Staying in the money

How to position your company for financing **Interviewed by Meredyth McKenzie**

The current economy has brought many changes to business, particularly regarding financing. The multiples of cash flow that most banks are lending has decreased significantly, anywhere from one to 1.5 multiples, and many banks have stopped cash flow lending. Banks are also more cautious when lending to businesses.

"What were the standards 12 months ago are no longer in place because so many banks are looking to deleverage," says Barry Worth, CPA/ABV, CVA, CM&AA, member and head of mergers and acquisitions and turnaround consulting at Brown Smith Wallace LLC. "Bank lending policies have changed significantly to where they will lend much less money at today's levels than they did 12 and 15 months ago."

Smart Business spoke with Worth about how different areas of financial analysis and structuring can help you improve your financial position.

Barry Worth, CPA/ABV, CVA, CM&AA
Member, head of mergers and acquisitions and turnaround consulting
Brown Smith Wallace LLC

What financial analysis and structuring measures should be used during these times?

In all types of transactions, a debt and capital structure evaluation, along with a working capital review, are key to structuring debt and equity. These analyses require planning and forecasting on the front end. Working capital is one of the major lifelines of the business — it's operating capital. You can't get through a 12-month period or a growth period without having adequate working capital.

So, you should definitely conduct a study of the working capital needs of the business. You should look at planned inventory returns, how long the receivable collection period is, and what the normal payment period would be for accounts payable. These all have a bearing on cash flow, which affects how much working capital is required on a periodic basis.

How can businesses plan and forecast in these areas?

You really need estimates of revenues and expenses, looking out over a three- to five-year period, to prepare budgets. People who have a good handle on their business generally have a feel for what their growth percentages will be and how they're going to achieve those. What they can never fully know are what the market conditions will be.

For instance, some businesses go through cycles. But, whatever the situation, the important thing is that a company prepares forecasts. They need to roll those forecasts forward based upon current conditions as they change, so they're prepared to either recapitalize the business — put in additional equity — or determine that they're going to have greater borrowing needs — increase the debt. If either of these options aren't available to you because banks believe you're over leveraged, you can pursue either additional investors or mezzanine lenders, which provide funds that are always subordinated to senior debt.

Can you still effect a merger or acquisition?

Sure. A number of companies with strong balance sheets are looking to acquire strategic assets. Whether you are seeking acquisitions or considering selling, a strong financial position will help you.

From a financial perspective, most deals will be successful or unsuccessful based upon the structuring of the debt and equity. There's always a balance you have to strike. Banks will lend primarily based upon collateral, so some deals may not go through because the banks have cut back on how much they will lend on a transaction.

Look at how you're going to structure the total needs of the business, between how much debt you're going to be able to get from the banks and how much equity you can raise, either from yourself or yourself plus investors. If there is a gap, you can go to the mezzanine players, where the funds can be interest bearing and/or interest bearing plus some convertible securities.

What options does a troubled company have?

Troubled companies have had significant losses, and banks demand a lot more from them, including 'find another bank.' A lot of companies that are hurting now are going to have to get capital infusions of additional equity. There's always reluctance on the part of the company owner or owners to take in additional investors because it cuts down on their percentage of ownership. But, in most of these cases, the owners won't have a choice, it's a matter of survival. Generally, the debt restructuring or refinancing will require additional equity. These owners will have to show some improvement or a plan on how they're going to improve the business before they can get additional capital or refinancing. We'll be seeing a lot of these transactions in the next couple of years.

What are the benefits of a financial analysis and structuring initiative?

The critical value comes from understanding your business and establishing strategic positions and directions that you might not necessarily have thought of if you didn't plan. The practical value is that you'll be better able to convince a banker or investor to provide you with the funds to achieve your plan. <<

BARRY WORTH, CPA/ABV, CVA, CM&AA, is a member and head of mergers and acquisitions and turnaround consulting at Brown Smith Wallace LLC. Reach him at (314) 983-1202 or bworth@bswllc.com.