# CREDIT MEMORANDUM

Prepared for: Your Favorite Financial Institution
Prepared byYour Best Credit Analyst

| | |
|---|---|
| **BORROWER'S NAME**: | Bob and Barbara Brown |
| **BORROWER'S ADDRESS:** | 1494 Main Street, Minersburg, PA 17000 |
| **BUSINESS STRUCTURE:** | Individuals/Co-owners of commercial real estate |
| **LINE OF BUSINESS:** | Landscaping, snow removal, lawn maintenance, etc. |
| **DATE ESTABLISHED:** | 1995 |
| **DETAILS OF BUSINESS:** | Bob and Barbara Brown own and operate BB&B Landscape Contracting Inc. Bob solicits business and manages the projects and workforce. Barbara schedules appointments and maintains the records. |
| **PRIMARY MARKET AREA:** | Minersburg, PA and the three county surrounding area |
| **NICHE:** | Target businesses and high-income level home owners. |
| **PRIMARY COMPETITION:** | Other general landscapers/contractors |

**KEY EMPLOYEES:**

| | | |
|---|---|---|
| Owner: | Bob Brown | Years of Experience: 20+ |
| Owner: | Barbara Brown | Years of Experience: 15+ |

**GUARANTORS:** BB&B Landscape Contracting, Inc

**PROPOSED DEBT AND TERMS AND CONDITIONS:** The following loan will provide for the restructure of an existing commercial mortgage owed by the Browns to XYZ bank. The land is owned by the Browns personally and used by the business. It is located at 1360 E. Clarkstown Road Minersburg.

| | |
|---|---|
| **Borrower** | Bob & Barbara Brown |
| **Loan #** | 1 |
| **Amount** | $260,000 |
| **Type** | Mortgage |
| **Collateral** | Comm. Real Estate |
| **Rate** | 8.75% |
| **Term** | 60 Months |
| **Amortization** | 240 Months |
| **Fees** | 1% |

**COLLATERAL EVALUATION:** The loan will be secured with a first lien mortgage against the commercial property utilized by the landscaping business.

| Assets: | Appraised 6/9/03 | Collateral Value | Advanced Rate | Lending Value |
|---|---|---|---|---|
| Comm RE-1360 E. Clarkstown Road, Minersburg | | $325,000 | 80.00% | $260,000 |
| | | $325,000 | | $260,000 |
| Liabilities: | | | | |
| Proposed Commercial Mortgage | | $260,000 | | $260,000 |
| | | $260,000 | | $260,000 |
| | Difference | $65,000 | | $0 |
| Loan To Value: | 80.00% | | | |
| Collateral Coverage: | 1.25 | | | |

**SOURCES OF REPAYMENT:** The primary source of repayment on the commercial mortgage loan will result from rents paid to the Brown's by the Corporation; secondary sources shall result from any other liquid sources of the Brown's and tertiary sources shall result from the liquidation of the collateral.

**FINANCIAL ANALYSIS:**
2002-Personal Tax Return-Bob and Barbara Brown

Barbara Brown- Credit Score-739 (as of 02/26/04)
Bob Brown-Credit Score-619 (as of 02/26/04)

A personal financial statement was received from Bob & Barbara Brown dated February 18, 2004. Their net worth was reportedly $211,764 based on assets of $673,728 and liabilities of $461,964. Liquid assets consisted of cash of $5,500 and CSVLI of over $15,000, an IRA held with Legg Mason and valued at $15,000 and an Oppenheimer account valued at $3,200. Other long-term assets were identified as: commercial vehicles held in Bob's name totaling approximately $92,000, their personal residence carried at a value of $135,000, and the commercial real estate on Clarkstown Road valued at $325,000.

Liabilities were primarily with XYZ Bank and were associated with mortgages on their personal residence and commercial real estate. Additionally they identified debt with ABC Credit Union in the form of an unsecured line of credit, and auto loans with GMAC, one related to a business-use vehicle. Additionally, they identify credit card debt totaling $48,000, much of which is associated with the business.

