

**It can happen very quickly:  
Credit quality is being upended overnight.**  
*Field examinations are key to understanding the fundamental matrix  
of your borrower and your true collateral position.*

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*Published April 13, 2020. Russell Barber is a Senior Field Examiner for Dopkins ABL Consulting Services. He recently shared insights from his prior career experience in the manufacturing industry in relation to the credit challenges business may be facing as a result of the COVID-19 pandemic.*

From 1995 to 2007 I was a senior auditor and then audit manager of a non-bank asset based lender and factoring company in Texas. Our portfolio was securitized, so field examinations were an integral component of our credit policy and a lender requirement. In 2007 I left the firm for an industry position as CFO of a manufacturing company in Illinois. That company was in the midst of a banner year, having doubled revenues in each of the prior two years. During that period the company took on a significant debt burden to facilitate the growth, primarily CapEx and lease expansion, while also securing a larger working capital facility.

Our business was somewhat cyclical with the first quarter typically slow, so the start of 2008 was not alarming to us. Things started to pick up, although unusually late in the second quarter, but the deal flow was on pace for another good year. In the middle of the third quarter our major customer started pushing back on already scheduled deliveries and then abruptly cancelled everything for the remainder of 2008 at the beginning for the fourth quarter. Revenues fell 60% YOY.

Q1 2009 business activity was non-existent. Without the prior year bolstering of our cash position we were in an extreme situation. We were forced to lay off 40% of the manufacturing staff, cut the remaining plant workers to 32 hours and imposed a 20% cut for salaried employees. Our debt service and non-productive payroll quickly consumed what cash flow we had. We began to draw extensively on our line of credit and were pushing covenant thresholds. The reality of the situation was that we went from a company that was bankable credit in the middle of 2008 to an extremely distressed borrower and in default in less than 9 months. Fortunately, since the default was covenant and not collateral based, we were able to obtain a waiver. That waiver saved the company.

We did not see a field examiner until mid-2010 when our facility was up for renewal. Truth be told, had we had an examination in 2009 the bank would have seen the true breadth of our situation and likely utilized the default to curtail their exposure instead of granting a waiver.

I share the above only to offer an industry perspective on how quickly things can go south and to remind the reader that the great financial crisis was a slow boil. The credit quality deterioration that is likely to come as a result of the current crisis is happening as we speak and over a span of several weeks and not many months. Even if this turns out to be short lived, I do not feel the disruption to the economy will be. The break in the supply chain that has resulted will surely curtail a manufacturing company's ability to ramp up production in a timely fashion and that is assuming there is immediate demand to require the need. Demand will almost certainly impact many service businesses as well.

Prior to this crisis, many companies were highly leveraged to start with and are consuming any available credit now just to remain in business. Covenant defaults and downgrades will likely be significant. Cash flow interruption from companies unable to service their trade debt will likely strain your borrower's ability to fund their credit lines as availability from asset-based structures utilizing accounts receivable will be limited due to deterioration in AR aging parameters.

From my experience working with a lender I have observed that in ordinary times, most credit departments are equipped to adequately monitor their borrowers with field examinations being conducted in accordance with credit policy. In times of extreme stress, such as we are experiencing now, that ability can deteriorate quickly simply from the abrupt increase in the volume of distressed credits. In these situations, field examinations can be a useful and supportive tool.

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