

Stress Test Your Financial Plan Before Submitting it to the Bank

Banks will almost always impose some stress test against your financial plan and if you do not pass these tests, then your chances of getting a bank loan are severely diminished. These stress tests take the form of ratios which is simply dividing one number by another number directly off your financial statements. Here are four tests you should try and pass before submitting your plan to the bank.

1. Gross Margin or Gross Profit % Above 40% - You must show you can earn a profit and banks as well as investors will size up your profitability by looking at your gross margins.
EXAMPLE: Sales Revenues for Year 2 total \$ 53,200 less direct / variable cost of the product or service of \$ 29,200 = \$ 24,000 Gross Profits. $\$ 24,000 / \$ 53,200 = 45\%$ which is acceptable
2. Current Ratio Above 2.0 – You must show sufficient liquidity of current assets to cover your current obligations (current liabilities). EXAMPLE: Balance Sheet for Year 2 has total Current Assets of \$ 16,130 and total Current Liabilities of \$ 4,330. $\$ 16,130 / \$ 4,330 = 3.7$ which is well above 2.0 and passes this stress test.
3. Debt to Equity Ratio Below 2.5 – If you have too much debt (liabilities) on the Balance Sheet, you may have trouble making loan payments. NOTE: This varies by industry. EXAMPLE: Total Liabilities on the Balance Sheet in Year 2 = \$ 85,000 and Total Equity in Year 2 totals \$ 25,000. $\$ 85,000 / \$ 25,000 = 3.4$ which is higher than 2.5. Depending upon your industry, you may need to invest more of your own money to increase the level of equity.
4. Debt Service Coverage Ratio above 1.25. This is perhaps the most important stress test imposed by the bank. You have to generate enough operating profits to meet current year obligations. EXAMPLE: Gross Profits for Year 2 = \$ 56,100 less total Operating Expenses for the Year of \$ 32,400 = Operating Profits of \$ 23,700. For the entire Year 2, you have total loan payments you must make of 16,800. $\$ 23,700 / \$ 16,800 = 1.4$. This business passes the stress test since 1.4 is higher than 1.25 minimum acceptable ratio. NOTE: Some banks will impose a higher ratio (such as 1.35) if you cannot provide collateral to back the loan.

Additional Consultation is Available per the Scheduling Link Below:

<https://dc-small-business-mentor.as.me/schedule/309365be>

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