Cross Towne
MACHINING
A division of MG International Inc.

Written Statement

For

Congressional Oversight Panel

April 29, 2009

History of Crosstowne Machining

Bottom Line: Purchased the business in February of 2007, financed by a large amount of bank debt. Recession began in December 2007.

Crosstowne Machining is located in Muskego, Wisconsin. We are a machining business that specializes in precision machining and exotic metal machining (i.e. Titanium, Hastelloy, Nickel, Inconel, etc.). We take castings or bars of metal and machine them into finished parts for OEM's (Original Equipment Manufacturers) such as Caterpillar, Deere and CaseNH. The company dates back to 1989 and was led by two owners. Over the next seventeen years, the two owners built a small business that by 2006 had employed a total of ten people and had around $1 million dollars in sales. In 2006, they approached my co-owner (Layne Meyers) about buying the business. Layne was director of operations for a customer of Crosstowne Machining and had used Crosstowne as a vendor for many years. Layne and I bought the business and began our ownership on February 1, 2007. Our purchase was financed through a combination of bank loans and owner equity holdback notes.

Financial Background

Bottom Line: Fast sales growth in 2007. In 2008, industry changes mandating purchasing material to machine strains our capital needs. In 2009, a decline in overall sales began to occur due to the economic recession. Three straight quarterly operating profits, 3Q2008 thru 1Q2009.

While there were many challenges with taking over a company, we had a successful 2007. Even with a large amount of non-cash expenses such as Depreciation and Amortization Expense, our company still reported a small profit in our first year as we grew sales 90% to $1.9 million dollars. In 2007, we purchased two machines to help with the continued sales growth. While we were happy with our sales growth, we were seeing an increasing amount of our customers forcing us to purchase the material to machine their parts. This is a change that had been occurring in the machining world. Traditionally, machine shops were provided the material that they would machine from their customers. As companies continue their desire the shed inventory, they will ask machining businesses to "purchase complete". In other words, the machine shop buys the metal, machines it, outsources any other steps that may need to be completed and provides the finished product to the customer. This creates a difficult cash flow challenge for smaller machine businesses like ours. While we had a working capital line of credit in place through our existing bank (Johnson Bank of Racine, Wisconsin), the excessive amount of material that we had to purchase was far more than the financial status of our company could handle. By May of 2008, we had accumulated an excessive amount of inventory and our company's cash flow was under immense strain. We went to our customers who asked us to purchase this inventory and told them that we were financially unable to continue this. After much discussion, they agreed and in May of 2008, we liquidated our inventory and took a charge off of $158,000. Because of this, we had an operating loss in the second quarter of 2008 of $170,000, but followed that up with an operating profit in both Q3 and Q4 of 2008. At the end of the year, we still increased our annual sales in 2008 to $2.3 million, an 18% increase over 2007's sales. We ended the 2008 year with 16 employees at our company, six more than when we brought the business in 2007. We felt that our

Q3 and Q4 performance, in light of the economic recession, demonstrated that our company was a very viable entity that had strong management. We also thought that maybe we had "weathered the recession" because of our strong Q4 sales and earnings. But almost overnight, by the middle of January 2009, we began to see a strong drop in sales due to the recession. Our backlog was rapidly dwindling. While our customers were still ordering parts from us, the volume was going down rapidly, with sales for Q1 of 2009 down 24% from Q1 of 2008.

Management of Current Situation

Bottom Line: We have aggressively reduced expenses while maintaining a strong marketing presence.

We faced this, as many businesses have, by aggressively managing expenses. We followed up Q3 and Q4 of 2008 with another operating profit in Q1 of 2009, an achievement our management team is very proud of. But unfortunately when you aggressively manage expenses, it usually comes at the cost of employees and our company was no different. By February, we needed to lay-off three employees and in March, we laid off two more. We currently stand at 11 employees. While this was tough, we did have some successes in Q1. We brought on two new customers, one of which is going to be very strong for us in the future. We were also asked to take on another line of business from one of our existing customers, starting in June 2009, which would amount to $1.5 million a year in sales, almost doubling our size. We have also been very aggressive in our marketing tactics, rebuilding our website, conducting several online marketing tactics to bring in new customers and executing a bi-monthly mailing campaign to potential customers. We have also purchased a booth at a large trade show in Chicago in May in which 3,000+ purchasers and engineers will be attending. While we are managing expenses, we are not cutting our marketing through this challenging economic period. These are all signs that our company is "here to stay" and unlike many competitors in our field, we will weather this storm.

Availability of Credit and our Banking Situation

Bottom Line: Johnson Bank is unwilling extend any additional credit, leaving us without any access to working capital. They are also unwilling to restructure our existing debt, leaving us with high debt servicing, due to high interest rates and short amortization terms.

