

SME Finance

Opportunities for CA's

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Almost half of all ventures fail
because of poor financial
management

-Dun & Bradstreet

Areas of opportunity

- Spotting /Planning for Bank Finance
- Loan Application/DPR
- Preparation of CMA data
- Syndication of Credit Facilities
- Assistance in Credit Rating
- Assistance in submission of Recurring Documents
- Debt Restructuring/ Stress Assets Funding

Case Study

S LTD

(Amount in Crs)

Particulars	Pre Structuring		Post Structuring	
Equity & Liabilities				
Share Capital	6.31		6.31	
Reserves & Surplus	22.90		34.69	
Non-Current Liabilities	<u>27.14</u>	56.35	<u>38.29</u>	79.29
Current Liabilities				
WC from Banks	13.59		0.68	
Other Current Liabilities	<u>41.28</u>	54.87	<u>39.47</u>	40.15
Total Liabilities		111.22		119.44
Non Current Assets				
Fixed Assets	66.33		62.64	
Investments	<u>6.17</u>	72.5	<u>4.64</u>	67.28
Current Assets				
Inventory	6.96		8.40	
Other Current Assets	<u>31.76</u>	38.72	<u>43.76</u>	52.16
Total Assets		111.22		119.44
Gross Turnover				
EBITDA		17.38		28.91
PAT		6.32		12.52
Current Ratio		0.71		1.30
Quick Ratio		0.58		1.09
Debt-Equity Ratio		0.93		0.93
TOL/TNW		2.81		1.91
Rating		BB-		BBB-

Key considerations

- ✓ Preliminary checks about the assignment feasibility
- ✓ Formal mandate with defined scope & fees
- ✓ Client expectation assessment
- ✓ Assignment progress communication
- ✓ Identify at-least 2 potential lenders
- ✗ Excessive circulation of proposal with multiple lenders
- ✗ Overcommitment without proper assessment

Preliminary Checks

- × CIBIL score \leq 650 -700
- × SMA reporting 1/ 2
- × External Rating \leq BB+
- × Restructured accounts
- × Direct relatives of any willful defaulters
- × Frequent delay in payment of statutory dues
- × Poor client reputation / multiple legal issues
- × Declining T/O & EBITDA in last 3 years
- × Ongoing dispute among Directors/ Partners

Sources of Finance



Selecting the right source

- Amount to be borrowed
- Time line available
- Cost of funds
- Tenure
- Security cover available
- Borrower's risk profile
- Prevalent economic conditions

Short Term Finance

Working Capital by Banks

Factoring

Commercial Papers

Inter Corporate Deposits

Mobilisation of information



Promoters / Directors Background

Management / Executive Team

Industry Scenario – Competitors, Demand & Supply, Trend

Major Customers & Suppliers – Terms of Trade, WC Cycle

Business Plans & Projections – CMA Data

SWOT Analysis

Ratings – External & Internal

Working capital finance by Banks

- Cash Credit / Overdraft / WCDL
- Letter of credit (L/C)
- Bank Guarantee
- Bill Discounting
- Buyer's Credit

Cash credit/ OD / WCDDL

- ❑ Borrower allowed to borrow up to certain limits against the security of Current Assets.
- ❑ Interest is charged on the amount actually utilized usually at a rate of base rate (MCLR) + 1-4 % spread
- ❑ **Security Margins:**
 - ✓ Stock: 25-30%
 - ✓ Book Debts: 25-40 %
- ❑ **Current Assets Level:**
 - ✓ RM: 1-3 m
 - ✓ WIP: Process Cycle
 - ✓ FG: 1-2 m
 - ✓ Receivables: 2-4 m

- ❑ **Key Financial Ratios:**
 - ✓ Current Ratio: Min - 1.25 , Desired - 1.33
 - ✓ TOL /(Adj) TNW: Max - 3 , Desired - ≤2
 - ✓ Interest Cover: Min - 2

- ❑ **Ratings:**
 - ✓ External: Min – BB+ Or Equivalent
 - ✓ Internal: Min – 4 & above (40 %)
 - ✓ CIBIL: Clean for Co. & Directors

