What will the lender be looking for from me and my business?
Financing is …

• A means to accomplish short and long-term goals for the business.

• A strategic tool to aid in taking a calculated risk to obtain a future reward.

• For most, a necessary part of doing business today.
Financing includes …

• Credit lines, term loans and leases obtained from a traditional lender.
• Overdraft protection on checking accounts.
• Credit cards.
• Trade accounts with suppliers.
• Non-traditional sources, such as private individuals.
A Good Banker/Lender is…

- A trusted advisor who is willing to LISTEN to your dreams and goals, and is not just out to sell a product.

- Has your best interests at heart for the long-term, even when the answer is something you may not want to hear.
Banker / Lender…

- Can customize solutions to fit your needs (within prudent lending standards).
- Willing to help clients understand what they need to do to “get to the next level.”
A Good Customer …

• Is honest with their banker and keeps him/her informed, especially when facing financial challenges.

• Provides complete and accurate information as needed on a timely basis.
Customer...

- Recognizes the importance of maintaining good credit history and pays bills on time.
- Understands that the relationship must be mutually beneficial for both parties.
- Realizes their banker is not their enemy!
The C’s of Credit

Basic Components of Credit Analysis

Capital
Conditions
Character
Collateral
Capacity
Capital

- Applicant’s equity or net worth.
- Owner’s personal investment in company.
- How much risk are you taking.
- Can provide a “Plan B” repayment source.
- Type of business – differences in needs.
Conditions

- Local economic climate.
- Other industries could affect your business.
- What is the purpose of the loan.
- Political influences/historical context.
- Competition.
Character

- Check on your company’s financial status.
- Personal credit history/creatures of habit.
- Experience.
- Responsible company leadership.
- Timeliness in fulfilling obligations.
Collateral

- “Plan C” Repayment Source.
- Anything of use for security of repayment.
- Personal Guarantees.
- Hard Assets, AR, Inventory, Goodwill.
- Loan to Value Ratios.
Collateral Discounts or LTV’s

- Are based upon perishability and/or liquidation value under duress.

- Allow “cushion” for potential fluctuations in value.

- Prior liens are subtracted after discounting to find net available value.
Collateral Discounts…

• Typical discounted values for businesses -
  ◦ Inventory—40-50% (type, obsolescence?).
  ◦ Equipment—50-75% (age, condition, market?).
  ◦ Real Estate—75%.
  ◦ Some inventory and equipment may have little or no value because of limited resale market.
Capacity

- Repayment ability.
- Ability to get repaid.
- Cash Flow!
- Innovation, education, knowledge, experience.
- Consideration of other liabilities.
Common Sense
How to figure Debt Service Coverage …

Part 1—Calculating funds available to service debt

Net Income from Sch. C or Form 1120/1065

- Net Income from Sch. C or Form 1120/1065
- + Depreciation.
- + Interest.
- - Family Living Allowance if not in labor expense.
- - Allowance for income taxes (actual or 30%).
- - Allowance for normal capital expenditures.

= $$$$ AVAILABLE TO SERVICE DEBT.
How to figure Debt Service Coverage …

Part 2 - Calculating DSCR

Divide $$$$ AVAILABLE TO SERVICE DEBT (from Part 1) by Total Principal and Interest payments for 1 year, including any new proposed debt.

Resulting number needs to be greater than 1.0, preferably 1.25x or higher.

Ratio <1.0 means insufficient cash is available to pay debt obligations.
Other things to know about Debt Service Coverage …

- Also looked at on a “Global” basis - including personal debt and other significant businesses owned by client.

- Typically only 50% of outside (non-business) income is considered as “available” to cover non-business debt (if earner is on the loan).
DSCR....

• Usually calculated as a 3-year historical average.

• Major changes in operations—may use projections.
Your Credit Report From a Lender’s Perspective

- Hard inquiries.
- Available balances on open accounts.
- Payment history.
- “Maxed Out” credit lines.
- Debt to income.
Consumer Credit vs. Commercial Credit

• Consumer
  • Credit history.
  • Employment history/ earnings potential.
  • Stability (residency, personal reserves etc).
Consumer Credit vs. Commercial Credit

- Commercial Credit
  - Commercial number years in business.
  - Type of business (retail, service, manufacturing etc).
  - Legal structure.
  - Location.
  - Seasonal vs. non-seasonal.
  - Area market, industry in general.
  - Management strength.
Preparing a Loan Package

• Being Prepared:
  • Portrays positive image.
  • Greatly increases chances of securing capital.
  • Improves response time.
Things that make your lender happy …

• A down payment!
  ◦ 20-25% is standard for most projects.
  ◦ More may be required for riskier ventures, such as restaurants and recreational enterprises (35%).
  ◦ At minimum, 10% actual cash is required as part of the typical 20-35% down payment for SBA loans—usually cannot be borrowed money.
• Additional down payment required may be made up with equity in other assets; long-term loans will require real estate equity.