The Brown's earn wage income from the S-Corp, $49,667 in 2002 and $46,788 in 2001. The Brown's also receive rental income from the S-Corp for use of the commercial property located on Clarkstown Road. In 2001, gross rents paid to the couple totaled on $9,377 compared to $33,370 in 2002. (2001 may have been a partial year).

Combining all forms of income, their 2002 Personal Tax Return revealed CAFDS of $78,410, compared to $50,336 in 2001. Refinance of the commercial mortgage debt, will provide for a new Debt Service Requirement of $78,572. When compared to the CAFDS of $78,410 a DSCR of 1:1 results in 2002.

<u>Commercial Property Only Evaluation:</u>
Based on the rents paid by the Company to the Browns and the expenses that the Browns report on the commercial property, it produced a DSCR of 1.12:1 in 2002. (2001 appears to have been a partial year)

| Clarkstown Road-Commercial Property | 2002 | | 2001 | |
|---|---|---|---|---|
| Gross Rents- Paid to Brown's By Corporation | $33,370 | 100.00% | $9,377 | 100.00% |
| Operating Expenses - Interest Expense | $2,618 | 7.85% | $976 | 10.41% |
| Depreciation Expense | $7,932 | 23.77% | $686 | 7.32% |
| Interest Expense | $20,984 | 62.88% | $3,117 | 33.24% |
| Total Expenses | $31,534 | 94.50% | $4,779 | 50.97% |
| **Net Income/(Loss)** | **$1,836** | **5.50%** | **$4,598** | **49.03%** |
| Cash Flow: | | | | |
| Net Income/(Loss) | $1,836 | | | |
| Depreciation Expense | $7,932 | | | |
| Interest Expense | $20,984 | | | |
| **Net Operating Income (CAFDS)** | **$30,752** | | | |
| Proposed Debt Service on Commercial Mtg | $27,576 | | | |
| Cash Excess/(Deficit) After Debt Service | $3,176 | | | |
| **DSCR** | **1.12** | | | |

**FINANCIAL EVALUATION OF GUARANTOR:**
1/31/2004-Management Prepared P & L Statement-BB&B Landscaping Contracting
12/31/2003-Management Prepared P & L Statement-BB&B Landscaping Contracting
12/31/2003-A/R Aging Report-BB&B Landscaping Contracting
2002-Compiled Financial Statements and Tax Return-BB &B Landscaping Contracting

<u>Income Statement:</u>

According to the management prepared 2003 financial statements, sales for BB&B Landscaping peaked at a three year high of $2,029,727, up 7% or $126,000 from 2002. The steadiest increases have been in the areas of maintenance and snow removal income. Offsetting these improvements was an increase in operating expense levels. Total operating expense levels peaked in 2003 at $1,943,387 or 96% of sales, compared to $1,845,433 or 97% and $1,682,743 and 94% in 2002 and 2001 respectively. (Peers maintained operating expense levels of 94.2%)  Increases in the maintenance and snow removal labor costs caused the recent rise in overall operating expense levels.

Some expenses such as rent (paid to the owners) and advertising expenses declined in 2003.  The largest area of decline was reportedly in professional fees. In 2002, this line item expense rose as the result of litigation, which according to the loan officer has been settled favorably for the prospective borrower.

Interest expense declined as well from $37,091 in 2002 to $25,744 by 2003. Total operating expenses were maintained in excess of total revenues all three periods causing negative operating income of ($3,695) or (0.18%) in 2003; ($50,035) or (2.63%) in 2002 and ($664) or (.04%) in 2001.  Peers produced an operating profit margin equal to 5.8% of sales.

In 2001, interest expense was earned by the company at a rate of 1.03 times over.  In 2002, the year of the high professional fees, the times interest earned was (0.35):1.  And most recently, the Interest Coverage Ratio was 0.86:1, compared to the RMA industry average in the median quartile of 2.9:1.

In 2003 the CF/CPLTD was .96:1, compared to .36:1 in 2002, and 1.60:1 for peers.

When the Company's 2003 interest expense of $25,744 is combined with the CPLTD of $63,525, an annual Debt Service Requirement (DSR) of $89,269 results.  When this is compared to Cash Available for Debt Service of $86,499 a current DSCR of .96:1 results.

