



SBA West Virginia District Office
320 West Pike Street, Suite 330
Clarksburg, WV 26301
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Calculating Global Cash Flow

December 13, 2016

Level: Advanced

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PRESENTERS:

GARY E. GRIFFIN – CAPITAL GROWTH SOLUTIONS

RAY CHIAMULERA – RADAR LENDER SERVICES

Acknowledgment

We would like to thank Gary Griffin and Ray Chiamulera for their time on this webinar and offering information regarding their experience in lending and working on SBA loans from their perspective.

All opinions, conclusions, and/or recommendations expressed herein are those of the presenter(s) and do not necessarily reflect the views of the SBA.



Presentation Content

1. SOP Requirements
2. Reading a Tax Return
3. Reading a Credit Report
4. Basic Cash Flow
5. Global Cash Flow
6. Working Capital Adequacy

Cash Flow – Why is it important to YOU!

The SBA SOP 50 10 5(I) states:

SBA has authorized PLP Lenders to make the credit decision without prior SBA review. The lender must perform a thorough and complete credit analysis of the applicant, establish that the loan is of such sound value as to reasonably assure repayment and document its analysis in the loan file. See HORROR STORIES (just kidding, sort of!).

3 Scenarios per SOP

1. \$350,000 or Less
2. Greater than \$350,000
3. SBA Express Products

SBA Underwriting Requirements

The SBA SOP 50 10 5(I) also states:

Lenders must analyze each application in a commercially reasonable manner, consistent with prudent lending standards. The cash flow of the Small Business Applicant is the primary source of repayment, not the liquidation of collateral. Thus, if the lender's financial analysis demonstrates that the Small Business Applicant lacks reasonable assurance of repayment in a timely manner from the cash flow of the business, the loan request must be declined, regardless of the collateral available or outside sources of cash.

Under \$350,000

SIMPLE: Credit Score!!!

Caution: These loans MUST be treated as similarly sized convention commercial loans. If you underwrite to a certain criteria, you should underwrite these loans to that same criteria. SBA has indicated that loans that “score” in their model will receive less scrutiny than larger loans however (due to performance data).

Over \$350,000

That's what this is all about. SBA has a 1.15X rule, and used to have a 1.0 DSC rule for global, which disappeared in the "h" edition. For non-PLP lenders, you still have the benefit of a financial review at the Processing Center. This session will show you what the SBA LO will be evaluating. For ALL PLP lenders, beware. Follow our presentation closely, and DOCUMENT EVERY DECISION AND ASSUMPTION CLOSELY!

SBA Express

Treat the same as similarly sized conventional commercial loans (that's what the SOP says). Our recommendation is that on loans which are "projection" deals, treat the same as any PLP request. In other words, DOCUMENT your assumptions in DETAIL, and have support. After 18 months, you should be clear. It's not the SBA! OIG is the live wire in the room.

Where Is It?

Personal Credit Report – does not include contingent

Personal Financial Statement

Form 1120 – Schedule M-1 & other deductions (Statements)

Form 1065 – Personal Taxes

Form 1040 – K-1, Schedule E (affiliates), real estate taxes and income taxes

		1a	190,100	
		1b		
Income	1a	Gross receipts or sales		
	b	Returns and allowances		
	c	Balance. Subtract line 1b from line 1a	1c	190,100
	2	Cost of goods sold (attach Form 1125-A)	2	37,414
	3	Gross profit. Subtract line 2 from line 1c	3	152,686
	4	Net gain (loss) from Form 4797, line 17 (attach Form 4797)	4	
5	Other income (loss) (see instructions—attach statement)	5		
6	Total income (loss). Add lines 3 through 5	6	152,686	
Deductions (see instructions for limitations)	7	Compensation of officers (see instructions—attach Form 1125-E)	7	7,700
	8	Salaries and wages (less employment credits)	8	
	9	Repairs and maintenance	9	5,286
	10	Bad debts	10	
	11	Rents	11	1,452
	12	Taxes and licenses	12	5,038
	13	Interest	13	24,617
	14	Depreciation not claimed on Form 1125-A or elsewhere on return (attach Form 4562)	14	23,926
	15	Depletion (Do not deduct oil and gas depletion.)	15	
	16	Advertising	16	
	17	Pension, profit-sharing, etc., plans	17	
	18	Employee benefit programs	18	
	19	Other deductions (attach statement)	19	91,893
	20	Total deductions. Add lines 7 through 19	20	159,912
	21	Ordinary business income (loss). Subtract line 20 from line 6	21	-7,226

