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LOS ANGELES BUSINESS JOURNAL®

March 24-30, 2008 $3.00

SPECIAL REPORT: **BANKING & FINANCE**

Turning On the Cash Flow

There's no doubt it's tough for businesses seeking loans from stingy lenders. But that doesn't mean it can't be done. Marco Giannini, right, president of a Westwood dog food maker, scored a loan from a local business bank – and he's far from the only success story. Inside, read about their tactics to skirt Wall Street's credit crunch.

PrepWork Pays Off for Middle Market Businesses

BY HOWARD FINE
Staff Reporter

Here's some advice to middle market companies seeking a commercial loan these days: Get out of the comfort zone.

Consider what Dogswell LLC, a Westwood-based pet food manufacturer, went through recently as it sought a multi-million dollar loan for equipment to expand into canned and dried products.

First, executives made sure Dogswell's balance sheets were squeaky clean as they knew any blemishes or question marks would make a loan harder, if not impossible, to get.

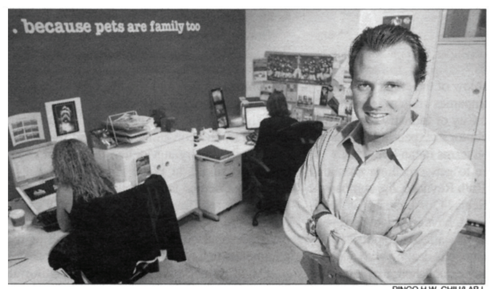
Then, instead of going to big mainstream banks making headlines for investments in worthless mortgage-backed securities, the executives opted for California United Bank, a three-year-old bank focused on business loans.

"We started with a small business bank in L.A., since most of these banks don't deal with mortgage-backed securities and haven't had the time to rack up all of these bad loans," said Marco Giannini, Dogswell's president and founder.

After a process that lasted a couple of months, Dogswell closed its loan in early March and is now set to expand production.

Dogswell's experience shows that even during these tough times, with credit markets across the globe in wrenching turmoil, thousands of middle market companies are able to get loans. But they must have clean balance sheets, be prepared to bring more assets to the table and be much more careful in how they go about getting their loans.

"We just came through a period when lending institutions were very generous in their loan terms. That's gone now and we're back to more traditional terms and more traditional leverage multiples," said Chris Lewis, co-founder and principal with Los Angeles-based private equity firm Riordan Lewis & Haden.



Unleashed: Marco Giannini, president of pet food maker Dogswell at his West L.A. office.

RINGO H.W. CHIU/LABJ

For companies using future cash flow as their main loan repayment vehicle and that don't bring a lot of assets to the table, Lewis said the leverage multiple has dropped from about six times cash flow a year ago to about three times cash flow today. That means most banks today will loan out a smaller amount based on the same cash flow as a year ago.

"With a recession either looming or already here, future cash flow is now viewed as more risky for banks and there has been a tightening of terms, conditions and credit spreads in that area," said David White, Southern California regional president for Detroit-based Comerica Bank.

Borrowers now have to settle for a smaller loan amount or look around for alternative sources of financing to close the gap. Options include hedge, private equity or mezzanine funds. But these sources generally come at a cost – either in terms of dollars up front or ceding some control of the business.

White said that the percentage of business borrowers relying solely on cash flow is a small part of Comerica's overall business customer base. Most customers set up working capital facilities using a percentage of receivables or inventory as collateral or set up equipment finance facilities using equipment as collateral. "If you bring these assets to the table, then the loan terms haven't changed much in the last year."

Indeed, this mix of cash flow-based and asset-based loans is now becoming more common as banks seek more repayment guarantees in the face of uncertain economic times. In previous years, asset-based loans were mostly reserved for companies in some degree of financial distress. Now, lenders aren't as willing to stake an entire loan on the expectation of future cash flow, so even relatively healthy companies now might have to put up at least some assets.

"Asset-based loans have become a busier market as there has been a reduction in leverage multiples in the middle market" for companies relying on cash flow, said Stender Sweeney, senior vice president and commercial banking director of the western banking group for Charlotte, N.C.-based Wachovia Corp.

Banks also are paying more attention to a borrower's past track record, according to Lloyd Greif, president of Greif & Co., a middle market mergers and acquisitions firm that arranged Dogswell's credit facility with California United Bank. "Lenders are no longer just looking at how a company says it's going to perform in the future. They are focused on collateral and the historical track record of companies."

In this environment, lenders and dealmakers said, it behooves companies to clean up their balance sheets and maintain conservative spending patterns.

"We definitely do continue to be careful about how we spend our money. That's a huge thing that lenders look for now," Dogswell's Giannini said.