

Loan Request (cont.)

How will the money be used?

Uses include working capital, inventory, equipment or machinery, furniture and fixtures, construction, repairs, expansion, or improvements. Also, for paying off loans or buying a business. Give amounts for each category, and a grand total.

How will the loan be repaid?

Pay the loan with money from selling an asset, an outside investor, or from business revenue/cash flow. This information should be detailed in your Financial section.

What collateral do you have to offer?

Collateral consists of assets the bank will take if you cannot repay the loan. It can be personal (savings, stocks, or real estate), or business (receivables, inventory, equipment, or real estate). Be aware that lenders require appraisals, and they discount values. Inventory is discounted 20-30%. Fixed assets are usually 50%. Be sure the total collateral equals the total loan request.

SBANC Pointer: Include:

- ➡ **detailed collateral/assets information**

Financials

Accounting Methods: Cash vs. Accrual

There are two ways to handle your accounting -- **cash** and **accrual**.

1. The **cash** method means you do not record a sale until you collect money and you do not record an expense until you pay for it.
2. The **accrual** method, the one lenders want, means: Sales are made, but payments are not immediately collected. Your customers pay later, which creates "accounts receivable."

Business purchases are made, but paid for later, creating "accounts payable."

Financials (cont.)

Assets (like equipment) are depreciated (allocating the cost) over their lifetime.

Net Income does not always mean cash since money is tied up in accounts receivable and inventory.

Four Financial Statements Must Be Included in this Section:

1. **Balance Sheet:** This is a snapshot of your business. A moment frozen in time.
2. **Operating Statement:** Think of this as your business "report card."
3. **Personal Financial Statement:** Your own personal financial health will be carefully **examined by the lender**.
4. **Cash Flow Statement:** This will show how much money comes in and how much goes out.

Hints for Developing Financials:

Make realistic assumptions. Do not be afraid to address risks and weaknesses as long as you explain how they will be handled. Lenders know there are risks. They like to see business owners who recognize and solve them. Show reasonable links between past (if buying a business), actual, and future projections.

Watch for these Common Financial Problems:

- **Limited Capital**
Capital is just another word for money, and if there is not enough of it, it can lead to insufficient working capital (money for day-to-day activities). Do not try to make money stretch too far. Ask for more loan money, or cut down on liabilities and expenses.
- **Little or no record keeping**
You must keep meticulous records for yourself, the IRS, and your lender.
- **Failure to seek outside help**
Consult an accountant and business advisor including the Service Corps of Retired Executives (SCORE), the Small Business Advancement National Center (SBANC), the Small Business Administration (SBA), Small Business Development Centers (SBDC), and your state's Department of Economic Development. Listings for SCORE, SBA, SBDC's, and economic development departments can be found in the telephone book. Your advisors' input is valuable, but do not be totally dependent on them. Educate yourself. You should have basic understanding of your company's finances. Know how to read your own financial statements and reports.
- **Poor management**
A business needs a good financial manager (within the company or an outside advisor). It is your money, so be very self-disciplined.
- **Reluctance to invest in the business**
Why should the lender stand behind you if you will not invest any of your own money? You must put about 25% of your own money into the company.

1. The Balance Sheet

The Balance Sheet is a snapshot of your business. The numbers change every single day.

Your Balance Sheet Must List the Following:

ASSETS: What the company owns

Current Assets: Can be converted into cash in one year

Cash

Accounts Receivable (*sales made but not collected*)

Inventory (*inventory on hand, waiting to be sold*)

Total Current Assets: add up all of the current assets (*cash, accounts receivable, and inventory*)

Non-current Assets: takes one year or more to turn into cash

Fixed Assets (*this includes property, plant, and equipment*)

Less Depreciation (*subtract Accumulated Depreciation*)

Fixed Assets (net) (*Fixed Assets minus Accumulated Depreciation*)

Advances to Owners (*money owners take out of the business in the form of a loan to be repaid*)

Total Non-Current Assets (add up all the Non-Current Assets)

Total Assets (*Current Assets plus Non-Current Assets*)

LIABILITIES: How much the company owes

Current (Short Term) Liabilities (*liabilities due within one year*)

Current Portion of Long-Term Debt (*one year's worth of loan payments*)

Notes Payable (*due within one year*)

Accounts Payable (A/P) (*purchases not paid for*)

Total Current Liabilities (*total all the Short-Term Liabilities*)

Long-Term Liabilities (*due for more than one year*)

Loan Payable (*due after one year's worth of payments*)

Total Long-Term Liabilities (*total all the Long-Term Liabilities*)

Total Liabilities (*add the Long-Term and Short-Term Liabilities*)

CAPITAL OR NET WORTH: The business' equity

Owners Investment (*amount of money owners have invested*)

Retained Earnings (*income earned and kept in the business*)

Total Capital (*add Owners Investment and Retained Earnings*)

Total Liabilities & Capital (*add Liabilities and Capital. This figure must equal the dollar amount shown on the Total Assets line*)

(See next page for an example of a Balance Sheet.)