• Seller financing does not count towards the SBA’s 10% cash down requirement.

• Be prepared to put up your house!

• Collateral discounting previously discussed applies!

• Credit worthiness and relationship with borrower may impact requirement.
• Good credit scores (>720).
• Debt Service Coverage Ratio >1.25x.
• Profit on the tax return!
• Working Capital Ratio >1.25x.
  ◦ Current Assets divided by Current Liabilities including current portion of long term debt.
• Abundant collateral.
• Equity (Assets – Liabilities) > Liabilities.
• Adequate insurance to mitigate risks—property, life, health, disability, business continuation?
• Estate and succession plans clearly thought out and in writing.
• Business agreements with partners in writing.
Questions to Ask Yourself

- What is the specific purpose?
- What amount do I need--not how much can I borrow?
- What collateral is available?
- How much cash can I put in the deal?
- Terms: What rate? How long? What is the estimated payment?
- Can I repay the loan?
Other tidbits …

- Lenders can only base lending decisions information you report to the IRS.

- Clients must balance the desire to pay minimal taxes against the need to obtain current and future financing, including a cushion for growth.
• For a spouse’s outside income to be considered in debt service calculations, spouse must usually be a co-borrower or guarantor.

• Poor personal credit history of the spouse can hamper the business’s ability to get credit or increase rates.
• If you have to be late on something, don’t let it be a payment to the bank or something that’s reported to the credit bureau.

• Bankruptcy is at least a 7-year problem.

• Late payment of taxes, particularly payroll taxes, is a MAJOR problem.
Do Your Homework

- All lenders are not the same
- Research various lenders, ask questions.
- Establish a relationship with your lender
- Different loan programs
  - Ohio Grow Now Program
  - SBA Small Business Administration
  - Gap Financers
Loan Package Check List

___ Business Plan
___ Market Research (where applicable)
___ Resume of Owner(s) and Key Management
___ Sources (bank loan, owner’s cash equity, etc.) / Uses (building, inventory, working capital, equipment, etc.) of Funds include Annual Debt Payment of any Loans
___ Copy of Partnership Agreement, Articles of Incorporation, Articles of Organization
Loan Package Check List

(continued)

___ Copies of Licenses, Permits, Trademarks, etc.

___ List of collateral (with serial numbers where applicable), age, cost, current market value

___ Personal Financial Statements for Anyone with 20% or more Interest in the Business

___ Personal Federal Tax Returns for the Previous Three (3) Years for Anyone with 20% or more Interest in the Business
Loan Package Check List

(continued)

___ Name, Address, Telephone Number of Business Attorney, Accountant, Insurance Agent, Business Consultant

___ Twelve (12) to Twenty-Four (24) Month Cash Flow Projection with Line Item Description

___ Three (3) years of Projected Annual Profit and Loss Statements

___ A Beginning Balance Sheet for Start-Ups or a Projected One (1) Year Balance Sheet for an Existing Business

___ Written Quotes on any equipment Purchases / Leases and / or Construction Costs
Loan Package Check List
(continued)

___ Copies of any Real Estate/ Other—Purchase/ Lease Agreements

___ Legal Description of Real Estate that is a part of the Business or to be used as Collateral

___ Recent Property Appraisals or Business Valuations

___ EPA Related Documents

___ Letters of Intent from Prospective Customers
Existing Businesses Should include the following:

- Profit & Loss Statements and Balance Sheets for up to the Previous Three (3) Years
- Interim (within the past 90 days) Profit & Loss Statement and Balance Sheet
- Company’s Tax Returns for up to the Previous Three (3) Years
- Aging of Accounts Payable/Receivable
- Contracts with Customers
- List of Customers and Percent of Business each account for
- Favorable Letters from Commercial Customers
Questions?