



SHARPEN YOUR BUSINESS LOAN NEGOTIATION SKILLS

PRESENTED BY:

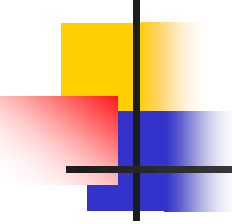
**Stephen Priddle, CPA, CA, CMA
Ottawa, Ontario**

**VP, Finance & CFO & Corporate Secretary
SureWx Inc.**

& President, Practical PD Seminars for Accountants

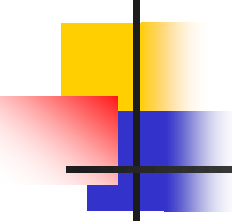
www.practicalpd.com

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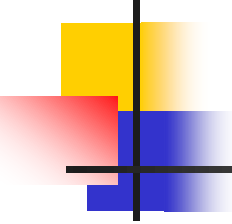
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Welcome

- My purpose is to help you better negotiate financing offers or advise on the same
- It will also help re-negotiate the annual renewal of an existing agreement
- I want you to gather ideas, smarts, tips that make you look good!



Notes

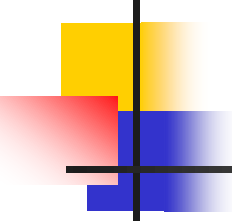
- The two hours of PD, include the time you need to read the case
- I will fill in the blanks in the handout in this presentation, it will make it more interesting...
- Send me an email when you finish, spriddle@bell.net, and I will send you fully completed slides and a written case solution

Where am I?



This is my home – foreign audiences....





Actually

- some of them almost believe it



At age 20, I became a CGA

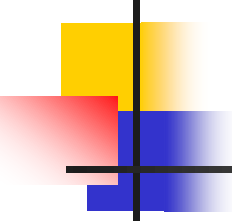
- Yes, **Chief Gluing Assistant** in a federal government office, gluing paper on the evening shift... because I didn't want to go to university...
- I later became a **Certified General Accountant...**



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

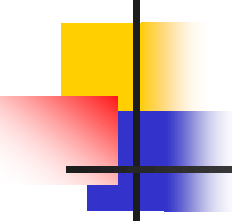
VP, Finance & CFO &
Director, co-owner
after 2015 MBO





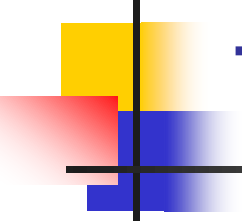
My background

- Employers
- Designations
- Writing
- Speaking

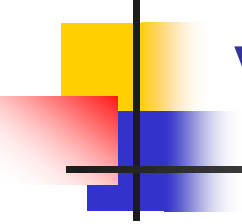


A career excerpt

- The move to treasury for four years...
- Short-term investments, banking, foreign exchange, letters of credit, commodity taxes, insurance & risk management

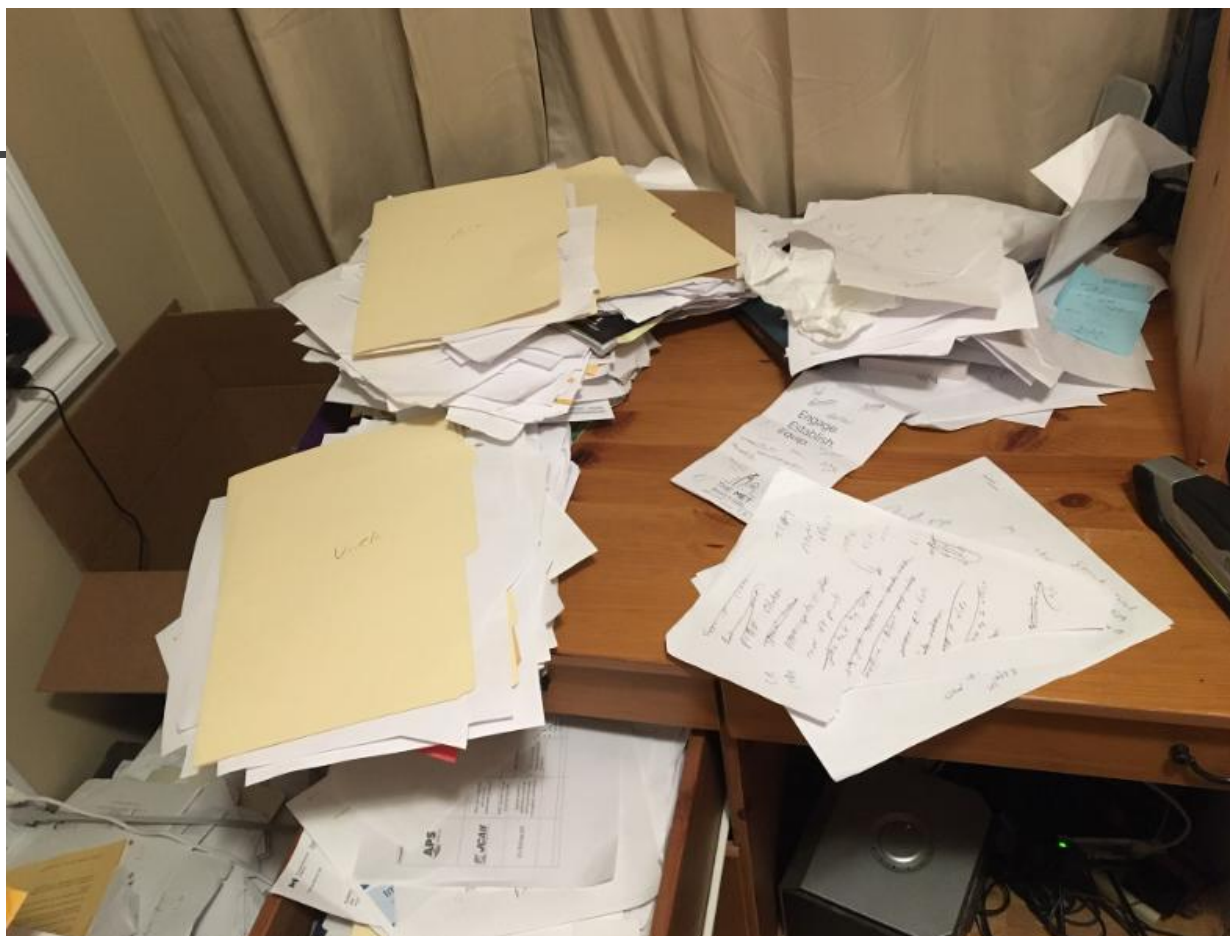


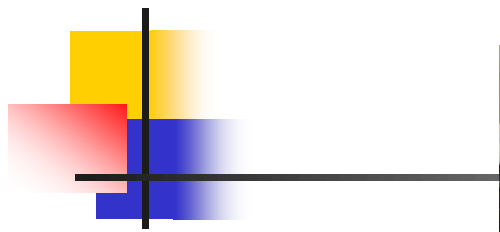
In our live courses we do
funny intros, I will do two



Type “messy” in the chat if you....

- You have a messy desk

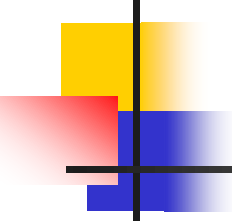






If a cluttered desk is a sign
of a cluttered mind, of what,
then, is an empty desk a sign?

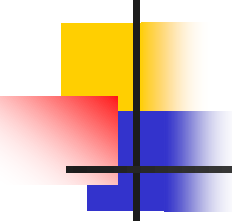
Albert Einstein



Type “yes” in the chat if you...

