

A Guide for Preparing for Financing

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When a business decides to seek a new loan, whether for funding general working capital needs or a specific transaction, the company should not wait until it contacts potential lenders to start preparing for the financing. Instead, businesses can take key steps in advance of and during these discussions to put themselves in the best possible position for closing on new financing most efficiently and on better terms. Here are seven questions – six to ask in advance and one question hopefully to avoid – that in-house counsel can use to guide discussions with business teams and advisers when preparing to obtain new financing.

1. **What is the objective driving the new financing?** Negotiating a new loan can often take on a life of its own, but ultimately the financing is simply a means by which to accomplish one or more underlying business objectives. In-house counsel should know these objectives, but understanding them goes beyond simple descriptions of being for working capital or to fund an acquisition.

For example, with a working capital facility, are the proceeds needed because the company is cash-strapped, in order to smooth out seasonal variability in revenue, as a more efficient approach to pay operating expenses, to free up capital for other uses, or for some other purpose? If the financing is to fund a specific transaction, such as an acquisition of a new subsidiary, is the new subsidiary intended to stand alone or be integrated into the company, and is this acquisition an isolated event or part of a larger strategic initiative? By understanding the underlying business objectives, in-house counsel will be better suited to advise business teams on the best structure for the financing, to evaluate competing proposals from lenders, and to assess the necessary trade-offs that inevitably come in negotiating the transaction documents.

2. **Will we have any special needs to address?** The structure of most loan documentation follows a common format: business terms, conditions to advances, affirmative and negative covenants, and events of default. Over the term of the loan, this structure may result in numerous constraints on a borrower's operations and other limitations on activities that it cannot undertake without lender consent. As a result, a borrower should identify upfront any special needs or "asks" so that they can be addressed as part of the preliminary negotiations with prospective lenders.

In some ways, this question is related to understanding the underlying business objective(s) driving the financing. For example, if a company's underlying objective is to grow the company through a series of acquisitions, it will need to seek flexibility on permitted acquisitions and future indebtedness. Other times, though, the special need may be for a key operational purpose, such as ensuring that the cash necessary to make timely payments to key vendors is available and not trapped in an account securing the credit facility.

3. **What do we want to avoid doing?** The flip side of identifying special needs is understanding what the company may not be willing to do in connection with a financing. This issue could come into play, for example, if there are certain assets or types of assets that the company does not want to include as collateral. Generally, the greater value, quality, quantity, and variety of collateral a borrower uses to secure a loan, the better the terms and availability of credit will be. A company, though, may not be willing to include certain assets as collateral for a financing for a strategic or other reason, such as saving the assets for use as separate collateral on a subsequent financing or wanting to have flexibility of managing the assets without them being encumbered.

Identifying matters such as excluded collateral or other commitments that the company would not want to make in connection with a financing before the process begins helps ensure that any prospective financing is structured and priced accordingly. Further, doing so allows expectations to be set appropriately from the outset of discussions with potential lenders.

4. **Are our books and records sufficiently organized?** In preparation for a financing, lenders will conduct their due diligence and credit underwriting on the prospective borrower. The better organized the company's books and records are, the smoother the underwriting process will be. Typically, lenders will look for key diligence materials, such as three years of financials for existing companies, pro forma financials for new or repositioning companies, lists and values of assets, major or material contracts, and organizational documents. Having this core information prepared and organized in advance will send a signal to prospective lenders about how well run the company is.

Conversely, having disorganized records may be seen as a red flag to a lender or, at a minimum, may make the underwriting more time-consuming and delay closing. Further, having organized books and records allows the company to respond better to follow-up questions or requests for additional materials, as well as to facilitate framing the company's story better if there is something negative in its history. For example, if the company had a poor performance during the typical three-year financial review period, presenting the lender with additional information at the outset explaining the performance or how the company has or will respond to this issue will better enable the lender to address the past poor performance in its credit underwriting.

5. **Do we have access to necessary information?** This question is an extension of the books and records question, but addresses information beyond the core documentation that may be required or requested by prospective lenders as part of their diligence. A company may start anticipating what type of information might be required, and determine whether it has easy access to such information. If not, it may need to start laying the groundwork to obtain the information if needed at a future date.

For example, perhaps the most common type of information in this regard is upstream ownership information. Since May 2018, as part of increased requirements tied to anti-money laundering rules, know-your-customer procedures, and anti-terrorism financing efforts, regulated financial institutions have been required to obtain certain personal information, including Social Security numbers, about any individual who owns a 25% direct or indirect beneficial interest in a business customer; banks also may adopt stricter policies that reduce this threshold to 10%. As a result,

companies will need to provide this personal information for any applicable beneficial owner in order to obtain financing with a regulated bank. Businesses, in particular those with outside investors or parent sponsors, should ascertain whether there are any applicable beneficial owners and, if so, whether the company has permission to disclose the personal information or needs to obtain consent from the beneficial owner to do so.

6. **What will the relationship with the lender be like after closing?** While prospective lenders are doing their credit underwriting on the potential borrower, a company can use this time to start to gauge what the relationship will be like with the lender over the term of the loan: How will the lender manage the loan? Will there be a dedicated customer service representative? What kind of electronic access will the lender's back office need, for example, to view the company's bank accounts?

Also, how the lender approaches interacting with the company during its diligence may provide a sense of whether the lender is looking to build a broader or longer-lasting relationship with a customer or simply assessing the transaction on an isolated basis. Finally, in-house counsel may look for clues in term sheets as to what the future relationship with the lender might be. For example, if the term sheet calls for multiple types of legal opinions, some of which are primarily used only in secondary market transactions, one could reasonably anticipate that the originating lender likely may sell the loan to a new lender at some point during the term of the loan.

7. **Why didn't you tell me this earlier?** This question is one that an in-house counsel hopefully never has to ask internal clients because it usually comes up in the context of a problem or potential problem. So, the best way to try to avoid this question in the context of a potential financing is to ask questions like the ones above early in the process. The desire to avoid asking this question applies also to outside counsel who may be assisting with or negotiating the credit facility. Therefore, information obtained by the in-house counsel should be shared with outside attorneys early in the process as well. With this information in hand, outside counsel too will be better able to advise the company and structure the transaction appropriately.

These seven questions provide a guide through the initial stages of financing, but also serve as a springboard for other possible questions to consider in advance of obtaining a loan. They also highlight that a successful financing is built on a foundation of planning and preparation.

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