Chapter 18

OTHER FINANCING VEHICLES

INTRODUCTION

Sometimes the choice of vehicle is driven by cost minimization, but other times choice of vehicle is limited because of factors such as the company's size, risk profile, profitability, and the time to exit a particular vehicle.

Many of the vehicles discussed in this chapter are variants of funding sources discussed in earlier, combined in clever ways, to address particular circumstances. Other vehicles are new. The most appropriate time to use each of these vehicles will be discussed as well as their costs and drawbacks.

SYNDICATED LOANS

A syndicated loan is a loan in which several banks pool funds to lend to a single customer. Usually, one bank, called an agent bank, finds a commercial customer, analyzes its creditworthiness, prepares the paperwork for the participating banks, services the loan that is it collects payments and disburses them to participating banks, and monitors the loan throughout its life. Agent banks take a share of the loan and receive fees for finding the customer, setting up, and servicing the loan. Not all banks are agent banks. As of 1999 there were only 223 agent banks as compared to 345 in 1995. As bank consolidation continues, it is likely the number of agent banks will decline further.

The average size of a syndicated loan in 1998 was $167 million, up from $145 million in 1995.[1] There is no reason to believe the size of syndicated loans will fall and every reason to believe they will continue to rise, so only companies that need on the order of $200 million are good candidates for a syndicated loan. As of 2001 there were more than $2 trillion in syndicated loans committed and more than $769 billion outstanding.[2]

How does syndicated lending help a business? First, syndication spreads lending risk, which lowers a business's risk profile and that translates into somewhat easier credit and lower interests. Second, individual banks may not have the statutory capital to lend the full amount requested. Third, banks are uncomfortable lending a large amount of money to a single customer because it creates a regulatory concentration problem. Concentration problems arise when a customer is sufficiently large, that if it failed it would have a material impact on the bank.

Syndicated loans are an attempt to recapture some of the business lost to junk bonds. Syndicated loans are longer than traditional bank loans, less subject to periodic restructuring, and have fewer covenants.[3]

BRIDGE LOANS

Bridge loans are short term loans, usually made to established companies to meet specific objectives. Maturities are often in the range of 90 to 180 days and range from $1 to $10 million.[4] Firms that make bridge loans respond quickly and expect significantly higher returns than banks.

The Internet company, iPass, filed an S-1 (a prerequisite for an IPO) in March, 2000. However, it was clear that it would not be able to raise the required capital under the market conditions at that time. It needed capital to cover operating expenses until the market recovered and its negotiating position improved. It contacted Sand Hill Capital, a company specializing in growth capital loans. Within two days, Sand Hill had a due diligence team at iPass, and it closed the loan in a month. Sand Hill represents that it can close some loans in as little as two weeks. This speed is unheard of for a bank.[5]

Firms that specialize in the bridge loan market project a company's value at the end of the bridge loan period and base their assessment of risk on that value. Unlike venture capitalists that are patient capital, firms that make bridge loans are impatient capital. Much of the bridge lender's due diligence is designed to verify that it can exit the loan on schedule. Bridge loans are the right vehicle for a very narrow range of circumstances such as those iPass encountered, but are not the best vehicle for most other circumstances.