Sample Loan Proposal

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1. History & Description of Business

Rebecca Lopez and Jon Horatio own the Ferrari Shop, a distributor of fine crystal (dining ware and corporate gifts) for various exclusive retailers, wholesalers and privately owned firms throughout the United States. The firm receives its products from various suppliers in the U.S. Europe and most recently from China. Jon (a former corporate art director for ten years) and Rebecca (a former national buyer for house wares and furnishings for an upscale department store chain in the U.S) are the owners. The firm was started in October of 2001 after both Jon and Rebecca were laid off as their companies were restructured. They finally decided to go into business based on, economic necessity, the market potential for their products and a business network they built up over a ten-year period.

In three months that had secured four clients, built a website and began to accept orders. In another year their reputation had spread and they were reaching sales of $300,000 with three employees. In the third year of operation they were approaching sales of $550,000 and hired another staff. In 2004 they moved into a 3,500 square foot commercial loft and got a three- year lease at a fantastic price. The Ferrari shop is an LLC and both owners are senior managing members with each owning 43% with the balance (14%) owned by an investor who loaned them $100,000 and is scheduled to be bought out in 2007. Jon and Rebecca initially funded their operation with personal funds, loans from family and friend and a small $50,000 line of credit from a credit card finance company.

2. Purpose and Description of Financing Request

Ferrari seeks to borrow $275,000 to reach its growth objectives. The funds are to be used for working capital, new hires, computers and the office build out on the second floor.

3. Sources and Uses of Capital

Amount	Source	Use	Collateral	Estimated Collateral Value	Advance Rate	Repayment Terms	Yearly Debt Service
$175M $25M	Bank Bank	Office Build out and Computers	Corporate Assets	$ 139M *($61M shortfall covered by SBA Gty*).	TBD	$200,000 at 6% for 60 months	$47M
$75M	Bank	Line of Credit	Corporate Assets.	$114M	75% A/R < 60 days	Interest only	$10M
$50M	**Owners**	Build out					$57
$325M	**Total**		Total:	$253M		Total:	

4. Collateral

Ferrari's corporate assets will serve as collateral for any new debt structure. The firm is short on long-term bank collateral but by $61M (200-139) they will request an SBA guaranty from the bank to mitigate this collateral shortfall. The business's assets primarily consist of a few delivery trucks and accounts receivables. It plans purchase 2 new trucks. The collateral value of the trucks alone at a discounted rate of 50 and 80 percent = $139M, as illustrated below:

Year of Truck	Model	Estimated Wholesale Value	
2001	Ford	$16.5M	
2001	Yukon	$16.5M	
2002	Suburban	$16.5M	
2002	Suburban	$11.5M	
2003	Ford Van	$ 17.5M	
Total: 5		$ 78.5M	$78.5M * 50% Collateral Advance Rate = $39M
2 @ New Yukons		$ 125M	$125M * 80% Collateral Advance Rate = $100M
			Total Collateral Value = $139M

The following table illustrates Ferrari's current accounts receivables distribution as of February 2000:

Client	Amount	Aging	
Holsten	$44,775	< 30	
Gabrilli	$14,622	31-60	
Gianni	$44,075	< 30	
Milkin Bros	$ 20347	31-60	
Pole Bros	$11,695	< 30	
Shane LLC	$ 5766	31-60	
Palmer	$ 1480	31-60	
Norcims	$ 1760	31-60	
Nicoles	$ 1040	31-60	
Palmer	$ 375	31-60	
Tudor Lamps	$ 6,425	31-60	
Total	**$ 152M**		
			$114M Collateral Advance Rate = 75% < 60 days old

5. Key Financial Issues

Issue 1: Ferrari's tax returns and financial statements currently reflect a negative net worth position at year-end 2004 of $16M. The net worth has been impacted by rapid growth and hiring new employees, buying new trucks (for cash) and higher labor costs. What is being done to enhance the balance sheet? How will the business accommodate future growth without sacrificing profit and net worth?

Solution: The current balance sheet does not reflect the fact that the owners have loaned the firm $35,000 in capital from their personal accounts. The addition of this information will produce a positive net worth. The purchase of new trucks with term debt will help cash flow and the firm will replace two part-time employees with one full time employee to offset labor costs. The cost of new employees will be offset by the margins associated with new revenues.

FERRARI'S	**2002**	**2003**	**2004**	**Projected 2005**
Revenues	$300M	$550M	$750M	$1MM
Gross Margins	69%	65%	20%	26%
Profits	$ 31M	($7M)	($5M)	$ 50M
Add back - Depreciation	$ 39M	$ 31M	$70M	$ 20M
Add back - Interest			2M	$ 30M
EBIDTA	$ 70M	$ 24M	$ 67M	$ 100M
Current Debt Service			$ 2M	$2M
Proposed Debt Service			$ 53M	$ 59M
DSCR			1.26:1	1.69:1

Issue 2: Ferrari's financials have shown inconsistent historical profit. Can it produce sufficient cash flow to retire new debt?

Solution: The answer is "yes." As the firm has grown, it has absorbed costs for labor, vehicles, fuel, insurance, and payroll. New sales revenue will not be impacted by an increase in these costs. As a result gross margins and profits will improve. In the future, all financials will be accrual-based. Ferrari is in the process of increasing its revenues, improving its gross margins, and reducing its overhead by taking the following steps:

- The firm hired a full-time professional buyer at a cost of $40M per year plus commission and it will retire two amateur full-time buyers savings of $50M per year.

