Small Business Finance

Just the facts ma’am…

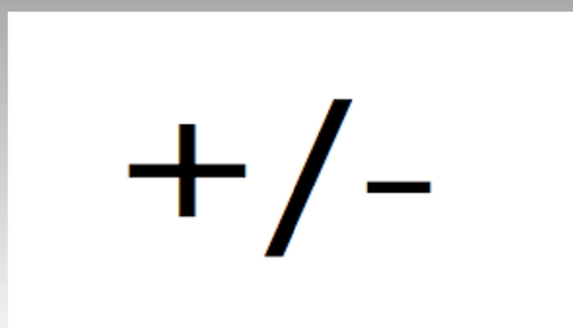
Two basic types of financing

- Equity = selling ownership of company
- Debt = taking a loan for the company

Equity Pros/Cons

- No interest payments – profit sharing in the future
- No liability if business fails
- No payments until profit

- Giving up portion of ownership rights



Debt Pros/Cons

- No loss of ownership rights
- Tax deductible
- Predictable payments

- Interest Payments
- Underwriting requirements/Liability for losses
- Reduction in cash flows to expand

Places to look first…

- Personal Savings
- Friends & Family
- Crowdfunding/lending
- Home/Auto Equity
- Credit Cards
- Rollovers as Business Startups

More places to look

- Economic Development Programs
- Corporate Programs
- Grants
- Angel Investors/Venture Capital
- Banks & Credit Unions

Business *is* Personal…

- 71% of Business Filings are Sole Proprietorships… The owners *are* the business.
- Clean up personal Finances!
- Clean up personal Credit!
- Put together some cash…

You’ve decided to take out a loan…

- Shop around for your lender.
  - Who do you know?
  - ASK QUESTIONS!
  - Open an account?
  - Declines are contagious…

  - Your loan officer wants an approval as much as you…

What lenders want (in a nutshell).

<u>The 6 Cs of Credit</u>

- Character
- Capacity
- Capital
- Collateral
- Conditions
- Controls

- Income to service payments/Investment of owner capital.

Creating a Loan Proposal

- Cover Letter
- Photos
- Executive Summary
- Borrower Information
- Collateral
- Marketing Plan
- Underwriting
- Recommendation

Cover Letter

- Relate request to initial conversations
- Highlight strengths
- Recommend loan approval
- 1-2 pages

*Equity financing should include exit strategy!

Photographs

- Pictures are worth 1000 words
- Show the lender who you are, what you want, etc.

Executive Summary

- Describe ownership structure/legal entity.
- Owners & Experience
  - Bios? Previous Successes? Years in industry…
- Highlight team strengths – why will you be successful?
- Sources and Uses of Funds

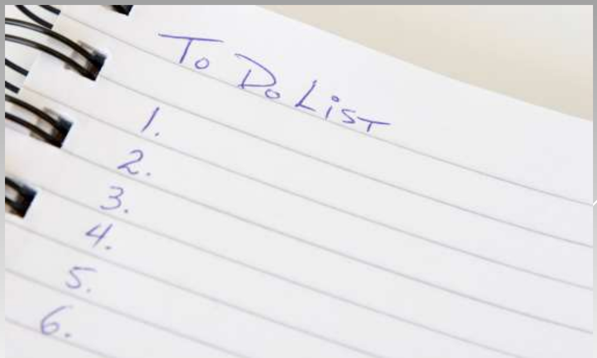
Sources and Uses of Funds

Sources of Funds		
Owner's Initial Contribution	$25,000	
Retained Earnings	$25,000	
Proposed loan/investment	$100,000	
Total funds available		$150,000
Uses of Funds		
Working Capital	$20,000	
Equipment	$30,000	
Purchase Property	$100,000	
Total uses of funds		$150,000

Don’t forget:

Production Equipment
Office Furniture
Legal/CPA fees
Insurance Premiums
License/Permit Fees
Lease/Utility Deposits
Remodeling Costs
Salaries
Shipping Costs
Office Supplies

Advertising Costs
Travel Costs
Vehicles
Office Equipment
Etc. etc. etc.



