THE DEALSTRUCK GUIDE

to Small Business Financing

TABLE OF CONTENTS

LOANS ARE A POWERFUL TOOL FOR GROWING A BUSINESS

INTRODUCTION

Choosing the right financing option is one of the biggest hurdles small business owners face. Understanding the trade-off between costs and benefits is a difficult exercise, and that's before you take into account the multitude of vendors, financial products, rates, and purposes.

Being familiar with the basics of the small and medium sized business *(SMB)* lending marketplace is important for making sure you take your first step forward on the right foot.

In the following chapters we will cover how different products in the market work to help you leverage your successes and grow your business.

CHAPTER 1

THE FUNDAMENTALS OF LENDING

LEARN THE LANGUAGE

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THE FUNDAMENTALS OF LENDING

In a classic loan a certain amount is lent to you (called the **"principal"**), and is repaid over a certain amount of time (called the **"term"**) at a certain price (usually called the "**rate**" or "**interest rate**").

Interest is calculated at the end of each month on the amount of principal that is remaining. Monthly payments are a fixed amount, and at the end of the term the loan's balance is zero.

The lender accepts risk because the borrower may not pay the loan back, and is therefore compensated for that risk via the amount of interest that the borrower pays over the lifetime of the loan.

Example: a **$100,000** loan at **20% APR**, with a term of **12 months.**

HERE'S WHAT THE PAYMENTS ON THAT LOAN WOULD LOOK LIKE:

Term (months)	Loan Amount	APR	Monthly Payment
12	$100,000	20%	$9,263

Month	Balance at Beginning of Month	Interest Accrued During Period	Payment	Ending Balance (Balance + Interest - Payment)
1	$100,000	$1,667	$9,263	$92,403
2	$92,403	$1,540	$9,263	$84,680
3	$84,680	$1,411	$9,263	$76,828
4	$76,828	$1,280	$9,263	$68,845
5	$68,845	$1,147	$9,263	$60,729
6	$60,729	$1,012	$9,263	$52,477
7	$52,477	$875	$9,263	$44,089
8	$44,089	$735	$9,263	$35,560
9	$35,560	$593	$9,263	$26,889
10	$26,889	$448	$9,263	$18,074
11	$18,074	$301	$9,263	$9,112
12	$9,112	$152	$9,263	$0

Total Interest: $11,161

For this loan, the total cost for the initial $100k ends up being $11,161

As the principal is paid down, the amount of interest per month decreases (also known as "**amortization**")

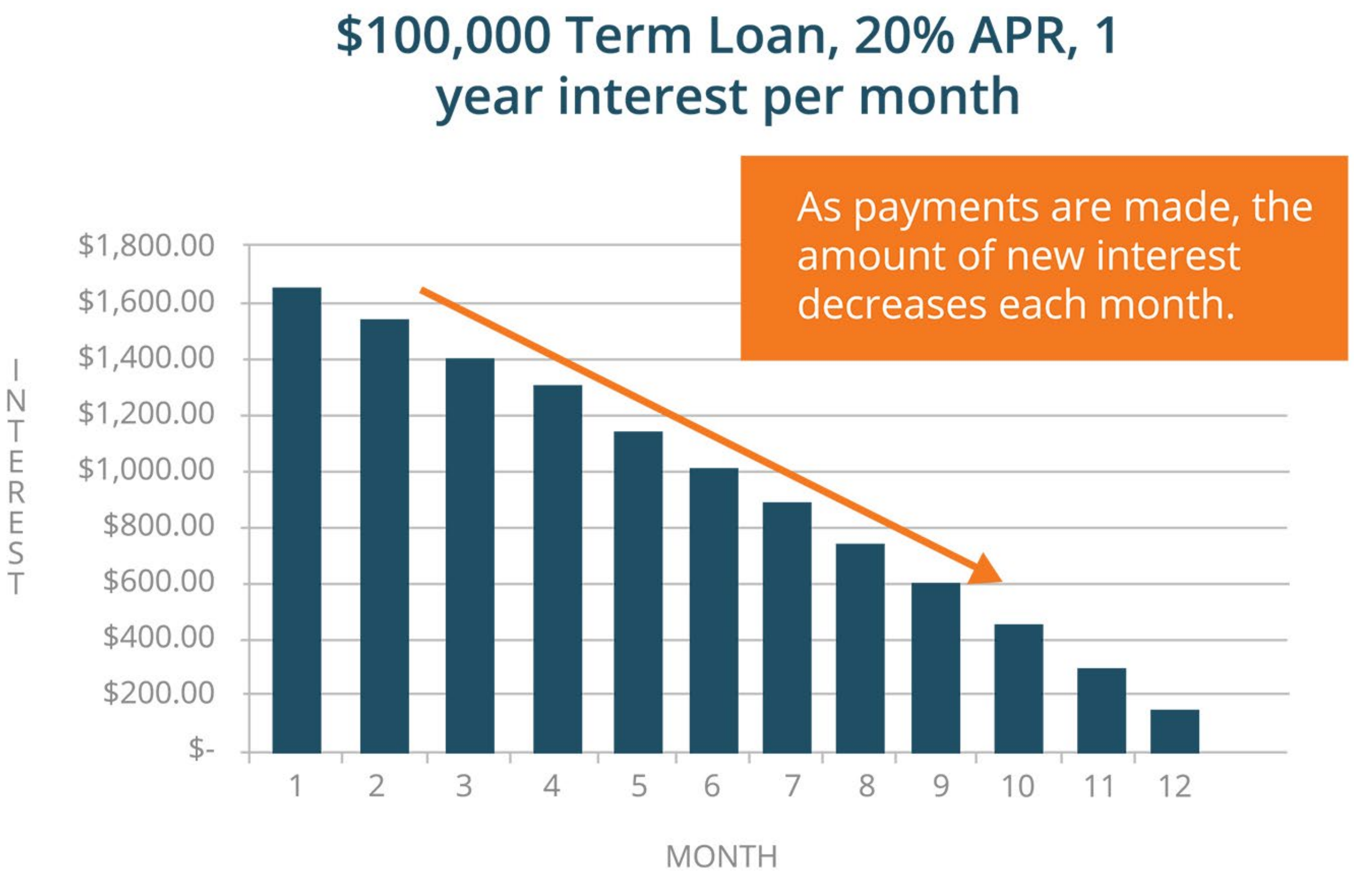
TERM LOANS

When most people think of a loan (fixed payments that include both principal and interest), they're actually thinking of a "term loan" – a loan with a stated Annualized Percentage Rate (APR).

