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BANK LOAN NEGOTIATION TIPS

PRESENTED BY:
Stephen Priddle, CPA, CA, CMA
Ottawa, Ontario
President, Practical PD Seminars for Accountants
www.practicalpd.com

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Introduction

- Welcome
- Timing
- Questions and comments, type them in the Chat any time
- Admin matters and slides
- Introductions you
- Introduction me

All my live seminars/webinars have an opportunity to win prizes

- Stay awake and participate to get them...max one per person
- However, the top participant will win a special prize, and can have won a prize earlier

Cameras on, strongly preferred

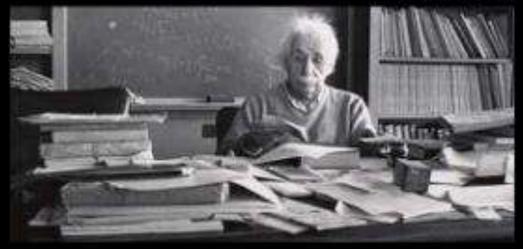
- So I have an audience...
- Don't just give us the forehead or chin view...
- Eating lunch on camera is fine
- Some prizes require camera on...

Type "messy" in the chat if you...

You have a messy desk



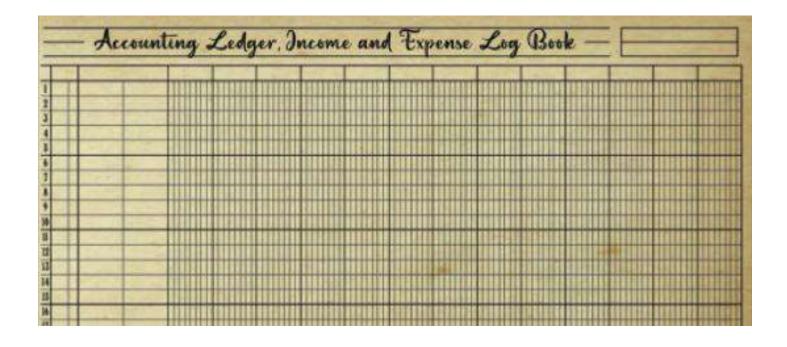




If a cluttered desk is a sign of a cluttered mind, of what, then, is an empty desk a sign?



You are so old that you once you worked with columnar paper!



Where am I?

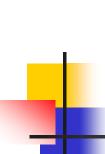


Here



I am not just a PD guy

- But a veteran, active CFO, who teaches on the side...
- And consults, people who take my courses engage me for more work
- And authors cases
- And sits on Boards
- I started my career at....
- 4 years in large corporate banking/treasury



I co-own a world-leading company in aviation software

SureWx, helping flights in the winter – safer, less cancellations





Banking

- Obviously we need a banker joke...
- How does banking work?
- Have you heard of the <u>1-3-1</u> model of banking?
- (rates have changed recently)

The <u>1-3-1</u> model

- They give customers 1% on deposits
- They lend money at 3%
- They go golfing at 1 PM every day



Like many of you do!



- I have dealt with all the major banks in Canada at different times
- Accounts, loans, letters of credit
- With one company I increased the operating facility <u>10 fold</u> in 4 years
- I had a recently retired 30 year veteran banker review most of this, no longer in banking so he could speak his mind

However

- The best loan I <u>never</u> got, just before COVID hit, with my aviation systems company
- No bank debt since age 29
- Remember, the proverb: <u>The borrower</u> is servant to the lender

Recent comments

- I just took the (video) course tonight. Found it quite captivating and very relevant. I am in the middle of a multi-million \$ bank loan negotiation and can certainly apply many principles discussed in this course as soon as tomorrow!,
- We just had our yearly review with our bank and I applied several of the items from your course with great success



If you are a veteran, you will know some of the tips



- These are bank negotiation extracts from some of my 25 practical courses for CPA
- I will give some general tips
- Then some tips on negotiating lines of credit and term loans
- Reference will be made to a generic Canadian Big Five bank offer in the handout

Key

- Every single bank is different
- It is not possible to every say that a particular approach will always work
- Everything is a negotiation

A lot depends on leverage

- Leverage varies, for example:
- Small weak company wants a \$50K line of credit
- Large, strong company wants \$500M of financing...

Note

- The negotiation <u>principles</u> here apply <u>no</u> matter how small or large a business is, and many <u>apply to all kinds of debt</u> agreements, not just bank facilities
- (Not every company margins A/R)
- I will share some <u>failures</u> in my bank negotiations, maybe you can win the same ones
- "Failure is success if we <u>learn</u> from it"

Banks

- Remember "Banks are never there when you really <u>need</u> them"
- Do your clients have a plan for the <u>rainy</u> <u>day?</u>
- Guess which bank has the biggest market share among attendees? <u>Almost always</u> <u>RBC</u>
- Consider the non-Big Five banks and <u>niche</u>
 <u>US banks</u>

Approval

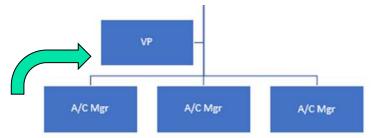
- Most people say to the bank, "this is what we need, what information do you want from us?"
- Ask about the <u>approval</u> steps and <u>limits</u> so you can position the co better



Relationships



- The key is a good <u>account manager</u>, who understands and believes in your business
- Suppose you don't like yours? <u>Ask for a new one (but you may make enemy...)</u>
- Get to know their boss, likely a VP



Banking

- Some ways to get your banker on side
 - When applying for loans, don't be overoptimistic in the financial projections you provide or they will <u>hang</u> you with your own <u>noose</u> (covenants)
 - (You should develop credibility with banks)
 - Present your projections in ways that put the best foot forward

Normal presentation

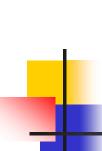
Data Systems All Incorporated	
Projections - Income Statement Year ending Dec 31, 2026	
Service revenues	\$ 12,234,023
Direct operational costs	8,345,201
Marketing & sales costs	1,441,458
Research & development costs	464,251
General & administrative costs	1,042,510
Interest expense	59,422
Amortization expense	89,442
	11,442,284
Net income before taxes	791,739
Income taxes	170,224
Net income after taxes	\$ 621,515