- You are so boring and unimaginative that you ... married another accountant





Recent chat responses

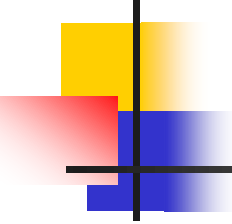
From Joey : I did

From Armando : no

From saile : fortunately no

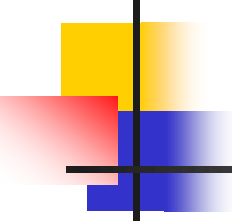
From Antonio Petruccelli, cpa, cma, acma to Stephen Priddle(Privately) : dating

From Armando : no thanks



The problem

- Many accountants can't find a spouse because...
- Many accountants want to marry another accountant
- Many non-accountants hear accountants are well-paid and employable so they want to marry one...



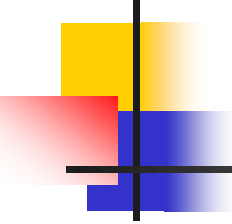
Note

- So, I am doing something to help in this area
- Check out my site:
- www.accountantsmatch.com

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

- So what are we going to do in this video course
- Send me an email after the course, with useful feedback, a joke, or a good question, and you will be put in a draw to win a prize...
- spriddle@bell.net



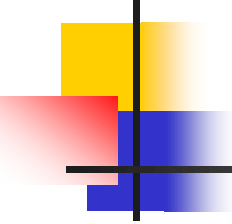


Banking joke

- The short-term loan

Parking?

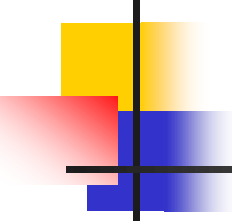




Banking experience

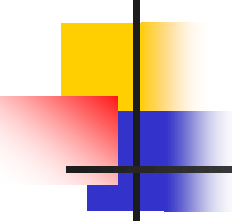
- I have dealt with all the major banks in Canada at different times
- Accounts, loans, letters of credit
- With one start up I increased the operating facility 10 fold in 4 years
- I used to teach a “canned” Corporate Treasury Management course

I had a 30 year veteran banker review this, no longer in banking so he could speak his mind



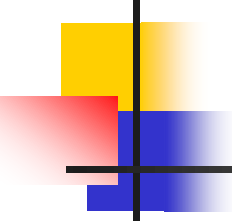
Key

- 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

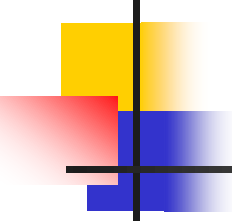
- Your leverage varies, for example:
- Small weak company wants a \$50K line of credit
- Large, strong company wants \$500M of financing...



Note

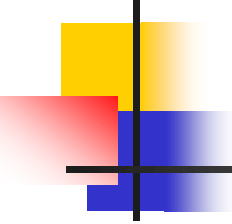
I have chosen
A small business
context

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

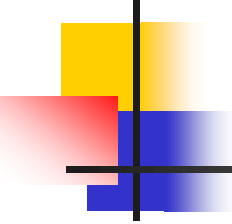


Bank negotiating tips

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



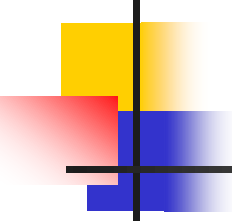
Will they negotiate terms?



Actual Big Five Bank email to me

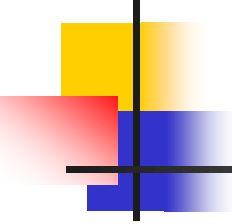
- *"If you have a suggestion to amend wording you may provide it, however any change will require legal review "*

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



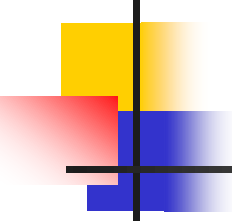
Remember banks focus on the two Cs

- **Collateral and Cash Flow**



Bank offer letter - objectives

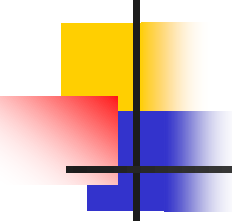
- Consider adequacy of offer
- Look “outside” the case as well
- (Don’t criticize what you don’t like – how to negotiate to improve it is the issue)
- Increase amount that can be borrowed
- Protect the company
- Protect the shareholders
- Minimize costs
- Loosen covenants & restrictions



Bank case

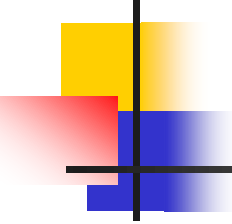
I am joking!

- 72 minute case
- Please write your response in a Word document, and email it me spriddle@bell.net
- A team of markers will grade them and return them to you, within 48 hours of receipt, with your national ranking in deciles...



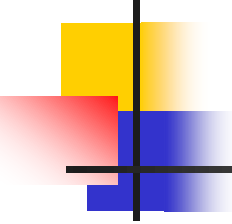
Time to read the bank offer

- Take the time to think of negotiation responses for every clause, you will learn more for this



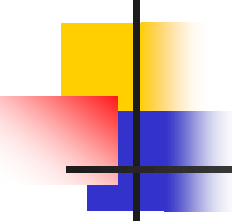
Someone said a bank agreement is like a

- Prenuptial agreement



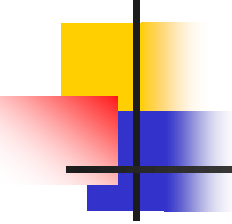
Finished reading

- Did you note the banker name joke in the case?
- Shylock, the nasty lender from the Merchant of Venice play by Shakespeare
- Did you notice the special note at the end of the definitions?...



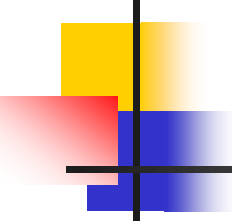
Note

- You “fail” the case if your answer is simply “find a different bank”



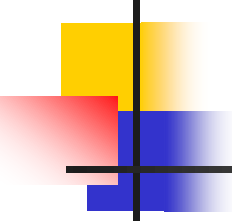
Bank case discussion

- Has you ever banked with the Northern Bank?
- What is good about the offer?
- Would you sign it?
- (The company probably needs a little more time than 14 days to consider the offer)
- How can this company get more leverage with the bank? Promise family's personal banking/investing business/group RRSP/payroll/get employees to bank there personally



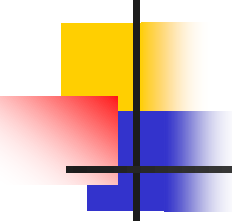
The offer

- The offer from the Northern Bank is not a great one, but a number of questions need to be asked and it may be possible to improve on it
- The Northern Bank was reasonable enough not to demand very extensive budget or business plan information before the loan was granted, in this small business context
- So far, the company has not been able to generate an offer from more than one bank, so it is not in a position to leverage other offers



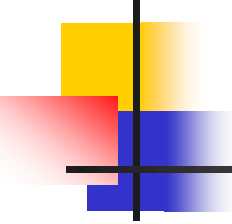
The offer

- If it had very good financial reporting and a strong business plan, it is likely that more offers could have been received.
- Perhaps it would be better to get a longer term for the agreement, but this is a new client for the bank
- If the company can perform well with the Bank for one year, it will have more leverage next year for the renewal
- Legal advice, from a good lawyer, with lots of banking experience should be sought before getting back to the bank.



