

**CITY OF SARATOGA SPRINGS
ECONOMIC DEVELOPMENT REVOLVING LOAN FUND REQUEST**

EXECUTIVE CREDIT MEMORANDUM

BORROWER:	KTMS, Inc. d/b/a Scallions	DATE: 04.02.2014
INDUSTRY:	Retail Business Enterprise: Upscale Fine Dining & Home Furnishings.	NAICS: 722511 442110
ADDRESS:	44 Lake Avenue. Saratoga Springs, NY 12866.	
JOB IMPACT:	Created FTE Positions: 2 Retained FTE Positions: 14 Total FTE Positions: 16	

LOAN SUMMARY:

Loan Type:
Term Loan.

Loan Offering:
\$50,000.

Submitted to: **Bradley Birge
City of Saratoga Springs
Administrator, Planning & Economic Development**

Prepared by: **Brian Hanrahan for Ms. Morris**

Approval: **City of Saratoga Springs City Council**

Approval Date:

LOAN OFFERING:

\$50,000.

EXPLANATION:

Proposal: Ten (10)-Year Term Amortization, with a Ten (10)-Year Term.

Purpose: To provide funding for: Leasehold Improvements, Equipment, Working Capital for KTMS, Inc. business models growth over next 1-3 years.

Rate: The City of Saratoga Springs Credit Facility will be priced at a 3% Fixed Rate for the duration of the Term Loan.

Term: Ten (10) –Year Amortization, with a Ten (10) Year Term. Monthly Principal / Interest Payments of \$482.80 are required to fully retire the Proposed Credit Facility as proposed.

FEES: Application Fee: \$100.00

Security: A 2nd Uniform Commercial Code Filing on all of the Business Assets of KTMS, Inc., subject to a 1st Business Assets Filing of the 1st Niagara Bank.

Assignment of Key Person Life Insurance:
Michele Morris in the amount of \$50,000.

Guarantor: Michele Morris.

I. History & Background:

KTMS, Inc. is an independent retail business enterprise that serves both the immediate Saratoga Springs and Capital Region markets. The business model is broken into two distinct segments: Scallions, an upscale, casual dining restaurant; and the adjoining Gallery that offers distinctive furnishings and American crafts.

Started in 1980s by founder James Morris (not related to Michele Morris), Scallions was located at 404 Broadway in Saratoga Springs. After tenure as an employee of the subject restaurant, Michele Morris purchased Scallions in FY 2000 from James Morris and formed KTMS, Inc. In 2006, the KTMS, Inc. lease expired at 404 Broadway and Ms. Morris transitioned the business to 44 Lake Avenue.

The 44 Lake Avenue property was a dilapidated, empty building that required significant amount of leasehold improvements. The total cost of rehabilitation of 44 Lake Avenue, which Scallions was to occupy, exceeded \$350,000 of which Ms. Morris borrowed \$300,000 from HSBC Bank in the form of Senior Debt and \$50,000 in a Subordinated Loan from the City of Saratoga Springs RLF. It should be noted that the Scallions move to Lake Avenue has been a success on two levels, both for the individual enterprise of KTMS, Inc. and as a catalyst in the gentrification of the Lake Avenue corridor.

At this point in time, KTMS, Inc. has reached a business model inflection point and needs to fulfill several critical requirements, for Capital Expenditures and Working Capital, which will facilitate the continued sustainability and growth of the subject corporations' business segments, Scallions Restaurant and the Gallery.

II. Project Economics Summary:

The following will delineate the Project Economics strategic requirements as follows:

Uses / Sources of Funds as follows:

Uses of Funds:

Equipment.	\$17,000
Inventory.	25,000
Marketing Programs.	8,000
Leasehold Improvements.	5,000
Total Uses of Funds:	\$55,000

Sources of Funds:

City of SS RLF:	\$50,000
Borrower's Equity:	5,000
Total Sources of Funds:	\$55,000

Assumptions to Project Economics Model:

1. Furniture / Equipment Requirements:

The following are the estimated Equipment Purchases over the next 1-3 Years.

Kitchen Range:	\$5,000
Ice Machine:	9,000
Refrigerator:	3,000
Total:	\$17,000

2. Gallery New Inventory:

Ms. Morris is estimating a new Inventory requirement for Gallery franchise, which will be \$25,000 over the next 12-18 months.

3. Marketing Plan:

- Social Media Campaign:

Securing services of a local media company to initiate and coordinate Mobil Media efforts that will increase Scallions / Gallery exposure to local customers.

- New Website Development:

Engaging a local firm to recreate KTMS, Inc.'s website with implementation of an online ordering system.

