Commercial Lending Skills Workshop

Accendo Financial

Welcome to the Commercial Lending Skills Workshop!

Engaging with your clients and creating the right outcome for them is what you love doing. The tough part can be dealing with the bank through the lens of financial statements, at times it feels like we're speaking a different language.

By the end of this two hour workshop you will know how to read financial statements, the profit and loss and the balance sheet, proficiently. You will also be able to anticipate questions from the bank, identify additional sales opportunities and speed up the approval process.

If any of the content is familiar you will discover extremely effective ways of sharing your knowledge with peers and clients.

Whether you have been in finance for many years or are relatively inexperienced, the Accendo Commercial Lending Workshop will give you a pathway that takes the mystery out of business lending, and provides you with practical knowledge to help deliver a seamless customer experience.

The Commercial Lending Workshop

Junction Wholesalers Case Study

Tina and James Myles took on the management of Junction Wholesalers 2 years ago, after Tina's parents retired having run the business for over 10 years. Dealing mainly in metal products, Junction Wholesalers distribute nationally to numerous customers.

Having won a large government contract in the previous financial year, the Myles are excited about their business prospects and foresee ongoing sales growth.

They approached their bank to build additional warehousing to cope with the increasing sales. The new warehouse will cost $900,000 to build, the land was purchased 2 years ago and it is ideally located.

The Bank however are concerned by constant Overdraft excesses and have declined the request. Tina and James have enlisted you to determine which lenders are willing to help their business reach its full potential.

YOUR TASK

1. Make an initial assessment of the business performance
2. Identify risks and how they will be mitigated
3. Assess what further information a lender will need

Junction Wholesalers

Profit & Loss Statement - Most Recent Year

Sales	**$**	**4,970,143**
Less: Cost of Sales	$	3,258,427
Gross Profit	$	**1,711,716**
General Expenses:		
Accounting fees	$	18,900
Bank fees	$	11,610
Cleaning	$	6,284
Consultancy	$	27,900
Depreciation	$	53,820
Vehicle expenses	$	189,900
Rent	$	175,995
Subscriptions	$	8,703
Travel	$	48,941
Wages	$	592,540
Utilities	$	131,800
Other Expenses	$	85,140
Less: Total Expenses	$	1,351,533
Operating Profit	$	360,183
Interest on loans	$	[77,100]
Other Income	$	0
Net Profit Before Tax	$	283,083
Less: (Tax)	$	[84,925]
Net Profit After Tax	$	198,158

Junction Wholesalers

Profit & Loss Statements - Last 3 Years

		Year 1		Year 2		Year 3
Sales	**$**	**3,461,410**	**$**	**4,385,099**	**$**	**4,970,143**
Less: Cost of Sales	$	2,201,004	$	2,871,199	$	3,258,427
Gross Profit	**$**	**1,260,406**	**$**	**1,513,900**	**$**	**1,711,716**
General Expenses:						
Accounting fees	$	13,500	$	16,200	$	18,900
Bank fees	$	7,650	$	10,260	$	11,610
Cleaning	$	4,230	$	4,590	$	6,284
Consultancy	$	16,200	$	22,050	$	27,900
Depreciation	$	24,102	$	41,400	$	53,820
Vehicle expenses	$	106,200	$	147,600	$	189,900
Rent	$	159,120	$	167,076	$	175,995
Subscriptions	$	6,120	$	7,652	$	8,703
Travel	$	28,962	$	42,787	$	48,941
Wages	$	442,004	$	539,489	$	592,540
Utilities	$	82,440	$	118,015	$	131,800
Other Expenses	$	71,296	$	79,440	$	85,140
Less: Total Expenses	$	961,824	$	1,196,559	$	1,351,533
Operating Profit	**$**	**298,582**	**$**	**317,343**	**$**	**360,183**
Interest on loans	$	[53,500]	$	[68,370]	$	[77,100]
Other Income	$	0	$	0	$	0
Net Profit Before Tax	**$**	**245,082**	**$**	**248,973**	**$**	**283,083**
Less: (Tax)	$	[73,524]	$	[74,691]	$	[84,925]
Net Profit After Tax	**$**	**171,557**	**$**	**174,282**	**$**	**198,158**

PROFIT & LOSS RATIOS

		Year 1	Year 2	Year 3
Gross Margin	Gross Profit/Sales			
Key Expense Margin	NPBT/Wages			
Net Margin	NPBT/Sales			