- ❑ **Collateral security:** 5% onwards

- ❑ **Forms/Reports:**
 - ✓ Monthly: Stock & Book Debts Stat
 - ✓ Quarterly: Production & Performance Data
 - ✓ Semi-annually: Budget & Performance Data
 - ✓ Annual: CMA & AR

- ❑ **Inspection & Audit:** At least once a year

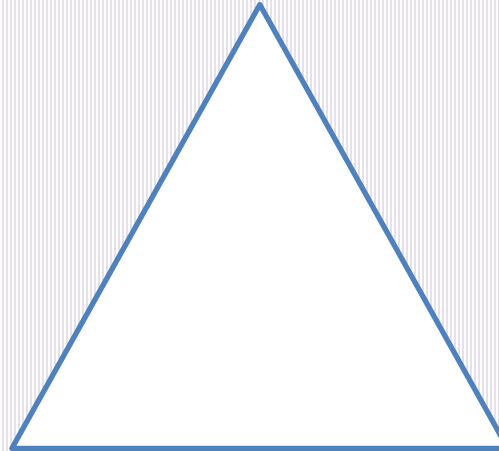
Letter of Credit (L/C)

- Issued by a bank at the request of an importer/purchaser.
- The bank promises to pay the exporter/seller upon presentation of documents specified in the L/C.
- A L/C reduces the risk of non fulfillment because the bank agrees to pay against documents.
- The L/C can be “At sight” or “Usance (30 - 180 days)”
- The L/C must contain a specified validity date and a maximum amount

Issuing Bank

The relationship between the issuing bank and the exporter is governed by the terms of the letter of credit, as issued by that bank.

Beneficiary
(exporter)



The relationship between the importer and the issuing bank is governed by the terms of the application and agreement for the letter of credit (L/C).

Applicant
(importer)

The relationship between the importer and the exporter is governed by the sales contract.

Bank Guarantees

Type of Guarantees:

- ✓ Advance Payment BG
- ✓ Performance BG
- ✓ Others – to Govt Dept

Tenure: 3-36 Months

Cash Margins: 5 to 100 %

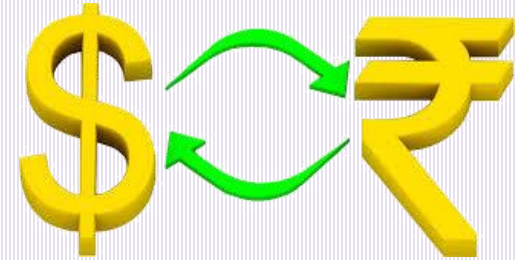
Security: Negotiable

Bill Discounting

- ❑ Under this Bank takes the Bill drawn by the borrower on his (borrower's) customer.
- ❑ Bank pays after deducting discount/ interest & commission.
- ❑ The Bank presents the Bill to the borrower's customer on the due date and collects the total amount.
- ❑ If the bill is delayed, the borrower or his customer pays the Bank a overdue interest.

Bill Discounting

- ❑ Constitutes a vital part of the working capital finance and is a major Trade Finance activity.
- ❑ Bills can be clean or backed by L/C.
- ❑ Liability in case of dishonor of the bill shifts depending on the recourse terms



Buyer's Credit

- ❑ Short term credit availed by an importer (buyer).
- ❑ Availed from overseas lenders - banks and financial institutions.
- ❑ Helps importers access cheaper foreign funds closer to LIBOR rates.
- ❑ Normally it is quoted as “3m LIBOR + 50/100 bps”

Steps Involved

Customer will import the goods either under LC or Direct document

Requests the Credit arranger to grant the credit

Overseas bank branch to provide a buyer's credit offer letter

On receipt of LOU of Indian bank, overseas bank to pay the supplier's directly

Importer's bank will recover and remit the same to overseas bank on due date

Buyer's Credit

- ❑ In India, buyer's credit tenure is:
 - ✓ 3-12 months for RM imports
 - ✓ 1-3 Yrs for Capital Goods
- ❑ Every 3/6 months, the interest on buyer's credit may get reset
- ❑ The currency of imports can be different from the funding currency.