- Print Ad Campaign:

Initiative to have KTMS, Inc. customers to dine at Scallions and Shop at Gallery. Increasing emphasis on Private Party, Wedding, Baby Showers, and Small Corporate events market.

4. Projected over the next 1-3 years, Scallions Restaurant / Gallery will require both \$5,000 in both structural and cosmetic Leasehold Improvements to subject property.

III. Project Eligibility:

- A. The Subject Company KTMS, Inc. will employ less than 100 Full-Time Equivalents or FTEs.
- B. The Subject Company, KTMS, Inc. is located in Saratoga Springs, New York.
- C. The Term / Amortization and the Uses of Proceeds are within the approved Credit Policy of the City of Saratoga Springs Revolving Loan Fund Program.
- D. The Loan Pricing for Credit Facility is within the approved Guidelines of the City of Saratoga Springs Revolving Loan Program and Credit Policy.

IV. Collateral Pledged:

- A. A Second Security Interest in all of the Business Assets of KTMS, Inc., subject to a First Security Interest by the First Niagara Bank.
- B. Assignment of Key Person Life Insurance of \$50,000 on the Life of Ms. Morris during the term of the proposed Credit Offering.
- C. Personal Guaranty of Michele Morris.

V. Management:

Michele Morris is President / CEO of KTMS, Inc. Ms. Morris has served in that management capacity since the company's inception in FY 1999. Over that timeframe, Scallions has maintained consistent profitability and is considered to have one of the premier restaurant brands in the Saratoga Springs market.

VI. Financial Analysis:

Cash Flow / Debt Service Analysis: (000' Omitted).

	<u>FY 2013:</u>	<u>FY 2012:</u>	<u>FY2011:</u>
Net Profit:	\$91.	\$50.	\$42.
Interest Expense:	14.	17.	23.
Non-Cash Expenses:	12.	13.	15.
<hr/>			
Total Cash Flow:	\$117	\$80.	\$80.
Less:			
HSBC Term Loan ADS:	\$44.	44.	44.
Existing SS RLF:	6.	6.	6.
Proposed SS RLF:	6.	6.	6.
<hr/>			
Total Annual D/S:	\$56.	\$56.	\$56.
Excess Cash Flow:	\$61.	\$24.	\$24.
DSCR Coverage Ratio:	2.09xs.	1.42xs.	1.2xs.
<hr/>			

Key Reference Points C/F Analysis:

1. Net Profit is derived from Annual Sub Chapter S-Corporation Tax Returns for: FY 2013 / FY 2012 / FY 2011.
 2. Interest Expense is an Add back in the C/F Analysis because it is included in all Loan Payments as outlined.
 3. Non-Cash Expense is an Add back in the C/F Analysis because it is the Depreciation Expense allocation for specific equipment purchases. However, based on the IRS Code only certain percentage can be deducted annually.
 4. HSBS Annual Debt Service is based on a Ten-Year Note, P/I \$3,675 monthly or \$44,100 annually.
 5. Existing City of Saratoga Springs RLF is based on a Ten-Year Note, P/I \$531 Monthly or \$6,372.
 6. Proposed City of Saratoga Springs RLF is based on a Ten-Year Note, P/I \$483 Monthly or \$5,796 annually.
 7. Annual Debt Service Coverage exceeds Industry Standard of 1.20xs in all Years of the C/F Analysis.
-

Income Statement Analysis:

A. Revenue Analysis:

KTMS, Inc. experienced it best year in its history as Revenues climbed 9.7% Year-Over-Year (YOY), FY 2013 from FY 2012, reaching \$835.9m. This is significant because in the previous YOY Analysis, FY 2012 – FY 2011 Net Sales (NS) were virtually flat. NS, FY 2012, were \$762m contrasted, to NS FY 2011 of \$771m.

The Revenue improvement in 2013 is significantly attributable to two factors:

- Scallions extending its Breakfast Days of Operation on an annual basis
- Increased Net Sales in the Gallery, Year-Over-Year

B. Gross Profitability Analysis:

Gross Profitability or GP increased to 65.4% in 2013 from 63.8% in 2012. This improvement in the GP is attributable primarily to improved Cost Management systems by Ms. Morris, specifically in buying and reordering practices.

C. Operating Expenditure Analysis:

Operating Expenditures (OE) decreased YOY, 2013 – 2012, based on a Percentage Sales calculus. In 2013 OE, as a Percentage of Sales (PS), were 54.5%, down from position of 56.7% in the 2012.

