Q "Financial statements are important when applying for a loan. What are the key components of the financial statement, and what do I need to need to know about each one?"

A Stephanie Castagnier Dunn, senior vice president, SBA division national sales manager, First Bank SBA

As a business banker lending to small businesses nationwide for over 18 years, there are basic financial fundamentals that will equip borrowers to master the numbers behind a business.

Knowledge is power, and being able to decipher how the bank will look at business financials is key to structuring the appropriate loan solution. Learning how to analyze financials will guide the applicant in applying for a business loan that is tailored to fit that specific business versus the usual one-size-fits-all loan the banks advertise.

When applying for a business loan, a completed loan application combined with all related financial documentation will be required. These financial statements come in various forms: income statements, balance sheets, cash flow statements, aging accounts payables, aging accounts receivables and business tax returns. A complete financial package is crucial in evidencing the financial strength and credit worthiness of the overall loan request. The bank is looking for consistency in cash flow and the applicant's ability to service the newly proposed debt as well as any other outside debt. Can the business pay its mortgage each month and support the individual borrower's personal living expenses?

An existing business will need to provide the last three years business tax returns as well as the year-to-date income statement and balance sheet. In analyzing the financials of the business, the last three years of business tax returns will be considered first. The bank will first look at the top revenue line over the last three years and determine whether there are positive or negative revenue trends. If the trends are negative year over year, it will raise a red flag and a request for further explanation. Is the negative trend in revenues due to new competition or is there evidence of a positive correction and upward turn in the most recent financials? Next, they will look at the net income trends on the business returns for each of the last three years.

The bank will then analyze the percentage fluctuations year over year of various line items from the business tax returns and the historical income statements. Are there notable percentages of revenue changes in the following year over year – cost of goods, salaries, maintenance, marketing and any other unusual variations in significant expenses? Any unusual or nonrecurring expenses will need to be explained and may be taken into consideration when computing the cash flow analysis.

Once the business tax returns and financials are cross referenced and charted, the bank will also look at the borrower's personal tax returns over the last three years and personal financial statement. The lender will need to determine the ongoing personal living expenses and if there is any other outside income that will continue to help finance the personal living expenses above and beyond said business. The borrower's personal credit report will be cross-referenced for monthly credit card payments and all personal debt obligations. The personal credit obligations combined with the outside salary will determine the needed owner's draw from the business.

Consistent business and global cash flow is of utmost importance in determining the debt repayment ability and help result in a loan approval. The bank will run a cash flow analysis of the last three years of business tax returns using the net income figure and adding back all customary business add-backs. Customary business add-backs consist of depreciation, amortization, rent expense, owner's compensation, interest expense and any nonrecurring documented major expenses outlined during the income statement charting. Once the total cash available figure is calculated, it is offset with the required personal owner's draw, insurance and property taxes. This bottom line will result in the true available cash flow to service the proposed debt and any other existing outside business debt.

Being able to evidence true available cash flow over the last three years of operation and the ability to cover the new proposed debt with a 15-20 percent-plus buffer is the name of the game. More importantly, understanding your financial statements and being able to present your loan application outlining your own financial analysis is even more impressive and indicative of a borrower worthy of this business loan.

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