Lending Terms

Affiliate: A company linked to a larger parent company, where that parent company holds partial stake of ownership in the affiliate company.

Amortization: The action of spreading out a loan into a series of fixed payments over time. With an amortizing loan, each payment is the same amount. That amount includes both principal (the initial amount you borrow) and interest.

Amortization Schedule: Shows the breakdown of each payment, indicating how much goes toward interest and how much reduces the principal. It also provides details about the remaining balance over time. Loan amortization ensures that you systematically repay both interest and principal, ultimately leading to the full repayment of the loan.

Assets: Items you own that have monetary value and can provide future benefits to your business. There are different types of assets, including:

> **Current Assets:** Items you or your business own that can be converted to cash within a year.
>
> **Fixed Assets:** Sometimes referred to as Physical Assets. Items that can't immediately be turned into cash but are tangible items that a company owns and uses to generate long-term income. Examples include land, machinery, building, vehicle, furniture, electronics, and tools.
>
> **Intangible Assets:** Non-physical items that are essential to a company, such as a trademark, patent, copyright, or franchise agreement or items that have no physical presence but do have monetary value such as accounts receivable or 401ks or stocks.

Balance Sheet: An important financial statement that communicates an organization's worth or "book value." The balance sheet includes a tally of the organization's assets, liabilities, and equity (see definitions) for a given reporting period.

Balance sheets are arranged according to the following question: Assets = Liabilities + Owner's Equity

Capital: The money and assets that a business uses to fund its operations and generate revenue. Capital can be in the form of cash, equipment, property, or other long-term assets that have value. Capital can come from different sources…such as working capital, debt, or equity. Capital allows businesses to pay for their expenses and produce their products and services to earn a profit.

Capital Gain: An increase in the value of an asset or investment above the price you initially paid for it. If you sell the asset for less than the original purchase price, that would be considered a capital loss.

Cash Flow: Cash flow refers to the net balance of cash moving in and out of a business at a specific point in time. Cash flow represents revenue received (inflows) and expenses spent (outflows). The total net balance over a specific accounting period is reported on a **cash flow statement,** which shows the sources and uses of cash.

Cash flow can help indicate the health of a business: Positive flow (more money moving in than out) can indicate solvency ability of a company to meet its financial obligations, while a negative value (more money moving out than in) can show that business expenses are higher than profits.

Collateral: Something pledged as security for repayment of a loan. If the borrower defaults on (can't pay back) their loan, this item would be forfeited to the lender so the lender can sell the collateral item to gain back the amount they lost on the borrower's lack of payment. Items like a car, home, office equipment, inventory etc. could all be pledged as collateral. The amount and type of collateral you need to pledge depends on the amount of your loan, type of loan, and other parameters set forth in your lender's specific loan program.

Compound Interest: This refers to "interest on interest." When you're *investing* or *saving*, compound interest is earned on the amount you initially deposited ***AND*** on any interest that original amount gained over time. Compound interest helps grow your savings.

When you have compound interest on debt, interest is charged on the initial amount you were loaned ***AND*** on the interest your loan amount gained. This adds to your overall loan balance over time and can potentially increase your debt.

Example of Compound Interest on an investment:
Let's say, you invest $10,000. It earns 10% a year in interest. After year 1, you'd have the original $10,000 plus the $1,000 in interest you earned totaling $11,000.

In year 2, you now earn interest on your new $11,000 total from end of year 1. So, at the end of year 2 you now earn 10% interest on $11,000 which gives you $12,100. You're earning interest on top of the interest you earned the year before. The investment compounds, or builds up, over time.

Example of Compound Interest on debt:
Your credit card charges interest on the balance on your card every single month. If you don't pay enough to cover that month's new interest, it'll be added to your credit card balance. Then, the next month's interest is calculated based on that new, higher balance amount that includes the interest you didn't pay off last month - which means you end up paying more and staying in debt longer.

Credit Score: A credit score is a three-digit number that rates your creditworthiness. FICO scores range from 300 to 850. The higher the score, the more likely you are to get approved for loans and for better rates.

A credit score is based on your credit history, which includes information like the number accounts, total levels of debt, repayment history, and other factors. Lenders use credit scores to evaluate your credit worthiness, or the likelihood that you will repay loans in a timely manner.

The three main U.S. credit bureaus are Equifax, Experian, and TransUnion and each may calculate your FICO score differently.

Depreciation: The decrease in an asset's value. It's a term commonly used in accounting and shows how much of an asset's value a business has used over a period of time.

A commonly known depreciating item is a vehicle. A vehicle loses its value over time due to age and wear. When you sell your vehicle a few years after you purchase it. It is worth less money than the price you originally paid for it.

DSC Ratio: Stands for Debt Service Coverage Ratio. It measures a business' available cash flow to pay their current debt obligations. Lenders like this ratio to be at or higher than 1.25. For every $1.00 of debt you have, you have $1.25 to service or cover it.

