



manow

Food Processing & Agriculture

July 2010

Accessing Capital in Today's Credit-Constrained Environment

by Wiley Kitchell, Managing Director,
Moss Adams Capital LLC

As we commence the third quarter of 2010, the lending climate for food processing and agriculture companies is improving but still fragile. Most major banks have successfully recapitalized their balance sheets, many of the weakest regional banks that were adding to the economic uncertainty have been absorbed by stronger institutions, and trends in lending are generally moving in a positive direction. However, borrowing terms, conditions, and covenants by all types of lenders remain restrictive by historical standards.

Lenders remain tentative for a number of legitimate reasons. First, significant uncertainty caused by the ongoing banking reform debate in Washington, D.C., continues to negatively impact all banks' lending appetites. Second, many banks are, and indeed need to be, more interested in cleaning up their current loan portfolios than in providing new loans to marginal credits. Third, while the business environment is improving, there's consensus among economists and others that the recovery will be impacted by meaningful and unexpected bumps and bruises

for an extended period of time. And finally, the global commodity risk associated with the goods and services produced by many food processing and agriculture companies causes lenders to be cautious about lending to the industry.

In order to access capital in today's market—either from traditional commercial (bank) lenders, business credit (fixed asset) lenders, or more expensive mezzanine lenders—borrowers, at the very least, need to show positive current cash flow and a positive forecast through the end of 2010.

At the same time, those companies that are cash-flow positive, have net earnings on a GAAP basis, and can show a flat to improving earnings trend line on a comparative year-to-date basis are still very bankable. Some companies in this condition may even want to consider shopping their banking relationship a bit. Interest rates, especially on working capital lines, are currently at or near historically low rates.

All current and potential borrowers do need to keep in mind that lenders are more focused than they have been in many years on managing their existing base of clients. Lenders want to maintain the good relationships they've spent time nurturing, developing, and investing in. We believe this type of relationship-driven

lending is going to remain in place for many quarters to come.

However even well-established borrowers should expect their lenders to apply more stringent due diligence standards and more rigid financial covenants and restrictions to their loan terms whenever possible. If you haven't already experienced it, the next time your loans are up for renewal expect to have your banker push for additional personal and/or corporate guarantees, higher fees, and greater financial penalties if your company fails to comply with the terms of your loans. We're in the middle of an intensely no-nonsense lending environment.



Jupiterimages, Getty Images

In addition to the traditional bank and asset-based lenders that food processing and agriculture companies typically use, there are a limited number of nontraditional lending options available today. For example, although no silver bullet of lending exists that can save the truly troubled borrower, mezzanine debt is available in selective cases, particularly if

a borrower has a significant amount of well-maintained or valuable fixed assets. The downside with such lenders is that interest rates on mezzanine capital are high—in the low to mid teens or higher.

Also, life insurance companies may be sources of capital—especially for pure real estate loans. However, insurance companies, like many of the larger institutional lenders, are operating more cautiously at present. When insurance companies do lend, they're asking for more collateral—and personal guarantees.

Explaining a company's story clearly, precisely, and accurately to a lender is more critical now than it has been in years. Banks are scrutinizing all possible details about a company's current and projected operating performance, including detailed current and projected full cash-flow analyses, itemized balance sheets and income statements, one to two years of financial projections, a detailed three-to-five-year financial history, a well-prepared management discussion and analysis, a comprehensive list of fixed assets, and recent appraisals on selected property, plant, and other assets.

Always remember that due diligence is a two-way street. As an owner, you must be prepared to discuss all your strengths, weaknesses, and business challenges to lenders in order to establish and preserve your financial credibility. This isn't possible unless management has carefully reviewed and analyzed its practices well before meeting with a lender.

Looking ahead at the next 12-18 months, we believe the financial markets will continue to experience a steady, though at times bumpy, recovery. More onerous financial due diligence reviews and more restrictive covenants will remain the new standard for banks. Interest rates will, for the most part, remain attractive over the short term. However food processing and agriculture companies should make every effort possible to secure working capital and credit lines today in order to avoid unexpected, perhaps even irrational, tightening in the financial markets down the road.

MOSS ADAMS

Founded in 1913, Moss Adams LLP is the 11th largest accounting and consulting firm in the United States. We serve middle-market public, private, and not-for-profit enterprises, in a wide range of industries, from 21 locations throughout Washington, Oregon, California, Arizona, and New Mexico. For more information, please visit www.mossadams.com.