The decline in OE, 2013 - 2012 is primarily linked to two critical Cost items:

- Reduction in Officer / Staff Compensation, a percentage of sales, YOY, approximately .08%
- Decrease in Interest Expense: As both the 1st Niagara Bank Term Loan and the City of Saratoga Springs RLF Interest Expense outlays decreased, due to the continue amortization of both Credit Facilities.

D. Net Profitability:

Net Profits jumped to \$91.4m / 11.0% in 2013, as a Percentage of Sales, from \$49.7m / 6.5%, as a Percentage of Sales. This 4.5% expansion of NP% is attributable to the pronounced containment of Direct Costs or COGS and the measured reduction in Officer/ Staff Compensation.

Balance Sheet Analysis 12.31.2014:

The Balance Sheet reflects a typical Restaurant enterprise, both from an Operating Cycle and Long-Term Debt position.

Operating Cycle: The Two key Operating Cycle Ratios reflect an entity that demonstrates a very good equilibrium between Inventory Purchases and the corresponding Liability Accounts.

- A. **Average Inventory Turn:** Disclosed an excellent position with Average Inventory Turn or AIT in 2013, at 21 Days. Contrasted to FY 2012 AIT of 17 Days. This slight increase in the Inventory Turn is significantly attributable to the Sales increase, YOY of 10%. Nonetheless, in both years KTMS, Inc. is demonstrating an excellent inventory management and positioning, which ultimately converts to Net Sales.

- B. **Average Account Payable Turn:** Average Accounts Payable Turn or APT was 44 Days in 2013 compared to 40 Days in 2012. With most Vendor Terms typically Net 30 Days, APT is higher than Vendor Terms because Accounts Payable 12.31.2013 included both Trade Debt and Corporate Credit Card Debt. To further explain, Trade Debt Obligations to suppliers are typically paid by KTMS, Inc. within 7-10 days but Corporate Credit Card Debt can be extended to 30-45 days.

Operating Cycle Summary:

The above calculus is reflective of an entity that has a very good capacity of Inventory Management and retiring corresponding Vendor Debt within an acceptable cycle period. Certainly, the above referenced Operating Cycle Analysis discloses that KTMS, Inc. is well-managed enterprise on a day-to day basis.

Capitalization:

The sustainable retention of YOY Profits has enabled KTMS. Inc. to elevate the Net Equity position of KTMS, Inc. This is evidenced by a reduction in the Debt / Net Worth position, from 26.6xs in FY 2012, to 15.6xs in FY 2013.

Admittedly, this presents a Debt/Net Worth position, but remains in the Lower Quartile of Industry Standards, although an appropriate context is required and supported by the following:

1. The Restaurant Industry, both locally and nationally, has had an excessive mortality rate during the Great Recession. But KTMS, Inc. has not only survived, but was able to sustain and increase profitability YOY.
2. KTMS, Inc. lost its lease on Broadway location through no fault of its own in 2006. This triggering event compelled the company to move to a new location and incur CAPEX of over \$300m, which required attendant borrowings. Previously, KTMS, Inc. had no long-term debt and a significantly lower Debt/ Worth ratio.

Personal Guarantor 01.15.2014:

Michele Morris submitted a Personal Financial Statement or PFS dated 01.15.2014. Ms. Morris disclosed a stated Net Worth of \$805m.

Total Assets were primarily centered in Real Estate, Personal Residence of \$330,000, and a Business Valuation of KTMS, Inc. of \$500,000. Other Assets included Cash \$10m, IRA \$30m, and Cash Value Life Insurance \$30m.

Total Liabilities were \$145m of Real Estate Mortgages and \$21m in Credit Card Debt.

Ms. Morris stated Personal Income is \$48m derived solely from her employee compensation from KTMS, Inc. as CEO/President.

VII. Economic Justification:

The proposed City of Saratoga Springs RLF will enable KTMS, Inc. to Retain 14 existing FTE Positions and Create 2 new FTE Positions within the next two years.

VIII: Credit Investigation:

A Tran Union Personal Credit Report, drawn on 03.28.2014, disclosed a Satisfactory Repayment History on all Accounts. To further explain, All Reporting Creditors stated a "Paid As Agreed Status". No Delinquent or Negative Credit History was disclosed.

X. Risk Profile Summary:

Credit Strengths:

- Excellent Entrepreneurial / Management experience by Ms. Morris.
- Strong Brand Equity within primary / secondary markets.
- Strong Cash Flow, with Debt Service Coverage Ratio exceeding Industry Standards.
- Sustainable Business Model evidenced over 15 Years of YOY profitability.

Credit Weaknesses:

- Continue national market competition, with continuous new entrants in Saratoga Springs Restaurant / Hospitality markets.
 - Leveraged Balance Sheet, based on Debt / Equity Ratio.
-