<u>Balance Sheet:</u>
The Corporate balance sheet contains several weaknesses.  First, cash levels have declined to their lowest level in four years of $7,091 or 1.23%, likely reflective of the recent higher level of operating expenses and lengthening receivable collection days and capital expenditures.  Peers maintained cash levels of 8.70%.  In the past year, accounts receivable levels increased 34%, compared to sales growth of only 7% during the same period.  Receivables now represent 44% of total assets, compared to 35% one year earlier and peer receivable levels of 28%.  Receivable days are 46, compared to 36 one year earlier and 34 for the peer average.

The majority of the Company's receivables are current, 60 days or less.  There appeared to be as many as 60 customers in the customer base as of 12/31/2003 with balances due in excess of $20.  Of those 60, 14 accounts have balances due of over $5,000 each.  The largest account balance from any one client was

$38,000 due from Pineville Health. Several of the largest clients have amounts that are current and more than 60 days past due; making the Corporation's credit issuance policy unclear. It may be appropriate to obtain another aging report to verify appropriate movement and age of items, as well as copies of invoices on some of the accounts more than 60 days past due. There may be several accounts that require a write down.

A/R Aging Report
(as of 12/31/2003)

| 0-30 Days | 31-60 Days | 61-90 Days | Over 90 Days | Total |
|---|---|---|---|---|
| $80,447 | $97,348 | $11,980 | $63,280 | $253,055 |
| 31.79% | 38.47% | 4.73% | 25.01% | 100.00% |

Inventory levels remain unchanged between 2002 and the internal 2003 data, making the accuracy of this information suspect.

Fixed assets grew by nearly $46,000, apparently largely financed with additional debt and cash reserves. Fixed assets represented 33% of the total asset base; while peers maintained net fixed asset levels equal to 45%.

Prepaid expense levels are reportedly unchanged as is the balance due on loans due from the officer.

Balances on the existing line of credit with XYZ Bank have steadily risen over the past four years to a high of $47,449. Accounts payable growth of 13% outpaced sales growth of 7%. Peers maintained payable levels equal to 13% of total assets, while this Company maintained payable levels of 58%.

Accrued liabilities also increased, rising $32,000. The largest area of increase was in the local and State payroll taxes due. All of the aforementioned changes caused current liabilities to increase by $77,553 or 16% to 95% of total assets. Peer maintained current liabilities at 40% of total assets.

The Company's current ratio was .53:1 in 2003 and its quick ratio was .47:1 also in 2003. Peer ratios were 1.30:1 and 1.00:1 respectively. Working Capital levels declined to a low of ($257,619) from ($178,545) in 2001.

Long Term Debt levels increased by $25,485 in 2003 as the result of additional capital expenditures during the year. Total liabilities continued to exceed asset levels at 113% while peers maintained liabilities at 67% of total assets. Equity remained negative at ($76,729) or (13.32%), down from the ($73,193) or (13.55%) reported in 2002 and ($23,158) or (3.86%) reported three years earlier. Net worth levels for peers were equal to 32.6% of total assets.

The Company's D/TNW ratio was (8.51):1 compared to peers at 1.70:1.

<u>UCA Cash Flow Statement:</u>

Despite the lengthening receivable days and higher than average expense levels, Cash After Operations was positive for the past two years. Much of which is the result of lengthening payable days.

Operational cash flows appear to have been sufficient to satisfy both interest expense levels and repayment of the current portion due on long term debt. Capital expenditures were made both years and largely financed with additional long term debt and cash on hand.

**SUMMARY:**

**Debt Service Ability:**
The commercial rental property reported produced a DSCR of 1.12:1 and the Brown's personally produced at DSCR of 1:1.

In 2001, interest expense was earned by the company at a rate of 1.03 times over. In 2002, the year of the high professional fees, the times interest earned was (0.35):1. And most recently, the Interest Coverage Ratio was 0.86:1, compared to the RMA industry average in the median quartile of 2.9:1.