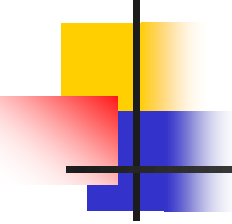
Big picture – Northern Bank

- Talk to other small business people who have a Northern Bank operating facility – are they happy?
- Are the clauses in this agreement standard Northern Bank clauses or is the bank being hard on you
- The Bank does see growth and they would like to get you signed up now, so they can be your banker if you really grow to become a major client



Big picture – Northern Bank

- Being a newer Schedule B bank, they may be a little more hungry and less risk adverse than the large Schedule A banks
- It would be good if the Bank has experience in your industry



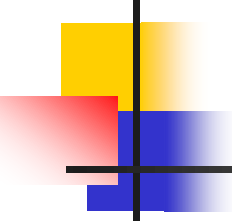
Big picture – Northern Bank

- It might be good to meet with the bank's credit people (usually kept away from customers by banks), they make the key decisions

Relationships

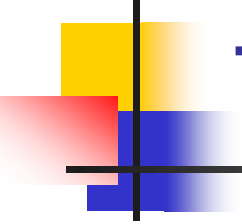
- Some people are good at getting results by “schmoozing”
- I am not good at it, and it is not my style
- A story



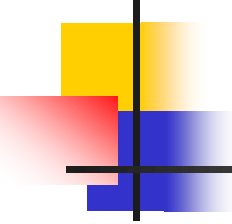


Is the facility enough?

- The company has been growing at over 200% per year to date
- Is \$250,000 is a large enough operating facility before too long and with the forecast for 2015 sales of \$8 million
- (Some banks use a 10% of revenues rule of thumb for operating lines of credit)
- The problem is the Bank will probably not offer any more to a young, relatively unproven company
- One argument to use with the bank is that if receivables are say \$1M, their operating facility is extremely well-margined



Where else could they get financing?



Small Business Loan program

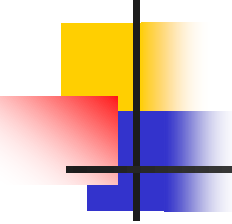
- Revenues under \$10M
- Up to \$1M

Canada Small Business Financing Program

Find a loan for your small business

This is a loan program in collaboration with financial institutions. If you are looking for other government financial incentives including grants or general information for small businesses, please access the [Canada Business Network](#).

- Budget 2021 proposes to improve the Canada Small Business Financing Program through amendments to the Canada Small Business Financing Act and its regulations. These proposed amendments are projected to increase annual financing by \$560 million, supporting approximately 2,900 additional small businesses. Proposed amendments include:
 - Expanding loan class eligibility to include lending against intellectual property and start-up assets and expenses.
 - Increasing the maximum loan amount from \$350,000 to \$500,000 and extending the loan coverage period from 10 to 15 years for equipment and leasehold improvements.
 - Expanding borrower eligibility to include non-profit and charitable social enterprises.
 - Introducing a new line of credit product to help with liquidity and cover short-term working capital needs.



✓ Equipment

✗ Working Capital

✓ Business Vehicles

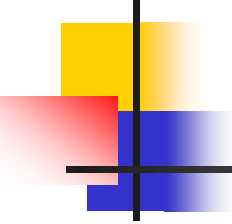
✗ Inventory

✓ Renovations

✗ Labour

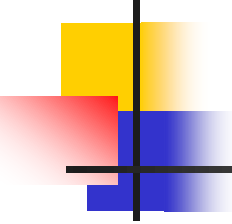
✓ Commercial Property

✗ Advertising



Other possible sources

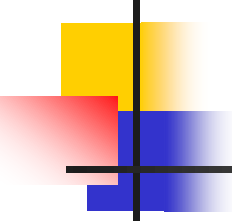
- Could the shareholders or relatives provide financing?
- Have any non-bank operating facility providers been considered? (some do 85% on A/R)
- Have suppliers been considered as a source of financing?
- Has warehouse equipment vendor financing been considered?
- Has leasing been considered?
- Have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



Other possible sources

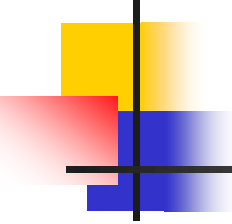
- Could the company considering factoring receivables (selling them), to provide cash and reduce the need for an operating facility?
- Has EDC (Export Development Corporation) been approached about helping this company which exports and working with the Northern Bank





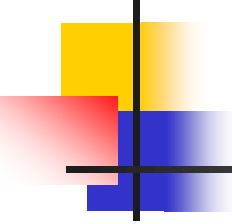
EDC help

- 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”

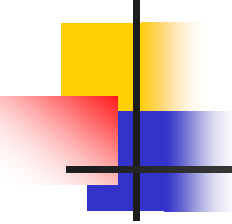


Question

- Someone once asked: how could one get another lender to rank equal with the bank?
- Answer: rare, bank must agree, and they always want to go first
- That is there would be security interest issues versus the bank's General Security Agreement if another lender had a security interest

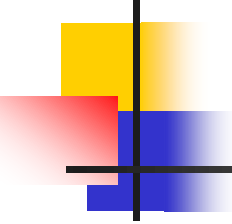
What clauses are “hills to die on”?





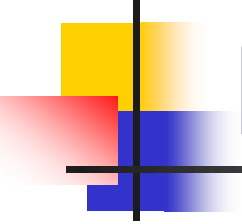
Most participants want to first discuss

- Personal guarantees

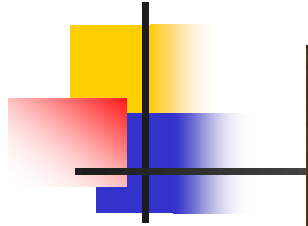


The clause

- (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

- Polling question

Are there personal guarantees with
your bank facilities?

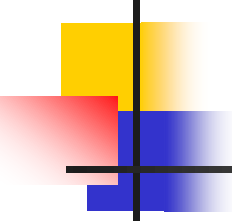


■ Yes ■ No

Personal guarantees

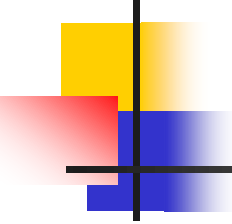


- The personal guarantees required of the founders, including a security interest in their principle residences, are likely very objectionable (they are legal)
- The personal guarantees also require the involvement of their spouses and the complication and cost of independent legal advice
- The bank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



The approach

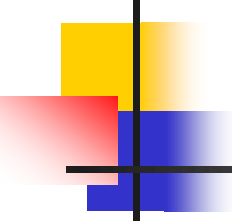
- Reduce or soften them any way possible
- Time them out if possible
- You should do the same for any similar requirements, from any bank, even if not personal guarantees



The clause

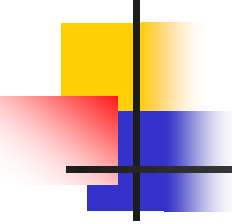
- (Interestingly, the bank has not asked for personal net worth statements)

Offering them might
help guarantee negotiations



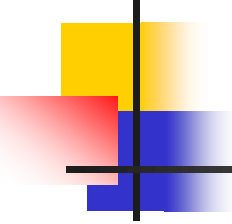
First question

- Ask the bank, what they would like in order to remove the personal guarantees?