- In these classic loans, the interest is calculated each period *(usually each month)*, so each payment pays some principal and the new interest.
- The loan on the previous page is a term loan.

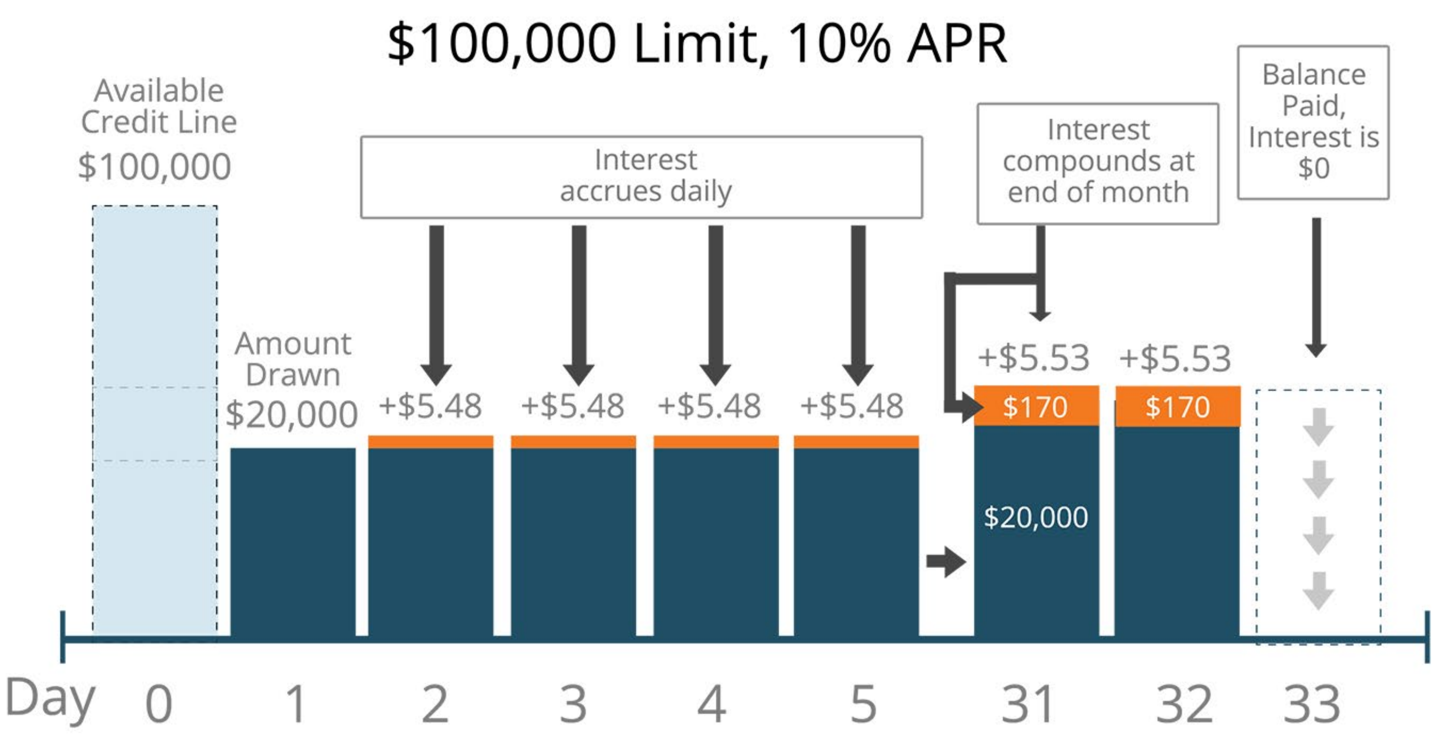
AMORTIZATION

- Amortization is when the amount of interest that accrues per month decreases due to the principal being paid down.



CREDIT LINES

- A credit line is a financial product that allows you to draw the specific amount you need, up to whatever the credit line's limit is.
- In a credit line, you only pay interest on what is the outstanding balance *(what you've drawn)*, so as you pay the balance down the monthly interest also decreases.
- Most credit lines are priced in terms of APR.



- Interest is charged on your outstanding balance.
- If your balance is $0, no interest is charged.
- Credit cards are the most common form of credit lines that people are used to working with.

CONSUMER VS. COMMERCIAL LENDING

- As consumers, we are used to thinking of lending in terms of **Annual Percentage Rate**, or APR – whether it's a mortgage, financing a car, or a student loan, all consumer loans are stated, by regulation, in APR.
- Unfortunately, commercial lending is NOT regulated like consumer lending, so commercial lenders don't have to state their financial products in terms of APR.
- This causes a lot of confusion, because oftentimes small business owners think that a commercial lender is speaking in terms of APR, when in fact the loan has completely different (and oftentimes more expensive) terms.

CHAPTER 2

TRADITIONAL SMALL BUSINESS LENDING

WHAT THE BANKS HAVE TO OFFER

SMALL BUSINESS ADMINISTRATION (SBA)

- The Small Business Administration exists to help small businesses succeed.
- The SBA doesn't directly lend money to businesses. Instead, it provides guarantees on a portion of small business loans, enabling banks to offer more loans and lower interest rates.

