Traditional Commercial Bank finance of a Merger or Acquisition

As a commercial banker, my true role is to provide the financing that contains the least amount of risk to the bank at the most advantageous price to all parties concerned.

A Merger

If you are merging two companies together, you need to provide your banker with a great deal of information about how the two companies will look on a combined basis. If you do not have a CFO level staff member, consider hiring one on a project basis. There are many firms with very qualified people available to manage this type of undertaking. Consider the following:

- What do the numbers look like?
  - The bank will need financial statements according to GAAP, for at least 3 years prior for both companies.
  - An opening balance sheet needs to be constructed to illustrate the components of the new entity.
  - Can the newly formed company support the debt that will be added as a result of the merger? Demonstrate the cash flow to support the new debt.
  - Who will be managing the company and what is the percentage ownership for each. What are their qualifications?
  - Will the previous owner remain and/ or is there a non-compete agreement?
  - Consider that the bank may require that any owner of 20% or more of the company be a guarantor for the debt. In that case, personal financial statements are required from each.
- What kind of due diligence has been performed on the internal accounting system and individual accounts. An audit by a bank approved CPA firm is preferable.
- Tell the story about why this is a logical business decision. If there is a business plan, submit that to the bank to help the bank tell your story to the Credit Administrator or Credit Committee.
  - What positive changes will result? Cost savings? Economies of scale?
  - What are the possible negatives and what would the mitigants be?
  - What kind of analysis have you completed in order to make the decision you have made?
- Is there a purchase and sale agreement?
- If real estate is involved, has an appraisal and an environmental Phase I completed? These will be required if using real estate as collateral.
- Sources of repayment, first and second, what are they?

A Purchase

Some of the same issues will be considered in a purchase of a business. If you are a new owner, a bank will want to know what your business experience is with managing and what your background is in that

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particular industry or business. Depending on the size of the purchase there are several options to financing a purchase transaction.

- Traditional term debt
- Seller financing; partial or whole
- SBA (limited to $5M)
- Bond financing-(larger transactions)
- Private Equity (non bank)

The same due diligence is required as with a merger. The same documentation must be presented to the bank in order for them to assess risk, management strength and source of repayment. If using a government sponsored program like the SBA, special applications and documents are required.

Another potential issue might be an earn-out provision. Make sure that the potential lender (s) is/are aware of the terms and conditions for example:

- How will the gains or losses be tracked? What are the metrics?
- How long is the earn-out period?
- Would the lender require subordination? What are the terms?
- Will the seller continue to be involved in the company? For how long?

It is important to engage your advising team, CPA, Attorney, and Lender in your Merger, Acquisition, and Sale. They will provide you with their previous experience and help to avoid any pitfalls that have befallen other “deals”.

- Give yourself sufficient time to perform a thorough due diligence.
- Keep in mind that the more in depth or complex a transaction is, the more time it takes.
- If engaging a government program, add extra time to the process.
- Know that there is capital available provided you and the company qualify.

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