In banking hell? Try an angel

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Angel investors provided funding for Daniel Noble, of Drive My Car Rentals, to help develop his business. *Photo: Supplied*

It's an oft-heard lament that smaller businesses struggle to get access to funds to grow. But if you prepare your business properly and it's exposed to a genuine growth opportunity, there are funding options out there. A channel to explore if you own a growing business that needs a cash injection, but haven't got the cash flow to satisfy banks, is angel investors.

“Angel investors add value beyond just capital,” says Daniel Noble, managing director of Drive My Car Rentals. “They often have years of business experience they can lend to start-ups, expertise we couldn't otherwise afford to pay for.”

Drive My Car Rentals lets car owner rent out their car privately – for example, if you have a spare car, if you're going away on holiday or don't use your car Monday to Friday.

Noble was able to secure funding to develop his business from Sydney Angels, a group of angel investors.

“After the first pitch, three or four investors came together with $300,000 in funding, then others came on board and by Christmas 2009 we had $600,000,” says Noble.

The funds were used to re-build the website and Noble was able to secure a further $600,000 in funding through Sydney Angels in mid-2010.

“Angel investors are unique – they're looking for a capital gain, not a dividend. They might invest $100,000 today and look to multiply their initial investment by 10 over five or 10 years,” Noble says.

David Hooton, managing director of junior telco Platform Networks, is currently in the market for funding. He says he is “cautiously but seriously investigating” a private equity investment in the business, “potentially looking at a combination of equity and debt provided by the same investor.

"This is the highest yield option that we have presently available to us, but it means we have to have all our ducks in a row internally and invest in strong management and operational teams to make sure we are an attractive investment option."

Hooton says a combination of equity and debt is the most attractive investment option for him.

"We're growing much faster than banks tend to be comfortable with and have goals that lend themselves to the private equity market," he says.

"It's way too early in the business's life to be offering up too much equity so for me a combination debt/equity solution is most attractive."

Funding will be used for acquisitions and to capture market share.

Hooton is looking to "raise an initial investment of about $5 million with follow-up rounds as we identify additional acquisition targets to a total of what we expect will be around $20 million over three to five years."

"I would anticipate that we would have market share for further acquisitions to be self-funded and for an appropriate exit strategy to be available to our investors at the five-year mark," he says.

Laura Raymer from CFO Strategic, which consults to businesses looking to attract private equity, says that for a business to be able to attract equity funding "you have to have a proven product and customers".

She says private equity firms all have different investment criteria and that a good place to visit to get a feel for businesses different firms are interested in investing in is the website of the Australian Private Equity and Venture Capital Association, which gives details on members' investment preferences and criteria.

Once you've researched private equity firms that might be interested in buying into the business, Raymer says it's a good idea to tailor the business plan to the firm's unique investment criteria, to give investors a reason to look seriously at the business.

Hawkesbridge Private Equity is one firm that invests in smaller businesses. Managing partner Josh Rowe says the firm invests in businesses valued at below $50 million, with historic annual operating profits of between $2 million and $10 million. He says he'll pay between 3.5 times and six times annual earnings for the right business and look to sell the investment for between 4.5 times and eight times annual earnings.

"For a really good business we'll pay five times earnings but if the business needs a lot of work to fix it we'll pay a lower multiple," he says.

After buying into a business Rowe will work with management to develop its strategy, put in place systems and procedures, appoint independent board members if the business requires it and introduce disciplined financial reporting. When the investment is ready to be realised it could be sold to another private equity firm, or it could be sold as a trade sale.

Due to the smaller size of Hawkesbridge's investments, unless there is a technology angle, an exit by way of an IPO is unlikely.

Interestingly, Rowe says post-financial crisis it's more difficult to add a lot of debt into the businesses Hawkesbridge acquires.

"At our end of the market the banks are still very tight on lending, you'd be lucky to get a debt multiple of more than two times EBITDA (earnings before interest, taxes, depreciation and amortisation), which is why we look for businesses with a good growth profile. Private equity is all about picking growth businesses with good management – gone are the days of clever debt financing to generate returns."

Rowe says "hopefully credit markets will improve", which will increase Hawkesbridge's ability to get follow-on finance to assist in expansion activity and make bolt-on acquisitions for businesses already in his portfolio. A relaxation of credit markets will make it easier for his firm to invest in small, innovative enterprises, which is good news for businesses readying themselves to talk to private equity firms.

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