Factoring

An agreement in which receivable arising out of sale are sold by borrower (client) to the factor (any financial intermediary) at discount

Factor is more concerned with the creditworthiness of the invoiced party than client's financial status

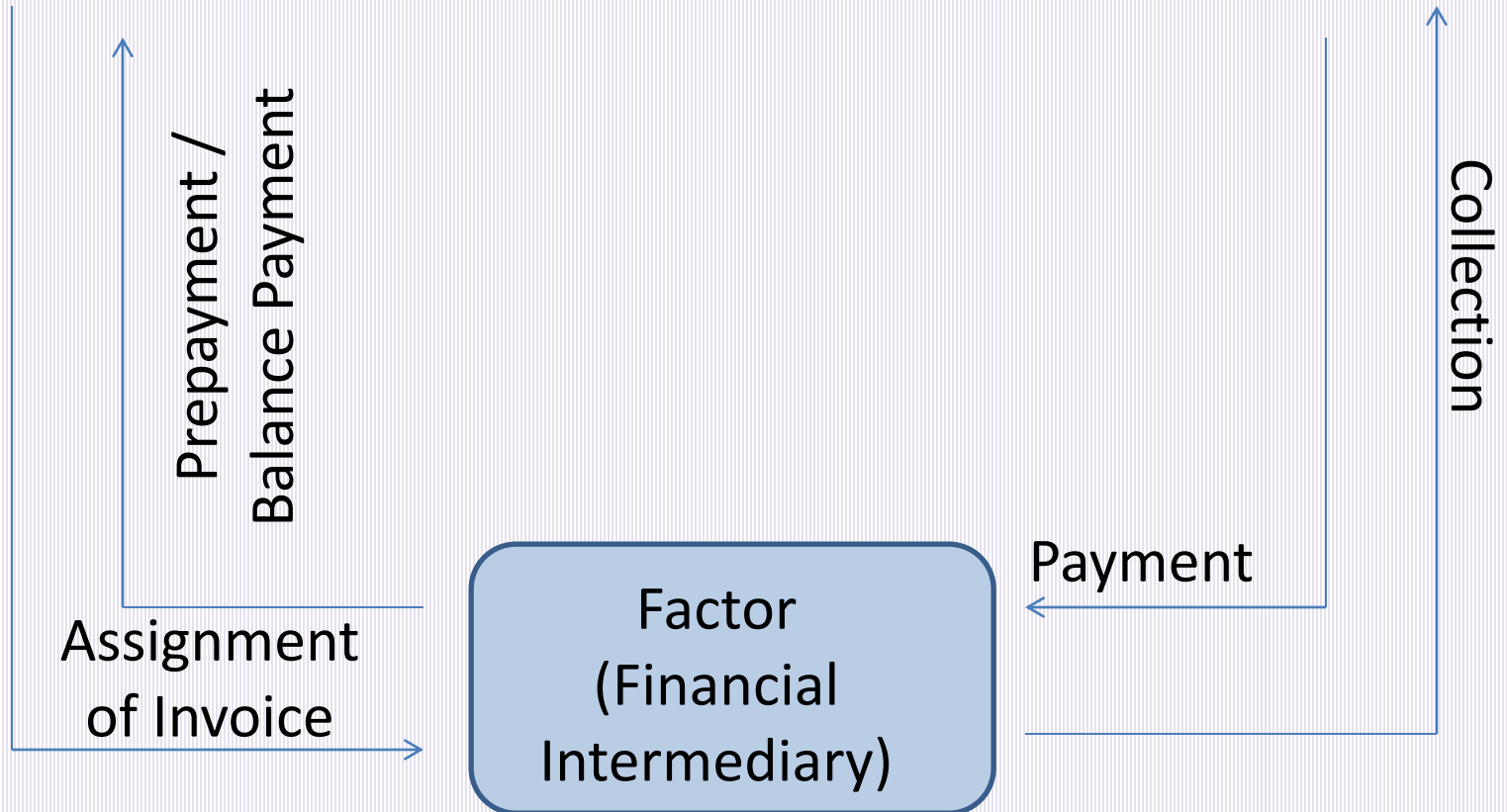
Factors usually make advances of up to 80-90% of the value of accounts receivable