Negotiation strategies

- Ask what size the facility would be without the personal guarantees, this finds out their “value”
- If inventory could be margined instead of A/R, could they be dropped entirely?
- A limited personal guarantee by each guarantor, not joint & several



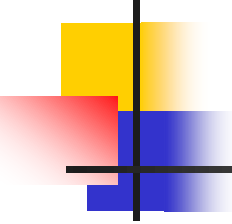
A real life example, I have seen

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

Negotiation strategies

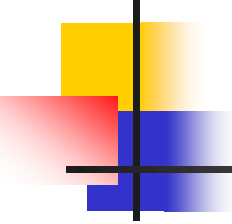
- A limitation against the principal residences, don't include them
- Provide some other collateral, say some personal investments, and exclude the principal residence
- A limitation against property owned jointly with the spouse
- Reduced guarantees in return for a family compensation cap





Negotiation strategies

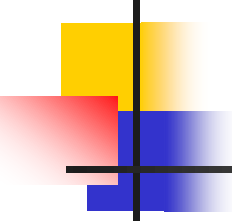
- The Bank agreeing to drop the guarantee after a year
- The Bank agreeing to “consider” dropping the guarantee after a year (weaker)



Negotiation strategies

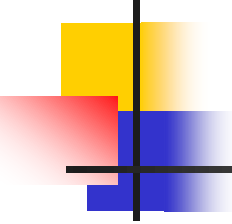
- The Bank agreeing to drop the guarantee once the company has a certain level of equity in the business, for example \$900,000 (worked for my brothers once)
- Covenant trade-off with the bank versus personal guarantee change

The milestone approach - 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..



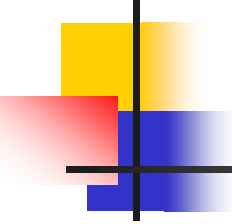
Finally

- What about a \$ limit on the personal guarantee?



Notes on guarantees

- 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
- If you are with a sub of a big foreign company, the issues may be quite different if you can get a parent company guarantee, it takes away a lot of the difficulties



Alternative to a guarantee

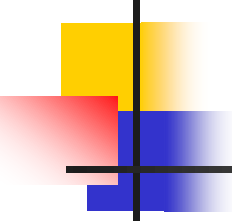
- I was once able to get out of a guarantee requested from the (public) parent company, with a comfort letter signed by the parent company

Someone said

- If they feed my firstborn and take care of them, this might work....
- Someone else was shocked that the bank would ask for cash in paper bags...

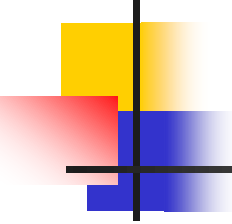


- It is a joke!



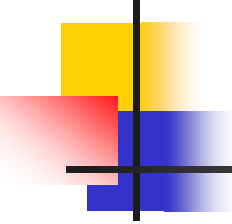
Random banking story

- The loan problem
- My fiancée's surname was "Lien"!



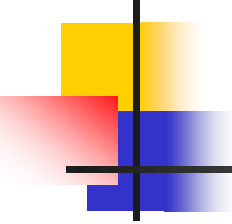
Covenants

- 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 maintainable - they need to be stress-tested which means projecting balance sheets
- A ball park calculation of the company's year end net worth is \$600,000 plus \$180,000 profit, less \$40,000 in dividends, giving approximate net worth of \$740,000, better than the covenant minimum of \$700K but close



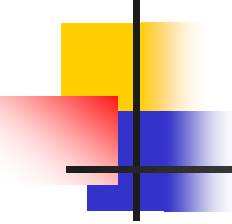
Covenants

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



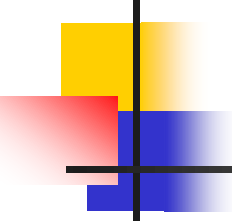
Covenants - evaluation

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



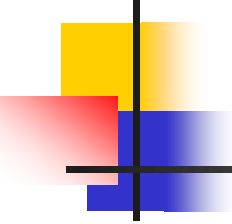
Current ratio covenant survey

- What is your current ratio covenant?
- All seminars: 1.38
- A mix of companies and credit risks



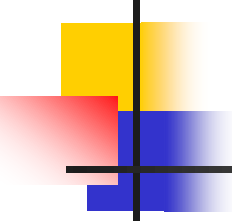
Net worth covenant

- 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 equity
- If the bank would accept them as equity, or exclude them from debt, this would help the company's position relative to the covenant
- It might be possible to actually convert some shareholder loans to equity, to help the net worth calculation



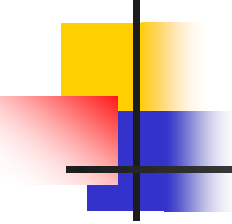
Intangible definition

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



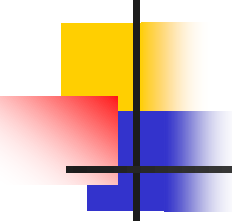
Experience

- I once got a major bank to agree not to exclude prepaid software licenses from intangibles
- After I left the company, they changed their mind
- I was able to dig up the old email and help my successor CFO push back on this



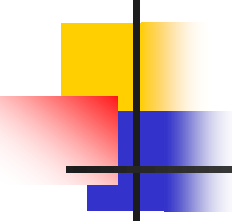
Covenants & estate planning

- 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)
- Under ASPE, it is possible, they can be reported as shares, with the proper disclosure, Section 3856.23
- You might want to discuss this with the Bank now
- Exclusion 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.)



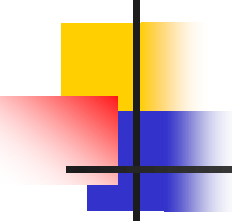
Negotiating covenants

- I once decided that it was illogical 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 I support that idea, I will go and check with my colleagues
- The colleagues said no.....



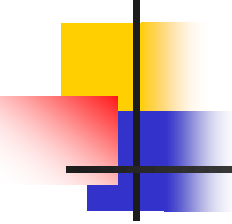
More on covenants

- 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 any agreements in the business world where breaches can hurt you...



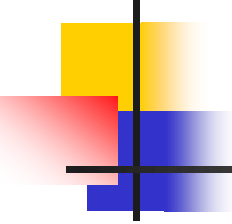
More on covenants

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



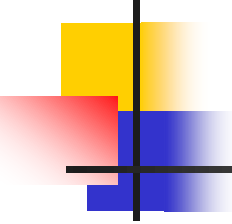
Possible debt service covenant

- The actual details of this Bank's version of a debt service covenant should be obtained
- Some projections 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 risky, because they can be violated with a single bad month, or a bad season



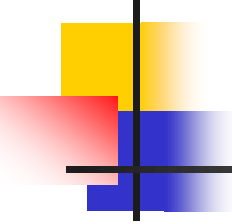
Possible debt service covenant

- The company usually won't blow a balance sheet covenant with one or two bad months, it takes longer term deterioration
- A rolling 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 known as TTM, trailing 12 months)



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 committed facility, 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 capital structure in this case

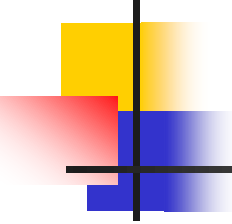


The bank can pull the plug when

- *"There is, in the sole opinion of the Bank, a major undesirable development in the financial condition, operation or ownership of the Borrower"*

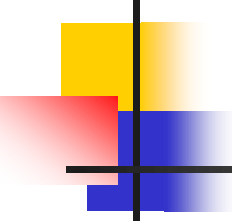
More commonly worded

- *"There is, in the sole opinion of the Bank, a **material adverse change** in the financial condition, operation or ownership of the Borrower"*



Analysis

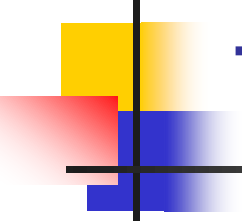
- Essentially this means that if they don't like something, they can pull the plug on the Term Loan and demand payment and the company could not really question the grounds for the judgement of major undesirable developments



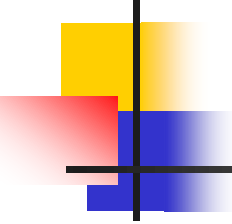
Analysis

- 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 says 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

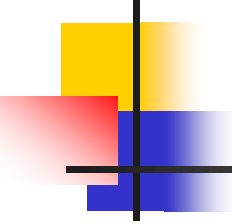


- Wording associated with the bank “acting reasonably” flowing from the material adverse change..



