



# How to Talk to Your Lender in Difficult Times

**Prompt communication with creditors and external assistance will help your company survive.**

When your business encounters a financial or operational downturn, your world can become turbulent. Many things are outside your control during a financial crisis, but you do have control over your communication with the stakeholders who are important to your company's survival. Your stakeholders include employees, owners, and vendors, but one of the most critical stakeholders is your senior creditor – bank or lender. Because of their rights in the loan documents that allow them to quickly protect themselves, your lenders can significantly impact your plans for survival.

Most business owners don't think to communicate with their bank on a regular basis. But when your company gets into trouble, that needs to change. The fact is you want help from your bank, and getting help will require that you share information and explain why it is in the bank's best interest to support you through the difficult situation. Therefore, you have to understand the situation through the eyes of a lender.

## **BUILDING TRUST**

You can never assume that because your bank has been with you for five, 10, or even 20 years that it will continue to support you indefinitely, especially without a clear understanding of your current situation and how your company is going to navigate through the difficult times. Many business owners assume that their lender is their business partner, when in fact, your bank is a service provider/creditor that is highly regulated by the government. Banks are required to make sound loans that provide a good return on assets, are repaid in a timely manner, and have low risk of default. This is legislated through federal and state lending laws and reviewed by regulators on a regular basis. Because of that, banks don't have the latitude to just let poor performance slide without action on their part.

A company in trouble should reach out to its bank as quickly as possible once an issue is discovered. Analysis of the issue is critical, but if you need time, prompt notice of the problem with a request for time to review is better than silence. Banks hate to be surprised! So the earlier the communication, the better. Furthermore, in times of financial distress, being anything less than truthful with your bank can be fatal to your company. Being transparent about all news as it happens, both the good and the bad, allows for open and candid discussions that will help you build trust with the bank. Establishing trust will build or strengthen a long-term relationship.

Conversely, the risk in not disclosing issues early is that it may cost you credibility with your lenders. When the bad news comes out later rather than sooner, your banker is likely to think you deliberately concealed it, in which case you are perceived as either dishonest or incompetent – or both. The heart of the relationship must be communication that builds trust.

Typically, once a company is in default on its loan – whether as a result of past-due interest or payment defaults, or of failure to comply with financial ratios as part of the loan structure – a loan may be put on a watch list and the lender will monitor it more closely. Once a bank has designated a loan as a problem, the loan takes on a new set of regulatory and policy requirements. Some banks transfer problem loans to specialized departments, sometimes called “Special Assets,” or the “Workout Group,” for handling. Workout bankers are charged not only with collecting loans but also with reducing the bank’s overall risk exposure to a financially challenged company. Anticipating what the workout bankers will analyze, and knowing what issues influence their decisions, is essential for the company and its professionals to address potential issues before they become operating emergencies.

If your loan is transferred to the workout department, you should meet with the workout officer assigned to your account as soon as possible. You will need to create a detailed business plan and projections of how the management team will stop the bleeding and turn the company around, and present this at

## WHAT TO PRESENT TO THE BANK

**A company’s presentation should include an executive summary/overview detailing the cause of the downturn in performance, a consideration of strategic alternatives, and a detailed turnaround plan supported by the following:**

**OPERATIONAL AND FINANCIAL OVERVIEW** – Provide operational and financial details of the company, identifying all its challenges, whether financial, operational, or managerial. You may be surprised how little understanding your lender has of your business, even though the bank has been your lender for years. When a company is in distress, the bank takes a fresh look at the business, with much closer scrutiny. There might also be a new banker from workout assigned to your account, and that person will not know your business as well as did your former loan officer.

**MARKET UPDATE** – Educate your banker on the industry and how your company is expected to perform within the marketplace and against its competitors.

**CURRENT FINANCIAL PERFORMANCE** – Focus on performance by month and year to date compared with the budget and prior-year period. Provide detailed pro forma financial projections by month and quarter for the next 12-24 months, including: balance sheet, income statement, covenant calculations and compliance, or suggested covenants; availability under the working capital revolver; and a plan to service the bank debt. Projections should address both a best-case scenario and a downside scenario, and be supported by key assumptions that are achievable. This is not the time to be overly optimistic. Be realistic.

**COST-CUTTING INITIATIVES** – Include details of cost-cutting initiatives, such as head-count reductions, location closings, reduced inventory purchases, and salary reductions.

**13-WEEK CASH FLOW PROJECTION** – This is a tool for controlling cash, but it can also be used as a storytelling device for your bank. The bank will recognize the positive effects of cost-reduction efforts along with increased accounts receivable collections and your ability to fund current operations.