Borrower Information

- Pre/post loan balance sheets
- Income/Cash Statements
  SHOWING ENOUGH CASH TO SERVICE DEBT
- Phone/account numbers for verification
- Your accountant can help, but…
- Marketing plan guides projected earnings

Collateral

- Property? (Equipment, etc. can be sold at a discount).
  - Appraisals?
- Highlight marketability of collateral
  - Lenders aren’t in business to sell your stuff…
- Other strengths should be shown if collateral is weak.

Marketing Plan

- Lenders/investors want to be paid.
- Earnings is how they get paid.
- Marketing & sales are how *you* get paid.
- Market research should guide financial projections.

Underwriting

- What are lender requirements?
  - Cash to service their loan.
  - Down payments/investment of owner capital.
- Create key ratios from financial data.
- Compare to underwriter/industry standards.
- Notate analysis to overcome weaknesses.

What if things don’t add up?

- Review assumptions & look for errors.
- Create more aggressive assumptions.
- Look for different underwriting standards.
- Change the deal so you meet the standards.
- Delay your request until revenues increase.

Recommendation

- Ask for what you want!
- Recommend loan committee approval.

- Review how much, when, what rate, etc.

That's 22 billion…

Bored?

Let’s take a break…

The Balance Sheet

- Assets = Liabilities + Owner's Equity
- A snapshot of your business at a certain time.

The Income Statement

- Revenue – Cost of Sales – Expenses = Net Income

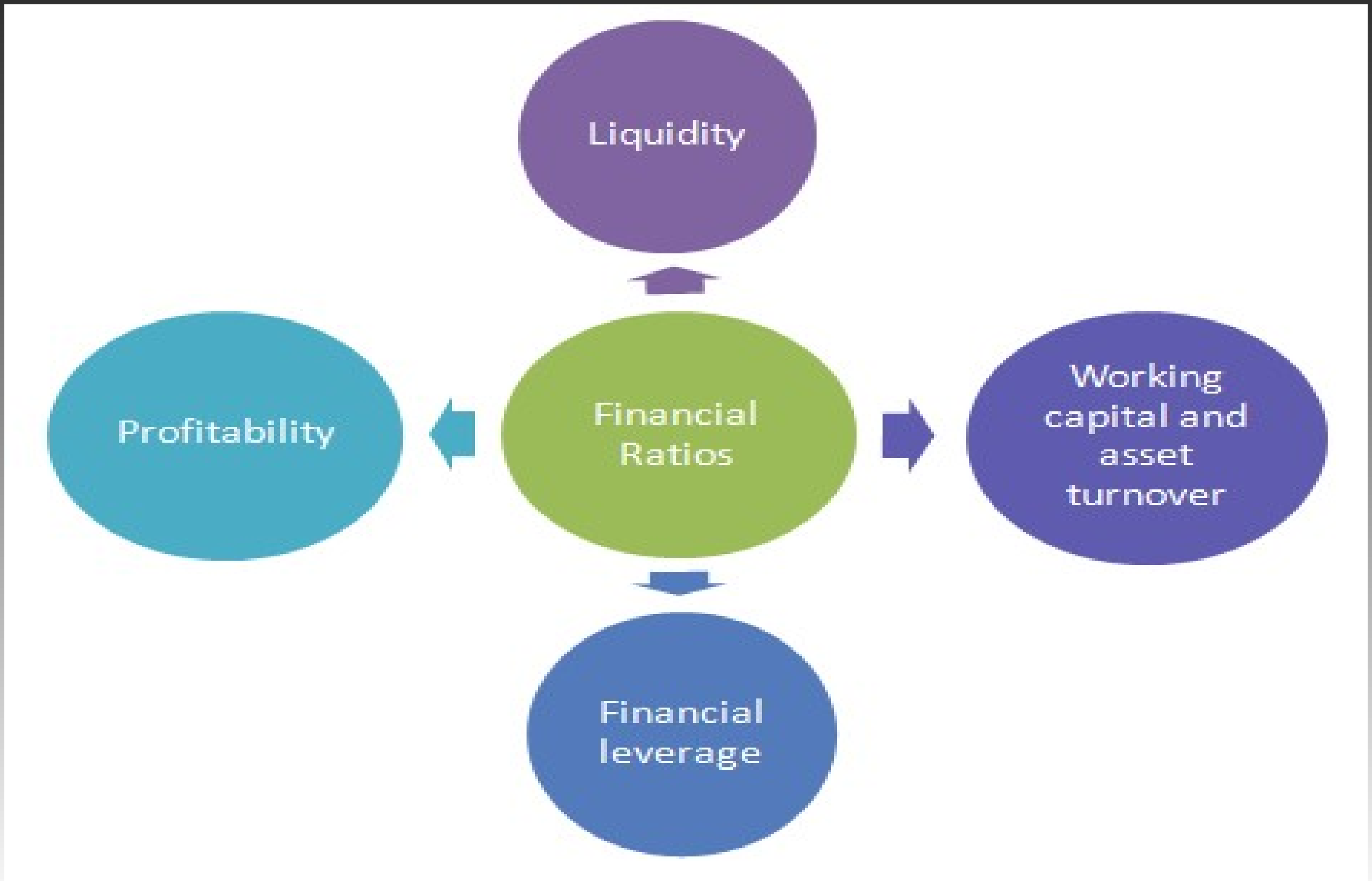
- Revenue = sales
- Cost of Sales = production costs
- Expenses = costs of doing business
- Net income = earnings after costs.