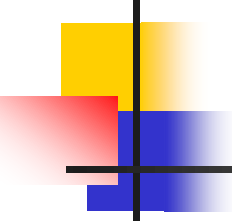
Note

- 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



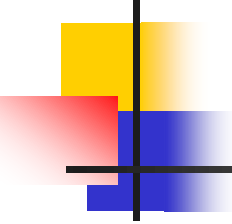
Events of default

- If there is an event of default under the agreement, the facility must be repaid
- There is no provision for getting out of default
- 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 life insurance
- Based on the offer, they can't get out of default, by getting the life insurance

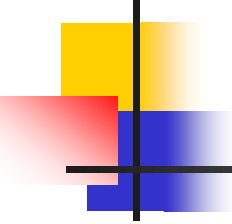


More events of default

- 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 dollar limit should be provided, over \$40,000 for example
- In practice banks may not exercise this, but if it is there, they have an option

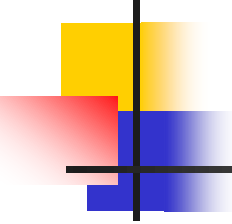


Let's look at the actual loans



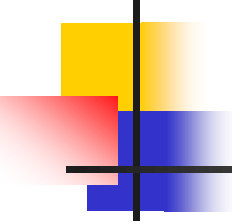
Term loan - term

- A longer loan term should be preferred, perhaps approaching the _____ of the equipment
- The term loan payment including principal will actually _____ over time, they are not flat payments (like most mortgages) which is easier for budgeting



Term loan - term

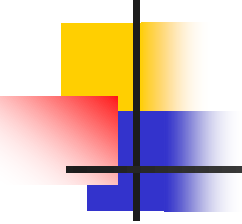
- A longer loan term should be preferred, perhaps approaching the useful life of the equipment
- The term loan payment including principal will actually ____ over time, they are not flat payments (like most mortgages) which is easier for budgeting



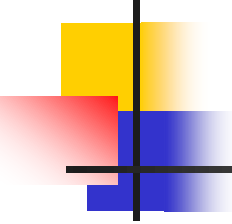
Term loan - term

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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

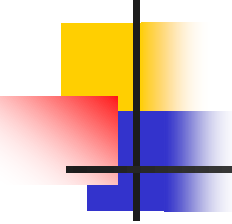


Let's talk about margining

- Which impacts what we can borrow day-to-day

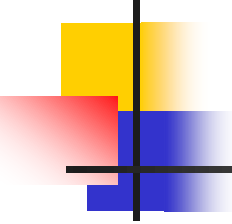
Let's talk about margining

		Raleigh Import-Export Inc.					
		31-Oct-21					
		Accounts Receivable					
	<u>Current</u>	<u>1-30</u>	<u>31 - 60</u>	<u>61 - 90</u>	<u>> 90</u>	<u>TOTAL</u>	<u>Terms</u>
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Health Limited	22,100.00	13,000.00	13,000.00		-	48,100.00	Net 30
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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
	<u>\$ 324,963.36</u>	<u>\$ 225,185.10</u>	<u>\$ 162,180.30</u>	<u>\$ -</u>	<u>\$ 192,571.76</u>	<u>\$ 904,900.52</u>	



Margining

- The Bank does not appear willing to margin any of the company's inventory
- It is common for inventory to be marginable in a bank agreement with receivables, at 50%, although I have got 25% on volatile computer chips
- (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



Side notes

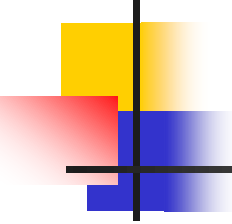


- I have tried to get a bank to base the margin on selling price of inventory, not cost (98% margin on software DVDs) but they refused
- Some companies are able to margin Work in Progress and accrued receivables under certain conditions – always negotiate

Foreign receivables

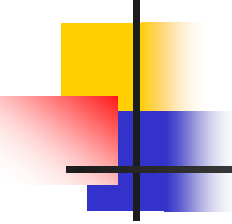


- Since the company sometimes sells to Spain and Portugal, the exclusion of these countries may cause a problem
- This should be discussed with the Bank
- It is possible that certain laws in these countries mean that the Bank excludes them
- (One of my Canadian bank's would margin Swedish receivables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



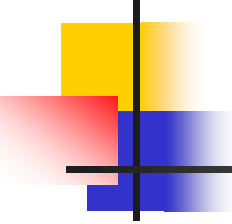
Foreign receivables

- 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



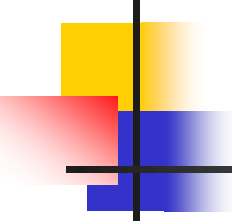
Note

- Credit insurance basically doesn't cover customer disputes



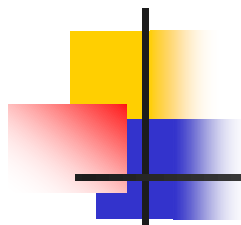
Foreign receivables

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



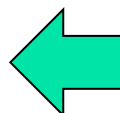
Margining mechanics

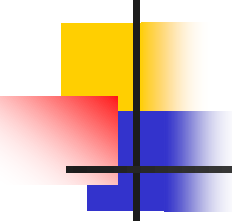
- Excluding receivables 90 days after invoicing, when some customers may be strong and are on 60 day terms does not make sense
- When 31 days late, these receivable are not marginable, whereas a net 30 receivable from a weak customer is marginable when 59 days late
- This is a standard policy the Bank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



Raleigh Import-Export Inc.
31-Oct-21
Accounts Receivable

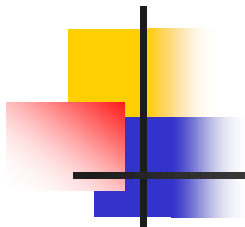
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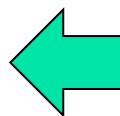


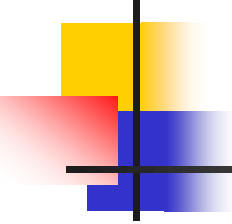
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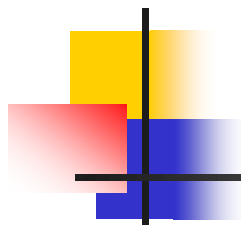
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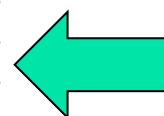


