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EASING THE CREDIT CRUNCH

By Bill Beattie

As we meet with and advise owners of foodservice distribution companies to help them plan for the future of their business – whether they are planning expansion by buying other distributors, planning to sell their company, or simply trying to figure out how to weather today's economic challenges – Keiter Stephens Advisors has a unique vantage point to gauge how banks currently view the industry.

This month's column describes our perspective on what's happening on the lending side. A good deal of the information we present below should be particularly helpful to companies in more challenging credit situations. That said, we have heard of distributors in solid financial condition whose bankers have approached them requesting credit line reductions, rate increases or requests for additional collateral. As a result, we believe this information should be reviewed by all owners and their financial managers.



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Over the past month and a half, we have witnessed a rapid shift in the way lenders are assessing their credit relationships with foodservice distributors. We have also seen that banks are evaluating the types of credit facilities they offer, and some banks are exiting lines of business they consider to be too risky. This more conservative trend of credit tightening policies is accelerating quickly, making it critical for foodservice distributors to take steps now to protect their financial position and financing sources.

This article starts with what may seem like a too-detailed explanation of the types of credit vehicles available – and then it moves into our view on what banks are doing today, and what you should consider doing immediately to address these challenges. *I recommend that you read through the credit vehicle vocabulary list even if it seems like a pain in the neck to get through.* This knowledge is critical for your conversations with lenders – to put it bluntly, you don't know how to ask for what you don't know exists.

Types of Credit Vehicles Used in the Foodservice Distribution Industry

Banks and finance companies have traditionally offered various types of credit to foodservice distributors:

- Term loans are generally used to finance the purchase of equipment or real estate. These loans have fixed maturity dates, are normally secured by liens on specific company assets, and require monthly principal and interest payments.
- Lines of credit are generally used to finance the working capital needs of the business; they have one or two year terms, with renewals based upon a review of the company's financial position and operations during the preceding year. These generally have a predetermined maximum balance. They are typically secured by liens on the company's accounts receivable and inventory, and often these liens extend to other company assets. Interest payments are required at least monthly.
- Asset-based lines of credit differ from standard lines of credit – the amount of credit that is made available by the bank is determined on a daily basis using percentages of the company's accounts receivable and inventory that are predetermined by the bank. They are typically more costly than standard lines of credit because of the increased monitoring and administrative reviews conducted by the bank.
- Equipment leasing enables companies to acquire equipment, trucks and trailers. Certain leases allow for the purchase of the equipment at the end of the lease term, others call for return of the leased assets to the lessor at the end of the term. While the lease rates are often more expensive than the interest rates charged by banks for term loans, leases present an alternative means of financing the longer term capital needs of the business without the outlay of large amounts of capital.
- Factoring is a term that is used to describe the sale of a company's accounts receivable at a discount in exchange for the receipt of immediate cash. The discount is generally very expensive, and the buyer of the accounts receivable often requires that the seller buy back the receivables if they cannot be collected. This type of financing is normally reserved for situations where the company cannot wait for the customers' payment under the normal terms of the sale.
- Purchase order financing applies to situations where the company has obtained a large purchase order or contract, but is inhibited in delivering the products required by the contract because it must pay its vendors before it can collect the receivable. The purchase order financing company pays the company's vendors and is paid as the receivable is collected. This is a more risky type of financing that is dependent upon the company satisfying the terms of its contract or purchase order. It can also be more complex to negotiate because of the need for an inter-creditor agreement with another financial institution. While we haven't heard of a distributor using this type of financing in a long time, it could be an alternative for financing specific customer contracts.

What We Are Seeing From Banks and Finance Companies

- New or expanded credit is more difficult to obtain.
- A number of asset-based lenders have announced plans to exit that line of business.
- Banks are reluctant to make new loans secured by real estate because of concentrations and uncertainties of those types of loans in their portfolios.
- Local and regional bankers have intensified their focus on monitoring loan provisions and borrowers' compliance with financial covenants.
- Lenders are raising interest rates and fees for those borrowers who are out of compliance with existing covenants.
- Lenders are more closely examining the collateral securing the loans, and working to identify and secure secondary sources of repayment in the event that the collateral is or could become impaired.
- Notices are being given that credit lines are being reduced or called for immediate repayment.

