



Bridge (loans) over Troubled Water



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*When you're down and out
When you're on the street
When evening falls so hard
I will comfort you*

*I'll take your part
When darkness comes
And pain is all around
Like a bridge over troubled water ...*

Bridge Over Troubled Water (Simon and Garfunkel)

What is a **bridge loan** and why would any business ever need – *or want* - one?

It is not uncommon for a business to run into a cash flow or capital bind where it has a need for a quick infusion of cash, but are is sure where to turn. The causes can be numerous, but typically include such events as;

- Customers are slow paying
- There is a critical piece of equipment that needs to be repaired or replaced
- Purchase orders have been awarded, but there is insufficient revenue to complete production
- A tax bill is due

These kinds of events, while common, will keep a CEO and CFO awake at night. For them, these can be “Troubled Water” and they need to find a way to get across.

Normally, one would turn to the local supportive banker, but as we all know, credit is tight and the stimulus packages doesn't seem to offer any relief. Also, by now the company has in all likelihood exhausted its bank lines. Somewhere in their careers, the CEO and CFO have heard of **bridge loans** and think “maybe this might be the solution ... “

But first what is a **bridge loan**?

Bridge loans come in various forms and carry different labels, as outlined below, but essentially they all have four elements in common;

- 1) They are relatively short term (usually months)
- 2) They are expensive (carry a VERY high interest rate)
- 3) Lenders expect some type of collateral and usually much more than the actual loan
- 4) They are usually the ‘loan’ of last resort, and are pursued instead of selling equity or some asset at a discount

Also, **bridge loans** are typically not given to start up companies.

- **Factoring:** Using Accounts Receivables (AR) as collateral.

These assets have to be clear of any creditor claims and lenders will usually extend credit of up to 95% on highly qualified Accounts Receivable. Customer's payments are then usually made to the factoring company directly, and once collected from the customer, the balance is sent to the company. Some factors will select only specific accounts receivable from the company's portfolio.

- **PO (purchase order) Financing:** Using Purchase Orders as collateral.

Normally the purchase orders have to be assignable and it has to be displayed that the financing will in fact generate the predicted revenue stream to repay the loan. PO financiers usually require a relationship with a factoring company.

- **Third Party Guarantees:** Using the guarantee of an executive, family member or another company as collateral.

In most cases the guarantor will be required to pledge tangible assets well in excess of the loan.

Now, having said that, there is an appropriate time and a place for a **bridge loan**; even though they are not right for every firm. Here are 3 simple questions to help assess if this sort of interim funding strategy might be right for your firm – and your situation:

1. The CFO has to have a comprehensive feel for the financial numbers and know exactly how much to ask for and what financial results will be gained. It cannot be “a bridge too far”.
2. The CEO must have a clear understanding of what purpose the bridge loan will satisfy. It has to be a tactical part of a bigger picture. As implied by its name, the bridge loan is interim funding and there has to be a strategic funding plan in place. It cannot be “a bridge to nowhere”.
3. The business plan for ‘life after the bridge’ needs to be clearly defined and clearly achievable; with the sufficient spike in growth and profitability that more than offsets this very high, short-term interest rate.

For example - If you have new contracts under negotiation, or new PO's in hand, or new pending business alliances to increase sales – and these initiatives are:

- *Finalized and pending implementation*
- *Confirmed as having the request impact needed on your cash flow and profitability*
- *Only a few months away from making this impact*

Then a Bridge Loan could be a viable option for securing sufficient working capital to ‘bridge’ these few months.

However – HOPE – does not suffice as a business plan for improving you positive cash flow, and generating sufficient working capital to run the business – and re-pay this high rate loan.

If this is your plan for recovering from your current cash flow crunch – and your rationale for obtaining a Bridge Loan – then do not do it. Because another name for a “bridge to nowhere” is a “cliff”.....

In summary, a **bridge loan** can be a very effective tactical financing tool when taken as part of a broader financing plan. If it is taken as a “stop gap” then the company will in all likelihood drown in the debt of its own “troubled water”.

If you are unsure if it is the right fit for your company, or if you need help building or confirming if the pending initiatives have the sufficient cash flow and profitability to justify the Bridge rates, it is a wise investment of your time and money to get a professional, experienced, and unbiased third party opinion.

And by ‘unbiased’, we are meaning someone without any personal gain from just recommending the decision to take the loan.

They should either be ‘fee neutral’, meaning a professional fee stated up front, and independent of the recommendation. Or they should also be ‘risk/reward’ based, meaning they are also willing to put some skin in the game for helping achieve your ROI from the initiatives at the other end of the Bridge.

No one needs to pay someone for the recommendation of driving off of a cliff...