In 2003 the CF/CPLTD was .96:1, compared to .36:1 in 2002, and 1.60:1 for peers.

When the Company's 2003 interest expense of $25,744 is combined with the CPLTD of $63,525, an annual Debt Service Requirement (DSR) of $89,269 results. When this is compared to Cash Available for Debt Service of $86,499 a current DSCR of .96:1 results.

**RISK RATING: Substandard**

______________________________ ________________________
**PRESENTING OFFICER** **DATE**

____________________________________ _________________________
**APPROVING AUTHORITY** **DATE**

**COMMENTS OR CONDITIONS OF APPROVAL AS NOTED BY APPROVING AUTHORITY:**_______________________________________________________________

| **BB&B Landscape Contracting Inc** | 12/31/2006 | | 12/31/2005 | | 12/31/2004 | | **Peer** |
|---|---|---|---|---|---|---|---|
| **Balance Sheet** | Internal | | Compilation XYZ Accountants | | Compilation ABC Accountants | | **Data** |
| Assets: | | | | | | | |
| Cash | $7,091 | 1.23% | $16,061 | 2.97% | $12,930 | 2.16% | **8.70%** |
| Accounts Receivable | $253,055 | 43.93% | $189,400 | 35.07% | $256,639 | 42.83% | **28.00%** |
| Inventory | $32,020 | 5.56% | $32,020 | 5.93% | $7,320 | 1.22% | **9.40%** |
| Other Current Assets | $0 | 0.00% | $0 | 0.00% | $0 | 0.00% | **1.00%** |
| Total Current Assets | $292,166 | 50.71% | $237,481 | 43.97% | $276,889 | 46.21% | **47.10%** |
| | | | | | | | |
| Buildings & Equipment | $772,763 | 134.14% | $727,180 | 134.63% | $671,968 | 112.15% | |
| Accumulated Depreciation | $582,727 | 101.15% | $518,436 | 95.99% | $447,679 | 74.72% | |
| Net Building & Equipment | $190,036 | 32.99% | $208,744 | 38.65% | $224,289 | 37.43% | **45.10%** |
| | | | | | | | |
| Prepaid Expenses | $8,363 | 1.45% | $8,363 | 1.55% | $6,176 | 0.010308 | |
| Intangible Assets | $0 | 0.00% | $0 | 0.00% | $0 | 0.00% | **2.70%** |
| Due From Officer and Other Non-Current | $85,532 | 14.85% | $85,532 | 15.84% | $91,821 | 15.32% | **5.00%** |
| | | | | | | | |
| Total Assets | $576,097 | 100.00% | $540,120 | 100.00% | $599,175 | 100.00% | **100.00%** |
| | | | | | | | |
| Liabilities: | | | | | | | |
| LOCs | $47,449 | 8.24% | $39,701 | 7.35% | $43,692 | 7.29% | **8.70%** |
| CPLTD | $63,525 | 11.03% | $63,525 | 11.76% | $56,925 | 9.50% | **7.70%** |
| Accounts Payable | $333,241 | 57.84% | $295,494 | 54.71% | $248,240 | 41.43% | **12.90%** |
| Accrued Expenses | $105,570 | 18.33% | $73,512 | 13.61% | $106,577 | 17.79% | |
| Other Current Liabilities | $0 | 0.00% | $0 | 0.00% | $0 | 0.00% | **10.70%** |
| Total Current Liabilities | $549,785 | 95.43% | $472,232 | 87.43% | $455,434 | 76.01% | **40.00%** |
| | | | | | | | |
| Long Term Debt | $103,041 | 17.89% | $141,081 | 26.12% | $166,899 | 27.85% | **24.20%** |
| | | | | | | | |
| Other Long Term Liabilities | $0 | 0.00% | $0 | 0.00% | $0 | 0.00% | **3.10%** |
| | | | | | | | |
| Total Liabilities | $652,826 | 113.32% | $613,313 | 113.55% | $622,333 | 103.86% | **67.40%** |
| | | | | | | | |
| Capital | $10,000 | 1.74% | $10,000 | 1.85% | $10,000 | 1.67% | |
| | | | | | | | |
| Retained Earnings | -$86,729 | -15.05% | -$83,193 | -15.40% | -$33,158 | -5.53% | |
| Total Net Worth | -$76,729 | -13.32% | -$73,193 | -13.55% | -$23,158 | -3.86% | **32.60%** |
| Total Liabilities and Capital | $576,097 | 100.00% | $540,120 | 100.00% | $599,175 | 100.00% | **100.00%** |