- Insurance costs will be reduced by $20M as the firm changed carriers.

These efforts will result in greater profitability and allow Ferrari to meet its debt payments. The table above illustrates projected cash flow sufficient enough to cover the debt 1.69 to 1.

6. Assessment of Management

Ferrari has been in business for more than 3 years. It was built by leveraging Jon and Rebecca's industry experience. Rebecca is responsible for the strategic direction of the firm and Jon handles day- to- day management. The firm has a corporate account with Big Bank in Farmdale, Illinois. This is the extent of its banking relationship. In prior years, FERRARI'S firm hired workers as independent contractors, but recently (in 2003) it formed a separate payroll company. There are other firms that compete in this industry such as Barsina, Solaris, and Strecchi Inc. However, there is more than enough opportunity for smaller firms such as FERRARI'S to grow and thrive within the industry.

Rebecca James, Senior Managing Member
43% Owner
Strategy

Jon Walker, Senior Managing Member
43% Owner
Day-to-Day Operations

Full-time Employees: 5
Drivers and Adminstrative Staff

7. Historical Financial Analysis

Quality of Information

Over the past 2 years, FERRARI'S has used the accounting firm of Kerry Jones & Company, CPAs, in Anytown, Illinois. They have prepared income tax/cash-based, financials for the periods 2002-2004. The firm has generated comparative interim income statements for April 2003 and 2004. FERRARI'S will have its financials prepared on an accrual basis beginning next year.

Income Statement Analysis

Sales have increased substantially over the past 2 years and management anticipates sales of $1MM for the year ending 12/31/05. It should be noted that in 2003 the gross margin dropped to 20 percent. This is a reflection of the fact that payroll shifted from independent contractors to company employees and is now a direct cost, instead of an overhead expense, as it was in prior years. The firm now pays its payroll through a subsidiary formed in April 2003. This accounting change has the impact of reducing the gross margin and overhead expenses. The most significant elements of Ferrari cost structure reside with employees and trucking expenses. The key overhead items on the income statement over the past two years were:

- *Outside services*, which represent the independent contractors paid by Ferrari.

- *Insurance costs*, which were higher in April 2003 than in April 2002 because Ferrari had to prepay for the balance of the year

FERRARI	**2002**	**2003**	**2004**	**4/04**	**4/05**
Revenues	$300M	$550M	$750M	$282M	$428M
Sales Growth		233%	57%	NA	52%
Gross Margins	69%	65%	20%	24%	26%

The financials do not reflect billings invoiced for the time periods expressed. Ferrari currently has over $152M in accounts receivables. It does not have significant vendor relationships that generate significant accounts payables.

Balance Sheet and Capitalization

The composition of Ferrari's balance sheet at year-end 2003 does not reflect the following:

- The $35M in additional capital contributed by the owners and management in February 2003. This will be represented as paid-in capital, which has the effect of improving leverage.

- The amount of financing provided by the owners via corporate credit cards.

- Accounts receivables of $152M.

Leverage and liquidity cannot be calculated fully because of Ferrari's income tax-based financial reporting. Management will submit compiled statements for review in the future.

Ferrari	2001	2002	2003	Proj-2005
Leverage/ D/TNW	NA	NA	NA	2.5:1
Current Ratio				2:1

Projected Cash Flow

Based on current trends, Ferrari management anticipates revenues of $1MM at year-end 2005 and generate profits in excess of $50M. This will be sufficient to retire debt service on associated growth. Ferrari has projected a break-even income statement that reflects sales of $996M (fixed cost plus debt service of $259/.26 = $996M) and an improvement in the gross margin to 26 percent as a result of lower overhead costs. These figures will allow the business to service its debt requirements based on its $275M loan requests.

8. Recommendation

Ferrari demonstrates the capacity to retire debt. The firm would request that the bank supply an SBA 7A Guaranty to offset the collateral shortfall. The firm has a history of sales growth and profit potential. Management is capable and has depth. Based on these factors, this loan should be approved as presented.

Pulling it All Together

Note that in the Ferrari example, the firm uses cash-based tax returns and has what appears to be a negative net worth. However, Ferrari has supplied information that offsets these issues and has positioned itself to borrow money in order to reach its growth objectives. Ferrari has answered the critical questions:

- **Is the firm ready to borrow?**

  Yes, based on profits, growth, and the owners' injection of capital, the balance sheet is positive, there are profits, and the collateral on long-term assets may be offset with an SBA 7A guaranty.

- **How much do I need to borrow?**

  $200M for office build-out and trucks, $75M for a line of credit.

- **What will I use the money for?**

  See the preceding answer.

- **How will I pay the money back?**

  The loan will be repaid from profits. The line of credit will be repaid through the collection of accounts receivables. The trucks and the accounts receivables are sufficient collateral to cover the amount of the loan.

Not all banks would consider Ferrari a viable candidate for funding. However, a bank financed this deal after looking at *all* of the factors. It made a lending decision in favor of the business.

The brevity and clarity of this sample loan proposal illustrates that a financing proposal does not have to include reams of data and information on strategy and industry. It should succinctly answer the critical questions and logically lead to a conclusion that is favorable to the borrower.

Becoming a world-class borrower requires you to understand the financial elements of your business (and personal financial condition) well enough to respond to the four questions posed above. Once you have mastered these questions you will be able to reach your goal of obtaining capital. More importantly, you will be on the road to successfully managing your company's financial foundation.