1. The Balance Sheet (cont.)

Tomahawk Company			
1.	Balance Sheet October 20, 2004		
	Current Assets		
	Cash	10,000	
	Accounts Receivable	75,000	
	Inventory	<u>85,000</u>	
	Total Current Assets		170,000
	Non-current Assets		
	Fixed Assets	140,000	
2.	Less Depreciation	<u>-25,000</u>	
	Fixed Assets (net)	115,000	
	Advances to Owner	<u>6,000</u>	
	Total Non-current Assets		121,000
**	Total Assets		<u>291,000</u>
	Liabilities		
	Current Liabilities		
	Current Portion of Long-term Debt	6,000	
	Notes Payable	100,000	
	Accrued Taxes	3,000	
	Accounts Payable (A/P)	<u>41,000</u>	
	Total Current Liabilities		150,000
	Long-term Liabilities		
	Loan Payable	54,000	
	Total L.T. Liabilities		<u>54,000</u>
	Total Liabilities		<u>204,000</u>
	Capital		
	Owner's Investment		20,000
3.	Retained Earnings		<u>67,000</u>
	Total Capital		<u>87,000</u>
**	Total Liabilities & Capital		<u>291,000</u>

1. **Date:** The Balance Sheet should not be more than three months old when applying for a loan.
 2. **Depreciation:** Except for land, assets wear out. The value goes down and can be deducted. Values for assets are presented via a reserve for depreciation. Market value, or the price you could sell it for, will differ from this figure.
 3. **Retained Earnings:** (Also called capital or common stock in a corporation.) Not an asset. Net profits accumulated through the company's life.
- ** **Total Assets** and **Total Liabilities & Capital** should be the same number.

2. Operating Statement

The Operating Statement is your company's report card. Expenses are subtracted from income, which gives you the business' financial performance or net profit/loss over a period of time. Other names for the Income/Expense Statement, Earnings Statement, or Profit and Loss Statement.

Your Operating Statement Must List The Following:

GROSS SALES: Revenue or income from sales

Less Cost of Goods Sold: *(cost to make products including materials and labor)*

Beginning Inventory *(the number used in the sample was pulled from the Balance Sheet)*

Purchases *(used to make product)*

Labor *(used to make product only. Other labor-related expenses are included in the Operating Expenses section)*

Less Ending Inventory: *(the number used in the sample above was pulled from the Balance Sheet)*

Total Cost of Goods Sold *(add up the Cost of Goods sold)*

GROSS PROFIT: Sales less cost of goods sold. This is your mark-up or profit margin

OPERATING EXPENSES:

Selling Expense *(salaries and expenses related to sales only)*

General & Administrative *(all other expenses used to run the company)*

Operating Income (or loss) *(shows how the business performed)*

Net Profit before taxes

Less: Income Taxes *(tax rates depend on your business' legal status)*

Net Profit

2. Operating Statement (cont.)

Tomahawk Company		
1.	Operating Statement October 20, 2004	
	Gross Sales	900,000
	Less Cost of Goods Sold:	
	Beginning Inventory	75,000
	Purchases	350,000
	Labor	<u>200,000</u>
	Total	<u>625,000</u>
	Less: Ending Inventory	<u>-85,000</u>
2.	Cost of Goods Sold	<u>540,000</u>
	Gross Profit	360,000
	Operating Expenses:	
	Selling Expenses	90,000
	General & Administrative	<u>170,000</u>
	Total Expenses	<u>260,000</u>
	Operating Income	100,000
	Interest Expense	<u>20,000</u>
	Net Profit Before Taxes	80,000
	Less: All Income Taxes	<u>27,000</u>
3.	Net Profit	53,000

1. **Date:** Represents activity for an entire period, at the end of that time period.
2. **Operating Income:** Gross Profit less Selling Expenses and General/Administrative Expenses.
3. **Important Note:** Compare numbers in the current year's Operating Statement with the previous year. You need to know if income/profits and expenses are going up or down (using percentages) for control purposes.