Junction Wholesalers

Balance Sheet - Most Recent Financial Year

Assets			**Liabilities**		
Current Assets:			**Current Liabilities:**		
Cash at Bank	$	21,760	Overdraft	$	291,700
Accounts Receivable	$	589,600	Accounts Payable	$	700,200
Stock	$	897,090	**Total Current Liabilities**	**$**	**991,900**
Total Current Assets	**$**	**1,508,450**			
Non-Current Assets:					
Land & Buildings		1,500,000	**Non-Current Liabilities:**		
Plant & Equipment	$	601,600	Lease / HP	$	127,600
Goodwill	$	0	Provision for Long Service	$	110,000
Total Non-Current Assets	$	**2,101,600**	Bank Loan	$	1,335,090
			Total Non-Current Liabilities	**$**	**1,572,690**
			Total Liabilities	$	**2,564,590**
			Net Worth		
			Start-up Capital	$	275,000
			Additional Capital	$	0
			Retained Earnings	$	770,460
			Total Net Worth	$	**1,045,460**
Total Assets	**$**	**3,610,050**	**Total Net Worth & Liabilities**	**$**	**3,610,050**

Junction Wholesalers

Balance Sheet - Position Last 3 Years

	Year 1	Year 2	Year 3
Assets			
Current Assets:			
Cash at Bank	$ 62,970	$ 51,980	$ 21,760
Accounts Receivable	$ 329,560	$ 471,680	$ 589,600
Stock	$ 481,200	$ 708,290	$ 897,090
Total Current Assets	**$ 873,730**	**$ 1,231,950**	**$ 1,508,450**
Non-Current Assets:			
Land & Buildings	$ 650,000	$ 1,500,000	$ 1,500,000
Plant & Equipment	$ 458,700	$ 552,866	$ 601,600
Goodwill	$ 0	$ 0	$ 0
Total Non-Current Assets	**$ 1,108,700**	**$ 2,052,866**	**$ 2,101,600**
Total Assets	**$ 1,982,430**	**$ 3,284,816**	**$ 3,610,050**

	Year 1	Year 2	Year 3
Liabilities			
Current Liabilities:			
Overdraft	$ 123,200	$ 207,600	$ 291,700
Accounts Payable	$ 302,550	$ 517,160	$ 700,200
Total Current Liabilities	**$ 425,750**	**$ 724,760**	**$ 991,900**
Non-Current Liabilities:			
Lease / HP	$ 169,400	$ 150,700	$ 127,600
Provision long Service	$ 60,000	$ 110,000	$ 110,000
Bank Loan	$ 648,000	$ 1,410,000	$ 1,335,090
Total Non-Current Liabilities	**$ 877,400**	**$ 1,670,700**	**$ 1,572,690**
Total Liabilities	$ 1,303,150	$ 2,395,460	$ 2,564,590
Net Worth			
Start-up Capital	$ 275,000	$ 275,000	$ 275,000
Additional Capital	$ 0	$ 0	$ 0
Retained Earnings	$ 404,280	$ 614,356	$ 770,460
Total Net Worth	**$ 679,280**	**$ 889,356**	**$ 1,045,460**
Total Net Worth & Liabilities	**$ 1,982,430**	**$ 3,284,816**	**$ 3,610,050**

BALANCE SHEET RATIOS

		Year 1	Year 2	Year 3
How to Calculate				
a) Working Capital **= Current Assets** **÷ Current Liabilities**	a)			
b) Gearing **= Total Liabilities** **÷ Net Worth**	b)			

JUNCTION WHOLESALERS - FINANCIAL RATIOS

	Formula	Year 1	Year 2	Year 3
Profitability				
1 Gross Margin	Gross Profit ÷ Sales	36%	35%	34%
2 Key Expense Margin	Net Profit Before Tax ÷ Wages	55%	46%	48%
3 Net Margin	Net Profit Before Tax ÷ Sales	7%	6%	6%
Business Strength				
4 Current	Current Assets ÷ Current Liabilities	2.05	1.70	1.52
5 Gearing	Total Debt ÷ Net Worth	1.92	2.69	2.45
Cash Cycle				
6 Stock Turns	Cost of Good Sold ÷ Stock			
7 Stock Days	360 ÷ Stock Turnover			
8 A/Rec Turns	Sales ÷ Accounts Receivable			
9 A/Rec Days	360 ÷ Accounts Receivable Turnover			
10 Creditor Turns	Cost of Goods Sold ÷ Creditors			
11 Creditor Days	360 ÷ Creditor Turns			
Operating Efficiency				
12 Assets to Sales	Sales ÷ Total Assets			
13 Return to Owners	Net Profit Before Tax ÷ Net Worth			