Sales Contract/ Purchase
Order

Shipment/ Invoicing
(Bill of Exchange, Promissory
Note as Applicable)

Seller/
Your Self

Buyer/ Debtor



Long Term Finance

- Term Loans
- LAP & LRD
- Lease & HP Financing
- Venture Capital/Private Equity
- Debentures
- External Commercial Borrowing
- Others – IPO, FPO, Public Deposits

Steps Involved



Additional contents of Project Report



- Status of land – NA, Levelling, Boundary, etc
- Building – Plan Approvals, Cost Estimates, etc
- Infrastructure – Power, Water, Roads, Common ETP
- Technical knowhow
- Production Process & Flow chart
- Raw material sourcing
- Note on Marketing
- Manpower assessment and recruitment plan
- Implementation schedule

Cost of Project

Particulars	Amount Incurred	Amount to be Incurred	TOTAL
Land	X	X	XX
Building	X	X	XX
P & M	X	X	XX
Misc. Fixed Assets	X	X	XX
P&P Expenses	X	X	XX
Interest during Construction	X	X	XX
Contingencies	X	X	XX
Margin Money for Working Capital	X	X	XX
TOTAL	XX	XX	XXX

Means of Finance

Particulars	Amount brought	Amount to be brought	TOTAL
Promoters Contribution			
a) Equity	X	X	XX
b) Quasi Equity	X	X	XX
c) Internal Accruals	X	X	XX
Subsidy from Govt.	X	X	XX
Bank Loans	X	X	XX
TOTAL	XX	XX	XXX

Term Loans

- ❑ Long term debt with a maturity of more than 3 years
- ❑ Obtained from Banks and FIs
- ❑ Mainly to finance company's capital expenditure
- ❑ Credit is extended under a formal loan agreement

Loan Against Property (LAP)

LAP is similar to other long term loans like Corporate loans, Equipment loan etc.

- ❑ **Quantum of Loan:** Depends on type of property & income of the borrower (LTV's @ 65-80% of PMV)
- ❑ **Tenure:** Flexible for 3 -10 years
- ❑ **Interest Rates:** 8 - 12% p.a.
- ❑ **Security:** Charge on Property

Lease Rental Discounting (LRD)

LRD is a type of Term Loan offered against rental receivables derived from long term lease contracts with corporate tenants

❑ **Quantum:**

- ✓ Based on the discounted value of the future rentals
- ✓ 60-80% of underlying property value

❑ **Tenure:** 5-10 years (Linked with lease period, lock-in, quality of tenant etc.)

❑ **Repayment Mode:** Rentals are payable by the tenant directly to an escrow account with lending bank

❑ **Security:** The underlying leased property is taken as prime security

❑ **ROI:** 8-12%

Lease Financing

- ❑ It is a contract in which the asset is purchased initially by the lessor (leasing company) and thereafter leased to the user (lessee company) who pays specified rent at periodic intervals.
- ❑ Types of leases
 - ✓ **Financial Lease**
 - ✓ **Operating Lease** – Heavy Machines (Oil Rigs) & Construction Equipments
 - ✓ **Sale and lease back**