BUSINESS LOAN CHECKLIST

- Below are the documents most commonly requested by banks:

✓ Personal Background Information
✓ Resumes
✓ Business Plan
✓ Personal Credit Report
✓ Business Credit Report
✓ Income Tax Returns
✓ Financial Statements
✓ Bank Statements
✓ Legal Documents
  - *Business licenses and registrations*
  - *Articles of incorporation*
  - *Contracts with third parties*
  - *Franchise agreements*
  - *Commercial leases*

✓ Collateral

- For a full list of documents, visit the SBA website:

Source: http://www.sba.gov/content/business-loan-checklist

A FEW QUESTIONS

- Institutions will almost always ask you these questions, so be sure you've discussed them with your team, and have good answers!
  - *Why are you applying for this loan?*
  - *How will the loan proceeds be used?*
  - *What assets need to be purchased, and who are your suppliers?*
  - *What other business debt do you have, and who are your creditors?*
  - *Who are the members of your management team?*

TIMELINE

- Although the SBA and most banks quote their underwriting process in terms of weeks, wait times of 3-6 months for a loan approval decision is not uncommon.
- If your business is facing a critical need where speed is of the essence, you might want to look at other options.

BANK TERM LOANS

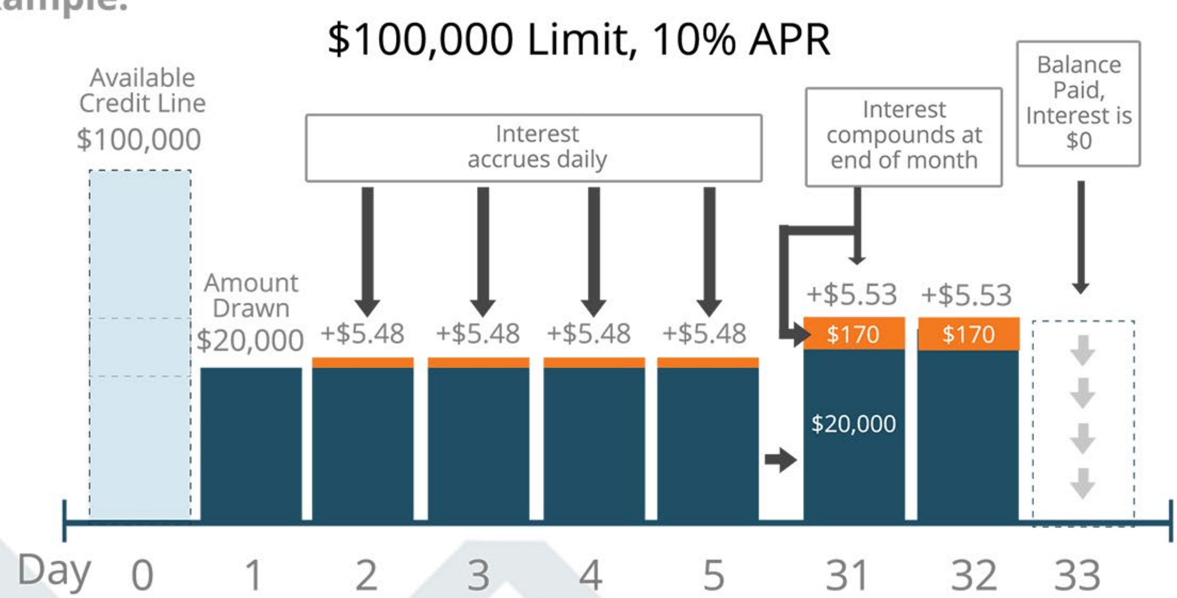
- Established companies with cash flow are able to get sizeable loans from banks and credit unions at the lowest available rates.
- These loans typically have a term of more than 5 years.

Example:

- $2 million dollar loan
- 5 year term
- 7% APR

BANK CREDIT LINES

- Established companies are also able to open large, revolving credit lines.
- **Example:**



TOP 25 SBA LENDERS IN THE U.S. (2014)

RANK	LENDER	NO. OF LOANS	TOTAL LOANS
1	Wells Fargo Bank	2,781	$801,774,095
2	Live Oak Banking Company	463	$387,196,250
3	U.S. Bank National Association	2,326	$288,445,290
4	The Huntington National Bank	3,021	$264,885,000
5	JPMorgan Chase Bank, National	2,540	$249,692,480
6	CDC Small Business Finance Corporation	271	$210,118,725
7	Ridgestone Bank	232	$169,254,575
8	Noah Bank	225	$165,883,485
9	Celtic Bank Corporation	595	$147,124,521
10	Newtek Small Business Finance,	181	$135,340,490
11	BBCN Bank	157	$132,327,928
12	Mortgage Capital Development Corporation	132	$128,250,000
13	SunTrust Bank	252	$126,833,305
14	Empire State Certified Development Corporation	195	$122,148,180
15	Florida Business Development Corporation	200	$106,932,000
16	Florida First Capital Finance	129	$105,649,000
17	Seacoast Commerce Bank	170	$104,297,295
18	Wilshire Bank	246	$98,264,550
19	Compass Bank	1,100	$94,761,580
20	CertusBank, National Association	81	$90,893,685
21	NewBank	118	$86,532,500
22	Mountain West Small Business Finance	114	$84,425,700
23	Commonwealth Business Bank	116	$82,848,916
24	TD Bank, National Association	528	$81,480,900
25	Manufacturers and Traders Trust	889	$80,047,345

http://www.sba.gov/lenders-top-100

KEY TAKEAWAYS

- Bank and credit union loans are ideal for established businesses with solid cash flow and good credit.
- They typically offer the lowest rates but if you need access to capital quickly, you may want to look at other options.