3. Personal Financial Statement

Personal financial health is carefully examined by the lender or investor.

Complete a Personal Financial Statement for each person listed in the business plan who will be guaranteeing the loan (partners, officers, stockholders). It's a good idea to order your credit report from the credit bureau and review it because lenders will scrutinize it. Be prepared to explain any negative reports.

Note: Most lenders will supply you with their "personal financial statement" form, but the information they usually request is shown in this sample.

Tomahawk Company

Personal Financial Statement

Ronald Rueben
12 Landsdowne Street
Tomahawk, MA 12378

Assets & Liabilities

1.	Assets	10,000
	Cash	10,000
	Savings Accounts	10,000
	Retirement Accounts	20,000
	Accounts & Notes Receivable	5,000
	Life Insurance, cash value	5,000
	Stocks & Bonds, market value	10,000
	Real Estate, equity value	150,000
	Automobiles, equity value	10,000
	Other Property	5,000
	Other Assets	1,000
	Total	226,000
2.	Liabilities	
	Investment Mortgage, amount owed	80,000
	Investment Mortgage	0
	Other loans	20,000
	Unpaid taxes	5,000
	Other accounts and bills due	5,000
	Total	110,000
3.	Net Worth	116,000
	Total Liabilities + Net Worth	226,000

- 1. Assets:** What you own
- 2. Liabilities:** What you owe
- 3. Net Worth:** Assets less liabilities

Include your name, social security number, date of birth, home phone number, and home address.

Also list your current and previous employer(s), length of employment, employer's address and telephone number plus a person to contact.

3. Personal Financial Statement (cont.)

Tomahawk Company

Income & Expenses

Annual Income:

Salary, Bonuses, and Commissions	60,000
Dividends & Interest	1,200
Real Estate Income	0
Other Income	5,000

1.

Annual Expenses:

Mortgage/Rental Payments	10,000
Taxes: Federal, State, Local, Property	15,000
Insurance Premiums	1,000
Other Loans	3,000
Alimony and Child Support	0
Tuition	0
Medical Expenses/Health Insurance	2,000
Notes Payable	1,000

2.

Contingent Liabilities	3,000
Other Debt or Liabilities	1,000
Total	36,000

3.

I hereby certify this statement is true and accurate. I authorize any inquires necessary to verify the statement's accuracy.

_____ (Ronald Reuben) Date: _____

1. Annual Income: Multiply monthly expenses by 12.
2. Contingent Liabilities: Endorser, co-maker, guarantee of loans or a result of legal actions or contested taxes.
3. End the statement with this sentence and your signature.

SBANC Pointer: Include:

- ▀ **stocks and bonds, real estate, notes payable, contingent liabilities, assets and mortgages.**

4. Cash Flow Statement

The Cash Flow Statement shows money that comes into the business and what money goes out. Profits do not guarantee positive cash flow. Cash must be available to pay for bills and day-to-day activities. It will also show an important figure, the breakeven point. The breakeven point is when cash income equals the cash outflow.

This statement must show the company has the cash to pay debts on time. You need to know or estimate income and expenses based on the direct and variable costs of your product or service.

Tips for Preparing Cash Flow Statements:

- Begin with revenue/income at the top, followed by expenses and repayment of the loan (not vice versa).
- Round off numbers. Do not use cents.
- Show realistic assumptions. If sales are projected to increase by 80% every year, the lender may be skeptical. Prove assumptions and attach to this statement.
- Cover the downside. Identify weaknesses.
- Cash jumps up from Year 1 to Year 2 because set-up or start-up costs are large in the first year.
- Negative or "Pull down" balances are common in the first year. Deficiencies must be covered by providing more cash (loans or owners investments) or reducing expenses.
- Increased sales normally cause a drain on the working capital (due to increased purchases of raw goods or labor). Show how you will overcome this.

Example: Cash Flow Statement

You should project revenue and expenses for three years. Put one year's worth month-by-month on a page. Fill in the blanks for items (A-H) listed on the "down the side" data information.

		ACROSS THE TOP							
		Pre-Start-Up		Month 1		Month 2		Month 3	
		Estimate	Actual	Estimate	Actual	Estimate	Actual	Estimate	Actual
DOWN THE SIDE	A. Cash on Hand								
	B. Cash Receipts								
	1. Cash Sales								
	2. Credit Account								
	3. Loans								
	C. Total Cash Receipts								
	D. Total Cash Available								
	E. Cash Paid Out								
	1. Purchases								
	2. Gross Wages								
	3. Payroll Expenses								
	4. Outside Service								

4. Cash Flow Statement (cont.)

Across the Top

Pre-Start-Up		Month 1		Month 2		Month 3	
Estimate	Actual	Estimate	Actual	Estimate	Actual	Estimate	Actual

Data for months of the year in the Cash Flow Statement, shown above.