EBITDA: An acronym standing for Earnings Before Interest, Taxes, Depreciation, and Amortization, EBITDA is a commonly used measure of a company's ability to generate cash flow.

To get EBITDA, you would add net profit, interest, taxes, depreciation, and amortization together.

EIN / Tax Number: Employer Identification Number (also known as a Tax Identification Number) is used to identify a business entity. Generally, businesses need an EIN. You may apply for an EIN in various ways, including online. This is a free service offered by the Internal Revenue Service and you can get your EIN immediately.

Equity: The amount of money that belongs to the owners of a business after all assets and liabilities have been accounted for. Using the accounting equation, equity can be found by subtracting total liabilities from total assets.

FFE: Acronym for Furniture Fixtures and Equipment

Financial Projections: Show the expected revenues, expenses, and cash flows of a business over the forecast period. A financial projection is based on a combination of historical results, expectations for changes in the market, and other changes in the circumstances of the business, such as an investment in a new product line. Typically, a financial projection is made for your next year two years. Projections show your lender the anticipated revenue and expense of your company, the cash flows, the estimated profits, and growth potential. This helps a lender make an informed financial decision about whether to invest in your company or not. It is important to not exaggerate projections to try to "win over" a lender. Be as realistic as possible.

Guarantee: A provision a lender puts in a business loan agreement that requires owners to be personally responsible for their company's debt in case of loan default.

A personal guarantee will require the borrower to pay back the loan with their own personal money if the business cannot (such as through bankruptcy or the business closing).

A guarantee can also be made by a person who is not the borrower but agrees to repay the loan if the borrower cannot. This may be a spouse, parent, or business partner. A guarantee may also take on the form of collateral provided by the debtor.

Global Debt Service: Considers all available cash flow from the business, the borrower, and all guarantors which could be available to cover the loan if needed.

Income Statement: A financial statement that summarizes a business's income and expenses during a given period. An income statement is also sometimes reffered to as a profit and loss (P&L) statement.

Injection (Equity Injection): Most business acquisitions that use lender financing require that the buyer ues some of their own funds towards buying the company. Some lenders also refer to it as a down payment.

Lien: A legal right to maintain possession of a borrower's asset until the debt has been repaid. A lender may place a lien against a piece of business or personal property to ensure the lender does not suffer a financial loss should the borrower fail to pay off their loan. The lien on the property is released once the debt has been paid in full.

Leverage: Using borrowed money as a funding course. Leverage is often used when businesses invest in themselves for expansions, buying another company, or other growth needs. Lenders often use financial leverage ratios to gauge a company's financial strength, with the most common being debt-to-assets and debt-to-equity.

You can analyze a company's leverage by calculating its ratio of debt to assets. This ratio indicates how much debt it uses to generate its assets. If the debt ratio is high, a company has relied on leverage to finance its assets. A ratio of 1.0 means the company has $1 of debt for every $1 of assets. If it is lower than 1.0 it has more assets than debt – if it is higher than 1.0, it has more debt than assets.

Debt Ratio = Total Debt ÷ Total Assets

Liabilities: The opposite of assets, liabilities are what you owe other parties, such as bank debt, wages to employees, and money due to suppliers, also known as accounts payable. There are different types of liabilities, including:

> *Current Liabilities*: Also known as short-term liabilities, these are what's due in the next year. Ex: employee wages or a bill due to a supplier.
>
> *Long-Term Liabilities:* These are financial obligations not due over a year that can be paid off over a longer period. Ex: vehicle or equipment loan.

Liquidity: Liquidity describes how quickly your assets can be converted into cash. Because of that, cash is the most liquid asset. The least liquid assets are items like real estate or land because they can take weeks or months to sell.

Mortgage: Type of loan used to purchase or maintain a home, plot of land, or other types of real estate. The borrower agrees to pay the lender overtime, typically in a series of regular payments that are divided into principal and interest. The property then serves as collateral to secure the loan.

Net: The amount that remains after certain deductions are made. For example, a business makes $10,000 in revenue (this is the gross/total number) and has expenses of $8,000. Its net income is then $2,000.

Net Worth: You can calculate net worth by subtracting what you owe (your liabilities) from what you own (your assets.) The remaining number can help you determine the overall state of your financial health.

Participation: Occurs between two or more financial institutions, allowing multiple banks or other lenders to effectively share ownership of the loan. Loan participation programs can allow all lending participants to share the risks associated with the loan equally, or they can be structured on a senior/subordinate basis to distribute both the risks and rewards associated with the loan to the various lenders managing it.

For example, if a borrower needs access to a large sum of money that an individual lender may not be able to provide by itself, participating the loan out to another lender or specialty lending program can help pool the resources of multiple lenders together. Participation allows lenders to collectively issue a loan to a borrower without individually exposing themselves to the risk of that borrower defaulting on a particularly large loan.