What Owners Should Consider Doing Immediately

Loan Agreements & Lender Relationships

- Review all of your existing loan agreements, including leases on equipment. Understand their provisions and your relative position to them. For more complex situations where multiple loans are cross collateralized, it may be advisable to have your attorney read each agreement and report on their implications if one becomes out of compliance. If you are out of compliance, and even if your lender has not yet called it to your attention, do whatever you can to get back into compliance. Be particularly attentive to any provisions that could trigger extra fees or allow your lender to call some – or all – of your loan(s).
- If you have an asset-based lending arrangement, look at the lending parameters on each asset to determine if they are sufficient to your current and anticipated needs.

Create A Budget & Realistic Cash Flow Projections

- If you don't have one, create a reasonable budget for the business that includes cash flow projections. Build in "what if" capabilities at key points and use them to project best case and worst case scenarios for each of those key issues.
- Measure your performance against industry standards and look for areas where your business is out of line with other companies of your size.

Accounts Receivable

- Closely monitor your accounts receivable trends in the number of days outstanding. Reassess your internal processes for credit review and approval. Be on the lookout for customers who suddenly shift significantly more business to you – it could be a warning sign they have been placed on credit hold with one of your competitors.
- Carefully examine applications from all new customers. There may be situations where you choose to accept a new account with less than sterling credit – but ask for a personal guarantee to shore up your position. Likewise, work to secure personal guarantees from existing customers who are in significant A/R trouble with you. This may allow you to secure payment from their personal assets should the business not be able to pay its bills.
- Be honest with yourself about questionable customer receivables. We frequently see distributors that fail to write off credits they know will not be collected. Some do this because their reserves are too small; others do it because writing off truly uncollectible accounts will have too severe an impact on profitability.
- There are many formal and informal working groups comprised of local/regional credit managers; some are made up of companies exclusively serving the foodservice industry. Ensure that your credit manager takes an active role and shares whatever information they can within the parameters of your agreements and within local legal provisions. [Check National Association of Credit Management: <http://www.nacm.org/>]

Inventory

- Stay ahead of your asset-based lender as it pertains to inventory. Run a list of products that have no sales for the previous 60 days and find a buyer for those products. If discovered, your lender will most likely remove them from your asset borrowing base and you may be better off with whatever cash you can generate before they intervene.
- Plan seasonal inventory purchases carefully (holiday, ice cream items, school items, etc.) so that you don't have to carry large inventories from season to season.
- Closely scrutinize requests for single customer inventory items (slow-moving SKUs, items with logos, etc).

Cash Flow Management

- Attempt to negotiate extended credit terms with your vendors.
- If you're not already doing so, consider using redistributors such as DOT Foods for lower volume or specialty SKUs. You may end up with a lower gross profit margin on these items, but you'll reduce inventory investment and risk.
- If you lease your facility from a third party, ask for payment deferrals or rent reductions. Many landlords will consider these requests rather than have an empty facility – but they generally ask for something in return, like an extension on the term of the lease or increased rent payments in the future.

- If trimming unprofitable accounts is necessary, be careful how you do it, particularly if it involves chain business. Carefully analyze whether the lost gross profit dollars are offset with reduced expenditures for miles and personnel.
- Carefully review all areas of operation and cut expenses earlier rather than later. While personnel cuts may be something you want to avoid, the overall health of your business must come first (heeding popular wisdom to avoid sales and marketing cuts – you need these areas to grow your business).

Other Strategies

- Meet with your accountant and look for ways to reduce your income taxes. You may have income tax savings from carry backs of taxable losses to prior profitable years.
- Conduct a customer profitability analysis to determine the viability of operators generating lower overall gross margins or which have unprofitable drop sizes.

This column is not written to scare anyone, but there are real risks in today's credit environment. You, your business, and your family will be well-served if you stay ahead of the potential problems. We hope that you will find some of the strategies we've listed above to be helpful to you as you plan to protect, and grow, your business. Please call if I can be of assistance as you consider how to move your company forward.

Please call or email me if you have questions or would like to discuss this further.

Regards,
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Keiter Stephens Advisors is the foodservice distribution finance and consulting subsidiary of Keiter, Stephens, Hurst, Gary & Shreaves. They have worked with over 50 privately-held distributors across the country. KSA services include:

- *Profitability Improvement on both the vendor and customer sides*
- *Mergers and Acquisitions: guiding the sales and acquisitions of foodservice distributorships and regional sales territories*
- *Custom Strategic Services, including transition planning for family-owned distributors and driving management consensus with KSA's 3-1-1 Planning Process*
- *Custom Finance Solutions, including finance strategy development, distribution center expansion analysis, lease or buy decisions on real estate and equipment, and cost segregation studies.*