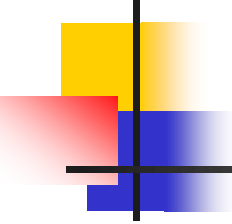
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Enron Corporation					8,053.54	8,053.54	Net 30
Walmart Canada					184,503.22	184,503.22	Net 60
Bell Canada Inc.	18,767.37	98,053.54			15.00	116,835.91	Net 60
Sweden Import AB	51,004.80	51,004.80			-	102,009.60	Net 30
Justin Trudeau Inc.	71,347.96				-	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
	<u>\$ 324,963.36</u>	<u>\$ 225,185.10</u>	<u>\$ 162,180.30</u>	<u>\$ -</u>	<u>\$ 192,571.76</u>	<u>\$ 904,900.52</u>	





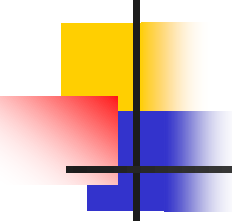
More mechanics

- If \$1,000 is disputed or late with a good account, nothing is marginable
- A compromise might be that if less than 10% 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

Margining mechanics

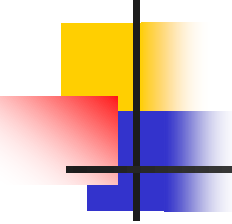
- In our Newfoundland seminar, a guy said if the bank won't margin a customer's receivable, because of one over 90 day disputed invoice, "just send a new invoice, that's what we do in Newfoundland"
- This is hopefully a joke, it is probably fraud...





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 official credit rating eg Moody’s or S&P, you should be able to margin



Bonus advice, gov't A/R

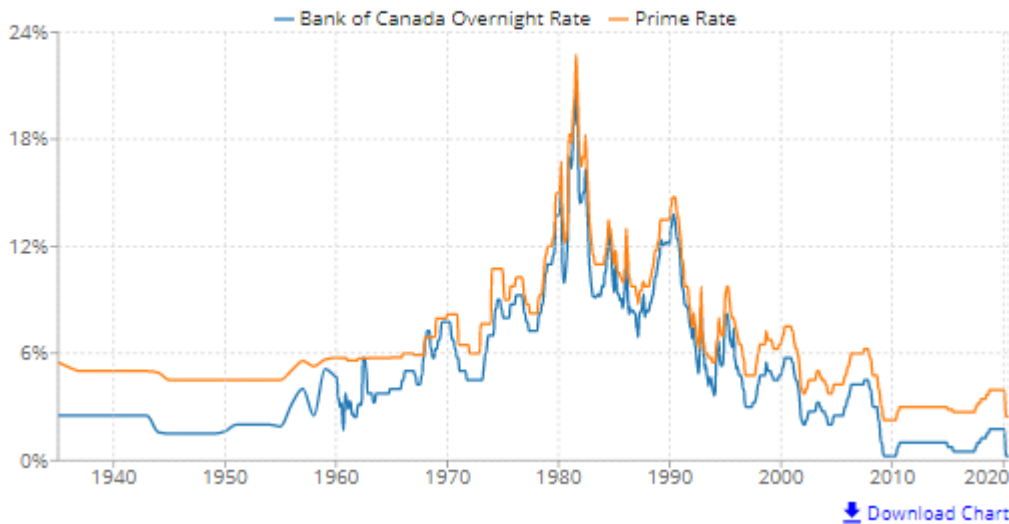
- Although there are no government receivables in the case, note that banks will often margin older government receivables, because they are a special case, but you may need to ask

Random banking story

- I get robbed by a bank...

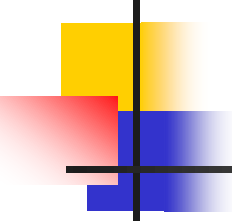


History of Prime Rates and the Bank of Canada Overnight Rate



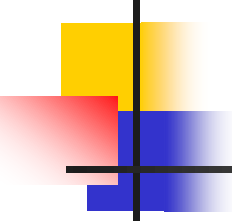
ate in

- 22.75% on Wednesday, August 12th
- Lowest 2.25%, April 2009



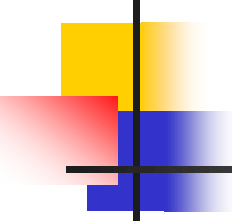
Interest rates

- Who remembers the prime rate in 1981?
- The highest ever in Canada
- 22.75% on Wednesday, August 12th
- Remember the payment impact, 25 year \$300,000 mortgage
- 2% interest - \$1,270
- 11.75% interest - \$3,043
- 20% interest - \$4,845



Interest rates overall

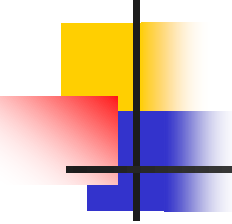
- You need to find out if the bank's prime rate, Canadian and U.S., generally moves with the major bank's' prime rate
- Some historic data should be available from the account manager if you can't google it
- Prime plus 2.5% is a bit high, not that unreasonable for a young business, given the risk
-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



Interest rate survey

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

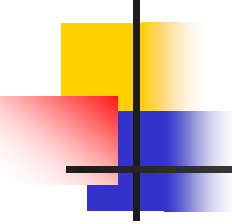
: prime plus a quarter
: I think I am at 1.25 to 1



Interest rates

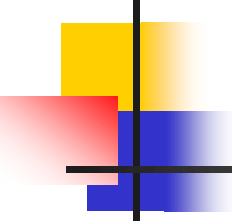
- Another alternative is a lower rate on say the first \$150,000 and a higher rate for the balance of the loans, where they have more risk
- You might be able to negotiate a rate improvement if for example the net worth or current ratio increases to a specified level
- For larger borrowers, try to get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

Danger – do not push this button



Interest rate comments

- The term loan has a floating rate
- It is generally better/safer to finance long-term assets with long-term financing at fixed rates
- 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

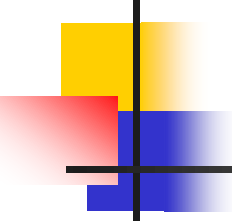


An option

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

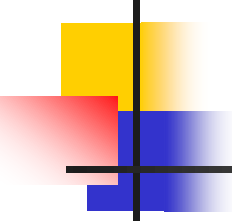
What is an interest rate swap?

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.



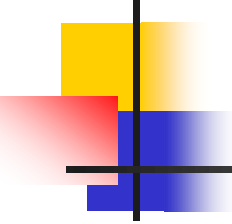
Other interest rate notes

- 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 interest and or principal holiday on the term loan for a period, but there would be trade off for this.



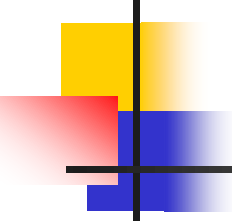
Interest on late amounts

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



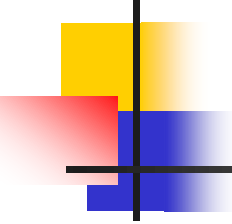
Interesting

- An American business person told me he once had \$200K on deposit with a bank a \$500K loan and they went bankrupt and he lost his \$200K and still had to pay the \$500K, which annoyed him
- There was no “set-off” clause to protect him in this situation



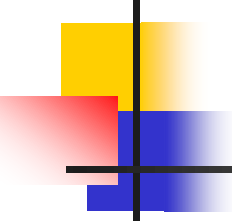
Interesting

- I asked a big five Canadian bank, if this could happen in Canada
- I didn't get a clear answer...
- Canadian bank reg's are tight, I am not very worried about them failing
- CDIC insurance covers the first \$100K on deposit of course



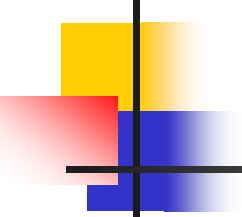
Bank fees and rates

- What do you think of them?



