

Dealing with Loan Restructuring

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Workout Plans

Goals:

- Prepare a plan that both the debtor and the bank can agree on.
- Assist the company in making changes to improve its long-term viability and success.

How do we accomplish this?

- Understand the client's business and industry.
- Prepare forecasted financial statements with the client's help.
- Develop a workout plan and adjust the forecasts accordingly to test whether the plan will work or not.

Workout Plans – Getting Started

- Understand your client's business, including:
 - Assets, including those which the company can sell
 - Outstanding debt
 - Ownership structure
 - Profitability
 - Expenses
- Understand your client's industry, including how your client compares to its peers

Workout Plans - Forecasting

- Forecasted budget is typically made for the workout period, typically 12 months, and is displayed either monthly or quarterly
- A forecasted budget should include a forecasted:
 - Income statement
 - Balance sheet
 - Cash flow statement
 - Bank debt worksheet
 - Borrowing base
- Each of these forecasted statements is interrelated and must be included to accurately assess the proposed workout plan. These relationships should be programmed into the forecast such that any changes are reflected in all of the appropriate areas (i.e., a cash payment on the debt should reduce the cash and debt balances on the balance sheet, as well as the interest expense on the income statement).

Workout Plans – Forecasting Assumptions

- Assumptions are inherent in any forecast
- Typical assumptions may include:
 - Revenue growth
 - Cost of sales as a percentage of revenue
 - Tax rates
 - A/R, inventory and A/P turnover
- Assumptions should be based on:
 - Historical financials
 - Your client's experience and expectations
 - Recent changes in the business
 - Planned changes in the business per the workout plan

Workout Plans – Forecasted Income Statement

	Source		4th Quarter 2009	1st Quarter 2010	2nd Quarter 2010	3rd Quarter 2010
Total Income			\$ 663,775	\$ 702,407	\$ 2,014,492	\$ 1,659,795
Cost of Good Sold		75%	497,832	526,805	1,510,869	1,244,846
Gross Margin			165,944	175,602	503,623	414,949
Advertising	Variable based on prior 20 mos.	0.3%	1,684	1,783	5,112	4,212
Phone Advertising	Fixed	9,000	9,000	9,000	9,000	9,000
Telephone	Fixed	12,000	12,000	12,000	12,000	12,000
Interest - Line of Credit	Forecasted Bank Debt Schedule	N/A	22,920	24,855	25,029	24,737
Interest - Equipment Loan	Amortization Schedule	N/A	8,843	7,850	6,839	5,810
Interest - Settlement Note	Amortization Schedule	N/A	5,388	5,328	5,268	5,206
Bank Fees	Variable based on prior 20 mos.	1.5%	10,288	10,887	31,223	25,725
Land Rent	Fixed (various locations)	181,629	181,629	181,629	181,629	181,629
Utilities	Variable based on prior 20 mos.	1.3%	8,371	8,858	25,405	20,932
Payroll Accounting	Variable based on prior 20 mos.	2.6%	17,085	18,079	51,852	42,722
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Total Expense			459,808	465,698	634,864	587,508
Net income (loss)			(293,864)	(290,096)	(131,241)	(172,559)

Workout Plans – Forecasted Balance Sheet

		<i>Budget</i>	<i>Budget</i>	<i>Budget</i>	<i>Budget</i>
Source/Assumptions		4th Quarter 2009	1st Quarter 2010	2nd Quarter 2010	3rd Quarter 2010
ASSETS					
Cash	<i>Cash Flow schedule</i>	\$ -	\$ -	\$ -	\$ -
Accounts Receivable	<i>See Assumptions</i>	780,060	953,406	953,406	780,060
Inventory	<i>See Assumptions</i>	4,808,040	4,487,504	4,350,132	4,304,341
Property, Plant & Equipment	<i>Note [1]</i>	233,614	212,120	190,626	169,132
Prepaid Expenses	<i>Constant</i>	184,547	184,547	184,547	184,547
Total Assets		6,006,262	5,837,578	5,678,711	5,438,080
LIABILITIES					
Accounts Payable	<i>See Assumptions</i>	151,272	277,331	378,179	201,695
Line of Credit	<i>Bank Debt_LOC work sheet</i>	2,185,682	2,235,733	2,154,212	2,313,050
Note Payable - Equipment	<i>Bank Debt_Equipment worksheet</i>	455,929	399,947	342,955	284,932
Note Payable - Settlement	<i>Bank Debt_Settlement work sheet</i>	305,603	302,168	298,672	295,114
Total Liabilities		3,098,486	3,215,179	3,174,017	3,094,792
EQUITY					
Common Stock	<i>Constant</i>	3,778,230	3,778,230	3,778,230	3,778,230
Retained Earnings	<i>Changes by prior month net income</i>	(581,050)	(870,455)	(1,155,831)	(1,273,536)
Current Earnings	<i>Changes by net income</i>	(289,404)	(285,377)	(117,705)	(161,406)
Total Equity		2,907,776	2,622,399	2,504,694	2,343,288
Total Liabilities & Equity		\$ 6,006,262	\$ 5,837,578	\$ 5,678,711	\$ 5,438,080
Notes:					
[1] Reduced by depreciation expense on income statement.					

