The Advisor – Spring 2007

Special Loan Situations

In our Fall 2006 Newsletter, we touched on Special Loan situations with a company's lender. Below we describe this in more detail and provide some insight on what to expect in these circumstances.

This scenario usually occurs when a company's performance is sub-optimal and it is in violation of one or more of its financial covenants. Cash flow is usually very tight. The lender decides to move the loan from its regular Account Management Group to its Special Loans Group. The Special Loans Group will then do the following:

1. Assess the lender's security position (normally through a third party consultant and paid for by the company) in relation to the collateral pledged for the loan;
2. Determine if the lender's security position is deteriorating. If it is deteriorating rapidly, they will likely appoint a receiver and take control of the company in order to "stop the bleeding";
3. Review the company's reorganization plan and assess if it is realistic and achievable. This will include a review of the short term cash flow needs and forecasted net income or loss for the next one to six months; and
4. Based on all of the above, determine if they want to continue to lend to the company on a longer term basis.

In our experience, the answer to 4 is "No". Lenders are a very conservative lot and would rather not risk a further loss in the future. This is true even if their security position is strong. The old adage "the first loss is the best loss" usually applies here.

So what should a company do if its credit facility is placed in its lender's Special Loans Group?

Determine why the Company is in Special Loans in the First Place. Sometimes it may be due to factors beyond management control but it usually points to a flaw in the business model. Assess the cause of the problem and try to fix it.

Generate a Restructuring Plan. This is where company management sets out how it plans to fix the problems identified as part of its internal assessment. This may involve getting out of a low margin business and/or right-sizing overhead costs to a lower sales volume. This will also be a key document the lender will use to assess the viability of the company in the short and long term.

Generate a Short Term Cash Flow and Income Forecast. Although the lender's consultant will require this information as part of their assessment anyway, company management will need this as well. Cash is king in these situations and suppliers will be looking for answers as to why they're not being paid on time. Negotiating payment plans with suppliers and incorporating them into the cash flow is extremely important. This is also the time to focus on collecting receivables and selling off redundant or non-performing assets in order to maximize inflows and satisfy any negotiated payment plans.

Keep in Constant Communication with the Consultant and the Lender. It is important to provide the consultant accurate information on a timely basis. If the information provided is incomplete or delayed in getting to them, the lender will fear the worst and will question management's credibility and ability to turn things around.

Don't Wait to Look for Financing Alternatives. It will take three to six weeks before the lender will be able to make a decision on whether or not it will continue to finance the company. This includes the time spent by the company compiling all of the information for the consultant and the time required by the consultant to review the information and generate their report for the lender. Waiting six weeks to start looking for alternative financing would not be prudent. If the lender decides not to finance the company, it will usually want to get out of the loan as soon as possible. It will give the company a short period of time (three to four months) to find another lender via a negotiated forbearance agreement. And during the forbearance period, fees will increase. The lender will charge a forbearance fee, based on a percentage of the total operating line. It may also increase the monthly monitoring fee and the interest rate charged on the loan. In addition, the lender may require the consultant to assist in monitoring the loan while the company seeks alternative financing, all at the company's expense. It follows then that it is in the company's best interest to find an alternative lender as quickly as possible. The lender may also provide more flexibility in their lending requirements to the company if they know an alternative financing is imminent.

Get Some Help. An advisor who has experience in special loan situations can be an invaluable resource as a company works its way through the process. They will be able to assist management in generating the cash flow and restructuring plan and compiling all of the other information required by the consultant. They can act as the company's liaison with the consultant and the lender and will be able to anticipate their reaction as information is provided to them. They will also be able to find alternative lenders to the existing one. Through the knowledge gained by working with the company, they will know which lenders will provide a good fit and can assist in closing the new financing on an accelerated basis. This will shorten the process considerably.

Aries Advisory Group Ltd. has a great deal of experience in special loan situations and can provide assistance in all of the areas described above. Please contact us at info@ariesag.com to see how we can help you should this situation arise in your company.