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INVESTMENT BANKERS

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Tending to Your Lender

Mitigating your lender's fears may be the key to retaining a critical relationship.

by William S. Hanneman

Cash is the lifeblood of a business and relationships with capital suppliers must not be interrupted. Unlike previous downturns, businesses have fewer lenders to choose from, and those remaining are suffering from a crisis-of-confidence. The future success of your business may be predicated on your ability to mitigate your lender's fears.

Given the preoccupation of banks with their own problems and a reduction in alternative lender choices, it is essential for business owners and managers to view the situation from their capital supplier's viewpoint, and work within this more-constrained framework. Due care is always advised in the handling of a credit relationship, but the situation is different now. The margin for error is less. Don't take this critical supply line for granted.

UNDERSTAND YOUR LENDER'S FRAME OF REFERENCE

While it is arguably true that lenders have contributed to, and perpetuated, the current economic crisis, don't expect any consequent obligation to provide funding to your company. Everyone is in survival mode. The capital received from the U.S. Treasury and the Federal Reserve will not readily trickle down to borrowers. Lenders seem intent on using these funds to soften further loan-loss erosion in their capital bases. Capital is very dear to lenders, so asset additions must be bullet-proof and very profitable.

The practical implications to borrowers are that it will take longer for lenders to evaluate potential extensions of credit, the amount and term of credit will be more tightly limited, covenants will be more restrictive, reporting will be onerous, and money will come at a higher price. That's just the way it is.

The fallout of having extended credit aggressively in advance of the current economic decline has left lenders embattled. In this environment, internal auditors and external regulators require extensive reporting on substandard loans. Everyone is subject to second-guessing. As credit problems have mushroomed, lenders are suffering from a crisis of confidence. It's simply human nature.

Borrowers must recognize that extensions of credit are built upon confidence, which is derived from both a favorable economic outlook and comfort with the borrower's handling of the relationship. Planning, communications, and management of expectations are critical to the successful retention of lender confidence.

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PLAN CONSERVATIVELY

Optimism is the hallmark of entrepreneurs. But when fear rules, lenders are more leery than ever of "blue sky" strategies and projections. In lieu of unbridled confidence, lenders find assurance in plans that address the following principles:

- All factors under management's control have been considered to rationalize the business;
- There is a well-articulated request to the lender that improves its situation (as well as your business) and does not require it to shoulder all of the risk; and
- The numbers justify the proposed action and confirm the story.

Business or turnaround plans must be conservative, meaning there is a clear bias toward exceeding rather than underperforming. In times such as this, the key assumption for success cannot be a "return to normal conditions." A well-conceived plan is but step one. Lenders must also understand what steps can be taken if the plan goes awry. Contingency plans are necessary.

CONSIDER WAYS TO IMPROVE THE BUSINESS

Regardless of what is expected by lenders, it is time to put all sacred cows out to pasture. Change is imperative and should begin with a careful examination of how and where your business makes money. Nearly every business is, in some manner, unknowingly impacted by the 80/20 rule. So, the challenge is to take a detailed look at the individual earnings contributions of customers, products, markets, and facilities, relative to the investment of capital for each. Moreover, this effort should look beyond the confines of the existing business to consider the economic and competitive benefits of external alternatives, such as consolidation or joint ventures. All alternatives that strengthen the company's competitive position should be evaluated.

AVOID SURPRISES

Regardless of the reason, surprises play to fears that the borrower is unknowledgeable or may be hiding the ball. In either case, management loses credibility. Once lost, credibility is difficult to restore and access to funding is jeopardized. It is more critical than ever that your lender is up-to-date on all aspects of your business and financial situation. Revise projections and plans as conditions change. As problems crop up, surface them promptly with your lender, together with a rational solution that is cognizant of the bank's parameters.

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GET HELP, CONSIDER AN ADVISOR

The reality of today's highly selective credit markets is that a well-reasoned and well-articulated plan that will pass muster in your

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lender's organization is a prerequisite to success. Capital cannot be arranged on an ad hoc basis. Convincing a bank to work with you, and the response you get, will be meaningfully influenced by how and what is asked for, as well as the strength and clarity of the business case supporting the request. With all that is at stake, consider using an advisor that has both experience in these matters and current market knowledge to assist in preparing and communicating your plan and negotiating the terms.

Treat your credit relationships with the importance they deserve. Promise only what can be delivered and gain your lender's confidence by demonstrating that you are on top of your business environment and acting prudently and promptly. Your lenders are critical partners and should be treated as such. But, they cannot be relied upon to plug all holes. Business owners and managers need to be resourceful and develop back up capital solutions to ensure that the business will emerge stronger and ready to create the next increment of shareholder value. ❖

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1200 Fifth Avenue, Suite 1500
Seattle, Washington 98101

www.ZacharyScott.com

ABOUT ZACHARY SCOTT

Zachary Scott is an investment banking and financial advisory firm founded in 1991 to serve the needs of privately held, middle-market companies. The firm offers a unique combination of in-depth knowledge of the capital markets and industry competitive dynamics, sophisticated analytical capabilities, and proven expertise in structuring and negotiating complex transactions. For more information on Zachary Scott, please go to ZacharyScott.com.

Mark D. Working
206.224.7382
mworking@zacharyscott.com

William S. Hanneman
206.224.7381
bhanneman@zacharyscott.com

Frank S. Buhler
206.224.7383
fbuhler@zacharyscott.com

Michael T. Newsome
206.224.7387
mnewsome@zacharyscott.com

Ray D. Rezab
206.224.7386
rrezab@zacharyscott.com

Doug Cooper
206.224.7388
dcooper@zacharyscott.com

Jay Schembs
206.838.5524
jschembs@zacharyscott.com

Brian J. Kremen
206.838.5526
bkremen@zacharyscott.com