What a Lender Wants

Understanding what your bank looks for before they lend and how to make sure they find it

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Date: **November 7, 2018**

What we will cover

- What does your plan need to be successful?
- What does dynamic growth look like?
- What could the worst case scenario be and how do you mitigate the risk?
- Planning your investment in working capital
- Markets, Markets, Markets

MNP

Farm Credit Canada

The Four M's of a Credit Decision

Money

- how much cash are you able to inject at the start of the project?
- how much will you need to operate?
- what other funding sources are available?

Management

Does management have:

- an industry track record?
- a history of proven performance?
- sound decision making capacity?

Materials

- what do you need to operate your production line?
- where will you source your raw materials from?

Markets

- where will you sell your product?
- how will you sell your product?
- how much will you sell your product for? - rationale

Plan your inventory accordingly

- Time of year that it will hit the market
- Product availability throughout the year
- Know the status of your inventory and its value, today
- Have a plan for unsold/dated inventory

Key Ratios: Current Ratio & Working Capital

Crunching the Numbers

- The ratio
- How is it calculated?
- What does it measure?
- Target

- Current ratio
- Current assets/current liabilities
- The ratio of assets that provide cash in the next year vs. cash needed in the next year
- 1:1 or better

Crunching the Numbers

- The ratio
- How is it calculated?
- What does it measure?
- Target

- Working capital cycle days
- AR + Inventory less AP (in days)
- The number of days it takes for a dollar spent on production costs to return as a dollar collected as sales
- Industry specific (less is better)

A Critical Balancing Act

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Assume…

- Current sales volume = 5,000 cases
- Average selling price = $24/bottle
- Sales mix 70% DTC/Winery & 30% to licensees (discounts 10% to 16%)
- Current gross profit 65%
- Grape cost = $2.08/bottle
- Finished cost = $8.08/bottle
- Current inventory = 6,000 cases (573 days sales)

