Aries Advisory Group Ltd.

The Advisor – Summer 2007

The Process of Closing a Loan

In previous newsletters, we've discussed the challenges a company faces in obtaining new financing for its business. This newsletter describes the process of obtaining alternative financing once a decision is made to switch lenders (whether the decision was made by the company or the lender itself).

There are eight broad steps a company must go through in order to obtain a new lender:

1. Prepare an Information Package for Potential Lenders to Review

The Information Package should be catered to the company's particular situation but in general, all lenders will want to see historical and forward looking financial information, a business or restructuring plan, as well as details on the assets the company will be using as security for the loan i.e. accounts receivable, inventory, fixed asset appraisals etc. Information contained in this package is crucial in that it will determine whether or not a lender will be able to fit the loan into its lending criteria or "box". If it's outside of their box, it will be difficult to get a deal done.

2. Identify Potential Lenders to Replace the Existing One

This can be done at the same time as the Information Package is prepared. The key is to only identify lenders who will finance the company given its current financial situation. For example, it probably doesn't make sense to target a Schedule A Bank if the company is currently in special loans with another Schedule A Bank. For the most part, all Schedule A Banks' lending criteria are identical. So it follows that a company in special loans with a Schedule A Bank cannot meet ANY Schedule A Banks' lending criteria. A lot of time can be wasted in step 3 below if management does not identify relevant potential lenders in advance of contacting and/or meeting with them.

3. Send the Information Package to/and Meet with Potential Lenders

In most cases, it makes sense to send the Information Package to qualified lenders in advance of meeting them. This will eliminate any lenders that management believes are qualified but for whatever reason are not interested in lending to the company. Once a lender has reviewed the Information Package and is satisfied that the loan fits its lending criteria, it will want to meet senior management at the company's premises. This is a crucial meeting in that it will be a lender's first impression of management's commitment to the company and its ability to execute its business plan.

4. Obtain and Negotiate a Term Sheet from One or More Potential Lenders

If all has gone well thus far, the company will receive one or more term sheets or "offers to finance" from potential lenders. These letters will outline the terms and conditions under which a lender is prepared to finance a company. The letters are usually "non-binding" and are subject to the due diligence requirements of the lender. Most lenders attempt to provide a term sheet that they believe they can lend against based on the information provided up until this point in order to maintain a good reputation in the marketplace.

If the company is in the enviable position of having at least two term sheets, management may be able to negotiate better terms with multiple lenders depending on how "hungry" they are for the deal. However, the process could backfire if lenders believe they have no chance of obtaining the financing and are merely being used to obtain a better deal from the alternatives. In this instance, many will simply withdraw their term sheet leaving a company with little choice (or no) at the end of the day. Companies need to tread carefully and negotiate with all lenders in good faith to avoid this situation from occurring.

5. Decide on a Lender and Sign the Term Sheet

Once a choice is made and the terms and conditions are agreed upon, the term sheet should be signed by company management. If there are personal guarantees required as part of the loan, the guarantors will be required to sign the term sheet as well.

6. Fulfill the Requirements of the Lender Due Diligence

Of all the steps outlined, this is the most important. For companies who qualify for Schedule A Bank loans, the due diligence will be minimal because Schedule A Banks rely primarily on financial covenants to ensure the company is performing well and their security position is not deteriorating. But for cash flow and asset based lenders, the due diligence process will be more stringent. They will be relying on asset values and the company's ability to generate cash from these assets in order to advance funds. Asset based lenders will monitor a loan more closely than a Schedule A Bank once a loan is in place. They will normally require weekly rather than monthly reporting of asset values; hence their requirement to have strong reporting systems when they finance a company. This is something asset based lenders will assess during the due diligence process.

7. Finalize the Lending Agreement

Assuming the company meets the minimum due diligence requirements, finalization of the lending agreement will commence. A formal loan agreement will be drafted between the company and lender's lawyers. Any final points will be negotiated at this time. The lender's lawyers will also perform all of the required legal searches to ensure its security will be valid and enforceable once the loan is in place.

8. Close the Financing

Once the lending agreement is finalized, the closing and funding of the financing is the last step. It is usually performed at the offices of the lender's lawyer and involves the signing of all of the documents required to close the financing. This step should be a mere formality provided there were no significant issues in each of the previous seven steps.

As can be seen, there is a great deal involved in securing a new lender for an existing business. The purpose of the above is simply to provide an outline of what is necessary. There is far more required within each step in order to close a loan. If you have financing issues, contact Aries Advisory Group Ltd. to see how we can simplify the process for you. We have extensive experience in assisting companies throughout the new lender process and can add value in each of the required steps, saving your company valuable time, headache and money. Please contact us at info@ariesag.com or at (416) 467-7878 for a free consultation to see how we can help.