Hire Purchase

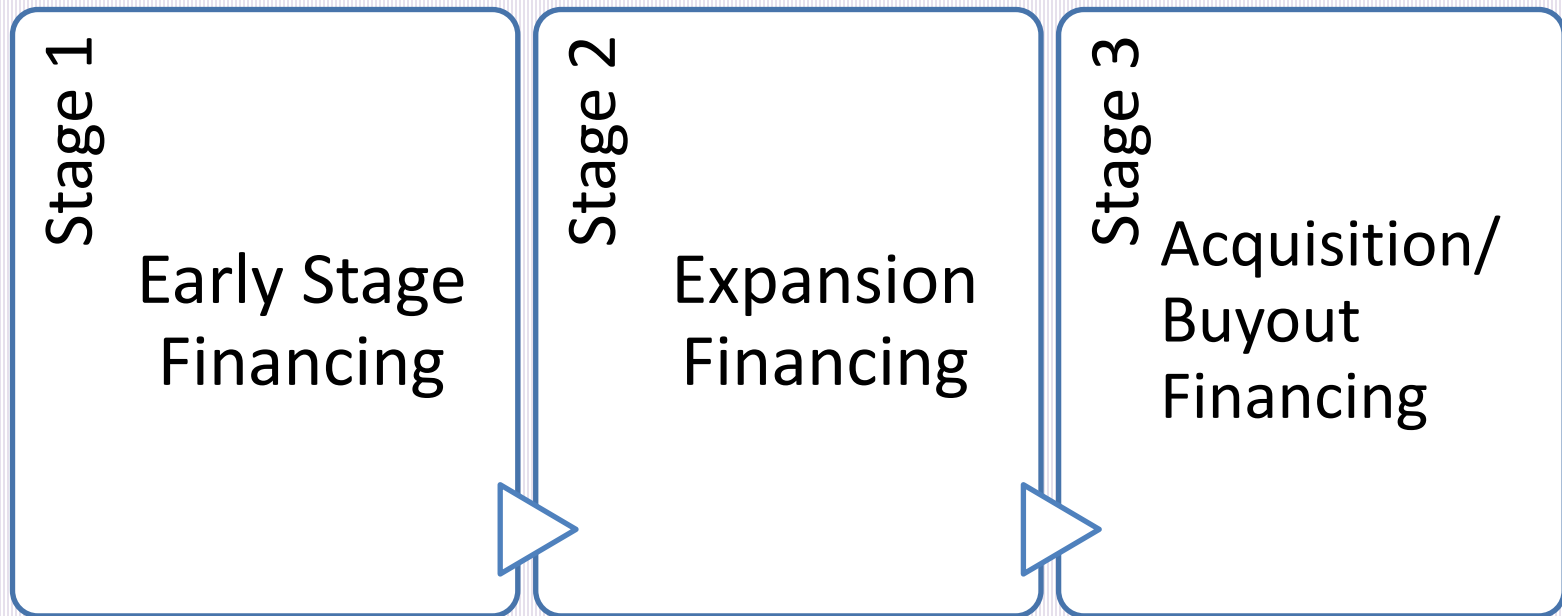
Transaction in which goods are let out on hire with option to the hirer to purchase with following conditions:

- Payment made in installment over specified period
- Possession given to hirer at start of contract
- Title of the assets passes to the hirer on payment of last installment
- Each installment is treated as hire charges (if default in any installment seller entitled to take away the goods)
- Hirer is free to return the goods without being required to pay any further installments falling due after the return