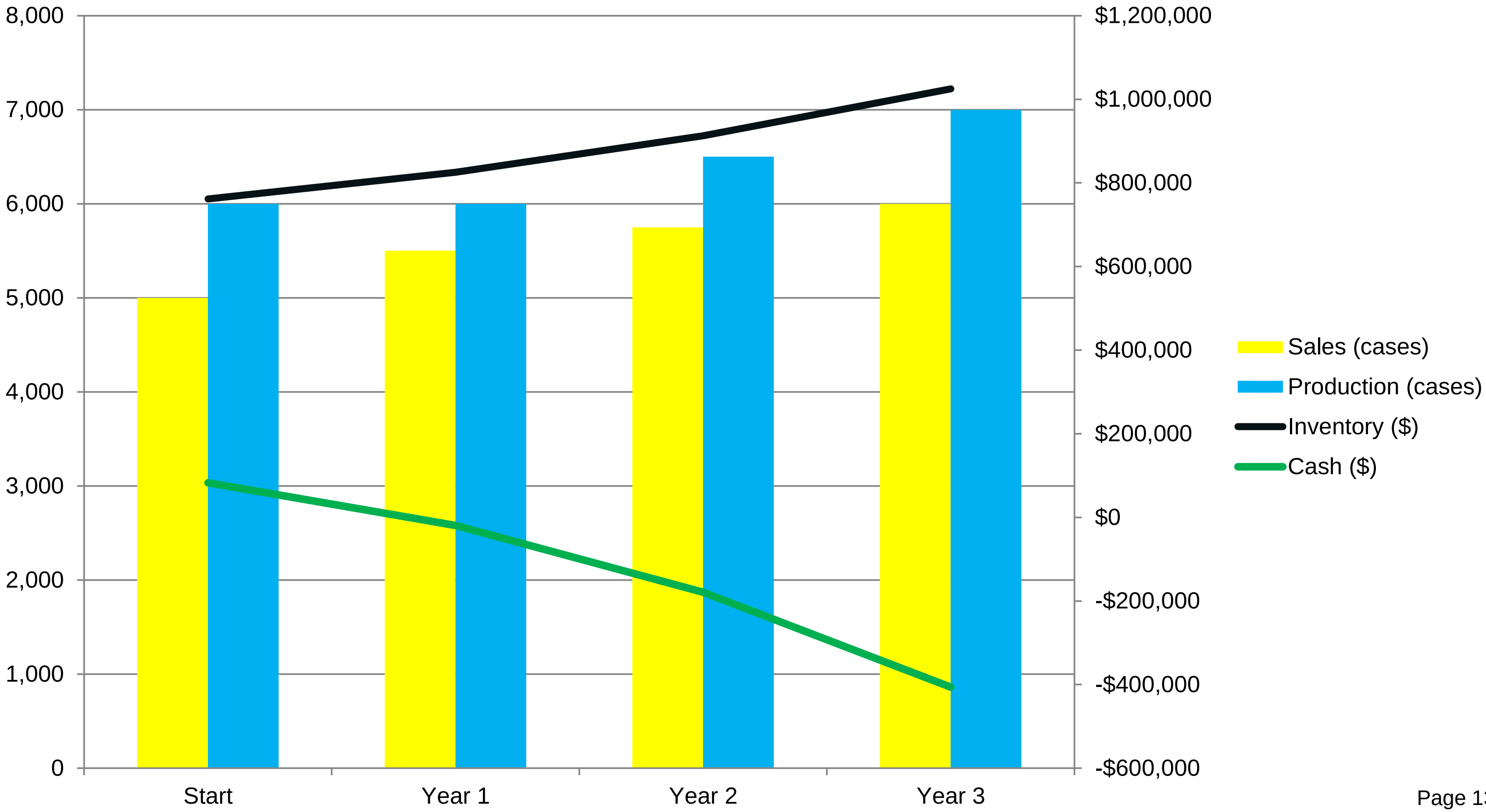
The Plan…

- Produce 6,000 cases next year and grow production by 500 per year after that, up to 7,500 cases

The Reality…

- Maintaining growth is tough
- Winery visitors have levelled off
- Selling to restaurants & private stores is costly & time consuming
- You manage to increase sales by 500 cases in year 1, but sales grow by only 250 cases per year in years 2 and 3

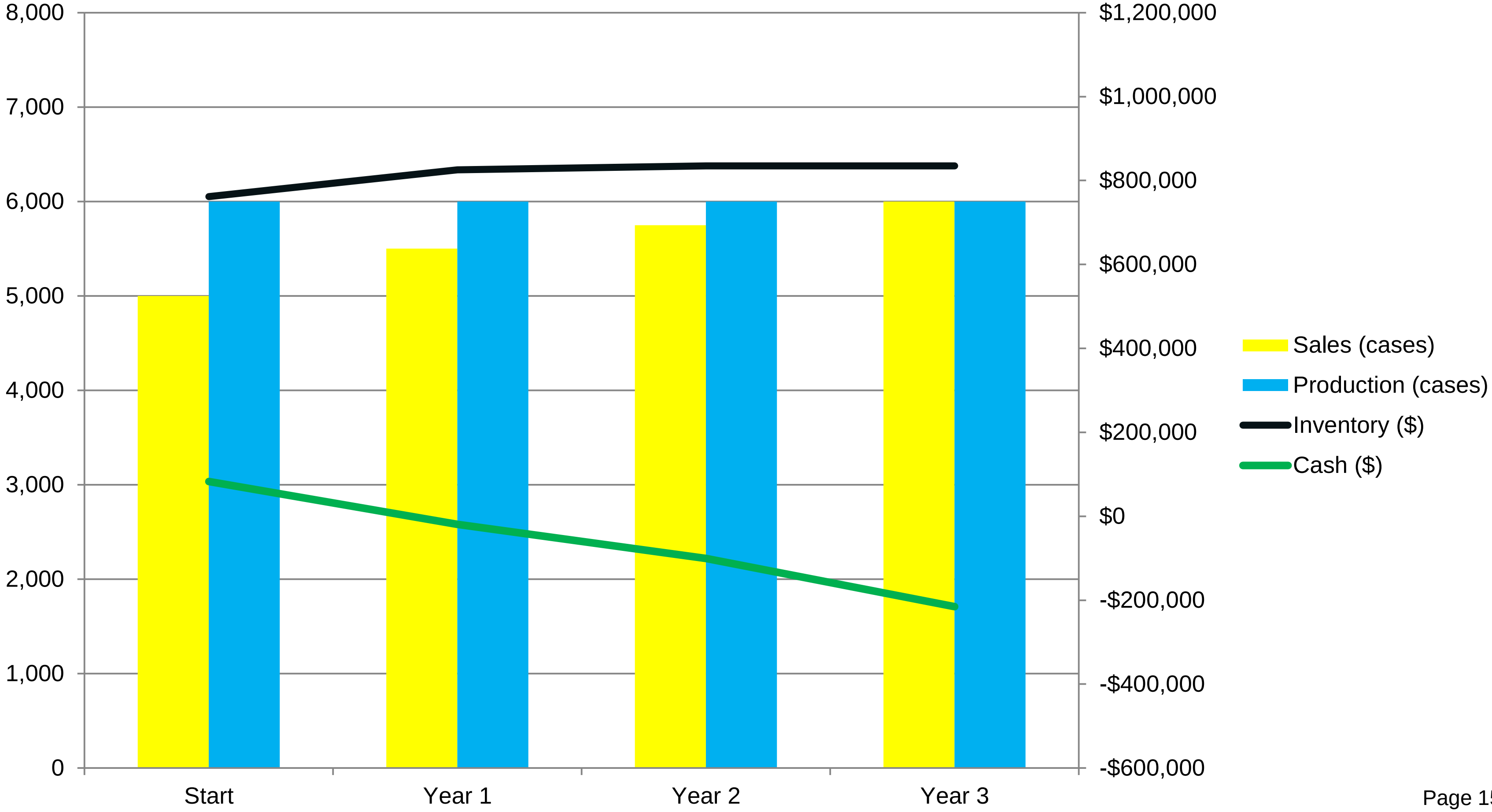
What happens when sales fail to keep pace with production



