Live Oak Bank

Financing Growth When Winning Contracts and/or Buying a Small Business with Federal Contract Assets
Interactive discussion about challenges with financing contract wins

Examples of government contract financing for organic growth

Reminder to avoid predatory lending that puts your business at risk

Financing an acquisition for inorganic growth

Sharing an acquisition story
Questions for the audience –

- How did you finance your first contract win?

- What challenges did you face with onboarding a large team, and meeting payroll and direct expenses for the first few pay periods between the start date and the government’s first payment?

- Have you ever considered growth through acquisition?
Federal Acquisition Regulation - Payments

FAR 32.904 Determining payment due dates.

(a) General. Agency procedures must ensure that, when specifying due dates, contracting officers give full consideration to the time reasonably required by Government officials to fulfill their administrative responsibilities under the contract.

(b) Payment due dates. Except as prescribed in paragraphs (c) through (f) of this section, or as authorized in 32.908(a)(2) or (c)(2), the due date for making an invoice payment is as follows:

1. The later of the following two events:
   (i) The 30th day after the designated billing office receives a proper invoice from the contractor (except as provided in paragraph (b)(3) of this section).
   (ii) The 30th day after Government acceptance of supplies delivered or services performed.

DFAR 232.903 Responsibilities.

DoD policy is to assist small business concerns by paying them as quickly as possible after invoices and all proper documentation, including acceptance, are received and before normal payment due dates established in the contract (see 232.906(a)).
“Accelerated Payments to Small Business Subcontractors” was added to the FAR by Federal Acquisition Circular (FAC) 2005-71, issued on November 25, 2013. The new clause will be effective December 26, 2013, and will be included in contracts awarded after that date. The clause requires that prime contractors who receive accelerated payments to accelerate any payments due to their small business subcontractors to the maximum extent practicable. The new clause does not modify the Prompt Payment Act so contractors will not earn interest in the event payments are not accelerated. Further, the clause does not impose any penalties on prime contractors who fail to make accelerated payments to their small business subcontractors. However, if the Contracting Officer determines the prime is not accelerating their subcontractor payments, the Government will cease accelerating payments to the prime.
Federal small business contractors need lending products tailored to their unique business challenges.

**Optimize Cash Flow**
- Unfavorable debt instruments thinning cash flow
- Unable to draw a meaningful salary (owner/officers)
- Volatile cash flow due to nature of billing and reimbursement cycles

**Leverage Anticipated Monthly Invoices**
- Awarded multiple contracts in a short period
- Inadequate capital to fund related contract expenses
- Convert assets to cash

**Cash to Start the Work**
- Inadequate funds to cover direct payroll and expenses during the gap between start date and invoice/payment.
- Borrowing base on line of credit can’t sustain growth of large contract start up.

**Working Capital / Refinance**

**Contract Line of Credit / Refinance**

**Mobilization Financing**

National 8(a) Conference
Federal small business contractors need lending products tailored to their unique business challenges.

- Winning awards is labor-intensive, costly and inefficient
- Unable to win new contracts
- Sunsetting of certifications (e.g. 8(a)) limits new growth prospects

Key Takeaways --
- The best sellers have performance periods remaining on contracts. Similarly situated buyers can leverage the set-aside contracts and the benefits of the acquisition for years to come, while continuing to grow and diversify their business.

- Transparent discussions with the agency about mitigating risks to performance and avoiding employee turnover will gain the contracting officer’s proactive support to transfer the contracts.
### Marketplace Lending Options

<table>
<thead>
<tr>
<th></th>
<th>SBA Lender</th>
<th>Non-bank Factoring</th>
<th>Alternative Financing</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Business Term Loans</strong></td>
<td>✔️</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Loan Amount</strong></td>
<td>Up to $5MM</td>
<td>Invoice-dependent</td>
<td>$5,000-$500,000</td>
</tr>
<tr>
<td><strong>Lines of Credit</strong></td>
<td>✔️</td>
<td>Factoring</td>
<td></td>
</tr>
<tr>
<td><strong>Line of Credit Amount</strong></td>
<td>Contract-dependent</td>
<td>N/A</td>
<td>$2,000 - $300,000</td>
</tr>
<tr>
<td><strong>Average APR</strong></td>
<td>SBA: 6.5% - 8.5% (plus fees)&lt;br&gt;Conventional: 6.5% - 9%</td>
<td>20+%</td>
<td>8%-108%</td>
</tr>
<tr>
<td><strong>Terms</strong></td>
<td>1-10 Years</td>
<td>1 – 2 Months (Factoring Period)</td>
<td>1 month – 5 years</td>
</tr>
<tr>
<td><strong>Approval Time</strong></td>
<td>24-72 Hours</td>
<td>Varies</td>
<td>1-7 Days</td>
</tr>
<tr>
<td><strong>Earliest Receipt of Financing</strong></td>
<td>10 – 30 Days</td>
<td>1 – 5 Days</td>
<td>1 – 5 Days</td>
</tr>
<tr>
<td><strong>Minimum Credit Score</strong></td>
<td>Varies (650+ preferred)</td>
<td>N/A</td>
<td>500 Term Loan/600 Line of Credit</td>
</tr>
<tr>
<td><strong>Years in Business Min</strong></td>
<td>1 Year</td>
<td>1 Year</td>
<td>1-2+ Years</td>
</tr>
<tr>
<td><strong>Minimum Income Requirement</strong></td>
<td>Contract-dependent</td>
<td>Varies</td>
<td>$75,000/Year</td>
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<tr>
<td><strong>Personal Guarantee Required</strong></td>
<td>✔️</td>
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</tbody>
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Case Study: Working Capital / Refinance

