MargolisBecker
The Business and Management Advisors

Stu's View

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You and Your Bank

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There is no question about it: the economy has changed, the banking industry has changed, and traditional relationships between printers and their banks have changed. Helping printers find financing, employ strategic measures and keep strong cash positions has been an increasingly popular service of our firm recently. To explore the changing nature of banking relationships, we interviewed Kurt Knutson, President and founder of Freedom Bank in Kansas City, during our monthly "A Cup O' Joe" (*) conference call discussion for printers.

From his extensive experience in providing financing for printers, Knutson drew parallels between today's banking situation and the 1980's savings and loan crisis. He particularly focused on the number of financial institutions that are going under and the enforcement actions. "To put it in perspective, there are 8300 FDIC insured banks across the country, and there are 40 banks that have failed" (as of late August 2009), says Knutson. He was quick to point out that "the overwhelming number of banks are doing fine," however. As for the increase in enforcement actions, Knutson noted both the "level of scrutiny and enforcement actions out there have increased dramatically." This is particularly true for those banks that were heavily involved in the real estate market.

Dealing with enforcement actions draws bank manpower and focus away from you, their long-time customer. The current economy and the heavy regulatory scrutiny also make banks very cautious about lending money even to their best customers. As Knutson says, "The dollars that are being lent are that much dearer to the banks, so they are looking at it from the perspective that they have to be choosy to get the return." This situation has caused many printers not to get financing for recent equipment purchases or forced needed capital purchases to be delayed or canceled. Some printers have resorted to using their lines of credit to buy the needed equipment, hurting the flexibility in their cash flow. In addition, many banks are requiring printers to reduce their upper limit on their lines of credit, again losing much-needed cash flow in the process. Once a printer uses up their cash reserves and credit, there may be little alternative but to close their doors, as has happened for some 2000 printing companies out of 35,000 entities nationwide. Stressed or not, it is obvious that the banks have become an even more important player in our businesses.

Most banks are now looking at us more carefully when assessing our viability, applying measurements that are more stringent. One of the most important measurements used by banks is covenants. The covenants could include:

- **Total debt to equity**
  Example: If total liabilities are $2M and equity is $1M, the total debt to equity ratio is 2:1. While each company and situation is unique, we generally see this ratio below 3:1 in covenants.
- **Tangible net worth**
  This again varies greatly with each company.
- **Cash flow coverage**
  Cash flow coverage is determined as follows:

  EBITDA = Net income + depreciation + interest
  Debt Service = Total of annual principle payments on debt + total of annual interest expense

  The comparison of EBITDA to Debt Service is the Cash Flow Coverage ratio, which we normally see ranging from 1.2:1 up to 1.5:1.

Most larger loans have a financial covenant that alerts the bank when the printer is not performing well. During these difficult times we have found that this has become a serious issue for most printers. If your bank is under pressure from the regulators, they will be less lenient in overlooking covenant violations. If there are covenant violations, the loan can be called and/or the interest rate increased. Trying to avoid such outcomes means that we will be spending even more time and money communicating with the banks.

So how do we succeed in this changing landscape? And how do we get our banks to respond positively to our financial needs? As printers discussed the situation with Knutson, it became apparent that these are burning questions for many.

There are several steps that we have recommended to our print clients:

1) **Increased communication with your bank is essential.** Keeping your bank informed and updated – of both good and bad financial news about your business -- is very important. Plans need to be developed, not only for the bank, but also for your own survival. These plans should include income and expense projections that then can be converted to analyze the resultant cash flow and determine if the cash flow is sufficient to service the debt and working capital. A contingency "plan B" also needs to be developed in the event the original plan and sales projections are not realized. Both plans should be communicated to the bank, making them aware that you have considered the various scenarios and are being proactive in planning your responses to those scenarios.

2) **Be patient and be prepared**. Negotiations with banks are taking longer than before in this economy where everyone is trying to figure out the new "rules". Focus on the operating side of your company when talking to the banks, showing them where and how you have cut expenses, why certain expenditures are necessary at this time, and how a short-term investment will increase future profits.

3) **Improve your management skills.** Take advantage of the changing economic environment to plan, innovate and reorganize. Explore new markets or services to show you can change with the times, and share your vision – and your success story -- with your bank.

4) **"Cash is King."** MargolisBecker has always been a proponent of this operating philosophy. If you have cash, keep it as cash, even if it means you get a smaller return on it in the short term.

5) **Check the financial health of your bank.** Visit the FDIC website (www.fdic.gov) for updates and resources on the banking industry, including FDIC's List of Enforcement Actions to determine if your bank is undergoing enforcement activity. If you see (or suspect) that your bank is in financial distress, consider developing a new relationship with a more stable entity. Great disparities in service can exist between financially healthy banks and entities in distress.

In short, you need to plan, prepare and protect yourself in order to prosper in this economy. If you want a piece of the banking "pie," your company, your request, and your vision need to mesh with your bank's own standards and business goals.

(*) "A Cup O' Joe is a complimentary teleconference series for printers offered by MargolisBecker on timely topics for the graphic communications industry. Details and registration forms for upcoming sessions are available at www.margolisbecker.com under the "Events" tab. Questions may be directed to Bonnie Pfaff at 888.577.1717 or bpfaff@margolsbecker.com

Stu's View is contributed by Stuart Margolis, CPA and Partner of MargolisBecker LLC to provide information that helps firms operate profitably. More information can be found at www.margolisbecker.com.