JUNCTION WHOLESALERS - FINANCIAL RATIOS ANSWER PAGE

	Formula	Year 1	Year 2	Year 3
Profitability				
1 Gross Margin	Gross Profit ÷ Sales	36%	35%	34%
2 Key Expense Margin	Net Profit Before Tax ÷ Wages	55%	46%	48%
3 Net Margin	Net Profit Before Tax ÷ Sales	7%	6%	6%
Business Strength				
4 Current	Current Assets ÷ Current Liabilities	2.05	1.70	1.52
5 Gearing	Total Debt ÷ Net Worth	1.92	2.69	2.45
Cash Cycle				
6 Stock Turns	Cost of Good Sold ÷ Stock	4.6	4.1	3.6
7 Stock Days	360 ÷ Stock Turnover	79	89	99
8 A/Rec Turns	Sales ÷ Accounts Receivable	10.5	9.3	8.4
9 A/Rec Days	360 ÷ Accounts Receivable Turnover	34	39	43
10 Creditor Turns	Cost of Goods Sold ÷ Creditors	7.3	5.6	4.7
11 Creditor Days	360 ÷ Creditor Turns	49	65	77
Operating Efficiency				
12 Assets to Sales	Sales ÷ Total Assets	1.75	1.33	1.38
13 Return to Owners	Net Profit Before Tax ÷ Net Worth	36%	28%	27%

APPENDICES

Appendix One: Suggested actions for optimising Profit, making your business Stronger and having available Cash

Optimise Profit	Increase prices.
	Increase sales volume.
	Decrease costs.
	Reduce waste.
	Take discounts for early payment.
Make Your Business Stronger	Retain more profit.
	Avoid borrowing where possible.
	Seek equity partner.
	Sell off unused equipment.
	Consider sale and leaseback of premises.
Have Available Cash	Maximise supplier terms and request extensions where possible.
	Strict debtor invoice and collection controls.
	Don't bulk buy stock.
	Seek 50% deposit on work to be completed.
	Offer discounts for early payment.

Appendix Two: Business Structures

How your clients structure the ownership of their business influences family members, taxation liability and their very ability to make decisions to run and then potentially sell the business.

Every finance professional should have a basic understanding of what types of ownership structures are available. By having an awareness of the current and flow on effect, you can match the loan structure with your client's goals and anticipate the type of information required when presenting a loan.

There are four types of business structures;

1. **Sole Trader:** individual is 100% liable for whatever happens in the business which means there is a high risk to personal assets.
2. **Partnership:** there are two reasons your clients would want to share control, they either need to or want to.
3. **Company:** not individual but in the form of a shareholder, or owner. There is at least one Director, who runs the business. There is a lower risk to losing personal assets although loans may require personal guarantees from each Director.
4. **Trust:** these are set up for the benefit of others, the 'beneficiaries' of the Trust. The person or entity running the business, the 'Trustee', is responsible for tax returns, income (or loss) distribution and making sure the bills get paid. The trustee can be personal or corporate with the risk factors noted above.

Each structure has tax and risk implications that should be considered in equal importance and remember, the best structure is the one that is right for you.

Business Owners are encouraged to seek professional advice.

Appendix Three: Case Study - Junction Wholesalers, 5 Areas of Focus

1. Gross Profit

	Y2	Y3
Sales	$ 4,385,099	$ 4,970,143
COGS	$ 2,871,199	$ 3,258,427
Gross Profit	$ 2,126,556	$ 1,711,716

If: in Y3 we could achieve same gross profit margin as in Y2

Then: increase in margin from 34% to 35% = additional 1% of sales

$4,970,143 x 1% = $49,701 extra bottom line profit

2. General Expenses to Sales

	Y2	Y3
Sales	$ 4,385,099	$ 4,970,143
General Expenses	$ 1,196,559	$ 1,351,533
GExp/Sales	27%	27%

If: in Y3 we could achieve same general expense margin as in Y2

Then: decrease in margin from 27% to 26% = additional 1% of sales

$4,970,143 x 1% = $49,701 extra bottom line profit

Note: these costs are fixed and should not automatically rise with sales

Total Extra Profit $99,402

3. Stock Control

	Y2	Y3
COGS	$ 2,871,199	$ 3,258,427
Stock	$ 708,290	$ 897,090
turns per year	4.1	3.6
days held**	89 days	99 days

Stock turnover = COGS ÷ Stock

If: in Y3 we could turn stock over as quickly as in Y2

In other words what would stock held figure be if 4.1 turns per annum were achieved

Then: COGS $3,258,427 ÷ 4.1 (Y2 turnover) = stock target $794,738

Potential $102,352 Extra Cash

**** 10 days difference or $102,352 ÷ 10 days = $10,235 per day**

4. Debtor Collections

	Y2	Y3
Sales	$ 4,385,099	$ 4,970,143
Accounts Receivable	$ 471,680	$ 589,600
turns per year	9.3	8.4
days outstanding	39 days	43 days

Account Receivable turnover = Sales ÷ Accounts Receivable

If: in Y3 we could collect accounts receivable as quickly as in Y2

In other words what would stock held figure be if 9.3 turns per annum were achieved

Then: Sales $4,970,143 ÷ 9.3 (Y2 turnover) = Account Receivable target $534,423

Actual Debtors Y3 $589,600 less target $534,423 =
Accounts Receivable held reduction of $55,177

