



KREDED



HELPING BUSINESSES
KEEP THEIR LIGHTS ON

LET'S TALK ABOUT LOANS

A beginner's guide to loans.
What they are and What they are good for

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INTRODUCTION

If you are reading this book is because you have made the decision to take your business to the next level, you have understood that in order to expand and grow, you need capital, but you are not convinced that giving up equity is the solution, or perhaps you have already maxed out your equity.

Whatever your reasons, you are about to learn the basics of credit (loans) that will help you when approaching lenders.

But, how does a business know what type of loan it needs?

This will depend on how the business plans to use the money or the purpose of the loan. It will also depend on the collateral securing the loan. *We will discuss collateral in another book.*

WHAT IS A LOAN?

A loan is a financing vehicle use to finance an asset of a business. Loans have certain characteristics that make them attractive to business owners, when comparing to other sources of capital, such as equity.

Loans are versatile, they can be long-term loans, short-term loans, collateral specific, and purpose specific.

- **Long-term loans:**

Repayment terms of the loan exceed 12 months. Typically a loan financing real estate is a long-term loan.

- **Short-term loans**

Repayment terms are typically less than 12 months. An example is a Line of Credit (LOC). An LOC is used to finance working capital and because a business cycle is typically a year or less, these types of loans are paid back with cash flow from operation.

- **Collateral Specific loans**

An example of this type of loan can be an inventory loan; which is repaid as inventory is sold and converted into cash.

- **Purpose specific loans**

A purpose specific loan can be the buy out of a partner or the purchase of another company. While these loans will need to be collateralized, some can be structured as unsecured loans.

PROS OF A LOAN

Each company has its own needs, but there are several common reasons why companies turn to debt rather than equity.

1

You retain ownership of your business.

2

In most cases they have tax benefits.

3

Versatile repayment and term options.

4

You can take several loans for different purposes.

CONS OF A LOAN

Loans are a very good option, but they also have some challenges that borrowers need to be aware of. However, it is safe to say that most of these challenges can be overcome and do not deter businesses from pursuing them.

1

Possible high interest rates.

2

Possible high fees.

3

Can take a long time to close due to paperwork and negotiations.

4

Possible strict financial covenants.

QUALIFYING FOR A LOAN

The main goal of a lender is to get their money back. And whether it is a non-recourse (no personal guarantee) or a recourse (personal guarantee) loan, lenders understand that people run businesses, so it is important that you know that when seeking a business loan, the lender will look into what we call the five C s of Credit to ensure they have a good understanding of the business and who they are doing business with.



Capacity

Refers to the business capacity to generate cash flow from operations.

Is this business operating as ongoing concern?



Capital

Refers to liquidity. Is the level of liquidity of the business and its ability to raise capital from shareholders adequate?

QUALIFYING FOR A LOAN



Character

Refers to the owners of the business honesty and willingness to repay the debt. Do they post any risk of fraud?



Condition

Refer to the economy. What are the macro and micro economic conditions this business is operating?

Does this business have the capacity to operate under high-pressured environments?



Collateral

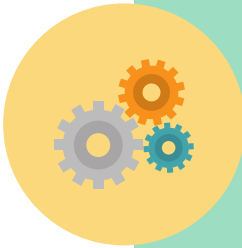
Refers to the asset securing the loan. Is this asset valuable? Does this asset can increase or retain its value? Is it marketable ?



Bonus: Credit Score

Some lenders are incorporating the Credit Score of the owner as a measure to extend credit, separately from Character. A Credit Score can provide a good insight as to how an individual manages debt.

TYPES OF LOANS



Term loans:

Can include equipment loans.
Typical repayment terms are longer than one year.
Term loans can be structured a senior debt or junior debt.



Lines of Credit:

Use to finance short-term working capital needs.
Covers the cash conversion cycle.
Can be reused as the business pays down the principal (this feature is called revolver).



Real Estate:

Typically a long-term loan with repayment structure longer than 12 months.
Secured by a real estate asset.
It includes construction loans.

TYPES OF LOANS



Some other more sophisticated loans structures include

Mezzanine: a hybrid debt and equity vehicle that gives the lender the right to convert the debt into equity.



Unitranche: a hybrid debt structure that incorporates a senior debt and a subordinated debt into one loan.

There are many other types of loans and the ones listed above can be structured differently, depending on their purpose and collateral. They can also take on different positions, senior or subordinate debt, but at least you get the idea of what types of loans are available in the market.

WHAT YOU CAN FINANCE WITH A LOAN

Loans are versatile and can serve to finance several needs and projects. As long as the company can prove its repayment capacity, loans can be structured to finance pretty much anything. These are just a few.

1

Enter new markets.

2

Introduce a new product.

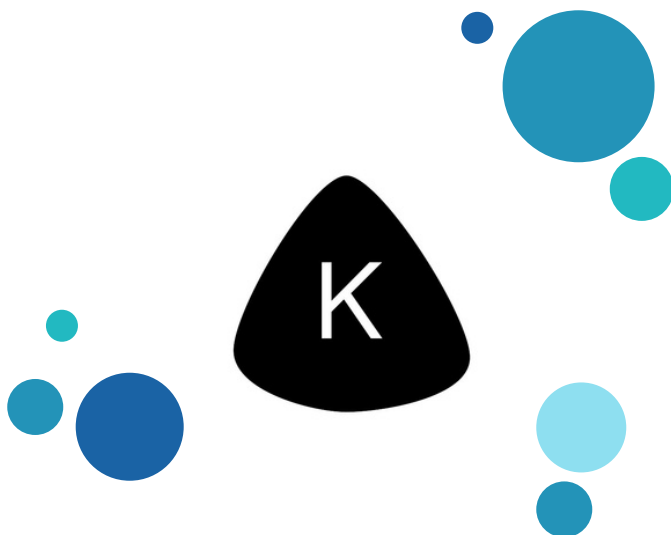
3

Support growing contracts.

4

Buy out a partner.

ABOUT KREDED



KREDED

KREDED is an innovating commercial loan marketplace, servicing middle market companies. Our mission is to help businesses keep their lights one by giving decision makers more time to focus on operating their businesses; while providing convenience and a streamlined funding process.

You can email KREDED at capital@kreded.com