SEE STMT 1

Statement 1 - Form 1120S, Page 1, Line 19 - Other Deductions

<u>Description</u>	<u>Amount</u>
ACCOUNTING	\$ 3,238
AUTOMOBILE AND TRUCK EXPENSE	10,180
BANK CHARGES	304
CONSULTING /RESIDENT REFRRAL	3,454
COMPUTER AND INTERNET EXPENSE	237
CONTINUING EDUCATION	742
DUES AND SUBSCRIPTIONS	427
INSURANCE	8,923
JANITORIAL EXPENSE	1,210
OFFICE EXPENSE	1,064
PEST CONTROL	502
POSTAGE	943
RESIDENT EXPENSES	27,035
SECURITY	1,755
TELEPHONE	5,405
TRAVEL EXPENSE	4,468
UTILITIES	10,892
AMORTIZATION	8,101
50% OF MEALS & ENTERTAINMENT	3,013
TOTAL	<u>\$ 91,893</u>

Schedule M-1 Reconciliation of Income (Loss) per Books With Income (Loss) per Return

Note. The corporation may be required to file Schedule M-3 (see instructions)

1 Net income (loss) per books	-127.	5 Income recorded on books this year not included on Schedule K, lines 1 through 10 (itemize):	
2 Income included on Schedule K, lines 1, 2, 3c, 4, 5a, 6, 7, 8a, 9, and 10, not recorded on books this year (itemize):		a Tax-exempt interest \$ _____	
3 Expenses recorded on books this year not included on Schedule K, lines 1 through 12, and 14l (itemize):		6 Deductions included on Schedule K, lines 1 through 12 and 14l, not charged against book income this year (itemize):	
a Depreciation \$ _____		a Depreciation . . \$ _____	
b Travel and entertainment \$ _____ 3,092.	3,092.	7 Add lines 5 and 6.	
4 Add lines 1 through 3.	2,965.	8 Income (loss) (Schedule K, ln 18). Ln 4 less ln 7	2,965.

Schedule M-2 Analysis of Accumulated Adjustments Account, Other Adjustments Account, and Shareholders' Undistributed Taxable Income Previously Taxed (see instructions)

	(a) Accumulated adjustments account	(b) Other adjustments account	(c) Shareholders' undistributed taxable income previously taxed
1 Balance at beginning of tax year	-173,775.		
2 Ordinary income from page 1, line 21.	3,015.		
3 Other additions			
4 Loss from page 1, line 21.			
5 Other reductions * STMT	3,142.		
6 Combine lines 1 through 5	-173,902.		
7 Distributions other than dividend distributions			
8 Balance at end of tax year. Subtract line 7 from line 6.	-173,902.		

Part I Income

1	Gross receipts or sales. See instructions for line 1 and check the box if this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked <input type="checkbox"/>	1	390,870.
2	Returns and allowances	2	
3	Subtract line 2 from line 1	3	390,870.
4	Cost of goods sold (from line 42)	4	362,426.
5	Gross profit. Subtract line 4 from line 3	5	28,444.
6	Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)	6	
7	Gross income. Add lines 5 and 6 <input type="checkbox"/>	7	28,444.

Part II Expenses

Enter expenses for business use of your home only on line 30.

8	Advertising	8		18	Office expense (see instructions)	18	
9	Car and truck expenses (see instructions).	9		19	Pension and profit-sharing plans	19	
10	Commissions and fees	10		20	Rent or lease (see instructions):		
11	Contract labor (see instructions)	11		a	Vehicles, machinery, and equipment	20a	
12	Depletion	12		b	Other business property	20b	
13	Depreciation and section 179 expense deduction (not included in Part III) (see instructions).	13		21	Repairs and maintenance	21	1,915.
14	Employee benefit programs (other than on line 19)	14		22	Supplies (not included in Part III)	22	48.
15	Insurance (other than health)	15		23	Taxes and licenses	23	5,410.
16	Interest:			24	Travel, meals, and entertainment:		
a	Mortgage (paid to banks, etc.)	16a		a	Travel	24a	3,120.
b	Other	16b		b	Deductible meals and entertainment (see instructions)	24b	
17	Legal and professional services	17	596.	25	Utilities	25	
28	Total expenses before expenses for business use of home. Add lines 8 through 27a <input type="checkbox"/>	28		26	Wages (less employment credits)	26	
29	Tentative profit or (loss). Subtract line 28 from line 7	29		27a	Other expenses (from line 48)	27a	17,370.
30	Expenses for business use of your home. Do not report these expenses elsewhere. Attach Form 8829 unless using the simplified method (see instructions). Simplified method filers only: enter the total square footage of: (a) your home: _____ and (b) the part of your home used for business: _____. Use the Simplified Method Worksheet in the instructions to figure the amount to enter on line 30	30		27b	Reserved for future use	27b	
31	Net profit or (loss). Subtract line 30 from line 29. • If a profit, enter on both Form 1040, line 12 (or Form 1040NR, line 13) and on Schedule SE, line 2. (If you checked the box on line 1, see instructions). Estates and trusts, enter on Form 1041, line 3. • If a loss, you must go to line 32.	31					-15.