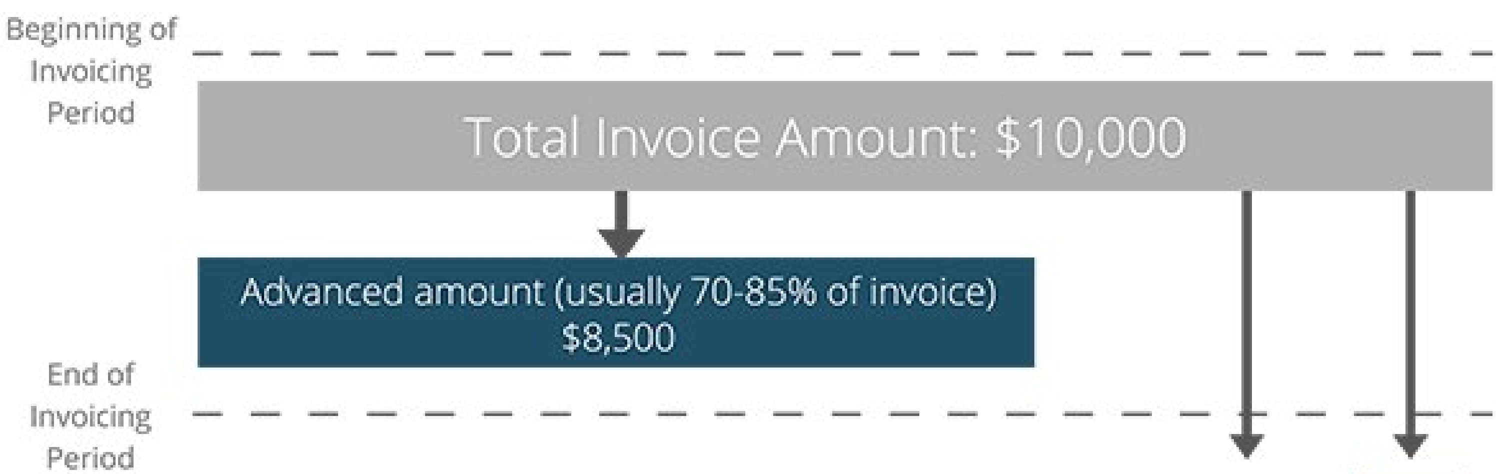
CHAPTER 3

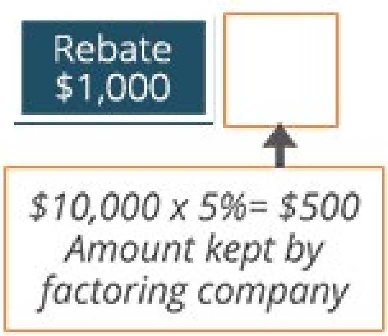
SHORT-TERM SMB LENDING

QUICK, BUT COSTLY SOLUTIONS

FACTORING

- Simply put, **factoring** is when a **factoring company** buys one (or more) of your invoices, advances you a certain amount of the invoice, and then collects the invoice for you and keeps a certain cut.
- Businesses that use invoices to track payments from customers (usually B2B businesses) oftentimes find themselves in a crunch when they are waiting for their receivables to be paid. Factoring is a common lending structure in this situation.
- There are three components of a factoring deal:
  - *What you get advanced*
  - *The 'rebate' you're given at the end of the deal*
  - *What the factoring company keeps*





Factoring deals are stated in one of two ways:

- *Percentage kept by the factoring company at the end of the deal*
- *The "rebate" amount (with the factoring company's take already deducted)*

Important: when a factoring company quotes their price as a percentage, it is a percentage of the **invoice's value,** *not* APR!

KEY TAKEAWAYS

- Factoring is beneficial for businesses that rely on accounts receivable.
- Factoring is best for short-term immediate needs, but not revolving needs (due to high cost).
- One common complaint from business owners is that factoring companies routinely contact their invoiced customers – both to confirm the invoiced amount and to collect.

MERCHANT CASH ADVANCE & DAILY DEBIT

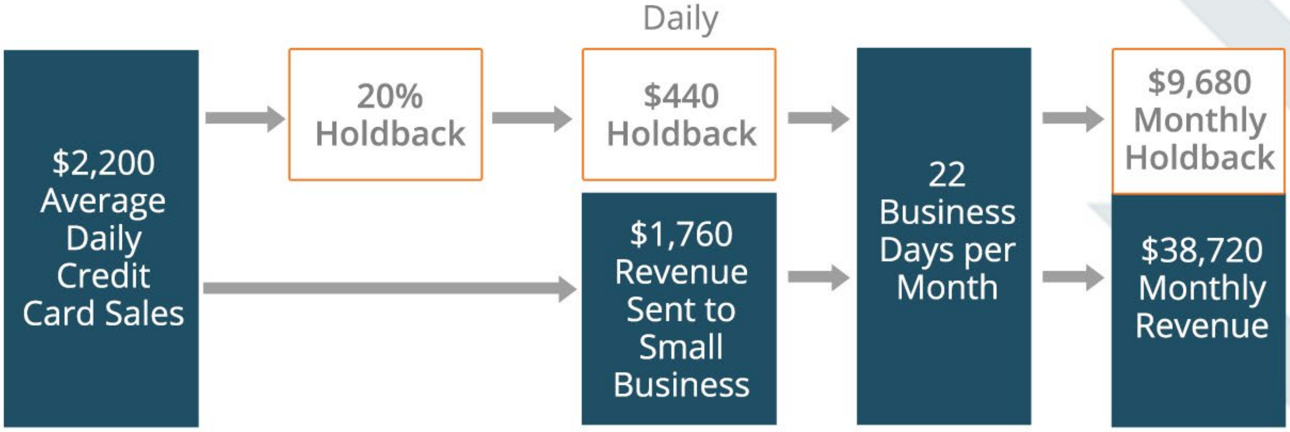
- A Merchant Cash Advance (MCA) is a short term loan that is often offered to young businesses who do not have other funding options.
- For repayment, MCA lenders use one of two payment structures (that, in the end, are very similar): Daily Debit or Merchant Cash.
- MCAs almost always quote their loans in terms of "buy rate" (or "payment multiplier").
- For example: an MCA lender offers you $100,000 at a 1.3 Buy Rate, to be paid off over 6 months.
- 1.3 is an average Buy Rate, although it isn't uncommon to see buy rates of 1.4 or even 1.5.
- Let's look at the cost on this loan:

- Our $100,000, 20% APR, 1 year term loan from earlier has a cost of $11,161 (or, $.11 per dollar borrowed). Compare that to this $100,000 MCA that has a cost of $30,000 ($.30 per dollar borrowed) - this MCA loan is nearly three times more expensive.
- In fact, if you reverse-engineer the math, paying $30,000 of interest on a $100,000 loan over 6 months would have an APR of 96%!