Borrower with negative $500K cash flow turned into positive $270K

Borrower Challenges
- 662 credit score
- $36,200 monthly debt and $575,000 total principle owed
- Revenue took a 66% ($350k) hit in 2013 due to sequestration
- Negative $500,000 in cash flow after debt payments

Product: Working Capital / Refinance
- Pay off original debtors
- Provide additional permanent working capital
- Stretch payments over 10 years

Outcomes
- New total monthly payments result in $30k of monthly savings
- Paid off principle balances
- Allows to take a salary
- Excess cash flow of $270k annually
Case Study: Line of Credit

Small Business contractor in growth mode faced with low liquidity

**Borrower Challenges**
- Growth mode
- Credit score: 650
- Interest payments to alternative lenders and aggressive BD spending led to liquidity issues and inability to consistently pay/manage payroll

**Product: Line of Credit**
- Provides affordable capital
- Borrowing base made up of 90 days of eligible receivables
- Low cost of origination
- Monthly pipeline discussion

**Outcomes**
- Borrower now able to meet payroll, chase and capture new work and bring on necessary headcount to deliver on new awards
- Established line 4x anticipated monthly invoices
Case Study: Business Acquisition

Traditional banks often don’t understand unique nature of projections in this sector and typically won’t provide financing

Acquisition Target

- Graduated 8(a) --
  - $11M revenue
  - $985K EBITDA
  - $4.0M purchase price
- Purchase price based on active contracts, options, and projected revenues from new awards,
- Contracts with 4 different agencies
  - DoD / GSA / Treasury/ Dept State

Product: Business Acquisition

- Finances purchase of business & assets
- Borrower injects 10% ($400K)
- Payments stretched over 10 years
- SBA Loan for $3.6M
- Price o/a 4 x EBITDA

Outcomes

- Buyer able to acquire new business with little out of pocket--liquidity then helps fund growth
- Business grows with injection of new revenues from acquired contracts
- Assumption of relationships and past performance enhances ability to capture new work
- Retention of workforce creates a seamless transfer for the government
Borrower Profile for Acquisition

Considerations for potential borrowers include:
- Credit score(s)
- Cash flow minimums
- Growth Strategy
- Ownership/Management experience
- Personal equity/assets
- Personal debt service

What is EBITDA?
- EBITDA – or earnings before interest, tax, depreciation and amortization – is an indicator commonly used by prospective buyers or investors to measure a company’s financial performance.
- In its simplest form, EBITDA is calculated by adding the non-cash expenses of depreciation and amortization back to a company’s operating income. Below is the basic formula:
  \[ EBITDA = \text{Operating Profit (EBIT)} + \text{Depreciation (D)} + \text{Amortization (A)} \]
- By eliminating the non-operating effects that are unique to each business, EBITDA can help balance the scales by focusing on operating profitability as a singular measure of performance. This is particularly important when comparing similar companies across a variety of industries or different tax brackets.
Valuation and Win Win Win Acquisitions

- Most successful government contractors have an exit date or strategy, and when they sell to another small business owner it’s a way to pay it forward. Sellers know that an acquisition brings instant revenue, and this alone helps the new owner divert their talents, innovation, and energy to bringing smart solutions to the country’s greatest challenges.

- For the acquisition to be win-win-win, all parties must win meaning the seller, the buyer, and the government. The seller wins with the highest practicable valuation. The buyer wins when the transaction results in contract revenue that facilitates business growth and the ability to meet the financial obligations to the bank that closed on the acquisition loan. The government wins with continued performance without a gap in service/delivery, avoidance of re-compete costs/effort, and maintaining the experienced and skilled contractor workforce.

- A small firm is most valuable to a buyer that can assume performance of the existing contracts and maximize the benefits for the current performance period and beyond. As a buyer, you gain the seller’s experience and past performance record with the acquisition. A buyer’s ability to maintain sole source contracts and/or eligibility to submit proposals on the re-competes significantly impacts the valuation of small business. With the home court advantage of direct experience and great past performance, over 80% of all incumbent contractors win follow-on procurements. The best transactions maintain the careers of the dedicated employees that helped grow the seller’s business, and further stimulates the economic strength of the nation by creating more jobs and building a stronger small business industrial base.
Sharing the Windwalker Acquisition Story

Paul Serotkin, EVP, Currently: Windwalker Group LLC Boston, MA, 8(a)

- 35 years in government contracting sector:
- GovCon Corporate Management- SB/8(a)
- Principal, Boutique Investment Bank (working with $5-$30 million firm owners)
- Director, Corporate Development/M&A - acquired 5 companies before selling to Titan Corp. (2000), then to L-3
- Significant use of institutional debt in buying and selling

Presented unique offering from other GovCon financing sources
Skepticism that a bank could fund small 8(a) to acquire like sized or larger contractor

Activity: Windwalker retained an investment bank to locate target. Quickly presented legitimate offer that sellers accepted, knocking out competitive bids.

Bank Benefit:
- Set negotiating range for us, based on ITS OWN contracts/financial diligence of both firms
- Provided intimate knowledge of SBA Regulations and small company financing structures
- Acquisition templates largely built

Transaction
- Doubled size of company; new client, new types of work, with more mature firm having sophisticated systems
- Completed deal August 2017
Questions for the Panel?

Questions?
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