well prepared for a capital raise is finding the weaknesses in your plans before the potential investors do. It starts off with a solid business plan, a clear and understandable financial model, a good team and a fairly low risk of opportunity to realize a return on investment.

The basis of any marketing and sales effort is a solid story. In this case it is a story of future success and growth. In reality, future numbers are educated guesses, but a forecast is important as it indicates how management is thinking about the business. Here is where a company can get tripped up. For example, if the forecast calls for an increase in inventory turnover, but doesn't include corresponding increases in capital reserves, this shows a potential weakness in the team's ability to run the business. In addition, are there plans in place to build out the company in order to support the

growth? Did management consider additional pressures on distribution, maintenance and customer support associated with new growth?

A story is of no consequence until it is told and told well. A well told business story captures the reader's attention and takes them on a journey to a desired end point -- in this case, investment in the company. Further, the details and facts behind the story need to be completely organized and ready for deep scrutiny once the story is conveyed.

The first step in creating the company's story is developing key messaging and positioning points. These points will drive any and all communication through the entire process of raising capital. It serves as the foundation for the story.

Unfortunately, many companies don't take the time required to create a solid messaging foundation. It is the same as building a skyscraper -- the final structure is only as strong as the foundation upon which it is built. The temptation is to jump straight into developing the story and skip over the message creation step. The risk is a story that rambles and misses the most important elements. Remember, making a strong first impression with a PE group is a one shot deal.

COMMUNICATION PLAN AND MATERIALS

The way the story is told should align with the various steps in the communication process with PE groups. Each step requires support from a different and specific communication vehicle.

An area often overlooked, or not fully understood, is translating a company's vision, plans and goals into language the PE investor understands. This is especially true for technical companies or unique product offerings.

Each situation is unique. However, there are three common communication pieces created when looking to raise capital: a summary sheet, an information memorandum, and the investor presentation.

The summary sheet is just that. It quickly sums up all the key reasons why a PE investor would be interested in the company. Don't make the investor search for the story -- make it blatantly obvious. This one page document introduces the company story at a very high level and contains little detail. It should be an honest representation of the company, the available market, the problem the product or service solves, how the company is uniquely qualified to solve that problem, and demonstrate the team's ability to manage the business now and through the growth gained via the investment capital being sought. The

summary should include a table of high-level financials and illustrate what the strategy will cost.

An information memorandum builds on the summary in much greater detail. The goal of the information memorandum is to answer all the key questions on the potential investor's mind. A company should be as specific as possible and support any and all claims with data and examples. Typically this document is 30– 50 pages long and includes fairly complete financials three years back and three to five years forward.

The investor presentation is critical for two reasons. It shows the company's ability to communicate in written form via the document, and verbally via the actual presentation. The presentation is usually a PowerPoint slide deck of 20 – 30 slides. These presentations are tailored to each PE group and should answer specific questions that have been raised in earlier conversations. However, much of the meat of the presentation won't change and it is a wise idea to prepare the heart of the investor slide show before the outreach begins. The temptation is to wait until the last minute. This is the worst possible time to be creating such an important communication document. When a face-to-face meeting is set, adrenaline is running high and it can be very difficult to think clearly. The foundation messaging and positioning can get lost and the presentation tends to meander causing significant harm to a company's prospects of closing the deal.

Hopefully, the presentation is made face-to-face. It is often the first chance the PE group is able to see the management team in action. The presenters should be well prepared and practiced. They should know what the other is planning to say and be ready to step in if the other presenter goes astray. Practicing in front of an experienced outsider provides crucial feedback. In addition, role playing allows for opportunities to anticipate questions, find deficiencies in the presentation and practice answering tough questions away from a pressured environment.

THE ROAD SHOW – AVOID BEING ROAD KILL

Each PE group is structured differently depending on size and resources. Consequently, it can be challenging to know who to target at each PE group. Larger firms may have specific points of contact for investment bankers or other groups. Smaller PE groups don't have many layers of sourcing and decision tiers, so a company may end up talking with the owners and key decision makers directly. Some groups are sector focused while others are size focused.

It is this complexity and lack of standardization that cause many companies to seek outside help when dealing with PE groups. Working with people who have relationships with PE groups and the ability to approach others they might not know can be very helpful and significantly shortcut the process.

Communicating with PE groups is almost always done incrementally. Not surprisingly, it is critical that communication at each touch point be done well – from the initial call to the face-to-face meeting -- to the detailed business plan discussion through the due diligence process. Each step in the process requires different information and presentation materials. For example, the initial call is very high level. And the face-to-face meeting is much more comprehensive and includes a broad range of financial information.

PE groups have been entrusted to invest its funds wisely. Portfolio managers on the whole are professional people with a high degree of integrity who don't get to pull the trigger on investments very often, maybe only 20 – 40 times over their entire career. One decision can often set the destiny of the entire fund for many years to come. As such, there is an important layer of skepticism that must be overcome.

The sheer volume of requests from investors means PE groups see solid companies mixed in with a lot of jumble. They need to quickly cut through the clutter and identify the companies worth pursuing. This is done by asking tough questions and hoping for clear answers that allow for a certain level of confidence to move forward. PE investors don't see a need to soften questions and provide feedback. At the same time, there is not a lot of ugliness; they are just not in business to make it easy.

This process can leave companies seeking funding feel a bit shaken up and then misinterpret the approach as antagonistic and adversarial.

In addition, PE groups test to see how well they would be able to work with management. Does the team listen? How strong are the communication skills? How would the team weather difficult times? Ultimately, they are looking for a team of top performers who are capable of being coached and can accept and run plays well.

SUMMARY

PE groups are looking for investment-worthy companies and many companies are in need of growth capital. The best way to bring the two together is to demonstrate why it makes sense to invest in the company, how it will use the investment funds to accelerate growth and provide expected returns, and to tell the story in a compelling fashion. It all boils down to understanding the process, being exceptionally well prepared and then effectively executing a capital raise strategy.



ESG Navigators is a highly experienced, cross-functional consulting team specializing in growth, turnaround, realignment, strategic transactions, and exit strategies for middle market companies in the electronics, semiconductor and other technology sectors.