Potential $55,177 Extra Cash

**** 4 days difference or $55,177 ÷ 4 days = $13,794 per day**

5. Accounts Payable

	Y2	Y3
COGS	$ 2,871,199	$ 3,258,427
Accounts Payable	$ 517,160	$ 700,200
turns per year	5.6	4.7
days outstanding	65 days	77 days

Accounts Payable turnover = COGS ÷ Accounts Payable

If: in Y3 we pay suppliers over the same period of time as inY2

In other words what would Creditors be if we had complied with 65 day terms in Y3

Then: COGS $3,258,427 ÷ 5.6 (Y2 turnover) = Creditors $581,861

Therefore, as business pay accounts 12 days later in Y3 than in Y2;

actual Creditors $700,200 less Y2 comparison $581,861 = $118,339

The business holds $118,339 in extra cash due to use of longer terms

**** 12 days difference or $118,339 ÷ 12 days = $9,861 per day**

Total Extra Cash, held and potential $275,868

Total Extra Profit $99,402

Appendix Four: Ratio Descriptions

	Ratio	How to Calculate	What it Means
Income Statement Ratios			
1	**Gross Margin**	Gross Profit ÷ Sales	Measures Profitability at the Gross Profit level: The percentage of Sales that turn into Gross Profit. For example, a Gross Profit Margin of 45% means that for every $1 of Sales, the business produces 45 cents in Gross Profit.
2	**Key Expense Margin**	Net Profit Before Tax ÷ Wages	Measures the percentage of Net Profit Before Tax generated from the selected Key Expense. For example, a Key Expense Margin of 90% means that for every $1 of that expense, the business generates 90 cents in Net Profit Before Tax.
3	**Net Margin**	Net Profit Before Tax ÷ Sales	Measures the percentage of Net Profit Before Tax from Total Sales. For example, a Net Margin of 10% means that for every $1 of Sales, the business generates 10 cents in Net Profit Before Tax.
Balance Sheet Ratios			
4	**Current**	Current Assets ÷ Current Liabilities	Measures Solvency: The number of dollars in Current Assets for every $1 of Current Liabilities. For example, a Current ratio of 2.50 means that for every $1 of Current Liabilities the business has $2.50 in Current Assets with which to pay for them.
5	**Gearing**	Total Debt ÷ Net Worth	Measures financial risk: The number of dollars of debt owed for every $1 of Net Worth. For example, a Gearing ratio of 1.80 means that for every $1 that the owners have invested, the business owes $1.80 in total debt.
Working Capital Cycle Ratios			
6	**Stock Turns**	Cost of Good Sold ÷ Stock	Measures the rate at which Stock is being sold on an annual basis. For example, a Stock Turnover ratio of 7.2 means that the equivalent of the Stock held in the business is turned over, or sold, just over 7 times during the financial year.
7	**Stock Days**	360 ÷ Stock Turnover	Converts the Stock Turns ratio into an average 'days Stock on hand' figure. For example, a Stock Days ratio of 48 means that Stock is held for an average of 48 days before being sold.
8	**A/Rec Turns**	Sales ÷ Accounts Receivable	Measures the rate at which Accounts Receivable are being collected on an annual basis. For example, an Accounts Receivable Turns ratio of 9.4 means that the equivalent of Accounts Receivable held is collected 9.4 times during the financial year.
9	**A/Rec Days**	360 ÷ Accounts Receivable Turnover	Converts the Accounts Receivable Turns ratio into the average number of days the business waits for its Accounts Receivable to be paid. For example, an Account Receivable Days ratio of 33 means that on average the business is taking 33 days to collect its Accounts Receivable.

Overall Efficiency Ratios			
10	**Creditor Turns**	Cost of Goods Sold ÷ Creditors	Measures the rate at which Creditors are being paid on an annual basis. For example, a Creditor Turns ratio of 6.1 means that the equivalent of Creditors held is collected 6.1 times during the year.
11	**Creditor Days**	360 ÷ Creditor Turns	Converts the Creditor Turns ratio into the average number of days the business takes to pay Creditors once an invoice is received. For example, Creditor Days or 40 means that on average the business is taking 40 days to pay its Creditors.
12	**Assets to Sales**	Sales ÷ Total Assets	Measures the efficiency of Assets in generating Sales: The number of dollars in Sales produced for every $1 of the Total Assets. For example, a Total Assets to Sales ratio of 3.50 means that for every $1 invested in Assets, the business generates $3.50 in Sales.
13	**Return to Owners**	Net Profit Before Tax ÷ Net Worth	Measures the efficiency of Net Worth in generating Net Profit Before Tax: The number of dollars in Net Profit produced for every $1 the owners have invested in the Business. For example, a Return to Owners ratio of 18.5% means that for every $1 of Net Worth the business has generated 18.5 cents in Net Profit Before Tax.