SFNet Crucial Conversations Webinar Series

Portfolio Management & Fraud Detection/ Prevention in the midst of Covid-19

APRIL 21, 2020 – 12:00PM EST

BROUGHT TO YOU BY

BRANDLIN AND ASSOCIATES

CLEAR THINKING GROUP®

Secured Finance Network

An association of professionals putting capital to work

Disclaimer

Today's webinar is for information purposes. It is open to SFNet members and outside participants, which may consist of media representatives, related authorities and other interested parties. Comments made by individuals participating in this meeting are not intended to represent the views of their respective companies. It is expected that information shared in this forum will be within the boundaries of best practices and based on publicly available information and in no way should be considered giving legal or business advice.

This program is being recorded for the benefit of our members and will be available at SFNet.com along with copies of all materials presented. Chat comments will not be recorded or attributed to individuals. No participant may be quoted without express written consent by the individual. We invite participants to continue the conversation after the meeting by joining the SFNet Discussion Group at SFNet.com.

Introduction - Presenters

Mark Fagnani

- Senior Managing Director – Clear Thinking Group, LLC
  - Financial Advisory Services
  - Turnarounds
  - Restructuring

Jeffrey E. Brandlin, CPA, CFF / CIRA, CM&AA

- Senior Managing Director – Brandlin & Associates
  - Financial Due Diligence
  - Workouts & Restructurings
  - Forensic Accounting
  - Litigation Support

Discussion Overview

1) ABL lenders have always relied on collateral, but how do they measure values and performance now? The old tried and true standard procedures have been rendered meaningless or unreliable.
2) Even your best borrowers may now be experiencing liquidity and/or collateral issues.
3) Weaker borrowers are already feeling the pressure – this is when lender due diligence activities historically need extra scrutiny.
4) Lack of liquidity has been the number one cause for frauds to be perpetrated – this is likely to remain true.
5) Field exams and appraisals may be impossible to fully perform for the foreseeable future – we now know desktop reviews will not suffice.
6) This will be a difficult time for all – borrow support is paramount and is being encouraged by the regulators, but how do we choose who is best to support and how?
7) Borrowers are victims of external events beyond their control.
8) P&I must be protected so vigilance is still required.
9) There may be borrowers that believe they are immune and choose to take matters into their own hands – these borrowers have always posed the biggest risk.

ABL Basics | Best Practices

Monitoring

1. Portfolio review – early and often, no longer the deep dive into each account but rather a quick but steady view with focus on:
   a) Short term cash needs and availability
   b) A/P Pressure – essential vs. non-essential payments
   c) Vulnerability to supply chain disruption
   d) Absolute emphasis on borrower behavior – Communication, Cooperation, Proactive Planning

2. Monthly statistics – trend card analysis
   a) Collateral turnover, dilution & other metrics – what do these numbers mean right now? Not what they used to but still require scrutiny and explanation. We still need to understand how the collateral is performing and why.

Red Flags

1. Borrower is performing better than its industry peers, reports no problems or is unaware of issues, no slow-down in revenues

2. Evergreening of receivables, change in aging methods, payments from non-creditors (related party or unknown source)

3. Borrower says it does not want to bother its customers during this extraordinary time / resists request

4. Borrower says it does not have the resources to increase reporting frequency / incapable of performing

ABL Basics | Best Practices (cont'd)

Monitoring

3. Verifications
   a) When in doubt, verify
   b) This seems to be one of the best defenses available at present but can we even reach the A/P department or receiving department?

Red Flags

5. Be suspicious of new customers, increased sales but no increased shipping expense

6. Increase in in-transit inventory (non-existent), difficulty in performing inventory rollforward, lacking documentation (PO, BOL, invoice, receiver), lack of mfg. orders

7. Look for duplicate payments, new or unknown vendors, rounded invoice amounts (whole payments), abnormal invoice volume, consider *Positive Pay*

8. Borrower is not able to provide logical explanations to reasonable requests or inquiries, consider site visit to observe operations or lack thereof

So, if the old techniques and practices don’t work right now, what should we be doing?

a) It is still paramount to identify your weakest and seasonal borrowers and those with more staying power and / or a more viable business model or product.

b) Focus of credit line personnel and senior management needs to be devoted to those accounts deemed most vulnerable.

c) Communication, Cooperation and Character assessment are key indicators. Borrowers that are unwilling to communicate on a regular basis (possibly daily) or will not cooperate with requests for additional information should be considered *Red Flags*.

d) Reporting frequency should have already been increased from monthly to weekly or even daily.

e) To the extent permissible under the terms of the loan documents, cash dominion should be triggered.

f) Inventory rollforwards using the gross profit method should be requested. While unlikely that these will tie exactly to reported numbers they can serve as an additional check given the inability to perform in-field test counts.

g) Daily or weekly telephone contact with every borrower is essential.

h) 13 week rolling cash flows should be required from every borrower.

i) Character assessment, while largely a matter of judgment, is paramount.

Tools to Navigate Liquidity Shortage

Cash Flow Forecasts / Budgeting

1. Be aware of and plan for liquidity issues early.

2. Borrowers should be encouraged to avail themselves of the government funds available under the CARES Act or the MSELF (Main Street Expanded Loan Facility).

3. Use consultants to vet or prepare financial forecasting as necessary – much of this can be done remotely.

4. Contingency planning should be considered.
   a) Most management teams are incapable of doing this analysis even in the best of times, let alone dealing with the current crisis.
   b) Employee furloughs, layoffs, spending cuts, plant or store closures, and other should be considered.
   c) Even after the outbreak subsides cash flows should be based on stabilization (preservation of cash) and then *gradual* recovery. Projections should have detailed assumptions and likely should include worst case, base case and best case scenarios as we do not know what will happen as the economy re-opens.

Proactive Response – Detected Issues

3rd party experts can be invaluable

1. Trust but verify.
   a) If reported facts cannot be supported, assume the worst.

2. As soon as possible:
   a) Get people on the ground to examine the collateral.
   b) Consider engaging consultants / experts early.
   c) You need eyes and ears in place and a steady flow of reliable information. Do not let / allow the borrower to limit the scope or communications.

3. Until the above are satisfied, funding for those borrowers that pose the biggest risk should be curtailed to a bare minimum.
   a) Matching cash disbursements (outflows) to cash receipts (inflows) is one way to ensure the loan does not increase or is under collateralized while you manage the situation.

4. Consider payroll tax lien searches.

5. Have counsel do a thorough legal file review.

About the Presenters

CLEAR THINKING GROUP®

Value Creation.
Value Preservation.

New Jersey
908.431.2121
or
Mark Fagnani Cell
516.680.1945

BRANDLIN AND ASSOCIATES

Strategic, Investigative Accounting for over 30 years

- **Financial Due Diligence**
- **Workouts & Restructurings**
- **Forensic Accounting**
- **Litigation Support**

Los Angeles & New York
310.789.1777
or
Jeff Brandlin Cell
310.990.4955