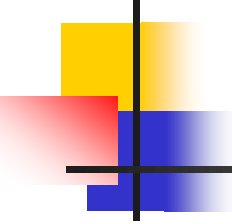
Fees and costs

- They are hitting you with fees all over the place
- There is an up front fee, as well as a monitoring fee, a renewal fee and the current activity 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 nearly \$25K per year.



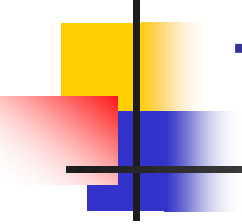
Bank's total return

<u>Total bank fees</u>	
Set-up fee	2,000
Monitoring fee	3,600
Renewal fee	1,500
Activity fees	2,160
Interest	
P+2.5% times	15,600
\$300K	
	24,860

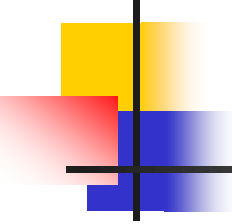


Activity fees

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

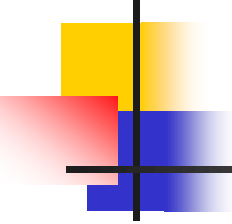


What is the “hidden cost” in the agreement?



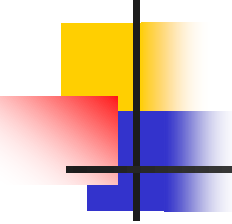
What is the “hidden cost” in the agreement?

- Your company will have to bear the legal costs
- Taking security interests costs involves some legal work
- You don't want these to be too high
- Ask the Bank what the estimated legal fees 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



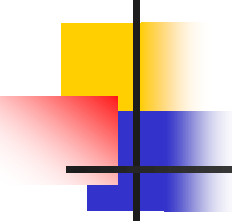
Other negotiation ideas

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



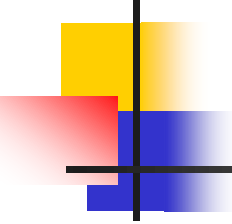
Don't worry

- If you didn't get all these bank negotiation ideas when you read this case....



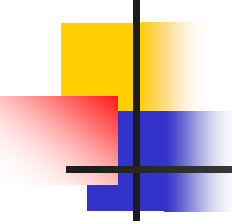
Bank fees and business stress

- 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, risk fee”
- “Now, we have decided to send a monitor in to check your situation weekly, the monitor will be PWC, oh yes, and you are paying...”
- Our loans were likely now with the “special” loans dept of the bank
- Lesson: open season on fees, if covenants have been violated..



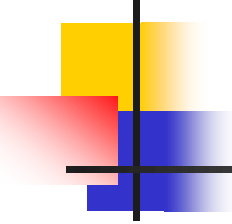
Bank reporting

- Bankers are not strong on accounting – a story
- 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



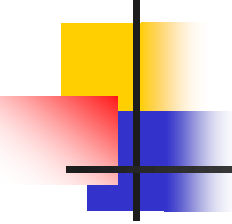
Bank reporting - timing

- 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 90 days
- 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



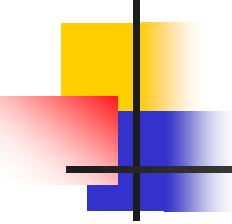
The demand for an audit

- 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



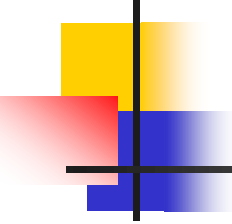
Audit pushbacks

- Often in small business, the Bank will accept a Review Engagement only
- Consider asking the Bank to drop the requirement to a Review Engagement Report instead
- Or at least drop to a Review after the first year, 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



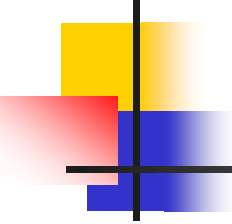
Audit final points

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



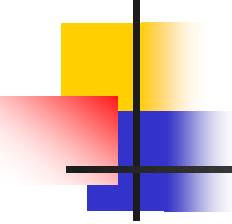
Since we are talking about an audit demanded by a bank

- A story...



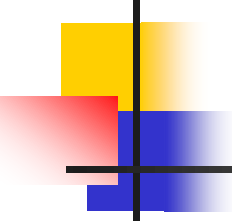
Auditing a Big Five bank

- I am on the joint audit with another big accounting firm
- My big moment in auditing, I found a \$50 million error
- Conclusion, immaterial, pass...
- Reason, balance sheet only
- (I never felt I fully understood the areas I was auditing...)



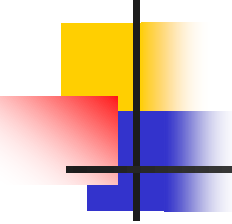
Since we were talking about auditing

- We need an audit junior joke



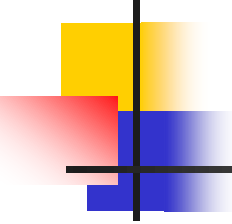
Jokes on audit juniors

- Junior finds that the audit senior is on the company payroll in the company payroll ledger they are given to audit



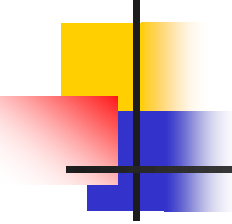
Jokes on audit juniors

- Junior finds that the audit senior is on the company payroll in the company payroll ledger they are given to audit (fake!)
- Junior is told that “the client does this to get a more favourable audit”
- Junior is shocked!
- I have collected about 75 audit jokes



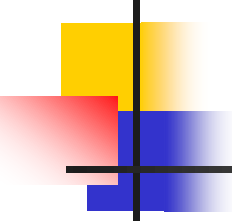
Veto rights

- The Bank proposes veto rights on: dividends, repayments of shareholder loans and changes in ownership
- The latter could restrict estate planning flexibility
- 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



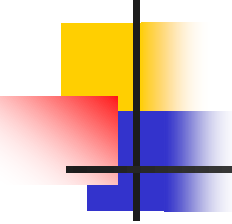
Key counter-argument

- You should argue that if the covenants, particularly _____, are on side, the bank should not worry about restricting dividends, this covenant controls excessive dividends



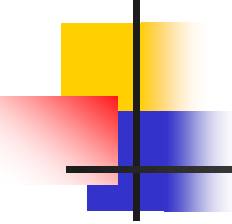
Key counter-argument

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



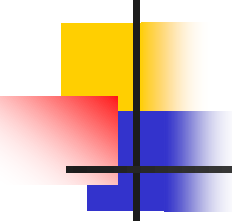
Other arguments

- You promise to give the bank notice of dividends
- Dividends could be paid if say an equal amount 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 softens the clause



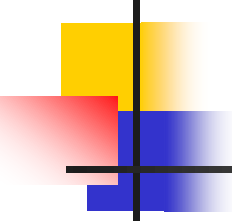
Other arguments

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



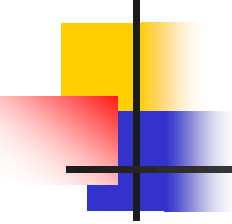
Note the approach

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



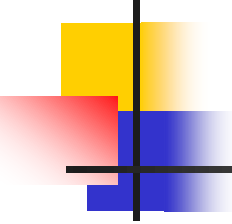
Budget

- The Bank requires an annual budget including balance sheets, income statements and cashflows
- It will be good discipline to prepare a budget
- This should be useful to the company otherwise and hopefully not too onerous once good reporting is in place
- Bank interest expense will need to be in the budgeted now