Personal Financial Statement (PFS): A physical snapshot of your assets compared to your liabilities. It gives you a real-time view of your wealth and helps you assess your current financial situation. While it’s beneficial for your own financial growth, lenders may ask for a personal financial if you’re applying for a loan.

If your total assets are higher than your liabilities, your personal financial statement reflects a positive net worth. This is a sign that you’re building wealth and signals to lenders that you may be a trustworthy borrower.

If your liabilities are higher than your assets, you have a negative net worth. This signals you may be spending more than you earn, and you could be seen as a higher-risk borrower to lenders. This may require some pre-loan business advising to help you lower your risk.

Profit Margin: Profit margin is a measure of profitability that's calculated by dividing the net profit by revenue. Companies often analyze two types of profit margins:

Gross Profit Margin: Which typically applies to a specific product or line item rather than an entire business

Net Profit Margin: Which typically represents the profitability of an entire company.

Example of Net Profit Margin Calculation:
Let's say your company has a revenue of $50,000, with the cost of the goods you sold totaling $29,000 and other expenses totaling $6,000. The first calculation would look like this:

Revenue – expenses = net profit (income)
$50,000 – ($29,000 + $6,000) = $15,000 net profit

The next calculation would be to divide net profit by total revenue:
$15,000 ÷ $50,000 = 0.3

The final step is to multiple net profit by 100 to calculate your net profit percentage margin:
0.3 x 100 = 30% net profit margin

If you currently have a sales mix, meaning you sell multiple products, it can be helpful to calculate the profit margin for all of your products individually. This margin calculation can help you determine which products are the most profitable.

Financial Projections: Financial projections show what your business expects to happen financially in its future. Projections are often put together in a spreadsheet to help your lender understand how your business plans to earn future revenue and where your business plans to spend money. Usually, a lender wants to see projections for the upcoming 1-3 years.

Projections essentially help lenders answer questions like, "If we lend you this money, what will you do with it? And how will you pay it back?"

Financial projections also help you see when you may have financing needs and the best times to make large expenditures. They help you monitor cash flow, change pricing, or alter production plans.

A few things often included in financial projections are sales revenue estimates, expense estimates, cost of sales or cost of goods sold (COGs), other operating costs, and sales increases.

Return on Investment (ROI): A calculation used to determine the expected return of a project or activity in comparison to the cost of the investment, typically shown as a percentage. This measure is often used to evaluate whether a project will be worthwhile for a business to pursue. ROI is calculated using the following equation: ROI – [(Income – Cost) / Cost] * 100

Let's say the owner of a new barbeque sauce business spent $1,000 to sell her new line of sauce for an upcoming vendor market. This included expenses of ingredients, jars for packaging, and a $300 vendor booth fee. The company sold $1,700 worth of hot sauce at the event.
ROI % = [(Income – Cost) / Cost] * 100
ROI % = [($1,700 - $1,000) / $1,000] * 100
ROI % = [$700 / $1,000] * 100
ROI % = .7 * 100
ROI = 70%

Revenue: Total amount of money generated from business before expenses are taken out. Sometimes revenue is called gross sales or the top line because it is the first line of an income statement. It only indicates how effective a company is at generating sales. It does not take into consideration operating efficiencies which could have a dramatic effect on the bottom line (net income). Revenue can be generated by (but not limited to): sale of goods/services, advertising, licensing agreements, fees, rental income, etc.

> *Net Revenue:* Total dollar amount gained from sales after subtracting expenses, which are usually operational in nature.

Terms: A broad way to describe the various details of a loan. This can include the repayment period, fees or other costs, interest rate, and any other special conditions that may apply. When applying for a loan, the lender should specify what all the loan terms are before finalizing any borrowing agreement.

TPL or Third-Party Lender: The financing for every SBA lending project is provided by two financing entities who partner together on the loan:

1. A Certified Development Company (CDC), such as Dakota Business Lending, and
2. A Third-Party Lender (TPL), such as a bank or private investor.

The Third-Party Lender (often a bank) provided a loan for typically 50% of the total project cost. Then, the Certified Development Company, like Dakota Business Lending, provides the additional amount of the loan.

UCC Filing: A Uniform Commercial Code (UCC) filing is a form that lenders file with your state's Secretary of State office that identifies the asset the lender is claiming as collateral. This lets any other creditors or lending institutions know that that specific asset of your business is already claimed so it cannot be claimed as collateral by another lending entity.

This form enables lenders to seize the listed property as a way of recouping the loan amount if the borrower cannot pay back the loan. UCC filings may cover an individual piece of collateral, or a lender can list all of a business' assets and then only repossess what is necessary to pay off the defaulted loan balance.

Valuation / Appraisal / CMA Valuation: The process of determining the current worth of an asset, company, or liability.

Working Capital: Money available for daily operation. This is the difference between a company's current assets (cash, accounts receivable, and inventory) and current liabilities (accounts payable, debts). The working capital amount can help determine an organization's operational efficiency and short-term financial health. It indicates if a business has enough assets to cover its short-term debts while also funding day-to-day operations.