Capital Solutions

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Does your Business have too much Debt?

The answer to this question is a simple yes, of course, if your business is unable to keep up with current payments on the debt.

Depending on how long that will be the case, you will need to negotiate a Forbearance Agreement with your lender, work to restructure your debt, and if all else fails attempt to settle your debt to address the problem.

Assuming you can meet the payment terms with your lenders, how do you know when your business is carrying more debt than it should, and when paying down that debt should take a higher priority?

Some of the key questions lenders ask, and some financial metrics they use to determine if a business has too much debt, include the following:

- **How does the company's debt load compare to others in its industry?**
- **Is there more than $3 of debt and liability dollars on the balance sheet for every equity dollar? Is it better or worse than this level of debt? Best to be less than 3 to 1, even 2 to 1, with respect to Total Liabilities to Tangible Net Worth.**
- **Is current annual cash flow, after all expenses, sufficient to cover all debt payments by 125% or more? Best to be at this level or higher.**
- **How consistent is cash flow year after year?**
- **If interest rates were to rise by 2%, would the business still be able to make its loan payments?**
- **Is total debt equal to more than 3 times annual cash flow? Higher than that? Best to be able to retire debt in 3 years or less if need be from current cash flows.**
- **Is the business able to pay down its line of credit throughout the year, or is it maxed out, and not moving?**
- **Are the assets behind the debt still worth as much as the financial statements indicate they are?**

- **Could the assets supporting the debt be readily sold to repay all debt?**

Generally speaking, if debt is used for liquidity purposes in the short-term to manage working capital, and used to purchase productive, cash generating assets in the long term, then the debt should be manageable.

You should determine if your business could (not will) repay all of its debt inside of 5 years from cash flow (excluding real estate debt), and use that as one gauge on whether or not debt is too high. Operating debt that takes more than 7 years to pay off from cash flow is probably an uncomfortable level of debt.

And if your answers to these questions do not answer the question "Does my business have too much debt?" , then it would be best to use the "Quality-of-Sleep" indicator.

What's that? If you are losing sleep worried about debt, and how its going to be repaid, then whatever amount you have is too much, even if it passes all of the lender's tests as being appropriate.

Thanks for reading. Let us know if you would like our help securing your next source of funding.

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