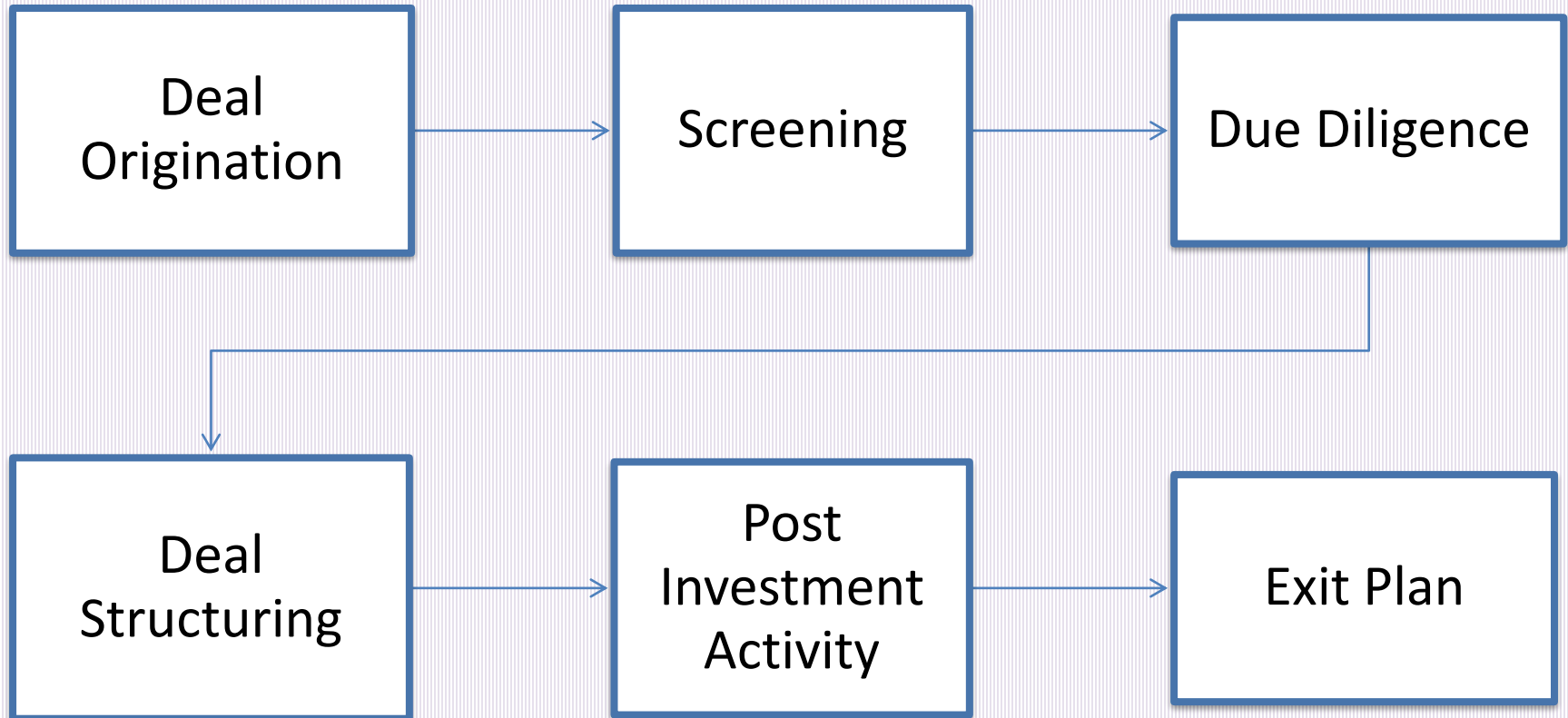
Venture Capital Financing

- ❑ It is money for new and/or small businesses that typically have little or no access to capital markets
- ❑ Features:
 - ✓ Equity participation
 - ✓ Participation in management
 - ✓ Long term Investment
 - ✓ High risk
 - ✓ Lack of liquidity

Stages in Venture Capital Financing



Venture Capital Investment Process



Tips to save borrowing cost

❑ For importers

✓ *Always use buyer's credit @ LIBOR + 0.50% (If no exports, go for hedging also)*

❑ For exporters

✓ *Use PCFC/ EPC & FBN/FBP facilities (even SMEs can take sub-limit with CC limit)*

❑ If you have good collateral

✓ *Always ask for best CC rates or convert part of CC in to WCDL/FCNR(B) Loan*

❑ Switching Banks

✓ *Change from co-operative/small pvt banks to bigger PSU banks/foreign banks for better interest rates*

- ❑ **For a supplier to biggies like HUL, ITC, PFIZER etc.**
 - ✓ *Never take spot payment against cash discount. It costs you 18-24% p.a. instead take bill discounting @ 8-9% p.a.*

- ❑ **To increase negotiating power**
 - ✓ *Go for External Rating to take best interest rates benefit*

- ❑ **For a better rating & to avoid penal interest**
 - ✓ *Submit your periodic financial statements in time*

- ❑ **For importers and exporters**
 - ✓ *Always deal with a forex branch of bank to avail better forex rates*

❑ Temporary liquidity crunch

✓ Go & explain the problem to the bank and take Adhoc limits instead of spoiling track record by not paying creditors

❑ If you are in good financial position

✓ Always avail cash discount from your supplier say 2% p.m. and use bank limits @ 8-9 % p.a.

❑ If you have large limits say 50 Cr +

✓ Always deal with more than one bank to negotiate better

Remember you don't get
what you want,
but you get what you
negotiate....

thank you!

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