Alternate presentation

Data Systems All Incorporated		
Projections - Income Statement		
Year ending Dec 31, 2026		
Service revenues	\$ 12,234,023	
Direct operational costs	8,345,201	
Marketing & sales costs	1,441,458 464,251	
Research & development costs		
General & administrative costs	1,042,510	
Interest expense	59,422	
Amortization expense	89,442	
	11,442,284	
Net income before shareholder remuneration & taxes	1,736,739	
Shareholder remuneration	945,000	
Net income before taxes	\$ 791,739	

Another idea

Projections - Income Statement		
Year ending Dec 31, 2026	(millions)	
Sales	\$	66,451
Cost of goods sold		41,997
		24,454
Committed costs (note 1)		6,582
Employee costs		8,465
Discretionary spending (note 2)		3,415
nortization expense		648
		19,110
Net income before taxes	\$	5,344



More ways to have a good relationship with your bank



Even press releases in advance (NDA may be needed)

- Immediately share <u>new important business</u> <u>developments</u>, good or bad (They don't like <u>surprises</u>, they are constantly checking on you)
- Invite bankers to special events, which make the company look good
- Suggest they come to your organization and present seminars on: <u>personal banking</u>, <u>RRSPs</u>, <u>TFSAs</u>, <u>mortgages</u>, <u>retirement planning</u> & <u>investments</u> to your employees
- Have them attend <u>Board meetings</u> (as an observer)??!!!





- Use good <u>business logic</u> to respond to the bank's unreasonable terms, ask for their rationale
- Think of a <u>range</u> of alternatives to what the bank is proposing from ideal to not so ideal
- Remember they are always trying to reduce their <u>risks</u> and <u>exposures</u>



Will they negotiate terms?

Actual Big Five Bank email to me

"If you have a suggestion to amend wording you may provide it, however any change will require legal review "

Banker: smaller businesses will find it harder to get the bank to negotiate terms and move away from standard bank agreements, and often the account managers have less experience and want to stick with the template

Another example, the new clause

- My company opened a new, overseas subsidiary and we had a Canadian operating facility and term loans
- I told the bank and they said, we are lending you money for Canada, we will need a new clause in the agreement, that restricts the company's ability to send money overseas
- I proposed a clause which they accepted instead accepting theirs

Remember banks focus on the two Cs

Collateral and Cash Flow

Bank offer reviews

- Consider adequacy of offer
- Look at alternative financing options
- Increase amount that can be borrowed
- Protect the company
- Protect the shareholders
- Minimize costs
- Loosen covenants & restrictions





Someone said a bank agreement is like a

- Prenuptial agreement
- "We love each other and plan to stay together but if ____ happens, this is how we split"

Another video course comment

The examples and tips provided were very useful I followed this course a few days prior to a meeting with the bank for a new term loan negotiation and the tips provided helped me negotiate the terms of the agreement, such as the ratios, fees and other.



 How else a company get more leverage with the bank? <u>Promise family's personal banking/investing</u> <u>business/group RRSP/payroll/get employees to</u> <u>bank there personally</u>

Big picture

It would be good if a Bank has experience in your <u>industry</u>

Big picture

- It might be good to meet with the bank's <u>credit</u> people (usually kept away from customers by banks), they make the key decisions
- There are lots of alternatives, in addition to bank financing...

Other possible sources

- Could the <u>shareholders or relatives</u> provide financing?
- Have any <u>non-bank</u> operating facility providers been considered? (some do 85% on A/R)
- Have <u>suppliers</u> been considered as a source of financing?
- Has <u>equipment vendor financing</u> been considered?
- Has <u>leasing</u> been considered?
- Have any <u>asset-based lenders</u> been approached?

Other possible sources

- Don't finance, collect A/R faster (discounts)
- Could the company considering <u>factoring</u> receivables (selling them), to provide cash and reduce the need for an operating facility?
- Has EDC (Export Development Corporation)
 between approached about helping this company
 which exports and working with the Northern Bank



EDC help

- Loan guarantees
- BDC co-lending
- Advance payment insurance
- Foreign exchange facility guarantee
- Performance security guarantee
- Credit insurance, to be discussed soon

EDC told me recently

- "We find HSBC and National Bank the best to work with"
- I have good experience with these banks versus the Big Five
- Will this change now that <u>RBC has</u> <u>bought HSBC</u>?
- I think so

Any more general bank negotiation tips?

Prize if your camera is on

One big five Canadian bank

- My experience with the bank
- Few bank with them
- Lots of complaints about them
- The former senior loan officer
- The CFIB survey

Non-consumer loans

- **\$201B**
- **\$178B**
- **\$168B**
- \$154B
- \$ 98 B



thestar.com 🕻

Business

to repay \$73 million after overcharging clients for 14 years

The Ontario Securities Commission alleged that short-comings in systems and controls at the dealers resulted in some customers being overcharged.

Most crooked Enron bank!

shares slip on \$2.4B US Enron lawsuit settlement

CBC News · Posted: Aug 02, 2005 4:29 PM ET | Last Updated: December 1, 2005

Shares of slid on Wednesday, a day after the bank agreed to pay \$2.4 billion US to settle an Enron lawsuit.

In afternoon trading, shares of were off 7.9 per cent or \$6.30 at \$74.34. The stock opened the day at \$74.

The settlement, about \$2.9 billion Canadian, is more than the company's \$2.2 billion profit in 2004.

The lead plaintiff in the class-action suit said Tuesday's settlement is the single-biggest payment by a financial institution.

The University of California said Citigroup paid \$2 billion US and JPMorgan Chase \$2.2 billion US.

Very recent

has agreed to pay \$125 million to settle a class-action lawsuit that had accused the bank of misrepresenting its exposure to U.S. residential mortgage-backed securities ahead of the financial crisis.

Investors launched the suit in 2008 alleging that the bank not only misled the market on the size of its exposure to the U.S. subprime market, but also to the volatility of the related investments.

