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The Art of the Add-On (Last of a Series)

THE LEAD | November 22, 2016

We’ve received a number of positive responses about our special series on add-ons. One partner at a NY-based private equity firm particularly liked our focus on why the right culture matters.

“The key is retaining talent,” he wrote us. “Even when it’s not apparent where they’ll be a fit. We had one executive who had been part of an add-on we did last year. He impressed us a lot, but I didn’t have anywhere to put him back then. But you never know so we kept him on in a consulting role.

“Then a couple months ago, we found a logistics company. Coincidentally our manager had an extensive background in that sector. It was a perfect fit, and he’s now running our platform company. The lesson is you never know when someone’s skill set will be a match for an add-on down the road.”

As we conclude our series on add-ons, we take a look at how lenders structure financings to support these acquistions.

In general, lenders are eager to finance add-ons. There are several reasons for this. First, they provide another bite at the apple in terms of fees earned on new transactions. They also allow new lenders to come into the credit, and existing lenders to increase their exposures. That’s particularly helpful for those accounts which had been underallocated in the initial syndication; they can now fill out their commitments.

And as we’ve covered in this series, it’s often the case at the time of the buyout, that platform companies need to diversify customers, products, and geographies. From a credit perspective, the sooner the borrower achieves that enhanced level the better.

Lenders use several tools to help private equity clients finance add-ons. Traditionally, revolving credits had provisions for smaller acquisitions. Today it’s more common to address the acquisition financing by providing delayed draw term loans (DDTL). These facilities have a relatively short draw period – one to two years – then term out with a final maturity that matches that of the term loan.

DDTLs are favored by lenders over RCs because there’s pretty much guaranteed usage with minimum required amounts to be drawn during the draw period. Also the “ticking fee” of 1% charged during the draw down period is double the unused fee for RCs. And the draw period is limited to two years max vs. RCs’ six year maturity.

As we’ve seen in this special series over the past several weeks, there’s more to add-ons than meets the eye. It’s not just about adding sales and cash flow, as one of our sources told us. It’s about figuring out ways to make two often very different companies work together on a complementary strategy.

Organic growth, as one private equity partner summed it up recently, is the holy grail of the industry. And achieving it can be just as elusive.