



KEY NOTES

- ▶▶ If the lender is familiar with merchant portfolios and residuals—or has executed deals in a complementary industry—there will be far fewer roadblocks on the path to approval.
- ▶▶ Always tie up any loose ends prior to initiating the funds application process. Ensure any pending audits are performed and that all financial statements and contracts are in order.
- ▶▶ Lenders prefer to be informed, upfront and in writing, of any negative information—which will almost certainly come to light during due diligence anyway. Borrowers can't afford to give lenders a reason to question their integrity.

Casting for Cash

When trolling for growth capital—whether from banks, venture capitalists, private equity firms, or vendors—persistence pays

By Julie Ritzer Ross

Despite the increasingly tight credit market, growth capital is out there for ISOs and processors looking to expand or improve operations, but procuring it isn't for the weak hearted.

"Arranging for growth capital is a long, sometimes frustrating, process, but can be a worthwhile endeavor for those ISOs that are ready to get to the next level" in terms of their scope of services, products, and the like, says Kevin Kidd, an attorney in the Nashville-based law firm Waller Lansden Dortch & Davis LLP.

Expect big challenges when approaching banks. The current economic climate, coupled with the credit crunch and the obligation to answer to Wall Street and private investors, has rendered many financial institutions reluctant to or incapable of offering loans to some clients. A long-term relationship with a financial institution once would have been sufficient to deem a borrower worthy of desired funds; that's no longer the case. So be prepared to seek funding from financial institutions other than your own—several, in fact.

Venture capital and private equity firms are other resources, and the former are often a good choice for young companies and startups that are in the black or close to it, Kidd says. He offers up Richmond, Virginia-based Harbert Management Corp. as an example. The company, which has identified transaction processing as "one of several sectors of

investment interest," invests in early stage growth companies with "defensible positions in large and growing markets," in amounts of \$500,000 to \$3 million. The tradeoff is that most venture capital companies seek, at a minimum, board representation at the companies in which they invest.

Another emerging source of funding? Vendors. Certain "super ISOs" and large processors have established growth capital acquisition programs for their ISO and processor partners. Atlanta-based Elavon, the merchant acquiring subsidiary of U.S. Bancorp, lets MSPs use their monthly residuals as collateral for procuring growth capital monies. Loan amounts vary and run up to \$2 million, with a "substantial" merchant portfolio required for approval to receive funds at the high end of the range.

"For our MSPs, the advantage of such a program is that there is no need to liquidate or sell residuals in order to raise capital," explains Howard Haffner, Elavon's director of MSP relationship management.

In a slightly different vein, Dallas-based Calpian, which originated as an ISO, has initiated three programs designed to offer capital exclusively to the ISO community. Its Wealthbuilder option, for newer ISOs, provides monthly cash in exchange for merchant residuals. Payments are based on merchant residual dollars sold to the company. The SWAP program, for seasoned ISOs ready to grow their

businesses to the next level, uses existing residual streams to provide growth capital for a period of up to 36 months. A third offering, Northstar, provides long-term incentives through large future payments.

Do the Homework

Still, identifying viable sources of growth capital represents only half the battle. Before proceeding with an application process, funds-seekers need to investigate several issues. Perhaps most notably, be sure the lender being considered understands the electronic payments space.

“Experience has taught us that if the bank or other type of lender is familiar with merchant portfolios and residuals—or at least, has executed deals in a complementary industry, like point-of-sale hardware—there will be far fewer roadblocks on the path to approval,” says Michael Berman, chief operating officer of Outside Ventures Ltd., the New York City-based parent company of ISO Tribul Merchant Services LLC. “For example, lenders that know the ISO business comprehend portfolio valuation and can easily see a good portfolio as a point in potential borrowers’ favor. Those that don’t, and can’t get their arms around it, are going to throw up more barriers.”

Another issue is the degree of lender/investor involvement you’re willing to accept in return for funds. Some lenders insist on an equity stake in the businesses. Others, particularly banks, are more hands-off. “It all comes down to the level of interference one is willing to accept,” Berman says.