The combination of having to pay down our inventory charge-off, significant amount of debt and our sales slow-down was having detrimental financial effects by October of 2008. Our working capital line of credit was "maxed out" and while sales were still going strong, we could see our sales forecast beginning to slow down. Financially strained from our debt, I proactively approached Johnson Bank in late October 2008 for more working capital and/or to restructure our existing debt with them (approximately 80% of our debt is with them). By hoping to restructure our debt, I was hopeful that it would both lower our monthly debt servicing and provide the possibility of additional working capital. The working capital is extremely important to us because we will often have to purchase material for jobs that may require several internal and/or outsourced operations, which means we may not get paid until 90-120 days after the material has been purchased. Until last October, we used our working capital to provide the payment of that material. Since then, we have struggled to pay our material vendors with operating cash as we have no further access to any financing. We continued to have several meetings with Johnson Bank, but by January of 2009, they told us that they were not willing to do anything more for our company - no more money and no debt restructuring. One of the lenders said "I know that these are difficult conversations to have. I have had many of these conversations recently with companies whose sales are down 40 or 50%". But in January, our sales were not down 40 or 50%. They were going into their "bunker" and just hoping our company would make it through the recession. Not only was I disappointed in the lack of action in assisting our company, but I was even more disappointed that my strategy of getting my banker to have a better understanding our business was not effective. Prior to purchasing Crosstowne Machining, I spent fourteen years working in the Retail/Small Business Banking sector and I understood very well that most business owners shunned their banker. They only wanted to meet with the banker when they needed money and the banker had to "drag" financials and company information out of them. When we brought Crosstowne, I thought I would take a different approach of communication with my banker that included regular email updates on the business, spending hours with him onsite showing new equipment, discussing production, explaining the parts that we machine, how we do it and the economics of running the shop. I felt that if my banker knew us and our business, it would make him a "voice" of Crosstowne when he would go to loan committee or for some corporate need. I was even complemented and thanked on the updates that I would send him. But despite all of the hours of meetings, tours and email updates that I would send to my banker, in the end it did not matter. For while I felt that "my banker" wanted to help, I soon found out that he and the corporation were not interested and would just as soon have Crosstowne take our relationship elsewhere.

<u>Trying to Find Another Bank for Assistance</u>

Bottom Line: Six local banks, no new banking relationship for Crosstowne.

Given the nature of the situation, I decided in February of 2009 to try to find another bank that may want to help Crosstowne. I was well aware that in this economic and banking environment, it would be difficult. But I was also aware that besides the TARP program, the American Recovery and Reinvestment Act was just approved that gave a lot of incentives to both banks and businesses to look at loans through the Small Business Administration. I felt that with the TARP money and the SBA guaranteeing up to 90% of certain loans, banks may be more eager to lend to Crosstowne Machining.

I contacted six banks in the Milwaukee area to discuss their interest in assuming our banking relationship. They are:

1. Associated Bank-Milwaukee, Wisconsin
2. Wells Fargo Bank-Milwaukee, Wisconsin
3. U.S. Bank-Muskego, Wisconsin
4. Mid-America Bank-Janesville, Wisconsin
5. Foundations Bank- Pewaukee, Wisconsin

6. Investors Bank- Waukesha, Wisconsin

Between February 1st and March 31st of 2009, I met with business bankers from each of those banks. The initial meetings were very positive. Several bankers showed me how we could save $50,000 to $70,000 a year in debt servicing by having the relationship at their bank and teaming up with the SBA. The saving s would come from restructuring our debt to more favorable interest rates (6.00% versus the 8.00% I am paying now) and having longer loan terms (seven and/or ten years versus the five that I currently have). A couple of them also told me that we could add some working capital from the SBA program (one banker told me that we could possibly get an additional $100,000 in working capital thru the SBA program). But when the business bankers “ran it up the flagpole” at their respective banks, the responses were not good. One banker declined me by telling me that he “has not had any loans approved in the last three months and that they need to be perfectly clean” for his bank. After another banker told me that they would not approve my loan requests, I asked him “If this was two years ago and my financial situation is exactly the same, would you do the deal?” The banker replied “absolutely….things are different. The bank is more stringent now”. When I asked a couple of the bankers why they would not consider our company even with SBA’s 90% guarantee from the American Recovery and Reinvestment Act the responses were. “Just because the SBA guarantees 90% of the loan does not mean that there isn’t a lot of cost to the bank if the loans default….SBA is not easy to deal with”. Another banker told me that “there is so much paperwork and bureaucracy involved with the SBA that it is not worth it”. A third banker told me that a couple of years ago his bank had to recover assets from a liquidated company with an SBA guarantee and “the experience really had our bank not look favorably towards SBA lending”. In the end, there were not any banks that were willing to underwrite my banking relationship, even with a 90% SBA guarantee.