- Roadmap to earnings and reconciliation of costs.

The cash-flow statement

- Operating Cash Flow
- Investing Cash Flow
- Financing Cash Flow
- Detailed map of cash flowing in/out of business.

Analyzing Business Performance



- Financial Statements hold all the information.
- Key ratios are key…

Liquidity

- Net Working Capital = Current Assets – Current Liabilities

  20xy: NWC = 1560 – 1203 = 357

  20xx: NWC = 1260 – 919 = 341

- Quick Ratio = Cash & Mktb Securities / Current Liabilities

  20xy: (250+160) / 1203 = 0.34

  20xx: (190+150) / 919 = 0.37

- Current Ratio = Current assets/Current Liabilities

  20xy: 1560 / 1203 = 1.30

  20xx: 1540 / 919 = 1.37

Working Capital & Asset Turnover

- Inventory turnover = COS / Inventory

  20xy: 1700 / 450 = 3.78

  20xx: 1350 / 370 = 3.65

- Average collection period = AR / (annual sales / 360)

  20xy: 700 / (5070 / 360) = 49.7 days

  20xx: 550 / (4120 / 360) = 48.8 days

- Average Payment period = AP / (annual purchases / 360)

  20xy: 560 / [(.6 x 1700) / 360] = 197.7 days

  20xx: 540 / [(.6 x 1350) / 360] = 240 days

  *Assuming ASI purchases are 60% of COS

Working Capital & Asset Turnover

- Fixed Asset Turnover = sales / net fixed assets

  20xy: 5070 / 1740 = 2.91 20xx: 4120 / 1540 = 2.67

- Total Asset Turnover = sales / total assets

  20xy: 5070 / 3300 = 1.54 20xx: 4120 / 2800 = 1.47

Capital Structure (Leverage)

- Debt Ratio = total liabilities / total assets

  20xy: 1553 / 3300 = 47.1% 20xx: 1269 / 2800 = 45.3%

- Debt-equity ratio = long-term debt / Owner's Equity

  20xy: 350 / 1747 = 20.0% 20xx: 350 / 1531 = 22.9%

- Times interest earned = EBIT / interest

  20xy: 400 / 46 = 8.7 20xx: 60 / 35 = 1.71

Profitability

- Gross Profit Margin = (sales – COS) / sales

  20xy: (5070 – 1700) / 5070 = 66.5%   20xx: (4120 – 1350) / 4120 = 67.2%

- Net profit margin = net profits (AT) / sales

  20xy: 248 / 5070 = 4.9%   20xx: 17 / 4120 = 0.4%

- Return on Assets = net profits (AT) / total assets

  20xy: 248 / 3300 = 7.5%   20xx: 17 / 2800 = 0.6%

- Return on Equity = net profits (AT) / Owner's Equity

  20xy: 248 / 1747 = 14.2%   20xx: 17 / 1531 = 1.1%

But what does all this mean?

- Time series and cross-sectional analysis helps
- Should be compared to industry standards

- Is ASI getting a loan?

Takeaways…

- Equity vs Debt Financing.
- Places to look for $.
- Get personal affairs in order.
- Bob Hope & The 6 Cs of Credit.
- Elements of a loan proposal.
- Balance/Income/Cash Statements.
- Key Ratios and Performance Analysis.