Session Objectives

- Understand the CFO’s role in bank relationships
- Know the information every CFO should provide their bank
- Learn options for alternate financing
**Significant Changes**

- Liquidity Crisis caused changes:
  - Higher bank capital requirements
  - Decreased asset valuations
  - Real estate now bank’s last collateral choice
  - Real estate amortizations back to “normal” 15 years
  - Interest mark-up on LIBOR or prime higher

**Issues**

- Who are the important players?
- How do we get money?
  - Nurturing relationship
  - Debt capacity
- Loan covenants
- Investing excess cash
The Players

- Lending decisions influenced by many people at the bank:
  - Loan Officer
  - Credit Officer
  - Credit Analyst
  - Loan Group Head
  - Branch Manager

Nurturing Bank Relationships

- Want safe place to invest money.
- CFO’s role is to tell the company’s story to the bank.
  - Narrate strategy
  - Educate about operations
  - Interpret financial statements
  - Provide credible projections
Bank Meetings

- Quarterly with main bank
- Periodically with other banks
- Involve multiple people from both sides to provide relationship depth
- At minimum, interpret recent F/S
- Prevent surprises

Provide Bank

- Business Plan
- Sales brochures
- Projections
- Backlog reports
- Financials
- Discussion of results
- Major customer list
- Org. chart
- Values statement
- Code of conduct
- Internal control reports
- Appraisals
- AR & AP aging
- Inventory reports
Bank Financing

- Understanding how banks work is vital to negotiating with them.
- Lend dollars to make pennies.
- Lend based on an evaluation of the worst-case scenario.
- Short term financing matched with S.T. assets, long-term financing with L.T. assets.

The 4 (or 5 or 6) C’s of Credit

- Character
- Capacity
- Cash Flow
- Conditions
- Collateral
- Competition
Working Capital Loans

- Receivables: 70-80% of “good”
- Inventory: 50% of “good” FG, raw materials
- “Under formula” if …
  - It is losing money
  - It has uneven profitability
  - In an industry that “plays games” with financial statements
  - Inventory is high percentage of working capital loan collateral

Term Loans - Equipment

- Equipment preferred:
  - Easy to sell
  - Long life
- Valuation:
  - New equipment: 70-80%
  - Used equipment:
    - 70% of forced sale value (50% of used FV)
    - Appraisal required
Term Loans (cont’d)

- Rate - fixed or variable:
  - Often a 1 1/2% spread
  - Fixed rate: fixed payment
  - Variable rate: fixed principal
- Term - 3-7 years

Commercial Mortgages

- Similar to residential mortgages.
- 70-80% advance rate.
- Frequently 5 year term/15 yr. amortization.
  - Significant closing costs make term an important negotiating point.
- Environment survey usually req’d.
Debt Capacity Summary

- 70-80% of “good” accounts receivable
- 50% of “good” Inventory
- 70-80% of new equipment
- 50% of used equipment
- 70-80% of real estate

Case – Presenting Condition

- How do conservative fixed asset accounting estimates effect perceived debt capacity?
- Is conservative depreciation a good idea?
- How would you communicate asset value?
- Do you expect to change your fixed asset accounting in the future.
Workout Groups

- Violate covenants and you may meet them
- Handle bank’s “problem” loans
- They want:
  - Strong owner guarantees
  - 13 week cash flow projections
  - Frequent collateral reporting
  - Strong communication

Loan Covenants

- Performance against financial ratios.
- Bank consent required for certain transactions:
  - Sell assets
  - Buy assets
  - Pay dividends or shareholder loans
- Owner Guarantee.
Covenant Calculations

- Financial ratios used in covenant calculations may be unconventional:
  - Particularly debt/equity ratio
  - Subordinated debt often treated as equity
- See example on Exhibit 2.1

Owner Guarantees

- Reducing or eliminating guarantees will make you a hero.
- Fewer covenants are better:
  - Divide or limit guarantees.
  - Ask **when** guarantee may be eliminated.
10 Bank Negotiation Tips

1. Meet with multiple banks
2. Quarterly meetings
3. Limit covenants
4. Address personal guarantees
5. Calc. debt capacity
6. Identify hidden equity
7. Provide projections
8. Provide backlog report
9. Get account analysis
10. Implement Z.B.A.

Investing Excess Cash

- Big portfolios – beyond scope of class
- Moderate to small amounts:
  - “Sweep” account
  - Government bonds
  - Corporate bonds
Non-Bank Financing?

- When to look for non-bank financing:
  - Borrowing is approaching debt capacity
  - Company is in a start-up mode and has insufficient assets to finance
  - Company has negative cash flow

Alternate Financing?

- Asset-based lenders
- Venture capitalists (VCs)
- Angel investors
- Economic development corporations (EDCs)
- Small Business Administration (SBA)
Conclusion

- Tell the company’s story
- Know you business
- What is real economic substance?
- This is the fun stuff!

Who Was That?

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