| Reconciliation of Balance Sheet | | | |
|---|---|---|---|
| Assets: | $576,097 | $540,120 | $599,175 |
| Total Liabilities & Capital | $576,097 | $540,120 | $599,175 |
| Difference: | $0 | $0 | $0 |

| **Income Statement** | 12/31/2006 | | 12/31/2005 | | 12/31/2004 | | **Peer Data** |
|---|---|---|---|---|---|---|---|
| Landscaping Sales | $1,168,540 | 57.57% | $1,197,573 | 62.92% | $1,193,749 | 66.37% | |
| Maintenance Sales | $674,863 | 33.25% | $612,735 | 32.19% | $513,093 | 28.53% | |
| Snow Removal & Material Sales | $186,324 | 9.18% | $92,938 | 4.88% | $91,878 | 5.11% | **-** |
| Total Revenue | $2,029,727 | 100.00% | $1,903,246 | 100.00% | $1,798,720 | 100.00% | **100.00%** |
| COGS | $0 | 0.00% | $0 | 0.00% | $0 | 0.00% | **0.00%** |
| Gross Profit | $2,029,727 | 100.00% | $1,903,246 | 100.00% | $1,798,720 | 100.00% | |
| SG&A | $1,943,387 | 95.75% | $1,845,433 | 96.96% | $1,682,743 | 93.55% | **94.20%** |
| Depreciation | $64,291 | 3.17% | $70,757 | 3.72% | $72,353 | 4.02% | |
| Amortization | $0 | 0.00% | $0 | 0.00% | $0 | 0.00% | |
| Interest Expense | $25,744 | 1.27% | $37,091 | 1.95% | $44,288 | 2.46% | |
| Total Operating Expenses | $2,033,422 | 100.18% | $1,953,281 | 102.63% | $1,799,384 | 100.04% | |
| Operating Profit | ($3,695) | -0.18% | ($50,035) | -2.63% | ($664) | -0.04% | **5.80%** |
| Other Income | $159 | 0.01% | $0 | 0.00% | $1,927 | 0.11% | |
| Other Expense | | 0.00% | $0 | 0.00% | $0 | 0.00% | **1.30%** |
| Pre Tax Income | ($3,536) | -0.17% | ($50,035) | -2.63% | $1,263 | 0.07% | **4.50%** |
| Taxes Paid | $0 | 0.00% | $0 | 0.00% | $0 | 0.00% | |
| Net Income/(Loss) | ($3,536) | -0.17% | ($50,035) | -2.63% | $1,263 | 0.07% | |
| Distributions/Withdrawals | $0 | | $0 | | $0 | | |

| Reconciliation of Retained Earnings | | |
|---|---|---|
| Prior Year Retained Earnings | -$83,193 | -$33,158 |
| Plus/(Minus) Current Earnings/(Loss) | ($3,536) | ($50,035) |
| Less Distributions/Withdrawals | $0 | $0 |
| Retained Earnings After Adjustments | **-$86,729** | **-$83,193** |
| Current Year Retained Earnings | -$86,729 | -$83,193 |
| Difference | $0 | $0 |

