How the heck do we get financing these days?

Think outside the bank.

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If you had any doubt about the critical role banks play in today's economy, you need look no further than the federal government's willingness to dump trillions of dollars into the U.S. banking system. We've all come to learn that the current crisis was brought forth by "irrational exuberance" that resulted in unrealistic prices and associated debt levels within the financial, commercial and consumer segments of our economy. And when combined with the lack of regulatory oversight by both government and the rating agencies, the overblown bubble burst in a big way. Looking back to when the financial crisis first hit late in the summer of 2007, financial institutions and banks in particular became paralyzed, bringing financing activity to a screeching halt. Even with the extraordinary actions taken by the new administration this year, progress to date has been modest. But the question remains: why?

For starters, while the Federal government has come forth with billions in bank aid it is somewhat unrealistic to expect those institutions receiving the hand-out to immediately start lending again for one simple reason: these funds are needed to replace the real losses already incurred by banks and to cover future losses that bank management knows to expect. (As a commercial banker for the past 4 years I have experienced firsthand how banks make loans or choose not to). Instead of making funds more available to American business people, the government's money is allowing banks to maintain minimum capital levels, a fact the government and the banks know, but isn't getting much notice in the press.

Further muddying the waters, while "mark to market" accounting rules have been blamed for exacerbating the financial crisis by further decreasing banks' capital positions, they do not represent the root cause of the problem. As economic activity declined precipitously in the fourth quarter of 2008, the creditworthiness of many borrowers slid along with it, giving bankers an additional reason to curb lending.

THINKING OUTSIDE THE BANK

Given our current overall circumstance, commercial banks, more than other companies attempting to survive in these unprecedented times, have been limited as to what they can actually do. While banks may want to lend, and in fact are doing some lending, the focus of each individual bank has narrowed to support a sustainable comfort level within its core area of geographic or industry-specific competence.

By thinking outside the bank, therefore, companies would do well to contact an investment banker or financial consultant who specializes in the placement of loans and lines of credit. These organizations are designed to 1) analyze a borrower's creditworthiness, 2) understand the types of financing feasible in today's restrictive marketplace, 3) know which type of institution would lend to such a company, and 4) which specific bank or non bank lender would represent an appropriate match for the borrower.

In order to properly understand a company's creditworthiness, a capital source advisor will analyze the balance sheet in terms of the tangible assets, liabilities and current level of debt relative to the company's stockholder's equity, statements of income and cash flow in order to determine its present and future ability to generate enough cash to support the ongoing activities of the business. Further analysis will yield considered judgment about the company's ability to add additional debt onto its capacity to pay interest and principal on both existing and future indebtedness. Companies that have outstanding payments-in-kind (PIK) debt may be saddled with deferred obligations for which there is no current cash outlay, but rather is added to the obligation and due in the future when the debt matures and must finally be paid. The general ignoring of deferred obligations has been one further cause of the financial crisis and is yet another reason why lenders who have money to lend have been unwilling to do so for such borrowers.

FINDING THE RIGHT LENDER

Bank and non-bank lenders that have money to lend these days tend to be relationship oriented and more sensitive to a borrower's potential future problems. While there are numerous companies that are very creditworthy, have positive earnings before interest, taxes, depreciation and amortization (EBITDA) and free cash flow (after capital expenditures and debt service) and deserve to be financed, a company's projected future results are going to based on conservative assumptions as well as a conservative outlook for the economic environment in which the company operates.

Knowing what is feasible in today's market, therefore, is critical and this means that companies must come face-to-face with today's financing realities by accepting what independent advisors say is necessary to get the funding that will properly support the business. Nowhere is this more evident than in the treatment of interest expense. Many companies don't appreciate the fact that the Federal government's infusion of money and the Federal Reserve's pushing down of interest rates have created artificially low rates. Offsetting this, however, lenders have increased their spreads (the difference between a base rate and an offering rate) dramatically. Further, many lenders have established "floors" or minimum price levels for their borrowers. In practical terms, however, with the Prime Rate and LIBOR at record lows - despite higher spreads and floors - creditworthy borrowers are able to obtain financing at historically attractive interest rates.

CONCLUSION

Companies looking to tap a commercial lending source will do well to consult with an investment banker or financial advisor who knows the market, can properly assess your situation and perhaps most importantly, represent your best interests to a financial institution. Your advisor, having done his or her homework will be able to recommend financial institutions that want to lend to your company. Your likelihood for success is further strengthened when you take advantage of your advisor's credibility with your prospective lender.

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