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Corporate Finance Insights

Credit Market Conditions

The credit markets have gone through major changes in the last few years. Most business owners fondly remember when any one of several banks would receive their call and would offer loans at very attractive rates, with favorable terms. Then the financial troubles began and lending dried-up for a good long time.

Interest Rate Indicators

A difficulty we have had (one of many) is that rate indicators we've all grown accustomed to are not as dependable for pricing loans as they once were. The most common rate indicators are the Prime Rate, which most people know about, and another known as LIBOR. That's the London Interbank Offered Rate, which is the rate at which large banks lend money to one another. Even just a few years ago LIBOR was what some banks considered to be their "cost of funds." For large and strong companies interest rate discussions often revolved around how much above LIBOR the bank would accept. For your reference, the current 30-day LIBOR rate is 0.23%.

But I haven't heard any banker refer to LIBOR as their cost of funds for some time now. In fact, I've heard a good banker say that even the Prime Rate isn't a good measure of their cost of funds. Currently the Prime Rate is 3.25% (Prime has generally exceeded LIBOR by 2.75% to 3% on average).

"Any other collateral besides your heart of gold and million dollar smile?"

A couple things have happened. One is that some studies were prepared during 2008 that seemed to indicate the published LIBOR quote wasn't accurate; that it was understated. A lot has been written about it so I won't go into it here, but the net result — in my opinion — is that LIBOR isn't viewed as a rock-solid market measure like it once was. Additionally, part of the economic rescue program put in place by the US Treasury and the Federal Reserve Bank has the effect

Corporate Value Partners, Inc.

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Corporate Value Partners
Ronald D. DiMattia
President
1340 Depot Street,
Suite 102
Rocky River, OH 44116
(440) 333-1910 Office
(440) 333-4449 Facsimile
ron@corporatevaluepartners.com
www.DealDesk.com

Corporate Value Partners, Inc.
1340 Depot Street, Suite 102
Rocky River, OH 44116

of keeping interest rates artificially low, notably the Prime Rate. At the same time, it has become much more costly for banks to raise any type of capital.

As a result there was a disconnect between borrowers and lenders over the last year or two: Companies have grown accustomed to low borrowing rates, and still see a low Prime Rate and LIBOR being quoted; bankers, however, have had to adjust to the new reality and sometimes can't just accept LIBOR or Prime as a good starting point when discussing interest rates.

Things to Remember

Though there are some hopeful signs that banks and borrowers are starting to see eye to eye, I don't expect that things will go back to the way they once were. Changes in the regulatory environment have caused banks to be much less aggressive. So if you think your bank is not offering a competitive rate or terms, be careful. Don't expect a warm and ready welcome from new banks. They are all dealing with the same issues. That means preserving and improving your current bank relationship is more important now than ever.

One way to strengthen your banking relationship is to improve communications with your loan officer. Some good principles to remember are:

1. **Communicate early and often –** A good banker lives on information. Forget food (well, almost). What really sustains them is knowing how you're doing. So let them know what's happening, even if things aren't going well. A good banker knows that everyone hits hard times. When your banker has a good and steady flow of information the relationship is much stronger.
2. **Don't hide things –** Trust is a big part of any relationship. Bankers are no different than anyone else in your life. So don't hide information. But don't let bad news just sit there without any additional explanation. Put it in context and show that you understand what is going on and how to address it.
3. **Get your financial system in order –** Make sure that your financial statements are timely and accurate. Delayed and inaccurate financial statements are a good way to undermine your relationship with a bank. Make sure your tax payments are made (especially payroll taxes) and that you are current with all tax filings.
4. **Have a realistic plan on paper and in reality –** Commit a plan to paper. Even if it is just some bullet-points on a couple pages. Make sure that your plan shows some logic and thought behind it and that you can actually achieve your plans. Then share it with your banker and show them that you know your stuff.

The challenge we all have right now is to fight through this down period, preserve our relationships and get ready for the eventual improvement in our economy. Good communications with all our business partners, especially our bank, and some market knowledge will definitely help.

Please contact Ronald DiMattia at Corporate Value Partners at (440) 333-1910 or ron@corporatevaluepartners.com with any questions or to discover how CVP can help you get the most out of your assets.

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