Definitions

OCF-Operating Cash Flow = EBITDA

DS-Debt Service = P+I of all business debt including the subject loan

DSCR- Debt Service Coverage Ratio= OCF/DS

Unfunded Capital Expenditures-the amount of all Capital Expenditures less any Capital Expenditures funded by Permitted Debt, Subordinated Debt or by the proceeds of any equity issue of the Borrower

OCF Additions/Subtractions

Your loan analysis must document additions and subtractions to cash flow such as the following:

1. Unfunded capital expenditures;
2. Non-recurring income;
3. Expenses and distributions;
4. Distributions for S-Corp taxes;
5. Rent payments;
6. Owner's Draw

All additions and subtractions must be evident in the financial data.

Capital Expenditures

1. Obtain the financial statements of the target company as of the end of the year for the past two years.
2. Subtract the net amount of fixed assets listed on the financial statements for the preceding year from the net amount of fixed assets listed for the year just ended. The result is the net change in fixed assets. However, it must be adjusted further with these additional steps:
 - a. Strip out of the calculation all intangible assets. You are only interested in the expenditures for tangible assets - most intangible assets were obtained through acquisitions, not through a capital expenditure program.
 - b. Strip out all assets obtained through acquisitions during the reporting period. This information should be listed in the notes accompanying the financial statements.
3. Subtract the total amount of accumulated depreciation listed on the financial statements for the preceding year from the total amount of accumulated depreciation listed for the year just ended. The result is the total amount of depreciation for the year just ended. An alternative source is the depreciation expense listed in the income statement for the year just ended. This figure should not include any amortization, nor any depreciation associated with acquired assets.
4. Add the total depreciation for the year to the change in the net amount of fixed assets. This is the total amount that the company spent on capital expenditures during the measurement period.

Non-Recurring Income

Potential Non-Recurring Income items include:

Capital Gains

Legal Settlements

Insurance Settlements

Discontinued products/services

Distributions

Distributions are balance sheet adjustments and are not deducted as part of EBITDA

1. Determine how you are going to treat distributions and explain.
 - Personal Income
 - Business Expense
 - Neither and need will be included in draw requirement
2. Excessive distributions with no like increase in personal assets or decrease in personal expenses

Global Debt Service

SBA SOP 50 10 5(I) states

Lenders must demonstrate the Small Business Applicant's ability to repay the loan from the cash flow of the business by documenting the following:

- The small business applicant's debt service coverage ratio must be equal to or greater than 1.15 on a historical and/or projected cash flow basis
- Except for loans under \$50,000, the Small Business Applicant's global cash flow coverage ratio exceeds 1:1 on a projected basis.

Global Debt Service

The SBA does not formally dictate the definition of Global Cash Flow, but it should include

Income/loss from affiliated companies,

Adjustments for inter-company transactions,

Personal financial needs of all guarantors,

Analysis of both cash based and accrual based statements where appropriate,

An explanation of any excluded debt (debt to be placed on standby, debt being paid off within a short time period, etc.).

Basic Debt Service Calculation

Debt Service Calculation w/Standard Addbacks

Revenue	\$1,484,673
Net Income	\$130,307
+ Rent	\$180,000
+ Interest	\$23,354
+ Depreciation/Amortization	\$23,354
+ Officer's Salary	\$130,000
- Officer Draw/New Owner Comp.	(\$108,000)
Cash Available to Service Debt	\$379,015
Projected Debt Service	\$200,000
Excess Cash Flow	\$179,015
Debt Service Coverage Ratio	1.90

Personal Budget Analysis

Personal Budget Analysis

Personal Budget Analysis:				Borrower Name: Tejesh & Roma Patel		
	Monthly	Annual			Monthly	Annual
Income				Expenses		
Required Draw	\$0	\$0		Rental Property P&I	\$1,474	\$17,688
Gross Salary-Principal	\$0	\$0		HELOC	\$125	\$1,500
Gross Salary-Spouse	\$5,707	\$68,485		Rental Property Expenses	\$1,185	\$14,219
Gross Rental Income	\$2,444	\$29,328		Auto/Installment Loans	\$67	\$804
Interest Income	\$0	\$0		Revolving Credit	\$1,090	\$13,080
Other Income	\$0	\$0		Living Expenses (\$400/person) ¹	\$800	\$9,600
Total Income	\$8,151	\$97,813		Property Taxes (last actual)	\$0	\$0
				Income Taxes	\$483	\$5,801
				Misc. (5% of Total Income)	\$408	\$4,891
				Total Expenses	\$5,632	\$67,583
				Net Discretionary Income	\$2,519	\$30,230