As an employer

Worst Bank in Canada - employee review - Indeed

Worst Bank in Canada ... I have been working at one of for 2 years now and i'm yet to find a single person who is happy working for this financial institution, ...

Finally

- The accounting magazine survey
- But I won't tell you the full name of the bank..



Non-consumer loans

- **\$201B**
- TD

- **\$178B**
- вмо 🙆
- **\$168B**



• \$154B



• \$ 98 B

However

- I once chose this bank to underwrite our IPO
- This bank does well in the personal banking world
- We have banked with them personally for years
- They have good Visa cards....



- Work with the federal Small Business Loan program?
- The fed's guarantees 85% of the bank's loan to the client

Small Business Loan program

- \$1 million for term loans of which a maximum of \$500,000 includes:
 - o equipment and leasehold improvements loans (up from \$350,000); and
 - \$150,000 for intangible assets and working capital costs.

Plus

 \$150,000 for lines of credit for working capital costs (which is over and above the \$150,000 that can be used for working capital costs under the term loan product).

Small Business Loan program

Loan Is Guaranteed

85% of the loan is guaranteed by the Federal government.

Previous Purchases Are Eligible

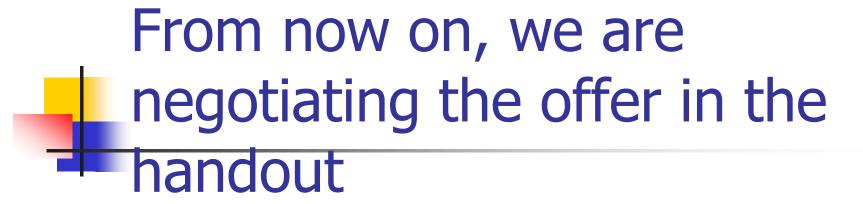
Purchases made within the past 365 days prior to the date of the loan approval are eligible for financing.

Repayment Options That Work for You

- Floating rate principal plus interest
- Floating rate principal including interest (blended payments)
- Fixed rate principal plus interest rate
- Fixed rate principal including interest (blended payments)

Terms That Meet Your Needs

 Amortization for all asset classes, including real property/immovable, equipment, leasehold improvement, intangible asset and working capital, up to 15 years



- It is a composite of bank offers I have seen, typical Big Five
- Medium-size client

Note

 There at least one joke embedded in the bank offer....



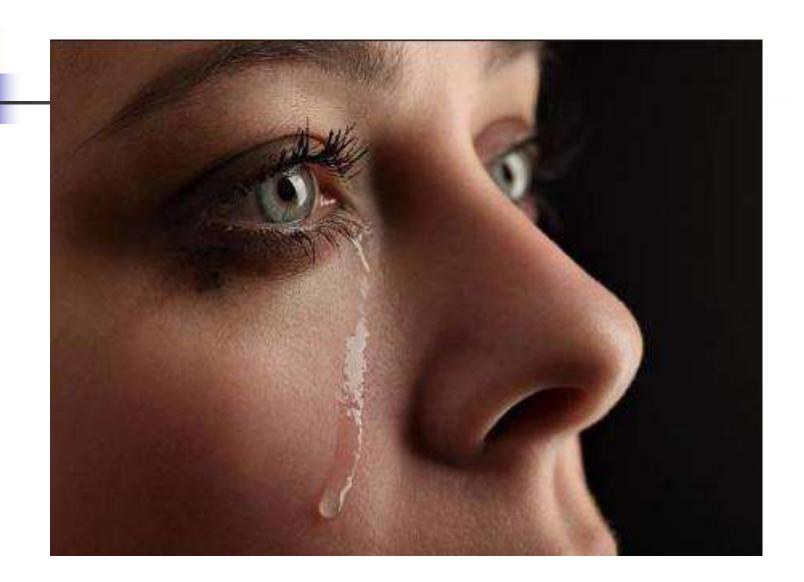
The big issue

Personal guarantees

(c) Joint and several personal guarantees of both principals include security interests in their principal residences. The principal's spouses will be required to get independent legal advice with respect to the principal residences.



My first ever experience with personal guarantees



Personal guarantees

- The personal guarantees required of the founders, including a security interest in their principle residences, are likely very objectionable (they are legal)
- The personal guarantees also require the involvement of their spouses and the complication and cost of independent legal advice
- The bank wants them to reduce risk, and ensure the business owners have some "skin in the game".







- Reduce or soften them any way possible
- Time them out if possible
- You should do the same for any similar requirements, from any bank, even if not personal guarantees



- Ask what size the facility would be without the personal guarantees, this finds out their "value"
- A \$ limit_on the personal guarantee
- A limited personal guarantee by each guarantor, <u>not joint & several</u>

A real life example, I have seen

- Bank wants \$500K guarantee joint & several guarantee from all 4 guarantors
- If the guarantee is triggered, the bank will likely go after the <u>richest/debt free</u> <u>guarantor</u>
- Much better:
- Each guarantor signs <u>a \$125K</u>
 <u>guarantee</u>, \$500K is not joint & several

Alternately

- Sign joint and several but have an <u>interguarantor agreement</u> that the other guarantors will equalize the impact if there is a call
- Eg: the bank takes \$500K from you, the other guarantors agree to give you \$125K each



Negotiation strategies

You can use my Bitcoin as collatera or other personal investments...

- A limitation against the <u>principal</u> <u>residences</u>, don't include them
- Provide some <u>other collateral</u>, say some personal investments, and exclude the principal residence
- A limitation against property owned jointly with the spouse
- Reduced guarantees in return for a family compensation cap



- The Bank agreeing to <u>drop</u> the guarantee after a year
- The Bank agreeing to <u>"consider"</u>
 dropping the guarantee after a year
 (weaker)



- The Bank agreeing to drop the guarantee once the company has a certain level of equity in the business, for example \$900,000 (worked for my brothers once)
- Covenant trade-off with the bank versus
 The milestone approach banks are often leary of this

banks are often leary of this after a court case said if a client achieves part of the milestone the guarantee should be proportionately reduced...



