A Clean Balance Sheet Can Help a Company in More Ways Than One

Investment banker says companies can help their situation with more than just investor relations

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When the corporate management of a publicly traded company is attempting to break through and eventually have a higher stock price, they usually first focus on the operational tactics or the public relations awareness of a company. However, without a clean balance sheet, the aforementioned could be futile.

The more debt a company carries on its balance sheet, is the more that their working capital and revenue have to be applied toward paying off that debt. Subsequently, this prevents management from re-investing those dollars back into the overall growth of the company. It also causes a company to have to issue more shares to raise dollars for working capital, which becomes dilutive to the company.

It really is no different than having personal credit card debt. The more that you accrue and accumulate the more that your personal earnings go toward paying off that debt. Hence, an individual or family with a lot of credit card debt is often challenged in bettering their personal well being.

The same applies with a publicly traded company. What is even more concerning about a company carrying excessive debt (compared to revenue or cash reserves on their balance sheet), is that it attracts the wrong people to begin following a company's stock.

80% of the financial institutions on Wall Street gauge the success of a company by its potential to have positive Earnings per Share (EPS) and a positive Return on Equity (ROE).

Interest expenses associated with debt, can hurt earnings per share. Additionally, one of the quickest ways to gauge whether a company is an asset creator, cash consumer, or debt accumulator is to look at the return on equity that it generates.

When Wall Street sees that there is significant debt on a company's balance sheet, accompanied with a low ROE and a low EPS, traders and investors calculate the likelihood of a stock going down versus going up. In many cases, this in turn, attracts short sellers to a company's stock. Intense pressure of short selling on a company's issue, without the company being able to eventually post positive earnings will not frighten the short sellers to have to cover their short selling position. Ultimately, this is what drives Micro Cap stocks into becoming penny stocks.

What is the answer? Companies need to rid their balance sheet of unnecessary debt. If the perfect situation of "zero debt on the balance sheet" is unrealistic, a company certainly needs to strive toward at least having more money in the bank or revenue compared to debt on their balance sheet.

How does a company clean up its balance sheet? By restructuring their existing debt.

There are many options to restructure debt:

1. Note holder's can be proposed equity positions in exchange for their debt

2. If the company has cash reserves on hand, they can negotiate a price to retire the debt with note holders.

3. Contingent on a company's asset base, convertible debt can potentially be swapped into bank debt, in an effort to reduce the overall debt on the balance sheet. The company uses no cash, and the notes have more intrinsic value backed by the assets of the company.

4. Negotiate with bondholders to extend out maturity dates, in order have less debt on the balance sheet.

A company with a clean balance sheet creates tremendous opportunities for itself, planning forward. This helps a company in more ways than one, especially if it can begin to post positive earning per share and return on equity.

About the writer: James DePelisi is President and Founder of LDV Capital Management, a registered investment advisory firm licensed in state of Florida. LDV Capital Management offers investment banking services specializing in balance sheet clean-up, institutional capitalization, fairness opinions, valuations, financial advisory, and Merger and Acquisition work. For further information call: 954-746-3117 or Email: Jim@LdvCapitalManagement.com