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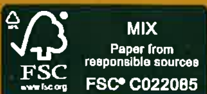

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Capital Market Success

WHAT MATTERS?

BY MICHAEL BURGMAIER

IN THE LAST YEAR, HUNDREDS OF BEVERAGE COMPANIES HAVE found themselves either looking for capital or a buyer. Neither is easy. What should they do to improve their odds of success? When raising capital of selling a company, what matters to the parties with the cash? To get to that "Promised Land", what should entrepreneurs and their boards keep top-of-mind when handling key strategic decisions? All companies require capital at some point and investors need a return on their investment, likely through selling the company (the famous "exit") or other methods like paying dividends and going public. In the last year, Silverwood Partners, where I work, has concluded multiple successful exclusive advisory engagements in the sale of beverage companies (Function Drinks to Sunsweet Growers) and capital raises (Zola, Maverick Brands/Sunkist Naturals).

As an investment banker focused on the consumer sector, the two primary professional activities that I spend my time with include assisting companies as they raise capital, and mergers and acquisitions (assisting companies in finding buyers or in finding businesses to buy). I am certainly not the only person qualified to talk about what investors and buyers look for, but as the deals above indicate, when it comes to beverage deals, our firm is in the thick of the market's activity.

Here are some thoughts on what helps guide us. Through our experience, we have identified several identifiable traits of companies which assist in successfully raising capital or selling – and doing so at attractive prices. In this article, I'll discuss a few of those traits and relate them to successful transactions. The process of raising capital or selling a company creates a situation with multiple would-be investors and buyers poring over, assessing, and scrutinizing every data point, every strategic choice, and dissecting the company's marketplace performance. A good buyer leaves few stones unturned and few areas of weakness unexposed. Every investor and buyer looks for one reason to say no. Don't give them one. Focusing the strategic attention of the board and management on some of the key areas below could help sell the vision of what a company can become under new ownership or with new capital.

1. GO DEEP, NOT WIDE

In our view, one mistake often repeated by companies is the sense that a product needs to be everywhere overnight (a "land grab"). But distribution takes money. Building a brand takes time. And one of the most important pieces of data in any capital process is how fast a product sells off the shelf, sometimes referred to as velocity or same-store sales. Creating velocity requires time and effort – demos, guerilla marketing, creative merchandising, and other things, but if a brand can't show same-store-sales growth over time, it is a brand in decline. Overall sales may go up because the product enters new distribution, but it's the quality of those sales that matters more. Companies that are able to concentrate on creating a story of same-store growth are companies that also create a story that investors imagine they can replicate. So perhaps start by succeeding in limited markets, with key retailers to create a growth story.

2. LEAVE HOLES

The corollary to not having flooded every distribution channel and geography is that major growth opportunities remain for the buyer or new investor. Items that can be sold in multiple channels with many doors, such as salty snacks and beverages, are often the ones that fetch the highest valuations. If a product can be sold in C stores, club, grocery, coffee and sandwich shops, etc... then a buyer knows they can easily ramp by turning on their sales and distribution power – if they see success in one or more channels or geographies, they can more easily see the path forward.

3. CAPITAL EFFICIENCY

In the current economic environment, accessing capital can be difficult – sometimes extremely difficult. Successful companies attractive to buyers and investors are often those that present the least amount of perceived risk. One way to minimize risk is to minimize the capital required to grow. The goal is to lessen the dollars required (paid-in capital) to achieve revenue. Simply put, often the lower the ratio of paid-in capital to revenue, the higher the value a company can achieve. Companies with high ratios may be heading towards down rounds (future rounds at lower share prices) or the inability to raise capital. For example, which company should get a higher valuation, the one where $1 million of investment achieves $1 million of sales or the one that can grow to $5 million with the same capital?

4. HAD ONE, WANT ANOTHER

Products which can be consumed quickly often lead to higher velocity and stronger sales. Companies can assess their current product lineup to see if there are ways to increase consumption patterns. Can a single-serve package (or convenient multi-single serve packages) be created? Can markets for new usage occasions be found? No one wants to be the product that stays in the refrigerator for six months; weekly replenishment creates more sales.

5. MAKING MONEY MATTERS

Simply put, EBITDA (earnings before interest, taxes, depreciation and amortization) matters. That means that gross margin matters. Startups may not have scale, but that does not mean that negative margins should be acceptable – at any stage. Margins can improve over time, but many of the best businesses are those that are designed to make money quickly (remember capital efficiency?). Companies are expected to lose money at first (see next point below), but the path to profitability must be clear.

6. FUEL THE GROWTH, DON'T FILL THE HOLE

As stated above, every investor expects and knows that early-stage company will experience losses. This time period, often described as the "Valley of Death," requires companies to invest in product development, team, inventory and more ahead of revenue. It's that process that describes the plunge into the Valley – and more and more, institutional investors have become reticent to fund that plunge; instead, they want their money to fuel growth, not fill a large hole of losses. Many of the points above (capital efficiency, velocity) are intertwined with this point, but the importance of this in today's capital markets to institutional investors cannot be overstated.

7. CREATE PERMISSION

For branded products, part of selling a growth vision is demonstrating where a brand can go. Management may not have all the answers yet in this regard, but the best brands are those that have strong market permission and the ability to extend into adjacent product areas (Honest, Kashi, Odwalla, Bear Naked, Rising Moon Organics...). Again, sell the vision and don't create one that is overly limiting at the outset.

8. BEEN THERE, DONE THAT

The right team minimizes investor/acquirer risk, and that team is typically a complete, domain experienced group that has already made money for investors. In addition, investors tend to like humble, experienced entrepreneurs who know what they know and also know what they don't know. Making money for investors the first time can be the easiest ticket towards raising money for the second go-round. Those investors need to invest their returns somewhere...why not back with you?

These are just a few of the characteristics of companies that are more likely to conclude successful capital market transactions. Others include market leadership (strong number one or solid number two), customer diversification, and product price point relative to competition and company size. If you can keep the numbers looking like they're going in your favor, you've got a chance. But as you can see, there's a lot of work to be done when it comes to making the process come out in your favor.

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