MERCHANT CASH ADVANCE PAYMENT STRUCTURE

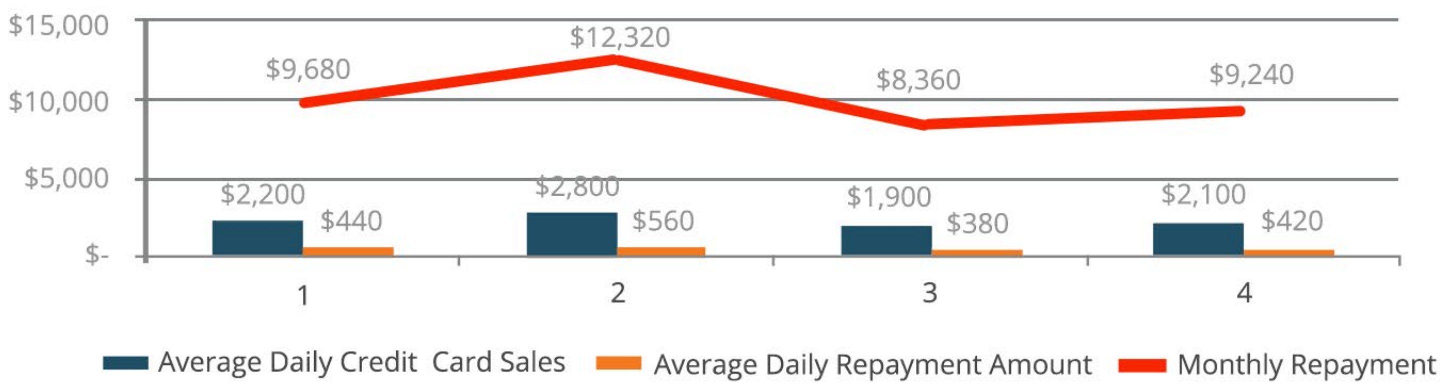
- A “merchant cash” lender processes credit card payments for the small business borrower and retains a portion of all credit card sales as a means of repayment.
- 10-20% of daily credit card sales is a typical repayment percentage. This is also called a “hold-back” or “redirection”.
- Because the repayment is determined by the business’s daily sales, MCA lenders often cap their loans at 2x-3x of the average monthly credit card sales.
- **Example**: Let’s use our $100,000, 1.3 Buy Rate loan with a Merchant Cash Lender who has a 20% holdback on credit card sales. Let’s say that the small business does around $2,200 worth of credit card sales each day. (Chart found on page 18).

- Here is how a typical day in Month 1 would be processed in this loan:



This example shows one of the key, hidden downsides to an MCA loan: the significant impact on your monthly cashflow. This borrower might not realize how severe the impact of retaining only 80% of their monthly cashflow could be.

- As the amount sold via credit card changes each day, so does the payment amount.



"DAILY DEBIT" PAYMENT STRUCTURE

- Daily Debit is the other repayment method MCA lenders use. In Daily Debit a pre-determined amount is withdrawn from your business's checking account at the end of each business day.

- **Example:** let's use the same $100,000, 1.3 buy rate, 6 month deal.

Using 22 business days per month, the MCA lender will determine what your daily debit amount will be:

$130,000
Total Amount Owed

$130,000 / (6 months x 22 business days per month)
= $984.85 deducted each day

$984.85	X 22 =	$21,667
Daily Debit Amount	Business Days Per Month	Equivalent Monthly Payment

One tricky thing MCA lenders do to hide the cost of their loans is to state their payments in terms of business days (22 per month), instead of amount per month. We all know that $21,667 is a significant sum of money, but "$984.85 per business day" doesn't sound nearly as expensive.

- Daily debit can be tough on businesses that have sporadic cashflows during the month (maybe you're a restaurant and make the majority of your revenue on the weekend). On good days you'll make more than the $984.85, but on slower business days you might be below that $984, meaning you'll be operating at a loss.

KEY TAKEAWAYS

- MCAs can fund within a day or two with minimal paperwork. If your business needs quick access to funds, this may be one of your only options - albeit an expensive one.
- Depending on buy rate, it isn't uncommon to see effective APRs of 40-120% APR on MCA loans.

CHAPTER 4

INVESTMENT SMB LENDING

LENDERS THAT INVEST IN YOUR GROWTH

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INVESTMENT LENDERS

- Investment lenders are a new type of lender that have appeared in the last few years.
- What sets investment lenders apart is that their financial products are focused on creating new revenue and growth for small businesses.
- For investment lenders, risk is often mitigated by investing in small businesses with high potential for growth.

INVESTMENT LENDING TERM LOAN

- A term loan from an investment lender is identical in structure to a traditional term loan in that it's fully amortizing and has fixed monthly payments.
- Loans from investment lenders are usually under $500k, less than 5 years in length, and have rates that typically range from 9% to 27%.
- There is a great example of a term loan from an investment lender found on the next page.