If there are outside investors with say 40%, some banks won't ask for personal guarantees of the 60% shareholder as it would be unfair



I was once able to get out of a guarantee requested from the (public) parent company, with a comfort letter signed by the parent company



I provide a range of options, some a lot better for the borrower, some just a little better...

Covenants

- Some bank clients have no covenants, this is a nice position to be in
- Have you seen any unusual covenants?
- It is important that the proposed covenants be examined to see if they are reasonable and <u>maintainable</u> - they need to be <u>stress-tested</u> which means projecting balance sheets



The covenants in the case

- 1.8 minimum current ratio
- \$700,000 tangible net worth

Covenants

- You should ask your network if they know how "<u>patient</u>" the Northern Bank tends to be in this city, with clients who violate covenants
- Do they "pull the plug" immediately, or do the work customers?
- If covenants are violated, RI could find itself needing to <u>repay</u> the Operating Facility and/or the three year term loan on demand, without the funds to do so and facing a real crisis

Testing frequency

- The Bank wants to test covenants monthly
- If you could get them to move the tests to quarterly or even annually, this would be better

Covenants - evaluation

- From a general banking perspective, the covenants are not too <u>unreasonable</u>
- A 1.75 to 1 current ratio would be more common that 1.8, a rather odd number
- Some banks will exclude <u>their debt</u> from the current ratio calculation – ask for this
- You might want to try to argue <u>deferred revenue</u> is not a real liability and should be excluded
- (Same with <u>Asset Restoration or any other liabilities</u> that are not like trade payable as well as deferred/future income taxes)



Current ratio covenant survey

- What is your current ratio covenant?
- All courses: <u>1.38</u>
- A mix of companies and credit risks

Debt to equity covenant survey

- (no D/E covenant in the case)
- All courses: 1.90
- A mix of companies and credit risks

Net worth covenant

- The Bank's net worth calculation, does not include, as "equity", related party indebtedness that has been postponed or subordinated, to the Bank's satisfaction
- Since the bank "controls" these liabilities, in effect they are <u>equity</u>
- If the bank would <u>accept them as equity, or</u> <u>exclude them from debt</u>, this would help the company's position relative to the covenant
- It might be possible to actually <u>convert</u> some shareholder loans to equity, to help the net worth calculation

Intangible definition

- Since RI has some software licenses on the balance sheet, you may want to find out if they are considered <u>intangibles</u> by the Bank
- They arguably don't have "physical substance", but they aren't mentioned specifically in the offer letter
- One approach is <u>not to ask</u>, since they are not specifically excluded
- The other approach is to get <u>clarification</u> now

Experience

- I once got a major bank to agree <u>not</u> to exclude prepaid software licenses from intangibles
- After I left the company, they changed their mind
- I was able to help my successor CFO push back on this

Covenants & estate planning

- The founders have started some estate planning steps
- Estate planning often includes the issue of high-low preferred shares (redeemable and retractable at a price that far exceeds the issue amount, to fix their value for income tax purposes, which normally are classified as debt under ASP
- Under ASPE, it is possible, they can be reported as <u>shares</u>, with the proper disclosure, Section 3856.23 exception only
- You might want to discuss this with the Bank now
- <u>Exclusion</u> from debt under the terms of the covenant definition would be reasonable
- The Bank might insist on a retraction veto right.
- (Some banks don't mind these activities for tax planning purposes, even temporarily waiving covenants.)

Negotiating covenants

- I once decided that it was <u>illogical</u> for a Big Five bank to flex the facility up or down with A/R and inventory, but with the net worth covenant it was "all or nothing"
- So I asked the bank to flex the facility with the level of tangible net worth
- A new account manager said <u>I support that idea</u>,
 I will go and check with my colleagues
- The colleagues said <u>no</u>.....

More on covenants

- A "covenant breach cure" clause would help protect RI. It could state that upon violation of any covenants, the company has 30 or 60 days to "cure" the violation, before the bank can take any action
- A great tip is that you should also include breach cure clauses in <u>any agreements in the</u> <u>business world where breaches can hurt</u> <u>you...</u>



- The actual details of this Bank's version of a debt service covenant should be obtained
- Some <u>projections</u> should be done to measure estimated future compliance
- The covenant would likely involve dividing income or cashflow before debt service obligations with debt service obligations
- Key point monthly income statement covenants are <u>risky</u>, because they can be violated with <u>a</u> <u>single bad month</u>, or a bad season

Possible debt service covenant

- The company usually won't <u>blow</u> a balance sheet covenant with one or two bad months, it takes longer term deterioration
- A <u>rolling</u> test would be better than monthly, that includes several months or quarters or even a full year, because it would smooth variations (rolling 12 months, also knowns as TTM, trailing 12 months)





Let's look at bank outs

Bank outs

- The Bank offer says it "may cancel or restrict availability of any unutilized portion of this facility at any time and from time to time without notice or demand"
- It would be preferable to get a <u>committed facility</u>, but difficult, given the company is a new client, with no track record
- Perhaps it could be negotiated as committed, with higher fees, the bank must make room in its <u>capital structure</u> in this case

There was a really nasty clause

The bank can pull the plug when

- "There is, in the sole opinion of the Bank, a major undesirable development in the financial condition, operation or ownership of the Borrower"
 More commonly worded
- "There is, in the sole opinion of the Bank, a material adverse change in the financial condition, operation or ownership of the Borrower"

Analysis

 Essentially this means that if they don't like something, they can pull the plug on the Term Loan and demand payment and the company could not really question the grounds for the judgement of major undesirable developments

Analysis

- RI should argue vehemently against this clause, telling the Bank, they already have lots of "outs"
- The bank might also want to shut down the loan, because of its own ratios, or its economists are pessimistic about the sector
- Some Canadian banks say the "material adverse chance" (MAC) clause is non-negotiable, but I know strong companies who have negotiated out of it

An alternative you could ask for

 Wording associated with the bank "acting reasonably" flowing from the material adverse change..

