

The Advisor – Winter 2007

Re-Negotiating Your Existing Credit Facility

In our last Newsletter, we discussed the pitfalls of refinancing one's business. This pertained primarily to situations where the business performance was lacking and the existing lender wished to terminate the current lending relationship.

But what about situations where a Company's performance is strong and it could qualify for any Schedule A or asset based credit facility?

As mentioned previously, changing lenders when there's no real need is an onerous task for a number of reasons. Namely:

1. The out-of-pocket costs involved are usually significant. They include set-up or commitment fees, due diligence fees and legal fees; and
2. The internal costs can also be material as well. They include time spent to:
 - a. Negotiate a new facility with the new lender;
 - b. Change all pre-authorized payments to the new bank accounts;
 - c. Inform all customers who pay via direct deposit to re-direct payments to the new bank accounts; and
 - d. Liaise and answer questions from the new lender and its consultants during the due diligence review.

The costs outlined in 1 and 2 can often be greater than the savings realized from making a change.

In addition, current lenders are aware of the costs involved to change so they know that even if their renewal is slightly more expensive, most companies would prefer to bite the bullet and stay rather than incur the short term costs and move.

And yet even if a move is made, switching to another lender may not necessarily result in lower prices over the long haul given Canada's unusual lending environment. With only a few Schedule A alternatives, the general consensus is that true competition amongst the major banks doesn't really exist. (And after seeing Schedule A Bank profits for 2006, one could argue that it's completely absent). Negotiating a better deal with the "devil you know" is therefore usually the best (and most cost effective) alternative. Assuming a company is happy with its existing lender's overall level of service, it is now a matter of determining that it is getting the best deal possible.

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Information is power. And when it comes to credit facility negotiations, it is the lenders who usually have the informational advantage. Obtaining the proper information as to what rates you should be charged is difficult at best. Asking business associates may help. The problem with this approach is that associates may be hesitant to provide full disclosure of their situation. In addition, it will most likely be comparing apples and oranges. Credit facility pricing is affected by a number of factors. These include (but are not limited to) the following:

1. Size of the loan;
2. Size of the company (revenues);
3. Industry the company operates in;
4. Head office location;
5. Quantity and types of customers doing business with the company;
6. Number of years in business; and
7. Historical profitability.

Finding an exact match is highly unlikely. And even if a match is found, what if their credit facility pricing isn't as good? Does this mean that your company's pricing couldn't be better?

An analysis done by someone who has experience in these types of negotiations will more than likely find areas of your credit facility that are over priced. This will be true even if quotes were received from other lenders. An expert in this area will have reviewed numerous term sheets from all of the major lending institutions in Canada and will know which areas are fairly priced or not. For example, having an operating line priced based on bankers acceptances rather than the bank's prime rate should always save you money. In addition, an area such as foreign exchange has traditionally been high margin business for banks and should be reviewed as well.

It doesn't take much in terms of savings to make a difference. Through proper negotiations, cost savings will become permanent rather than one-time. Assuming a 35% tax rate and a 5% after tax rate of return, if a company can save even \$10,000 annually in bank fees this will result in an increase in shareholder value of \$130,000!

After an expert review, it then becomes a matter of negotiating the appropriate (i.e. lower) prices with the current lender. Or should it be decided that a change is required, an RFP process can be commenced. In the latter case, your advisor can assist in the process and actually set target prices for potential lenders to meet should they wish to be successful. A novel concept in the area of financing one's business!

Lending institutions should welcome this kind of analysis. In the short term, their revenues will probably fall. But in the long run if their facilities are fairly priced and the service is acceptable, the risk of clients moving to another lender will be

significantly reduced. In fact, lenders that embrace this type of review will become known as “fair-priced” leaders in the industry and will attract business away from other lenders who are slower off the mark.

Aries Advisory Group Ltd. has significant experience in these types of negotiations. We can perform a detailed review of your credit facility, determine where your fees are fairly priced versus too high and negotiate the new facility on your behalf, either with your current lender or through a tender process.

If you are in the midst of a credit facility renewal or would like a no-obligation review, please contact us at info@ariesag.com to see how we can help.

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