TERM LOAN FROM AN INVESTMENT LENDER

Term (months)	Loan Amount	APR	Monthly Payment
24	$100,000	18%	$4,992

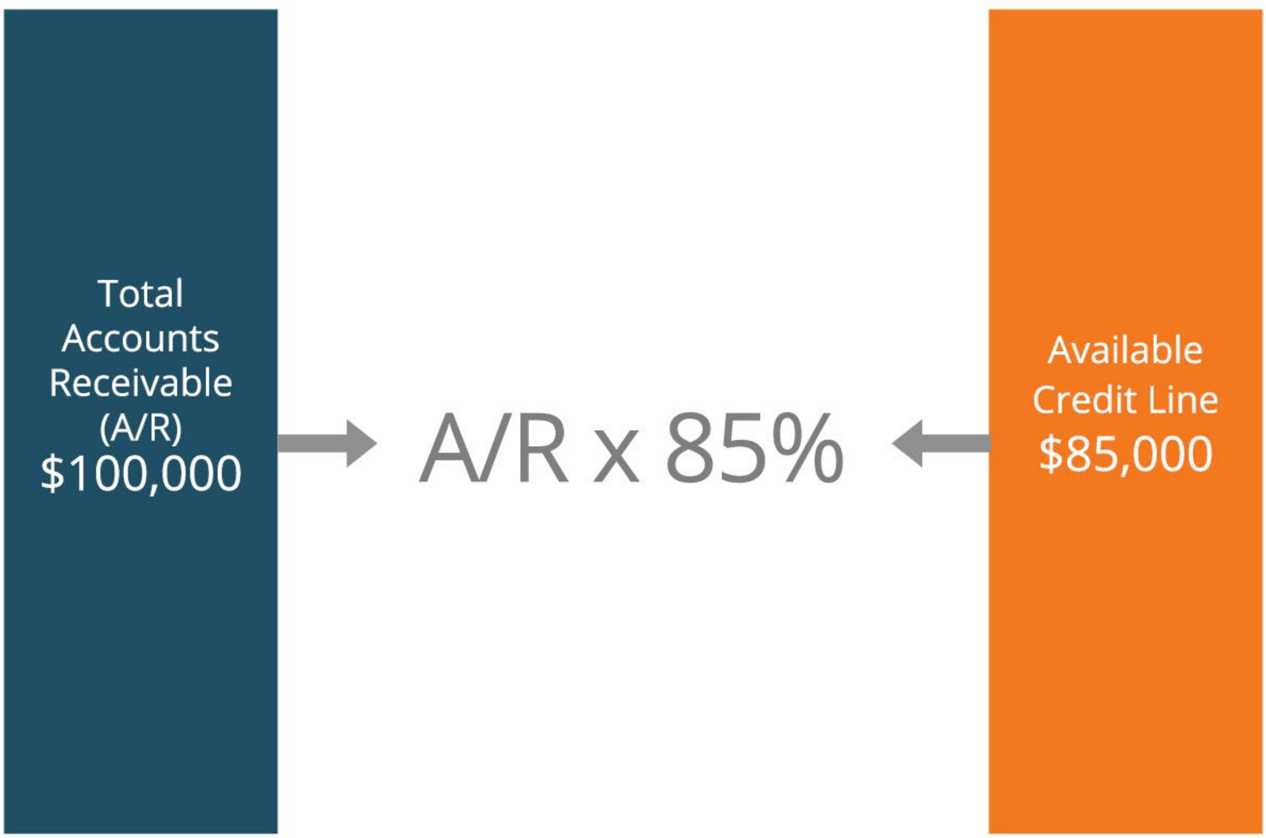
Month	Balance at Beginning of Period	Principal	Interest Accrued During Period	Total Payment
1	$100,000	$3,492	$1,500	$4,992
2	$96,508	$3,544	$1,448	$4,992
3	$92,964	$3,598	$1,394	$4,992
4	$89,366	$3,652	$1,340	$4,992
5	$85,715	$3,706	$1,286	$4,992
6	$82,006	$3,762	$1,230	$4,992
18	$32,941	$4,498	$494	$4,992
19	$28,443	$4,565	$427	$4,992
20	$23,877	$4,634	$358	$4,992
21	$19,243	$4,704	$289	$4,992
22	$14,539	$4,774	$218	$4,992
23	$9,765	$4,486	$146	$4,992
24	$4,919	$4,918	$74	$4,992

ASSET BASED LINES OF CREDIT

- One product type is an Asset Based Line of Credit (ABL). Instead of capital, an ABL is secured by an asset such as the borrower's Accounts Receivable balance.

- **Example:** Tim needs financing to meet payroll, he has $100,000 in Accounts Receivable.

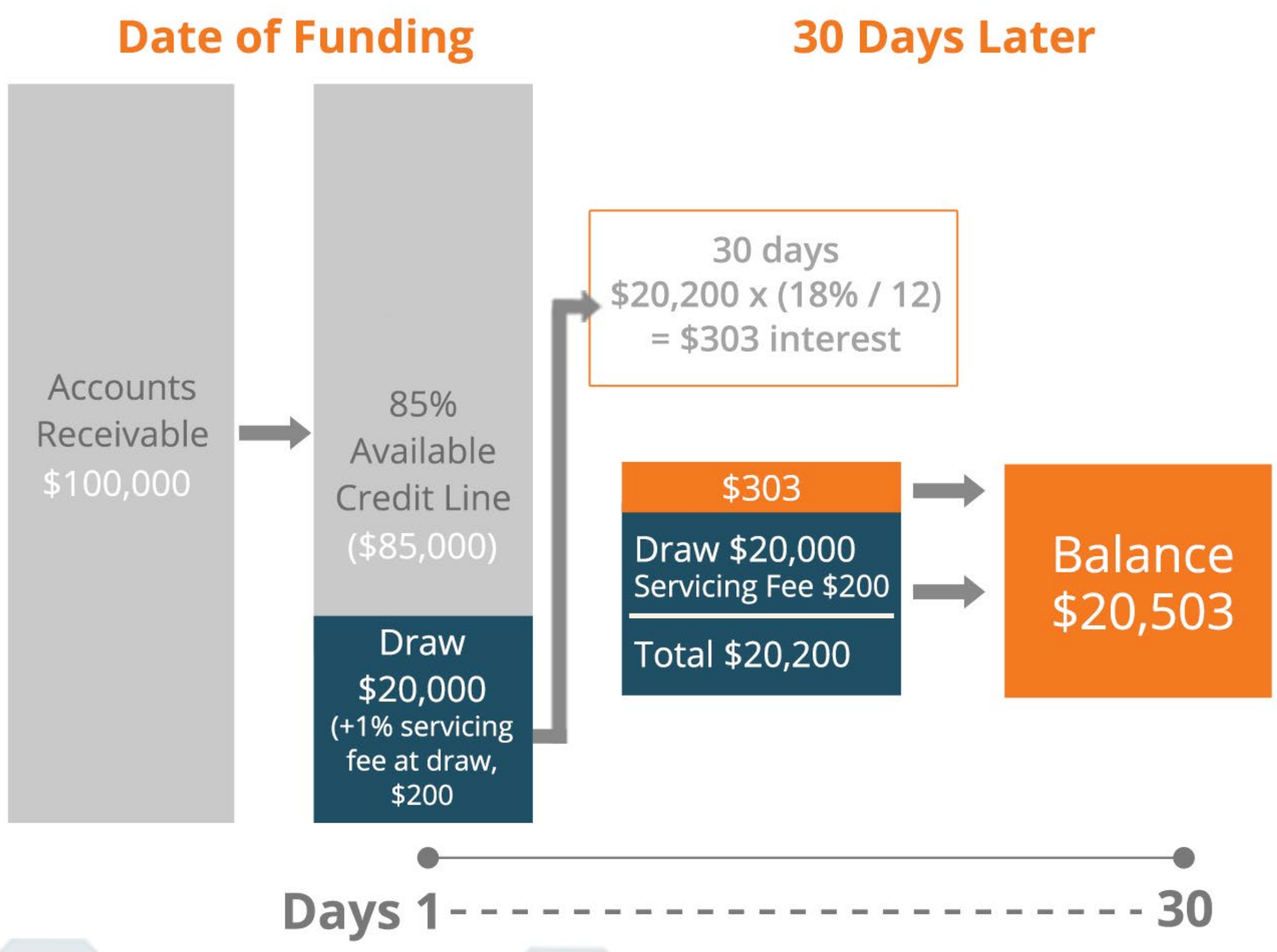
An investment lender offers Tim an ABL equal to 85% of his "eligible A/R" (anything less than 90 days old).