Global Debt Service

Global Debt Service Sample

	2010	2011	2012	2013
Personal Cash Flow-Guarantor #1	\$70,873	\$85,152	\$81,506	\$81,506
Personal Cash Flow-Guarantor #2	\$129,756	\$126,141	\$171,274	\$171,274
Personal Cash Flow-Guarantor #3	\$62,688	\$5,137	\$24,294	\$24,294
EBITDA - OC	\$642,715	\$711,714	\$648,611	\$583,259
EBITDA - Affiliate #1	\$193,652	\$219,849	\$347,329	\$343,817
EBITDA - Affiliate #2	\$118,028	-\$75,196	\$283,693	\$214,009
Total Existing Cash Flow	\$1,217,712	\$1,072,797	\$1,556,707	\$1,418,159
Personal Debt-Guarantor #1	\$304,392	\$304,392	\$304,392	\$304,392
Personal Debt-Guarantor #2	\$19,920	\$19,920	\$19,920	\$19,920
Personal Debt-Guarantor #3	\$44,148	\$44,148	\$44,148	\$44,148
Existing Debt-OC	\$89,124	\$89,124	\$89,124	\$89,124
Existing Debt-Affiliate #1	\$178,920	\$178,920	\$178,920	\$178,920
Existing Debt-Affiliate #2	\$188,580	\$188,580	\$188,580	\$188,580
Proposed New Loan	\$203,364	\$203,364	\$203,364	\$203,364
Total Debt	\$1,028,448	\$1,028,448	\$1,028,448	\$1,028,448
Global Debt Service Coverage	1.18	1.04	1.51	1.38

Working Capital Needs

One of the leading reasons for business failure is adequacy of working capital. Your analysis needs to show that working capital is sufficient to support the business and sales growth.

Adequacy of Working Capital

This is a key component to the credit decision and one that is scrutinized in repurchases and audits. The lender must determine and justify the adequacy of working capital in a loan request. Simply stating that the business is a cash business or that the principals have additional cash if needed is not sufficient. What is the cash cycle of the business? How much time will pro forma working capital support in the business? How much availability is there in other LOCs?

These questions must be answered and the amount of working capital in the loan supported.

Working Capital Analysis

Steps to determining adequacy of working capital for non-cash businesses.

1. Determine the cash expenses of the business
2. Calculate the cash needs of the business
3. Determine what sources will support the cash needs

Thank You!

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SPECIAL SBA One Training - October/November/December

SBA will be offering SBA One training throughout the next few months. Webinars will run approximately 90 minutes. Dates, times and connection information can be found below. Download the SBA One Update PDF document at the bottom of this page for your use/information. No registration is required!

Dec. 7 @ 10 a.m. Eastern - <http://ems7.intellor.com/login/707764> 877-369-5243 access code 0764426#

Dec. 7 @ 2 p.m. Eastern - <http://ems7.intellor.com/login/707765> 877-369-5243 access code 0279442#

Dec. 13 @ 10 a.m. Eastern - <http://ems7.intellor.com/login/707766> 877-369-5243 access code 0546883#

Dec. 13 @ 2 p.m. Eastern - <http://ems7.intellor.com/login/707767> 877-369-5243 access code 0423846#

Dec. 20 @ 10 a.m. Eastern - <http://ems7.intellor.com/login/707768> 877-369-5243 access code 0551237#

Dec. 20 @ 2 p.m. Eastern - <http://ems7.intellor.com/login/707769> 877-369-5243 access code 0132600#

Export Trade Financing Programs (Click here to register - online registration only)
December 6, 2016 - 11:00 a.m. Eastern

Spend 30 minutes with the WV District Office and SBAs International Trade Specialist Bill Houck to make sure you don't miss out on profitable lending opportunities throughout your commercial loan portfolios. Learn how SBAs Export Trade Financing Programs with their 90 percent guaranty, can help you expand your existing relationships, cross sell you commercial and business finance capabilities, and add more value to your offerings to be more competitive.

To access the webinar: Web Conference URL: <https://connect16.uc.att.com/sba/meet/ExEventID=84536711>, select **I am a participant** option, enter your name and email, select Join, then

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