Mezzanine Finance - An Alternative Way of Financing Development of Companies

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The significant limitations on credit actions for banks reduces the possibility of acquiring the necessary capital to finance investment projects. In Poland the future development of companies now depends on acquiring funds for development from alternative sources.

One of these alternatives is mezzanine financing. Mezzanine in French means a half-floor, which describes the nature of this financing excellently. The rule is that this financing is mid-term in length and that it increases companies’ funds by the capital necessary for future development for a specific period of time.

Mezzanine financing is a hybrid form of capital with features of both debt and equity. Debt means the financing of a company’s development with a typical loan contract. The other method to ensure financing is the issue of bonds to increase share capital.

We can therefore state that a financing entity is not only interested in interests payment (debt component), but is also financially engaged (capital/equity component) and, as one of the owners, strongly motivated to ensure growth of the company. In other words, the financing entity acquires a double benefit, interest on the borrowed capital or purchased bonds and participation in generated profit and possible sales of stocks or shares to a future investor.

The company benefits from the engagement of a partner (financing entity) that intends the value of the company to grow. The cost is the interest payments and profit-share. When making a decision on mezzanine finance both parties must conclude an investment agreement that regulates the whole project comprehensively.

An agreement of this type is an unnamed contract in Polish law, and as a result its construction is based particularly on rules that concern the freedom of conclusion of a contract. Parties should specify in such an agreement:

1) what is a form of financing (debt component) - a loan or issuing bonds?
2) what is the interest rate of a debt (taking into account limits that result from anti-usurious regulations)?
3) what is the term of the debt and interest rate repayment schedule (taking into account that the most common method is repayment of an interest rate with the main sum paid at the end of the financing term)?
4) how is the performance of the agreement secured (taking into account the capital engagement of the financing entity it is not common to have assets of a company as a subject of a security), and what is more
5) what are the rules of resigning from an investment by correlating the term of a debt repayment with an interest rate and term of sale of shares or stocks possessed by a financing entity?

Taking into account the aforementioned investment risk for a financing entity, it should be stated that choice of a company that would be a party to the financing project of a mezzanine-type should be preceded by penetrating analysis of such issues as: financial results of a company, its potential for growth, cash flow, debt level, business plan and abilities of the management.

We should only hope that the search for alternative sources of finance for development is going to stay in the Polish market after the end of the financial crisis.

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