ASSET BASED LINES OF CREDIT

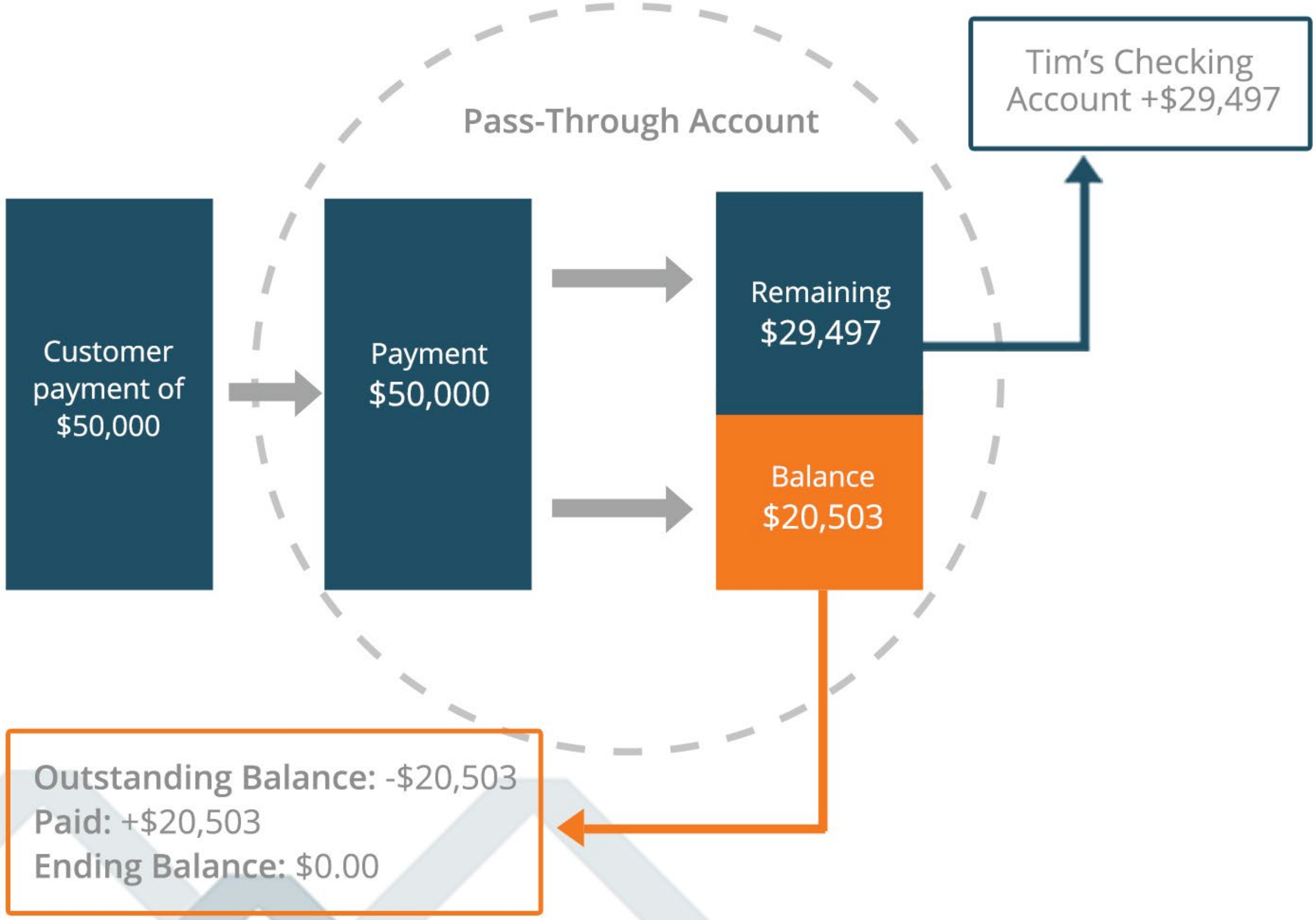
- To understand how the charges and payment of an ABL work, let's keep using Tim as our example:

  - The rate for Tim's credit line is 18% APR
  - There is a 1% servicing fee on the amount drawn
  - Tim draws $20,000



PASS-THROUGH ACCOUNTS

- A pass-through account is one way a lender can collect outstanding balances. It is another way investment lenders are able to mitigate losses and delays in payment.
- Pass-through accounts are commonly maintained by the investment lender but remain in the borrower's name.
  - *This way the borrower's customers don't have to be bothered by a third party (like what happens in factoring deals).*
- Here's what Tim's $85,000 credit line (with $20,503 outstanding) would look like when a customer pays off an invoice to the pass-through account.



KEY TAKEAWAYS

- Businesses that are not able to get SBA financing should look at investment lenders as the next best option.

- Because investment lenders look at the overall health and growth potential of the business, they are usually more willing to approve loans that banks turn away.

