

OED: *Rumination*. 1. Contemplation, meditation. b. *Pl.* Meditations, thoughts, reflections. 2. The act of chewing the cud.

In-Context Finance

An Intelligent Approach to Finance

Writing Effective Finance Proposals

The quality of a loan proposal is a key factor in achieving the results for a business. It can make the difference between a 'yes' and a 'no' to a loan application—and in these times, potentially even the renewal of existing facilities.

An effective loan proposal should be written such that it is a proxy for a credit submission within the financial institution ^{Note 1}. It should deliver a good understanding of the business or group, and satisfactorily address all credit risks. (See *Box*: The 4Cs of Credit.)

The structure set out below can be applied to most loan proposals. However, depending on the situation, it may be appropriate to change the order in which things flow or add sections to address issues specific to the business.

The objective when writing content under each heading is to progressively build a succinct well-argued financing case through critical assessment of the business and/or the transaction ^{Note 2}. "What?", "Why?" and "How?" are the questions you should be constantly asking yourself during this process.

1. PURPOSE

Provide a brief outline of the proposed transaction. Is it an annual review, refinancing, an increase in facilities or a variation in facilities? What are the reasons for the financing requirement?

2. BACKGROUND

Outline the business including its history. If the business is already known to the financier, provide an update on the business or project.

3. THIS PROPOSAL

Set out the details of the existing and proposed facilities and securities. This is best done in a "Terms Sheet" format.

4. OWNERSHIP/CORPORATE STRUCTURE

Include a diagram of the structure. The legal relationships between the entities of the group are important considerations in structuring security and covenants. For example, if the borrower is a holding company and all the assets and operations are in the subsidiaries, the financier will be structurally subordinated (ie ranks behind creditors of the operating companies) unless upstream guarantees (and cross-guarantees) are obtained as well.

5. MANAGEMENT

Include a diagram of management structure and brief summaries of the experience and capabilities of key management.

6. OVERVIEW OF INDUSTRY/ OPERATIONS/PROJECT (as appropriate)

The objective in this section of the proposal is to provide a more detailed understanding of the business. A SWOT Analysis should always be included.



Editor's Note:

Happy New Year!

Credit rationing is a fact of life in the on-going global financial crisis. Principles of risk assessment and management are being enforced by financiers—both for renewal of existing facilities as well as applications for new borrowings.

Effective communication with financier(s) is now more critical than ever. The reality for SMEs however is that their relationship manager is usually stretched across anywhere between 40–150+ accounts. Does he/she have time to sit down with you to really understand your business and put a well-argued credit case up the approval chain?

This guide to writing a credit submission is an adaptation of an article I originally wrote in 2008 for the Education section of Mortgage and Finance Brief, the official magazine of the MFAA. The actual crafting of a sound credit case is both art & science and comes from years of experience.

We have the experience. Talk to us.

*Siu Ling Hui
January 2009*

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This Overview may have to be done in several sections or sub-sections depending on the business and/or the transaction being considered.

Example: for a manufacturing/wholesaling business, issues that need to be addressed are likely to include Industry Overview (including the client's position in the industry and outlook for the industry), Major Customers, Major Competitors, Major Suppliers, Operational Overview (such as manufacturing facilities, distribution, marketing, R&D, IT facilities and MIS), and a SWOT analysis.

7. FINANCIALS

This usually consists of 2 sub-sections: (i) Historical Financials and (ii) Forecasts/Projections.

Summaries of the financials should be set out within the proposal for ease of reference. (Detailed accounts and forecasts, which must always accompany a loan proposal, should be referenced as numbered attachments or appendices.)

Comments on the financials should constitute critical, not elevator, analysis. The latter form – for example, “Sales went up x% and profit increased

by y%” - doesn't add any value: the reader can deduce that himself/herself from the numbers. Critical analysis means identification and explanation of the unusual or significant items. For example: “The x% increase in sales was driven by ..(give reasons, comment on sustainability of the trend)...”

It is also useful to incorporate tabular summaries of significant items as part of your comments in this section. Aged Receivables and Aged Payables are two items that are best dealt with in this way.

Critical analysis and comment are particularly important in the forecasts section. Are the assumptions reasonable? What is the impact on cash flow of changes in any of the key drivers of the business?

8. DEBT SERVICE/REPAYMENT/SECURITY

The assessment of capability to meet interest and scheduled principal repayments should be made with reference to the critical review of forecasts, particularly cash flow forecasts.

Identify at least two sources of repayment. Note

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The 4Cs of Credit

These are the fundamental planks of credit risk which must be addressed in a loan proposal. They should frame your thought process as you write the proposal.

Character

The integrity of the key people who are responsible for meeting a company's undertakings is key plank of credit. Business is about people and character is absolutely fundamental to quality of a credit (and in all business dealings). The most tightly drafted documentation and apparent abundance of security cannot guarantee the safety of a financier's exposure from fraudulent dealings. Further, mistrust is a poor foundation for any business relationship. You need to form an informed opinion about the key people involved in the loan transaction. Do they always endeavour to meet their commitments as and when they fall due? Do they have a sound reputation for being honourable in all their business dealings?

Cash flow

Cash flow is the lifeblood of any business. A critical assessment of a detailed cash flow forecast in

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that refinancing is not deemed a valid source of repayment from the credit assessment perspective. The reason is that refinancing is usually not available when it is most needed; as the sub-prime mortgage crisis has clearly demonstrated.

A critical assessment of quality and adequacy of security should also be included either as a sub-section or a stand alone section, depending on the circumstances. The quality of any guarantees should also be assessed.

8. SUMMARY & RECOMMENDATION

If the proposal contains the appropriate analysis, one should be able to clearly justify the safety of the proposed exposure for the financier. This section is also usually where an overt comment on Character is made, if any such comment is to be made. Note that you should refrain from making any comments about the integrity of the key people unless you really know them and can confidently make such statements.

The **acid test** of an effective loan proposal is when the financier asks for a soft copy so that he/she can “cut and paste” into the internal credit submission forms. Apart from giving your client the best chance of getting a ‘yes’, a good loan proposal can significantly shorten turnaround time and limit the number of protracted piecemeal requests for information.

The effort in putting together a well-thought out proposal is minimal compared to the benefits to all parties involved.

Note 1: The internal Credit Submission will include an Exit Analysis section . In our view, Exit Analysis is NOT appropriate in proposals prepared & presented on the client's behalf. Rather, the proposal itself should incorporate supportable arguments that are likely to

result in favourable outcomes when the financier undertakes Exit Analysis in the internal submission.

Note 2: The Generic Information Request List at our website provides an indication of the matters required to be addressed in a credit submission.

Go to www.in-contextfinance.com.au/ourapproachtofinance.asp

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context of the ability to meet interest and scheduled principal repayments is an essential part of any finance proposal. Interest cover calculations based on EBIT and EBITDA are not sufficient. As the old adage goes: “Profit is opinion, cash is fact”. The cash flow forecasts should ideally be part of a 3-way financial forecast model ie projections based on interlinking Profit & Loss, Cash Flow and Balance Sheet.

Collateral

The quality and adequacy of security must be addressed.

Capability

Quality of management and a balanced mix of management skills are fundamental to on-going success of a business. No one person can have all the skills required. For example, the owner of the business may be a marketing and sales whiz but barely able to read a set of accounts. Does he/she have capable finance and accounting support in the form of a full time employee or consultant to the business?

[Note: Capital is sometimes added as a 5th C. However, it is probably superfluous as Capital issues are effectively covered by Cash flow and Collateral.]