

LESSONS FOR A NEW ECONOMY How To Work With The Bank

Access to credit is perhaps the biggest challenge facing manufacturers and distributors today. Left in a weakened state by the recession, many have little left to attract lenders.

Their inventories are reduced and they have foregone capital expenditures, using that cash to fund operating losses and debt service. “You’ve got to have money to make money,” the old saying goes, but finding it is more difficult than ever.

Yet somewhere out there, banks are lending. Certainly, they are being more cautious than ever, but most banks do have money to lend. So yes, there is money to be had by manufacturers and distributors who position themselves correctly.

What’s the secret to unlocking the vault? As a potential borrower, it is important to understand what bankers are looking for when making lending decisions.

BE REALISTIC

Consider typical lines of credit. Most are based on the idea that current assets will be converted to cash within the next 12 months, and that cash will be available for debt service. Realistically, a fair amount of that cash is reinvested in new receivables and inventory. So with most lines of credit, what borrowers perceive as a “short-term” loan is actually a permanently revolving investment in current assets.

As long as the lender is willing to renew the line of credit every time it matures, this works fine. But more often than not, that is not happening in today’s market.

Lesson: *Be realistic about your financing needs and be prepared to offer a cogent repayment plan. You may be asked to take your line of credit to zero periodically, and that will require ready cash.*

TELL THE WHOLE STORY

Banks are lenders, not investors. At some point, they expect to be paid back. Only cash repays loans, so banks are very interested in how a business generates and uses its cash.

Borrowers often believe that the highest and best use of cash is as working capital to grow the business. Lenders, burned by business owners who grew their businesses and their lavish lifestyles, are now focused on understanding the borrower’s total financial picture, often referred to as global cash flow.

This means the bank wants not only financial statements and tax returns for the business, but comprehensive financial information for all the entities the borrower is involved in. This includes personal financial statements and tax returns, especially for borrowers organized as S corporations and LLCs.

Lesson: *Be prepared to verify and validate income from all ownership interests. Show that you are willing to endure a little pain and sacrifice by adjusting your personal lifestyle. Reduce lender frustration by having current financial information available and be prepared to present financial data even if you have not filed your tax return or are on extension.*

SHOW A RECOVERY PLAN

Today's loan will be paid with tomorrow's cash flow, so lenders are interested in the company's future. For manufacturing and distribution companies, lenders want to see a realistic recovery plan, with solid projections and their underlying assumptions. They want to know that you have a viable core business and a value proposition that distinguishes you from your competitors.

Let them know how you will cover any losses you're incurring now. What changes are you making in management or other areas to position the company for success? How are you planning to support the company's need for new equipment and other major capital investments?

Lesson: *Be ready to show why and how your sales and receivables will grow and how you plan to finance the growth. Prepare to demonstrate an ongoing ability to keep debt service current and to reduce future financing needs by managing inventory, receivables and fixed costs.*

Before approaching lenders, work with your financial advisors to prepare the documentation you'll need for fruitful discussions with bankers.

Having a sound value proposition, realistic financing expectations and a workable recovery plan may convince them that you are worthy of their attention — and their financing.

Manufacturing/Distribution Advisor is produced quarterly by Bober Markey Fedorovich's Manufacturing/Distribution Services Team. If you would like additional information about the services we provide, please call or email our team leader Cindy S. Johnson, CPA, CIT at (330) 762-9785 or cjohnson@bobermarkey.com.

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