- Although interest rates offered by investment lenders are not as low as bank rates, they offer competitive pricing and will work with businesses to structure a loan that fits the needs of the business.

"[Investment lenders] give businesses enough time to take a loan to make an investment in their company, let the loan improve their business, and pay it back over a reasonable time period.

This is a sharp contrast to the cash advance lenders whose short-term loans often force the borrowers into multiple renewals and increased rates."

"A New Group of Alternative Lenders: Investment Lenders"
Inc.com, Ami Kassar July 2014

CLOSING

CLOSING THOUGHTS

WHAT'S RIGHT FOR YOU?

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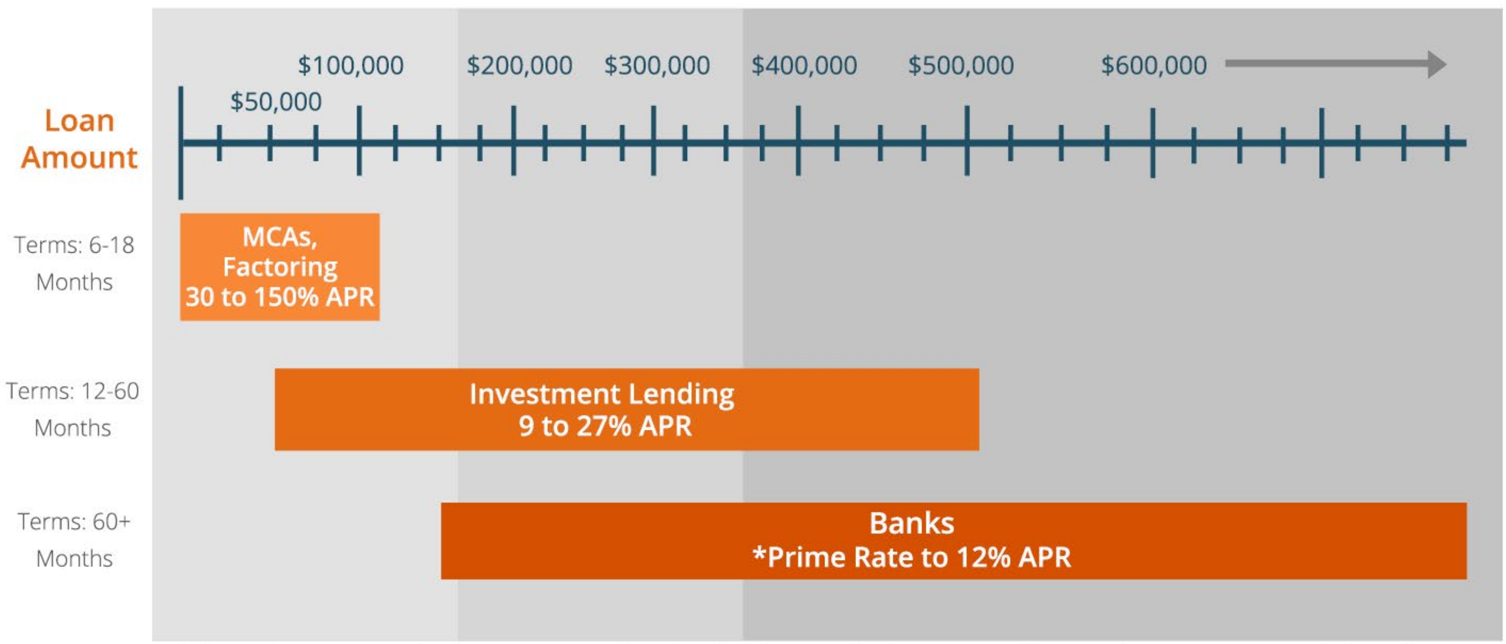
KNOW WHAT YOU'RE GETTING

- No matter what the product or price you choose, do your due diligence to ensure that you know exactly what you're getting – it's your money and you deserve to know.

WHAT'S RIGHT FOR YOU?

- There are many factors at play in choosing the right financial product for your business.
- Based on what you've just learned, here is a way to think about what lenders are appropriate for you, as determined by the unique needs of your business.



*The prime rate is the interest rate that banks charge their most credit-worthy customers. It is largely determined by the federal funds rate, which is the overnight rate which banks lend to one another.

SUMMARY

You have options!

Here's a convenient chart that shows your loan options at a glance:

LOAN OPTIONS
FOR SMALL BUSINESS OWNERS

	TRADITIONAL & SBA		INVESTMENT LENDERS		SHORT-TERM LENDERS	
	SBA FINANCING	TRADITIONAL BANK LOAN	LINE OF CREDIT	TERM LOANS	FACTORING	MERCHANT CASH ADVANCE
LOAN AMOUNT	Max: $5 million Average: $330k	$150k and up	Up to $500k	Up to $500k	70-90% of Invoices	Up to $500k
TIMING, APPLICATION TO FUNDING	3-6 months	2-4 months	1-2 weeks	1-2 weeks	1-2 weeks	Within a week
USE	Any business use	Any business use	Stabilize irregular cash flows	Inventory, capital, general growth	Cover operating expenses until invoices are paid	Short term needs: cover payroll and/or unexpected costs
TERM	3-10* years * Terms >5 yrs usually real estate	1-20* years * Terms >5 yrs usually real estate	1 year renewable contracts	1-5 years	Usually 30 days	3-12 months
PAYMENTS	Monthly Payments	Monthly Payments	Weekly, Bi-Weekly, or Monthly Payments	Weekly, Bi-Weekly, or Monthly Payments	No Payments (Cost is 2-3% of invoices)	Daily payments of a fixed % of sales
APR RANGE	Term Loan: 5.5%-6%, Line of Credit: 9%-12%	4%-8%	9%-23%	9%-27%	Equivalent APRs are 30%-50%	Equivalent APRs are often 60%-150%

- [Download the full version](#) of our Loan Option infographic.

ANY QUESTIONS?

The financing experts at Dealstruck can point you in the right direction.

Contact us at **855-610-5626**, **info@dealstruck.com**, or visit us at **www.dealstruck.com!**