Note

- A company apparently won an action against a bank for unfairly calling loans based on a MAC clause
- But it took years and years
- And the business was already destroyed

Events of default

- If there is an event of default under the agreement, the facility must be repaid
- There is no provision for <u>getting out of default</u>
- This should be provided for, or it is not fair, perhaps 10 days, 20 days, 30 days (a bit like a breach cure clause)
- For example, the company is in default for not having the <u>life insurance</u>
- Based on the offer, they can't get out of default, by getting the <u>life insurance</u>

More events of default

- The offer says that the entire facility is in default if "the Borrower defaults in the payment of any indebtedness to any Person"
- This might mean a technical default on a minor obligation to a supplier of \$10 (you forget to pay them) might collapse the whole banking agreement
- Perhaps a <u>dollar limit</u> should be provided, <u>over</u> <u>\$40,000</u> for example
- In practice banks may not <u>exercise</u> this, but if it is there, they have an option

Term loan - term

- A longer loan term should be preferred, perhaps approaching the <u>useful life</u> of the equipment
- The term loan payment including principal will actually <u>decline</u> over time, they are not flat payments (like most mortgages) which is easier for budgeting
- A prepayment without penalty clause should be requested, in case they want to pay the loan off early, for any reason

Line of credit tip



- Your line of credit may have a <u>bubble</u>, that is the ability of the bank to <u>lend you more than the</u> <u>stated amount</u>, but this is not in the financing agreement
- I called my Big Five bank once, and was told my \$2M line of credit, had a 10% bubble, if:
- a) the covenants were on side; and
- b) the account manager signed off
- You should call your bank after the course to find out!

Operation of facility



- If the company's account is negative two dollars, a \$10K loan is advanced
- The facility would be slightly cheaper if the revolving was in multiples of \$5K, \$1K or even nothing, rather than \$10K
- I had my bank go from \$5K to \$10K at renewal, and I complained and they went back to \$5K

Let's talk about margining

Which impacts what we can borrow day-to-day

Let's talk about margining

		Raleigh Import	-Export Inc.				
		31-Oct-202	5				
		Accounts Recei	vable				
	Current	1-30	31 - 60	61 - 90	> 90	TOTAL	Terms
9226-2674 Canada Inc	\$ 13,000.00	-	-	-	-	\$ 13,000.00	Net 30
Advantekss Inc.	63,126.76	_	-	_	-	63,126.76	Net 30
Health Limited	22,100.00	13,000.00	13,000.00		-	48,100.00	Net 30
Enron Corporation					8,053.54	8,053.54	Net 30
Walmart Canada					184,503.22	184,503.22	Net 60
Bell Canada Inc.	18,767.37	98,053.54			15.00	116,835.91	Net 60
Sweden Import AB	51,004.80	51,004.80			-	102,009.60	Net 30
Justin Trudeau Inc.	71,347.96				-	71,347.96	Net 45
Auston Matthews Inc.	63,126.76	63,126.76	63,126.76	_	-	189,380.28	Net 30
SellingStuff.com	22,489.71		86,053.54			108,543.25	Net 30
	\$ 324,963.36	\$ 225,185.10	\$ 162,180.30	<u>\$ -</u>	<u>\$ 192,571.76</u>	\$ 904,900.52	

Margining

- The Bank does not appear willing to margin any of the company's <u>inventory</u>
- It is common for <u>inventory</u> to be marginable in a bank agreement with receivables, at <u>50%</u>, <u>although I have got 25% on volatile computer</u> <u>chips</u>
- (If the Bank is only willing to provide a \$250,000 operating facility, the receivables alone may support it)
- Banks are less comfortable with inventory and may limit it to 25% of the borrowing base





- I have tried to get a bank to base the margin on selling price of inventory, not cost (98% margin on software DVDs) but they refused
- Some companies are able to margin <u>Work in</u>
 <u>Progress</u> and <u>accrued receivables</u> under certain conditions always negotiate
- Inventory can usually be margined at 90% if EDC insured for export

Foreign receivables

- Since the company sometimes sells to Spain and Portugal, the exclusion of these countries may cause a problem
- This should be discussed with the Bank
- It is possible that certain laws in these countries mean that the Bank excludes them
- (One of my Canadian bank's would margin Swedish receivables but not German)
- Could the bank margin them at say <u>some low %</u>, <u>say 25-50%?</u>

Foreign receivables

- It may be necessary to get EDC (Export Development Corporation) foreign receivable credit insurance, which is generally in the 40 to 90 basis points range for approved companies (0.4% to 0.9%)
- The result is 90% insurance coverage (10% deductible if there are losses) and 90% bank margining of any insured receivables, Canadian or foreign, any age

Note

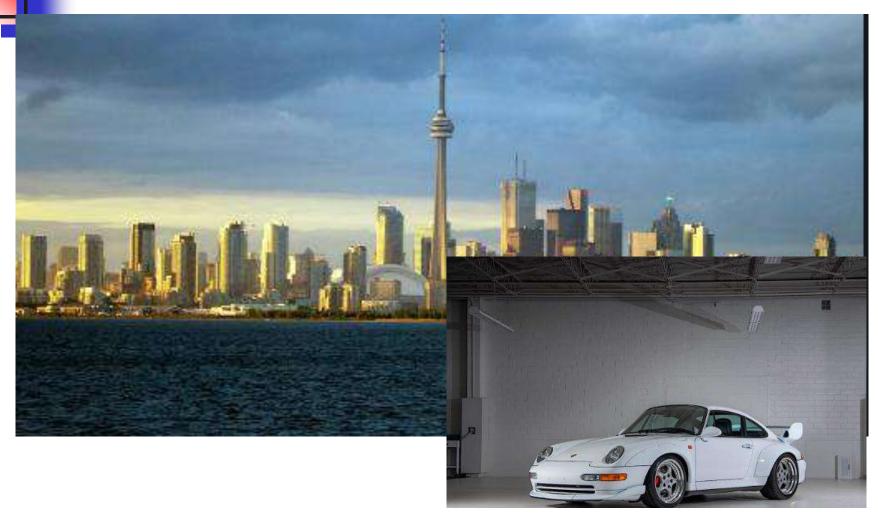
 Credit insurance basically doesn't cover customer disputes

Foreign receivables

- This also gives you high quality <u>free credit</u> <u>checking</u>, better than most companies can do themselves
- If EDC turns the customer down, it is an indication of real <u>credit concern</u> usually
- EDC's credit insurance services are very <u>user-friendly and are web-based</u>
- Credit insurance is also available from some <u>private</u> sources - a broker can help select the best source
- EDC can insure Canadian receivables with a partner



Parking?