| Traditional Cash Flow: | 12/31/2006 | 12/31/2005 | 12/31/2004 |
|---|---|---|---|
| Net Income: | ($3,536) | ($50,035) | $1,263 |
| Depreciation & Amortization | $64,291 | $70,757 | $72,353 |
| Interest Expense | $25,744 | $37,091 | $44,288 |
| Less Distributions/Withdrawals | **$0** | **$0** | **$0** |
| Plus any Add Backs | 0 | 0 | 0 |
| Cash Throw (Available for Debt Service) | $86,499 | $57,813 | $117,904 |
| | | | |
| Debt Service Requirement: | | | |
| Proposed Mtg Loan | $55,744 | $55,744 | $55,744 |
| | $0 | $0 | $0 |
| | $0 | $0 | $0 |
| | $0 | $0 | $0 |
| Total Debt Service Requirement | $55,744 | $55,744 | $55,744 |
| | | | |
| DSCR | 1.55 | 1.04 | 2.12 |
| | | | |
| Excess Cash After Debt Service | $30,755 | $2,069 | $62,160 |

| Ratios: | 12/31/2006 | 12/31/2005 | 12/31/2004 | **Peer** |
|---|---|---|---|---|
| Current Ratio | 0.53 | 0.50 | 0.61 | **1.30** |
| Quick Ratio | 0.47 | 0.44 | 0.59 | **1.00** |
| Working Capital | -$257,619 | -$234,751 | -$178,545 | |
| Debt/TNW | -8.51 | -8.38 | -26.87 | **1.70** |
| | | | | |
| CF/CPLTD | 0.96 | 0.36 | | **1.60** |
| DSCR: | 1.55 | 1.04 | 2.12 | |
| Interest Coverage Ratio | 0.86 | -0.35 | 1.03 | **2.90** |
| AR Turnover | 45.51 | 36.32 | 52.08 | **34.00** |
| AP Turnover | #DIV/0! | #DIV/0! | #DIV/0! | |
| Inventory Turnover | #DIV/0! | #DIV/0! | #DIV/0! | |

| UCA Cash Flow: | 12/31/2006 | | 12/31/2005 | |
|---|---|---|---|---|
| Sales: | $2,029,727 | | $1,903,246 | |
| Account Receivable | ($63,655) | | $67,239 | |
| **Cash From Sales** | | **$1,966,072** | | **$1,970,485** |
| Cost of Goods Sold | $0 | | $0 | |
| Inventory | $0 | | ($24,700) | |
| Accounts Payable | $37,747 | | $47,254 | |
| **Cash Production Costs** | | **$37,747** | | **$22,554** |
| **Cash Gross Profit** | | **$2,003,819** | | **$1,993,039** |
| Operating Exp (-Depr) | ($1,943,387) | | ($1,845,433) | |
| Prepaids | $0 | | ($2,187) | |
| Accrued Expenses | $32,058 | | ($33,065) | |
| Misc. Assets/Liabilities | $0 | | $0 | |
| **Cash Operating Expenses** | | **($1,911,329)** | | **($1,880,685)** |
| **CASH AFTER OPERATIONS** | | **$92,490** | | **$112,354** |
| Miscellaneous Income/Expense | $159 | | $0 | |
| Income Taxes Paid | $0 | | $0 | |
| **Misc. Cash Expenses** | | **$159** | | **$0** |
| **Net Cash After Operations** | | **$92,649** | | **$112,354** |
| Interest Expense | ($25,744) | | ($37,091) | |
| Dividends Paid | $0 | | $0 | |
| **Financing Costs** | | **($25,744)** | | **($37,091)** |
| **Net Cash Income** | | **$66,905** | | **$75,263** |
| Long Term Debt Reduction | ($63,525) | | ($56,925) | |
| **Cash After Debt Reduction** | | **$3,380** | | **$18,338** |
| Capital Expenditures-Tangible | ($45,583) | | ($55,212) | |
| Capital Expenditures-Intangible | $0 | | $0 | |
| Long Term Investments | $0 | | $6,289 | |
| **Long Term Expenditures** | | **($45,583)** | | **($48,923)** |
| **Financing Surplus/(Requirement)** | | **($42,203)** | | **($30,585)** |
| Short Term Debt | $7,748 | | ($3,991) | |
| Long Term Debt | $25,485 | | $37,707 | |
| Paid In Capital | $0 | | $0 | |
| **Total External Financing** | | **$33,233** | | **$33,716** |
| **Cash After Financing** | | **($8,970)** | | **$3,131** |
| **Actual Change in Cash** | | **($8,970)** | | **$3,131** |