Just as significantly, borrowers must determine whether they are likely to satisfy lenders’ requirements for collateral. “If you’re dealing with a bank, you need a worthy asset to put on the table so management knows it has something to go after if necessary,” explains Ross Federgreen, executive vice president and founder of CSRSI, a payment solutions advisory firm headquartered in Jensen Beach, Florida.

Many ISOs erroneously assume that they can collateralize a note based on the number of merchants in their portfolio, Federgreen says. “This was sometimes an option in the past, but given the current fragility of merchants and multiples, it doesn’t hold much water now.”

He adds that unlike ISOs that have been in existence for seven or eight years, younger organizations with only two to three years of

Prospects that must be “chased down” and probed for details are often deemed less than responsible and therefore poor candidates for a capital infusion.

operation must be prepared to demonstrate that they have assets outside the business, as well as have in place long-term contracts with known merchant and vendor entities.

Put It in Writing

While following a strategic approach to securing financing has always been a good idea, adds Kidd, the current economic climate and heightened scrutiny of potential borrowers mean that making a positive impression on lenders is even more important.

Tying up loose ends prior to initiating the funds application process is a critical first step. “Ensure that any pending audits are performed and that all financial statements and contracts are in order,” Kidd advises. “If this hasn’t been handled, and the individuals handling due diligence for the lender note that something is missing or seems amiss, they may decide that an ISO is not sufficiently well run or assume that other areas are equally ‘messed up.’”

In working on a recent growth capital deal, attorneys at Waller Lansden Dortch & Davis found that the organization in question had several other loans that had not been formally documented. The firm drew up the papers so that they could be presented to the lender during the application stage.

Amassing a dossier of other documents is equally important. In addition to three years of personal and corporate tax returns, include a recently updated business plan, profit and loss statements, and outstanding contracts with vendors and buyers. Also include descriptions of how the procured funds will be used and the factors that differentiate the ISO or processor from its competitors.

The latter two elements should be highly detailed in order to push lenders’ opinions in the right direction. For example, stating that

growth capital will be invested in expanding an ISO’s businesses or beefing up its sales forces isn’t enough. Revealing specific plans to hire new agents to cultivate a particular untapped market and/or territory is much better. Noting that growth capital will be spent to launch specific programs and products for merchants (e.g., gift cards or mobile point-of-sale devices), rather than to simply add to the service or equipment portfolio, usually yields a similar effect—so, too, does cataloging available merchant services, programs, and product lines alongside those offered by competitors to highlight areas of differentiation.

“Lenders don’t want to ask for this type of information. They expect that prospective borrowers will present it to them,” says Stephen Sheinbaum, CEO of Merchant Cash & Capital, a New York City-based firm that offers capital to operations in the service, retail, and restaurant sectors. Prospects that must be “chased down” and probed for details are often deemed less than responsible and therefore poor candidates for a capital infusion, he adds.

Don’t Sugarcoat It

Lenders also prefer to be informed, upfront and in writing, of any negative information about prospective borrowers, financial and otherwise. Such information will almost certainly come to light during background checks and due diligence procedures, but often does not pose a problem if it is already out in the open.

“Neglecting to bring all of the negatives up in the first place can be very damaging to an ISO’s or processor’s reputation; it can even inject serious doubts in lenders’ minds about the borrowers’ integrity,” Federgreen points out. “Few, if any, potential borrowers are absolutely clean. The important thing is to be honest and show the skeletons in your closet before lenders find them.”

On the flip side, don’t exaggerate and never fabricate. When the truth is revealed—and in today’s lending scenario, it will be—lenders might not think twice before walking away from the table.

“As in every step required for success in finding growth capital, take the high road,” Federgreen concludes. “With that and some patience, the infusion will come.” **TT**

Julie Ritzer Ross is a contributing writer for Transaction Trends. Reach her at jritzerross@gmail.com.