**COLLATERAL** – Provide an aging summary and updates on accounts receivable collections, past-due balances, inventory levels, and purchases. Discuss any impacts on availability under the revolver related to collateral levels and expected performance.

**CAPITAL EXPENDITURES** – Describe the dollar amount of expenditures needed to maintain existing equipment versus the amount needed to increase or maintain sales levels.

**ACCOUNTS PAYABLE** – Identify critical vendors, the company’s ability to pay vendors on time, past-due issues or concerns, or whether the company has been put on COD with any of its vendors.

**PREFERRED PLAN** – Provide details on the preferred restructuring plan, with measurable milestones along with a list of all current restructuring opportunities. Detail these options, which might include refinancing bank debt, selling a division, selling the company, raising equity, or some combination thereof. Provide a timeline over which these opportunities will occur as well as a list of potential hurdles to achieving them.

your meeting. Know the details of your financial situation, and be prepared to support your forecasted sales and expenses with tangible information and detailed assumptions. If your banker is concerned and you don't provide them with the detailed facts of the situation, they will fill the void with what they imagine the case to be with their own interpretations and projections, which are likely to be worse than the reality.

### SOLICITING THIRD-PARTY ASSISTANCE

Financial advisors have long complained that banks always wait too long to involve them in the process of helping troubled borrowers. Borrowers are typically short on two key resources: time and working capital. The earlier advisors enter the picture, the more time they have to address these shortages and help you develop a restructuring plan. This assistance from a third-party firm benefits banks in both the short and long term. Advisors can stop you, the business owner, from repeating the mistakes or bad habits that are a root cause of the crisis. The third-party financial analysis not only gives the bank a better look at your business, it also results in numerous recommendations you can implement to turn the company around.

At a minimum, the company should prepare a presentation for the bank that details the current situation. This would include how you got there and how you are going to turn the company around and get the bank paid. The information you provide allows the banker to better understand your specific issues and how you are addressing them. Typically, a banker will take your presentation to the loan committee to demonstrate to their superiors that your company is proactively addressing the issues. The opportunity here is for the company to control the narrative being provided to the decision makers at the bank, instead of relying solely on the bank officer to create or convey your story. The restructuring plan must be validated and supported by the bank. Without the bank's support, your company has very few options available to it in a distressed situation.

Do not simply email the presentation to your banker; arrange a face-to-face meeting to walk them through your plan. Encourage your banker to ask questions. This one-on-one meeting is critical for the lender to see that you are working to find a solution for all stakeholders, and that you have the bank's right to be repaid in mind. After the plan has been accepted by your bank, continued communication is also critical. In distressed situations, you should have calls or meetings monthly to keep the bank informed of your progress or any setbacks from the plan.

It is important for a company or borrower to understand that banks cannot and will not play the role of an equity provider. That is not the risk they agreed to when they made the loan to your company. Foreclosure is also not generally a first choice, as this typically increases their loss, and also creates potential legal risks for the bank. The bank will expect you to bring a solution that shows how the loan will be repaid. If not done, the

bank might require you to go out and raise equity in order to pay down the loan, or to sell parts of your business, regardless of the loss, in order to raise cash. It is important that you develop a realistic plan to repay your bank.

It is also crucial that a company be proactive in addressing signs of underperformance or distress. Failing to do so risks a suboptimal solution imposed by the lender. Lenders must have complete confidence in the management team and its ability to navigate the turnaround plan and effectively operate the business going forward.

A turnaround advisor should be retained early on, even if the company executives also have actual turnaround experience. Outside advisors bring a new set of eyes and are trained in managing and advising in troubled situations. You always need fresh and impartial analysis to really solve an intractable problem. An independent advisor also greatly increases the credibility of your plan and the lender's confidence in its execution and ultimate success. While a business owner may resist the help, deeming it an unnecessary expense or simply giving in to corporate ego, a senior turnaround advisor can provide seasoned insights, outside perspective, and specialized knowledge that can increase the support of customers, vendors, and, of course, the lender. Borrowers in many a troubled loan situation have lost credibility in addressing the issues or in meeting deadlines promised to the bank. Furthermore, turnaround advisors have much more experience in the successful execution of plans once they are formulated. The bank will view the hiring of a turnaround advisor as a positive in a distressed situation, as advisors bring a new set of eyes and are trained in managing and providing guidance in troubled situations.

Clear and accurate communication during any crisis is key to successful navigation through troubled waters. Communication to the lender should be early, with detailed facts given as promptly as possible and analysis thereafter as quickly as can be done with accuracy.

In these circumstances, an impartial advisor can make a key difference in a business' survival by adding credibility through both better solutions and increased stakeholder confidence in execution.

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**Banks hate to be surprised! Communicate with them early.**

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