Modifying the Plan

- Keep production at 6,000 cases until sales catch up

Modify production plans to match sales growth reality



Another Example…

- <u>Larger winery</u>
  - $1,582,000 in net sales
  - $1.75 million invested in land, building & equipment
- <u>Sales volume</u>
  - 15,000 cases

Gross Margin 55.7%

EBIT $236,398

Profitability 14.65%

Sounds good, but…

Cash from operations

($83,685)!

Working Capital Cycle

	Purchase inputs (AP days)	Make wine (Inventory days)	Sell wine & collect $ (AR days)	
bench mark	- 43	+ 500	+ 20	= 477
Our example	- 45	+ 631	+ 35	= **621**

Sensitize your Project

Aim for the best, but have a plan for the what-ifs:

-Interest rates

-Change in raw materials

-Change in final product

-Drop in sales

Key Ratio: Debt Service Capacity & Working Capital

Cashflow

- Positive cashflow is critical to business success
- Lenders and potential investors and buyers want to see a strong cashflow history

  BUT…

- Profit does not always mean cash

Ways to Manage the Cash Crunch

1. Work with lenders and creditors to adjust timing of payments
2. Stretch out your sales and grow new channels
3. Collect you receivables quicker (# days sales in A/R)
4. Budget and plan ahead
5. Manage your growth

Infrastructure Overkill, Kills

- Pace gross income ahead of infrastructure capacity
- Build up the pipeline before the premises
- Leave room for PLANNED expansion
- Don't move into phase 2 until phase 1 is completed

Key Ratios: Loan to Value, Debt Equity & Debt Service Capacity

Crunching the Numbers

- The ratio
- How is it calculated?
- What does it measure?
- Target

- Debt to equity
- Total liabilities/shareholders' equity
- How dependent the company is on debt as a source of financing
- Less is better (usually less than 1.3:1)

Crunching the Numbers

- The ratio
- How is it calculated?
- What does it measure?
- Target

- Debt service
- EBITDA / debt payments
- Whether the company earns enough to fund its payments through operations
- Larger is better (1.5:1 or greater)

The Keys to Successful Growth

1. Manage your cash flow and working capital (especially inventory)
2. Plan ahead and consider the “what if’s”
3. Walk before you run