The Annual Credit Review: Finding Opportunity in Obligation

While your company's annual credit review may feel like a chore, there are proactive measures you can take to turn it to your advantage. With the re-emergence from the lockdowns and the likelihood of fundamental changes having been made to your business model your annual review has heightened importance Ian Brenner, a Partner at GlassRatner and former CFO, explains.

Some yearly rituals—like New Years and Thanksgiving—tend to be greeted with excitement and delight. Sadly, the annual credit review isn't one of them. Instead, CEOs, CFOs, and their finance teams often find it a distressing obligation to prepare their submissions to their bankers.

However, perhaps it's time to turn the mindset that this is annual chore on its head. Rather than approaching the annual credit review with trepidation, you can use this as an opportunity to strengthen your banking relationships, demonstrate the company's soundness and growth potential, and explore new financing terms more aligned with the company's funding needs.

The key is to tackle the review with the mindset of providing your banker with greater insight into your strategic and financial position. And the payoff is considerable: beyond enhancing trust, a strong partnership with your bank will give you greater flexibility to maintain access to or raise capital, deal with a covenant breach, manage financing costs, or uncover new financial solutions that can support your business in both good times and bad.

If you're ready to turn this obligation into an opportunity, here are six steps to get you started:

1. Seek to understand what your banker

is looking for

It likely comes as no surprise that banks are serious about regularly evaluating the risk of their loans. Apart from their regulatory requirements, it's simply good business practice. This partly explains why your banker may be seeking supporting information and insight into your business during your annual credit review. Your relationship manager may even want to arrange for an onsite visit to discuss your business and industry prospects with management—something we will explore later in the article.

Typically, the bank will be looking for a full overview of where the company has been over the past year and its plans for the future, supported by the following documentation:

- annual financial statements with associated Management Discussion & Analysis (MD&A) and variance reports, assessing performance relative to plan
- detailed budget/forecast (including financial covenant tests)
- a strategic update (both short-term and long-term), including any indication of significant initiatives under consideration or in process, any pending management changes (i.e., departures, appointments, and status of succession plans), and a discussion on key risks and opportunities

2. Go beyond the numbers

Although a presentation of your financial health is critical during your annual review, it's really just the first step. If you truly want to build rapport with your banker, you may also want to:

- provide a succinct view of the business case or why the company's strategy is sustainable
- demonstrate that management understands its industry and is confident in its competitive positioning
- support and elaborate on the competence of your leadership team and their likelihood of executing to plan
- discuss the quality of cash flows and your ability to meet commitments
- share significant events that have improved the banker's collateral coverage, giving the bank comfort on its security and collateral position (i.e., accounts receivable insurance is in place, or the value of a secured asset has been enhanced)
- review the covenants and your historical and projected compliance. For example, the company may need to explain why non-recurring expenses should be excluded from EBITDA in a ratio of funded debt to EBITDA
- share any specific shifts in the business strategy and operating model (that happened during the pandemic) or prospects for the future—helping your bankers gain an understanding of any fundamental changes to your opportunities or risk profile

Be sure to also deliver your credit review package or presentation on time—or early. A missed deadline could signal that you may not have your business under control or that you don't take your relationship with your banker seriously—messages you want to avoid conveying at all costs.

3. Be radically transparent

When your company is poised for exciting change, it can be tempting to hype up the good news—a temptation it's best to avoid when speaking with your bankers. Whether you're sharing your historical performance or your future prospects, take care to communicate in a factual, clear, and honest way.

The same is true if the news you're sharing is bad. Bankers understand that all businesses go through difficult periods and sometimes face adversity. Experience shows they would much prefer to be told upfront about current or anticipated risks, issues, and challenges—rather than being surprised once it's too late to recover.

If you're concerned about meeting your covenants, be transparent and offer solutions. If your financing needs have changed, proactively request a revision. By providing insight into these issues, you not only demonstrate your solid understanding of your business; you also give both your team and your banker the luxury of time to identify solutions together.

4. Avoid overload and focus on nuance

During your annual credit review, your goal is to help your bank understand your current position—not to provide them with minutiae of every decision you're considering. A concise 15 to 20-page presentation will be appreciated more than a multi-page thesis crammed with information that needs to be analyzed. The key is to find the right balance between being informative and information overload.

When preparing your materials, include the type of information your banker most wants. Chances are the bank already has a view on your industry and a risk rating model to compare your historical results to industry rankings. Rather than providing this top-line detail, focus instead on:

- educating your lender about the nuances of your business
- discussing how shifts in your industry may affect your financial standing (particularly if things have changed since 2020)
- taking some time to understand current lending conditions so you can explain whether your activities fall within your bank's tolerance for risk

5. Get face time

If your banker has not visited your premises in a while, now may be the time to invite them over, especially as we emerge from lockdowns and restrictions. By taking your lender on a tour of your facilities, and making introductions to your management and key staff, you can help them gain deeper insights into your business and its culture. A well-planned onsite visit also brings the numbers in your review package to life by demonstrating that your operation is organized and well-run.

As an added benefit, an in-person visit will let you strengthen your relationship with your bankers. We spend so much time on video-calls, exchanging emails and playing phone tag, we often lose that personal touch when communicating. With quality face time, you can elicit their opinions on emerging industry trends, market conditions, and even new competitive products and services they may be aware of thanks to their relationships with hundreds of companies across all industries—including your own.

You can call it the old-school approach or humanizing your business relationships, but no matter how you label it—nothing beats an old-fashioned sit down with your banker to bolster trust.

6. Seek outside, experienced advice

Part of the reason companies sometimes struggle with their annual credit reviews is because they lack the in-house resources to deliver a strong package on time. If that's true for you, consider using an interim resource to bolster your finance team. An advisor with experience dealing with banks can help you properly explain your current financial realities and strategic positioning—whether you're growing like gangbusters or facing distress. The right interim can provide a seasoned voice and support for your executives during the review process, and may even be able to help you:

- build a financial model for projections, including underlying assumptions and sensitivity analyses
- assemble your final package for submission
- prepare for the presentation by taking executives through a mock review
- assist with follow-up questions and ensure completion or renewal of the term sheet

With the right support, a clear understanding of your obligations, and a willingness to strengthen your banking relationships, the annual credit review can become a source of differentiation and advantage for your organization rather than a source of stress. And, while it may not feature a midnight champagne toast or a bountiful feast, it can deliver more sustainable benefits in the form of an improved long-term partnership with your lender.

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