- receivables 90 days after invoicing, when some customers may be strong and are on 60 day terms does not make sense
- When 31 days late, these receivable are not marginable, whereas a net 30 receivable from a weak customer is marginable when 59 days late
- This is a standard policy the Bank may be unwilling to change

- Excluding receivables 90 days after invoicing, when some customers may be strong and are on 60 day terms does not make sense
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		Raleigh Import	-Export Inc.				
		31-Oct-20 Accounts Recei					
	Current	1-30	31 - 60	61 - 90	> 90	TOTAL	Terms
9226-2674 Canada Inc	\$ 13,000.00	-	-	-	-	\$ 13,000.00	Net 30
Advantekss Inc.	63,126.76	j -	-	-	-	63,126.76	Net 30
Health Limited	22,100.00	13,000.00	13,000.00		-	48,100.00	Net 30
Enron Corporation					8,053.54	8,053.54	Net 30
Walmart Canada					184,503.22	184,503.22	Net 60
Bell Canada Inc.	18,767.37	98,053.54			15.00	116,835.91	Net 60
Sweden Import AB	51,004.80	51,004.80			-	102,009.60	Net 30
Justin Trudeau Inc.	71,347.96	j			-	71,347.96	Net 45
Auston Matthews Inc.	63,126.76	63,126.76	63,126.76	-	-	189,380.28	Net 30
SellingStuff.com	22,489.71	-	86,053.54			108,543.25	Net 30
	\$ 324,963.36	\$ 225,185.10	\$ 162,180.30	\$ -	\$ 192,571,76	\$ 904,900.52	

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More mechanics

- If \$1,000 is disputed or late with a good account, nothing is marginable
- A compromise might be that if _____of the total receivable from a customer is overdue, then the balance is still marginable – I have persuaded a bank to accept this
- The company should also have the ability to persuade that a particular receivable is good, even if it not good by any of the fixed criteria, i.e. it is proven good because the customer paid after month end

More mechanics

- If \$1,000 is disputed or late with a good account, nothing is marginable
- A compromise might be that if <u>less than 10%</u> of the total receivable from a customer is overdue, then the balance is still marginable – I have persuaded a bank to accept this
- The company should also have the ability to persuade that a particular receivable is good, even if it not good by any of the fixed criteria, i.e. it is proven good because the customer paid after month end



- In our <u>Newfoundland</u> session, a guy said if the bank won't margin a customer's receivable, because of one over 90 day disputed invoice, "just send a new invoice, that's what we do in Newfoundland"
- This is hopefully a joke, it is probably <u>fraud</u>...



More mechanics

- The bank may be willing to have some "named exclusions" of companies, who they will margin always as they are "blue chip", even though by the agreement, they could not be margined, eg Walmart
- If the company has an <u>official credit rating eg</u> <u>Moody's or S&P</u>, you should be able to margin



Maximizing margin

- If you need to maximize the margin calculation:
- Time your <u>reporting</u> to maximize your margin & borrowing

You reported this on May 10, so this is your current margin base:

	30-Apr-22		Margin
Marginable A/R	854,204	75%	640,653
Marginable inventory	500,142	50%	250,071
	1,354,346		890,724

You reported this on May 10, so this is your current margin base:

	30-Apr-22		<u>Margin</u>
Marginable A/R	854,204	75%	640,653
Marginable inventory	500,142	50%	250,071
	1,354,346		890,724

At the end of May, it is:

	31-May-22		Margin
Marginable A/R	1,020,333	75%	765,250
Marginable inventory	<u>754,222</u>	50%	377,111
	1,774,555		1,142,361

You submit it at 7 AM June 1!

You reported this on May 10, so this is your current margin base:

	30-Apr-22		<u>Margin</u>
Marginable A/R	854,204	75%	640,653
Marginable inventory	500,142	50%	250,071
	1,354,346		890,724

At the end of May, it is:

	31-May-22		Margin
Marginable A/R	504,222	75%	378,167
Marginable inventory	454,722	50%	227,361
	958,944		605,528

You submit as late as possible, <u>June 30</u>

 Suppose in mid-May, you got a large order from a customer, so it is:

		14-May-22		Margin	
Marginabl	Marginable A/R		75%	842,492	
Marginabl	e inventory	635,433	50%	317,717	
		<u>1,758,755</u>		1,160,208	

 Then you call the bank and ask permission for margining <u>immediately</u>, before May 31



Maximizing margin

- If you need to maximize the margin calculation:
- Report margin calc <u>early</u> if <u>higher than prior</u> month, at the end of the month if <u>lower</u>
- 2. Ensure you minimize statutory deductions

Interest rates

- Who remembers the prime rate in 1981?
- The highest ever in Canada
- 22.75% on Wednesday, August 12th
- Today it is 4.95%
- The lowest ever was 2.25% April 2009



- What is Prime plus ___ on your line of credit?
- All sessions: Prime plus 0.90%
- A mix of companies and credit risks

: prime plus a quarter

Interest rates overall

- You need to find out if the bank's prime rate, Canadian and U.S., generally moves with the major bank's' prime rate
- Some historic data should be available from the account manager if you can't google it
- Prime plus 2.5% is a <u>bit high</u>, not that unreasonable for a young business, given the risk
- You should ask them to consider <u>reducing</u> the rate after a year

Interest rates

- Another alternative is a <u>lower</u> rate on <u>say the</u> <u>first \$150,000</u> and a higher rate for the balance of the loans, where they have more risk
- You might be able to negotiate a <u>rate</u> <u>improvement</u> if for example the net worth or current ratio increases to a specified level
- For larger borrowers, try to a get a built in rate grid, on a <u>Funded/EBITDA grid*</u>, lower leverage, lower rate
- *debt service

Danger – do not push this button

Interest rate comments

- The term loan has a floating rate
- It is generally better/safer to finance longterm assets with <u>long-term financing at fixed</u> <u>rates</u>
- This adds risk to the financing
- (It is absolutely standard for Operating Facilities to be floating rate)
- Ask the Bank about this, but they may not be interested in changing, or they might give a high fixed rate

An option

 You might be able to lay off the risk by entering into a <u>"fixed-for-floating"</u> interest rate swap, although the floating rate may be LIBOR (London Inter Bank Offering Rate)

What is an interest rate swap?