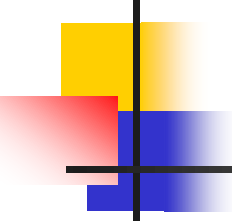
Credit card

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



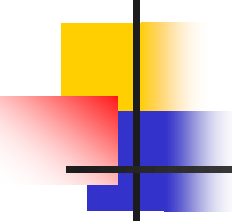
Side note on corporate credit cards

- It can sometimes be surprisingly difficult to get a corporate credit card
- (Contrast this with weekly offers in the mail for personal credit cards.)
- A CPA with a 1,000 person US public company said she was told to put an equal amount on deposit, to have a corporate credit card
- Perhaps a company can disappear more easily than a person, and there is limited liability



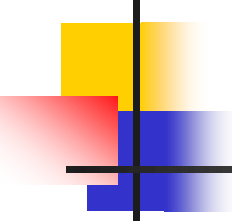
Side note on corporate credit cards

- I was once unable to cash secure a \$10K corporate credit card with a large Canadian bank
- I was told once, bring your billionaire owner in from Europe to the branch to sign the credit card papers!
- Another option I used once is a prepaid credit card, avoiding credit issues



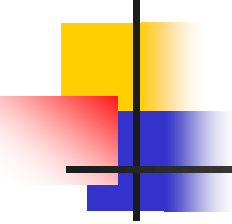
Life insurance

- 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 budgeted
- The cost should not be that high given the age of the founders, if they are in good health
- I have heard of bank life insurance that fluctuates with the changes in the total bank debt, so that the cost was lower



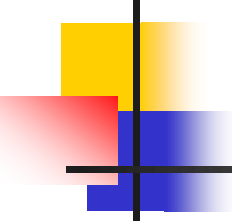
Interest on funds on deposit

- The interest rate for funds on deposit is only .03% per annum
- This should be negotiated
- It would be easier to negotiate this with some comparable numbers from other banks



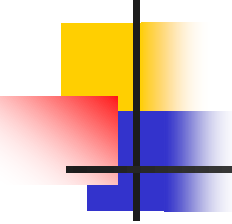
Other points

- It would be better to divide the types of breaches or events of default into major and minor, 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 hedging purposes, and these have banking implications



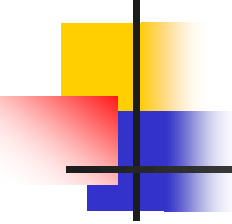
Other points

- 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)



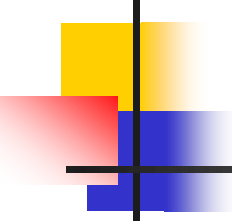
Other points

- The company must ensure that it has no environmental issues, 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 first or last day of the month
- The monthly reports could be put in a spreadsheet, 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 reliable as Schedule A banks



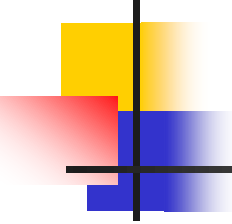
Conclusions

- A person in one live offering of this said at the end, he should read his own banking agreement, he never had!
- Hopefully you have learned quite a bit about bank negotiations, that you can put into practice
- The best loan I never got...
- Email me about some applications of this, or feedback



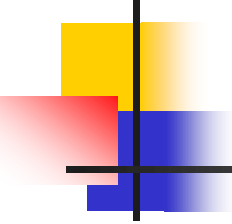
Other courses

- I have many other practical courses, based on experiential learning with some humour



Other courses

- **Practical Tips for Not-for-Profit Leaders**
- **Practical for Controllers & CFOs** over 11,000 have attended
- **Practical Work Smarts for All**
- **Practical Tips for Government Accountants**
- **Ten Practical Topics For Financial Leaders**
- **Practical Financial Negotiation Tips**
- **Practical Tips to Get Through a Cash Crisis**
- **Practical Work Solutions from Case Discussions**



Other courses

- **Practical Foreign Exchange Management**
- **Contract Review Tips for Accountants**
- **Ethics – More Than Just The Code**
- **Ethics – Where The Rubber Meets The Road**
- **Ethics – That Feeling In Your Gut**
- **Practical Tips to Improve Your Internal Financial Reporting**
- **And more being created...**

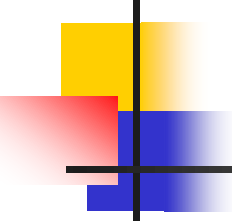
Coverage by course

Heavy coverage *** Medium coverage ** Light coverage *	Practical Tips for Controllers & CFOs	Practical Tips to Get Through Cash Difficulties	Practical Financial Negotiation Tips	Practical Brainstorming - Top Ten Trouble Spots & Other Practical Topics for Financial Leaders (1)	Practical Work Smarts for All	Practical Tips for NFP Financial Leaders	Practical Tips for Government Accountants	Practical Work Solutions from Case Discussions	Ethics – Some Different Angles
Length	7 hours	2 hours	Half day	Half day	2 hours	6 hours	6 hours	2 hours	1 hour
Humour	***	***	***	***	***	***	***	***	***
Improving financial reporting	**					***	**		
Bank negotiations	**	**	*			**			
Dealing with tight cash		***							
Negotiations	*	**	***	*	*	*	**	**	
Cost-saving	**	**		***		**			
People & management	*	*	**	**	***	*	**	**	
Business smarts	***	***	***	***	***	***	***	***	***
KPIs	***					***	***		
Fast close	**					**	**		
Technology/systems	**				**	**	**	**	
Strategic thinking	*	*	*		**			***	
Lawyers/contracts	***		*			***	***		
SRED	**								
Taking a new job	***					***	***		
Ethics	***	*	*			***	***	*	***



Course coverage

Heavy coverage ♦♦♦ Medium coverage ♦♦ Light coverage ♦	Sharpen Your Business Loan Negotiating Skills	Practical Tips to Improve Your Internal Financial Reporting	Contract Review Tips for Accountants	Practical Foreign Exchange Management	Ethics – Where <u>The</u> Rubber Hits The Road	Ethics – That Feeling in Your Gut	Ethics for Government Accountants	Ethics for Not-For-Profit Accountants	Build Your Ethical Muscles
Length	2 hours	1.5 hours	1 hour	1 hour	2 hours	2 hours	1 hour	1 hour	2 hours
Humour	♦♦♦	♦♦♦	♦♦♦	♦♦♦	♦♦♦	♦♦♦	♦♦♦	♦♦♦	♦♦♦
Improving financial reporting		♦♦♦							
Bank negotiations	♦♦♦			♦♦♦					
Dealing with tight cash									
Negotiations									
Cost-saving	♦		♦	♦					
People & management						♦	♦	♦	♦
Business smarts	♦♦♦	♦♦♦	♦♦♦	♦♦♦	♦♦♦	♦♦♦	♦♦♦	♦♦♦	♦♦♦
KPIs									
Fast close									
Technology/systems									
Strategic thinking									
Lawyers/contracts			♦♦♦						
SRED									
Taking a new job									
Ethics					♦♦♦	♦♦♦	♦♦♦	♦♦♦	♦♦♦



Closing

- You can also hire an ex-banker to help you negotiate
- You can email me with questions and to get completed slides and full case solution, and to enter the draw spriddle@bell.net
- I can do LinkedIn with you