Show monthly figures in the first year, quarterly figures in the second year, and a lump sum or one figure in the third year.

Use the estimated column when constructing this statement. If the exact amount is known, use the Actual column. Estimates may need to be adjusted in the future as you gain more knowledge and real figures.

A. Cash on Hand
B. Cash Receipts
1. Cash Sales
2. Credit Account
3. Loans
C. Total Cash Receipts
D. Total Cash Available
E. Cash Paid Out
1. Purchases
2. Gross Wages
3. Payroll Expenses
4. Outside Service

Down the Side

Data for items A-H in the Cash Flow Statement:

- A. Cash on hand.** After 1 Month, this figure comes from the Cash Position (Item G) of the previous month.
- B. Cash Receipts.** This is the business' Sales Volume. Include realistic figures based on your facility size, employee output, and realistic sales.
1. Cash Sales. *Omit credit sales unless cash is received.*
 2. Credit Accounts Collections or Accounts Receivable (A/R) *is the income expected from all credit accounts. Note: Bad Debt should be subtracted from Accounts Receivable in the month anticipated.*
 3. Loans. *Or other Cash Injections. Specify.*
- C. Total Cash Receipts** (B.1 + B.2 + B.3).
- D. Total Cash Available.** Before cash paid out (A + C).
- E. Cash Paid Out**
1. Purchases. *Merchandise for re-sale or for use in product (paid in current month).*
 2. Gross Wages. *Base pay plus any overtime. Excludes withdrawals.*
 3. Payroll Expenses. *Include paid vacations, paid sick leave, health insurance, unemployment insurance.*
 4. Outside Services. *Include outside labor and/or material for specialized work.*
 5. Supplies. *Items purchased for business use (office operating,) not for re-sale.*
 6. Repairs and Maintenance. *Painting, decorating, etc.*
 7. Advertising. *Amount should be adequate to maintain sales volume.*
 8. Car, Delivery, and Travel. *Personal car use including parking fees.*
 9. Professional Services. *Include bookkeeping, accounting, and legal.*
 10. Rent. *Real estate only. See E.16 (below) for other rentals.*
 11. Telephone.
 12. Utilities. *Water, heat, electricity.*
 13. Insurance. *Coverage on business property and products.*
 14. Taxes. *Real estate, inventory, sales, and excise taxes.*
 15. Interest. *Add interest on loan as if it was injected. See B.3.*
 16. Other Expenses. *Specify. Unexpected Expenditures. Equipment expenses including leases and rentals.*
 17. Miscellaneous. *Small Expenditures.*
 18. Subtotal of operating costs.
- F. Other Operating Costs**
1. Loan Principal Payment. *Payments on all loans including vehicle and equipment purchases.*

4. Cash Flow Statement (cont.)

2. Capital Purchases. *Non-expensed (depreciable) expenses such as equipment, building, vehicles, and leasehold agreements.*
 3. Other Start-up Costs. *Expenses incurred prior to first month projection and paid for after the start-up position.*
 4. Reserve and/or Escrow. *Insurance, tax, or equipment escrow to reduce impact of large periodic payments.*
 5. Owner's Withdrawal. *Include payment for owner's income tax, social security, health insurance.*
- G. Total Cash Paid Out** (E plus F).
- H. Cash Position** (End of month) (D minus G). *This becomes the "Cash on Hand" (Item A) figure for the next month.*

Essential Operating Data

These non-cash flow items can be kept separately or included at the bottom of your monthly cash flow projections under the heading "Essential Operating Data." They are important planning and cash flow projection tools.

- ➔ **Inventory on Hand** (end of month).
Last month's inventory, plus merchandise received and/or manufactured current month, minus amount sold current month. This relates to section E.1.
- ➔ **Accounts Receivable** (end of month).
Previous unpaid credit sales, plus current month's credit sales, minus amounts received (Section B.2).
- ➔ **Bad Debt** (end of month).
Should be deducted from the month anticipated. This figure is based on past history or industry standards.
- ➔ **Accounts Payable** (end of month).
Previous month's payable, plus current month's payable, minus amount paid during month. Total cash paid out for expenses (E and F).
- ➔ **Depreciation**
Assets wear out and lose value. Established by your accountant, as allowed by the IRS.