Workout Plans – Forecasted Cash Flow Statement

	<i>Budget</i>	<i>Budget</i>	<i>Budget</i>	<i>Budget</i>
	4th Quarter 2009	1st Quarter 2010	2nd Quarter 2010	3rd Quarter 2010
Beginning Cash	\$ 734,153	\$ -	\$ -	\$ -
Net Income	(289,404)	(285,377)	(117,705)	(161,406)
<u>Adjustments:</u>				
Depreciation	21,494	21,494	21,494	21,494
(Increase) decrease in accounts receivable	86,673	(173,347)	-	173,347
(Increase) decrease in inventory	(228,954)	320,536	137,373	45,791
(Increase) decrease in deposits and prepaid expenses	-	-	-	-
Increase (decrease) in accounts payable and accrued expenses	(100,848)	126,060	100,848	(176,484)
Cash provided (used) from operations	(221,635)	294,743	259,714	64,148
(Increase) decrease in capital expenditures	-	-	-	-
Cash provided (used) from investing	-	-	-	-
Change in Line of Credit	(164,749)	50,051	(81,521)	158,838
Change in Equipment note	(54,989)	(55,982)	(56,993)	(58,022)
Change in Settlement note	(3,376)	(3,435)	(3,496)	(3,557)
Cash provided (used) from financing activities	(223,114)	(9,367)	(142,010)	97,258
Net Increase (Decrease) in Cash	(734,153)	-	-	-
Ending Cash Balance	\$ -	\$ -	\$ -	\$ -

Workout Plans – Forecasted Borrowing Base

		<i>Budget</i>	<i>Budget</i>	<i>Budget</i>	<i>Budget</i>
		4th Quarter 2009	1st Quarter 2010	2nd Quarter 2010	3rd Quarter 2010
Total accounts receivable		\$ 780,060	\$ 953,406	\$ 953,406	\$ 780,060
Less: ineligible accounts receivable	80%	624,048	762,725	762,725	624,048
Total eligible accounts receivable		156,012	190,681	190,681	156,012
Finished goods inventory		4,808,040	4,487,504	4,350,132	4,304,341
Account receivable available	75%	117,009	143,011	143,011	117,009
Finished good inventory available	50%	1,750,000	1,750,000	1,750,000	1,750,000
Max: \$1,750,000					
Real Property	50%	1,000,000	1,000,000	1,000,000	1,000,000
Value: \$2,000,000					
Total funds available (see note)		2,500,000	2,500,000	2,500,000	2,500,000
Beginning loan balance		2,350,431	2,185,682	2,235,733	2,154,212
Add: advances this period		535,251	50,051	5,668	158,838
Plus: accrued interest		22,920	24,855	25,029	24,737
Less: interest payments		22,920	24,855	25,029	24,737
Less: payments this period		700,000	-	87,189	-
New loan balance		2,185,682	2,235,733	2,154,212	2,313,050
Loan eligibility (reserve position)		\$ 314,318	\$ 264,267	\$ 345,788	\$ 186,950

Note:

The total funds available has been calculated as the lesser of: a) the sum of total eligible accounts receivable, finished good inventory available, and real property or b) \$2.5 million.

Workout Plans – Forecasted Bank Debt

		<i>Budget</i>	<i>Budget</i>	<i>Budget</i>	<i>Budget</i>
	Assumptions	4th Quarter 2009	1st Quarter 2010	2nd Quarter 2010	3rd Quarter 2010
Interest rate:	4.5%				
Beginning balance		\$ 2,350,431	\$ 2,185,682	\$ 2,235,733	\$ 2,154,212
Draws		535,251	50,051	5,668	158,838
Interest expense		22,920	24,855	25,029	24,737
Interest payments		22,920	24,855	25,029	24,737
Principal payments		700,000	-	87,189	-
Ending Balance		\$ 2,185,682	\$ 2,235,733	\$ 2,154,212	\$ 2,313,050

Workout Plan – Other Considerations

- Can assets be sold and the proceeds be applied to the debt?
- Are there unencumbered assets that could be pledged as collateral?
- Would the client and the bank benefit from using an assignee account?
- Can the client improve cash flow through changes in the business (i.e., reducing collection time on receivables, increasing days outstanding on payables, reducing sales price of inventory to improve sales, etc.)?
- Do the loan terms and covenants need to be changed such that the client will not be in technical default during the workout period?