An interest rate swap is an agreement between two parties to exchange one stream of interest payments for another, over a set period of time. Swaps are derivative contracts and trade over-the-counter.

Other interest rate notes

- You could argue that the rate on U.S. loans should be the same as Canadian, after all the risk is the same.
- Perhaps the bank would go with an <u>interest</u> and or <u>principal holiday</u> on the term loan for a period, but there would be trade off for this.



- The interest rate on late amounts is a rather punitive prime plus 9%
- This should be argued with
- (I have seen prime plus <u>7%</u> in real agreements)



Bank fees and rates

What do you think of them?

Fees and costs

- They are hitting you with fees all over the place
- There is an <u>up front</u> fee, as well as a <u>monitoring</u> fee, a <u>renewal</u> fee and the <u>current activity</u> fees
- You are not renewing, you are setting up for the first time
- Perhaps they could make it one fee so it is less confusing
- An estimate of the direct revenue to the Bank under their proposal is \$38K per year.



Total bank fees	
Set-up fee	2,000
Monitoring fee	3,600
Renewal fee	1,500
Activity fees	2,160
Interest	
P+2.5% times	29,100
\$300K	
	38,360
Assumption:	
Prime is	7.20%

Activity fees

- The Bank wants to have the right to increase its activity fees <u>at any time</u>
- This is not <u>desirable</u>
- They should at least hold them for the <u>term of</u> the agreement
- Alternately, they should only move when the bank moves them for all its customers
- Or maxed at <u>CPI</u>





What is the "hidden cost" in many bank agreements?

- Your company will have to bear the <u>legal costs</u>
- Taking security interests costs involves some <u>legal</u> work
- You don't want these to be too high
- Ask the Bank what the estimated <u>legal fees</u> including out of pocket costs are and which law firm they propose to use, or are they using in house Bank lawyers?
- Have the Bank ask for a quote from the law firm that they pass to you before starting
- If the proposed law firm is an expensive, consider trying to get the Bank to use a cheaper one

Other negotiation ideas

- Veto rights on which law firm would be also be a better clause
- Even better, try to get the fees <u>capped</u>
- We have heard of banks being willing to use <u>client's lawyer</u>
- Ask to <u>see</u> the actual legal bills and be prepared to question the charges



 My 2 hour video course, How to Managing Lawyers & Legal Fees, is available



THIS MEETING HAS BEEN ZOOM BOMBED



Bank fees and business stress

- Public co I was Controller of had violated covenants and was in some trouble
- The bank said "we have decided to charge you a \$15K a month, <u>risk</u> fee"
- "Now, we have decided to send a <u>monitor</u> in to check your situation <u>weekly</u>, the monitor will be <u>PWC</u>, oh yes, and you are paying..."
- Our loans were likely now with the "special" loans dept of the bank
- Lesson: <u>open season</u> on fees, if covenants have been violated..

Financial stress

- I have created a 2.5 hour in-depth course on the topic of getting through cash problems,
- Deals with the bank <u>squeezing you</u>, covenant violations and many other topics, negotiating with suppliers, cutting costs, reducing payroll and more
- Practical Tips to Get Through A Cash Crisis
- Several thousand have taken it

Comments on course

- A useful course jam packed with valuable insights given the ongoing economic environment around us
- I feel you gave a good cheat sheet to any of the participants to help their companies survive through the current Cash Crisis
- Good to have practical tips, real life examples not just for during a pandemic but other times of crisis as well
- Your seminar was a great review of tools and things available to a company in this difficult cash flow time
- Well presented, like the questions and instant feedback
- It was very informative and thought provoking
- For myself personally the accounts payable ranking really stood out it was helpful to see it laid out the way that you did it
- I'm gathering my virtual learning kids around to watch this. Better than any other entertainment
- It was a good session, slides had good content, you have a personable delivery, this is good stuff (Licensed Insolvency Trustee)

The demand for an audit

- The Bank has asked for audited financials, perhaps because the company is a new client
- (Tell them no problem, as long as you pay for it...)
- A first audit will likely be messy and costly, the company has never had an audit before
- However, the shareholders will benefit from greater assurance on the financials, but this is a small business, they know the business well





Audit pushbacks

- Often in small business, the Bank will accept a Review Engagement only
- Consider asking the Bank to drop the requirement to a <u>Review Engagement Report</u> instead
- Or at least drop to a Review <u>after the first year</u>, if all goes well
- Another cheaper compromise position is to have the accountants do a Review and a report on performance of "specified procedures" on accounts receivable (and inventory if necessary)
- This would likely be cheaper than even a review, but would have to be approved by the Bank

Interesting comment recently

We were able to ask for a one-year delay on a requirement for review engagement financial statements on a 7-digit loan, with the explanation that the rapidly growing company could over the year organize its accounting processes to better meet the requirements of a review engagement. With their rapid growth, the accounting resources would be better deployed to supporting the growth, rather than focusing on digging through the past year's transactions - we expected a very messy switch to the review engagement. The bank went for it, surprised me somewhat \bigcirc .

Audit final points

- The ideal would just a <u>Notice to Reader or</u> acceptance of management's statements
- (I have heard of a bank that would <u>double</u> the facility if the financials were audited)
- I have occasionally heard of a bank asking for a copy of the <u>auditor's management letter</u> – it might not be good for them to see this

If you bank debt/facilities

- You likely have to submit the following monthly
- 1. Financials
- Covenant calc's & compliance certificate
- Margining calculations

1

What everybody does

Chris Halw

Account Manager

Grand Bank of Canada

Dear Chris, June 23, 2022

You will find attached our:

- May 31, 2022 financial statements
- 2. May 31, 2022 covenant calculations and compliance certificate
- 3. May 31, 2022 margining calculations for the line of credit

Yours sincerely,

Customer, CPA

What I do

Chris Halw

Account Manager

Grand Bank of Canada

Dear Chris, June 23, 2022

You will find attached our:

- 1. May 31, 2022 financial statements
- 2. May 31, 2022 covenant calculations and compliance certificate
- 3. May 31, 2022 margining calculations for the line of credit
- 4. Management's discussion of May 2022 results and Outlook for the rest of the year

Yours sincerely,

Customer, CPA

Veto rights

- The Bank proposes veto rights on: <u>dividends</u>, <u>repayments of shareholder loans and changes in</u> <u>ownership</u>
- The latter could restrict <u>estate planning flexibility</u>
- You can always take out shareholder remuneration in the form of salary or management fees, without the Bank having veto rights
- However, this has different tax consequences and you would rather have complete flexibility



Key counter-argument

Key counter-argument

 You should argue that if the covenants, particularly <u>net worth</u>, are <u>on side</u>, the bank should not worry about restricting dividends, this covenant controls excessive dividends

Other arguments

- You promise to give the bank <u>notice</u> of dividends
- Dividends could be paid if say an <u>equal amount</u> was repaid on the loan facility
- A fall back position would that dividends more than \$X (historical average perhaps) need approval of the Bank
- Another option is they need approval of the bank but "such approval not to be unreasonably withheld"
- This last clause would give the Bank some pause in vetoing dividends on a whim, it <u>softens</u> the clause

Other arguments

- (Note: A "such approval not to be unreasonably withheld" clause is a good compromise, any time bank permission is required for anything,, including ownership change)
- Another compromise would be a <u>total</u> remuneration (all types) above \$X (a high number) veto, giving more flexibility

Other points

- It would be better to divide the types of breaches or events of default into <u>major and minor</u>, the latter not resulting in the loan being called, but with smaller ramifications
- Give the company has some foreign sales, the company should negotiate some foreign exchange facilities (EDC can help)
- If the company faces longer term foreign currency risks, it might want to enter into forward contracts to buy or sell currency for <u>hedging</u> purposes, and these have banking implications



- Practical Foreign Exchange Management
- I am always creating new courses

There are some minor points

- Credit card
- Bank reporting timing
- Environmental issues
- Life insurance
- And more

Credit card

- The shareholder card should probably be dropped
- A <u>credit card facility</u> should be requested with the Northern Bank, that is company debt, rather than personal debt
- The Bank might be able to help, by <u>carving</u> an amount out of the credit facilities
- If not, other <u>credit card companies</u> could be approached for a corporate card

Bank reporting - timing

- The Bank may be asking for financials too soon after year end, at 60 days
- You are still getting consistent reporting in place
- The auditors will be busy with their bigger clients in January and February
- Talk to the Bank about this and ask for <u>90 days</u>
- It would be simpler if all Bank documents were due 30 days after month end rather than 20, including the financials, which the company has some difficulty in producing on timely basis at this point in time

Bank reporting

- The Bank is several years out of date, the term deferred taxes no longer exists under Canadian Generally Accepted Accounting Principles
- Should get the Bank to change this to future income taxes, for greater clarity
- However, unless the company has larger future income debits than credits, this will help the current ratio covenant

Credit card

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- If not, other <u>credit card companies</u> could be approached for a corporate card
- In real life, sometimes problematic, a prepaid card may the best option

Life insurance

- You will need to ensure that the founders get the life insurance because otherwise the facility could become null and void
- Quotes should be obtained immediately to determine the cost so that it can be considered and <u>budgeted</u>
- The cost should not be that <u>high</u>, given the age of the founders, if they are in good health
- I have heard of bank life insurance that <u>fluctuates</u> with the changes in the total bank debt, so that the cost was lower



Interest on funds on deposit

- The interest rate for funds on deposit is only 1.3% per annum
- This should be <u>negotiated</u>
- It would be easier to negotiate this with some comparable numbers from other banks

Other points

- The source deductions portion of the statutory prior claims should have no impact since you use a payroll service which makes all the required remittances
- You should ask that Bank what "such other financial and operating statements and reports as and when the Bank may reasonably require" might be
- The Bank should be satisfied with the monthly and annual statements and the budgets
- (I had this clause for years, but the bank has never asked for anything)

Other points

- The company must ensure that it has no <u>environmental</u> <u>issues</u>, because of the strong standard clauses the Bank agreement includes in this regards
- This may require specialized professional advice
- The pay date of the term loan might be more convenient for accounting cash planning purposes on the <u>first or last</u> <u>day of the month</u>
- The monthly reports could be put in a <u>spreadsheet</u>, to facilitate the preparation thereof
- Perhaps the Bank has such a spreadsheet available
- It should be noted that some people find that wire transfers sent by Schedule B banks, are not as <u>reliable</u> as Schedule A banks

I have over 50 hours of other courses

- All full of practical tips
- Including ethics courses to meet your ethics requirements

Coupon code

 Use coupon code EPCAL2025 to get 40% off my video courses, from my website, to December 31, 2025

Another negotiation course

- I cover dozens of other negotiation situations in this other course
- Practical Financial Negotiation Tips (4 hours)
- Financial negotiation tips, presented in a compelling way, with lots of examples
- Not primarily a tactical negotiating course
- Showing financial and business creativity in negotiating

My course

Practical Tips for Controllers & CFOs, my world's biggest seller, an 8 hour video, over 11,000 have taken it, has a lot of useful advisory points for entrepreneurial CPAs



- Was this boring?
- Top Participant prize
- Drop some feedback in the Chat
- You can do LinkedIn with me
- You can email me with follow up questions spriddle@bell.net

