

Taking Care of Business

A Publisher's Cash Management Plan: Part 3—Asset-Based Lending

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Asset-based borrowing for any company is a blessing and a loss of control at the same time. This article will discuss the key points you need to know about asset-based lending. First however, some background.

Nature of the Book Trade

Traditionally the publishing industry has been a slow-pay, low-margin business complicated by the aspects of seasonality and returnability. This is a model for a challenging cash flow.

To be successful a publisher must recognize these facts and make every effort to counterbalance book trade sales by selling into other channels that have faster payments, no returns, higher margins and/or higher prices.

Nevertheless, in the book trade, the sale of a new season's titles rolls out rather easily. Buyers place orders in advance of publication and the established patterns of buying at wholesale and retail take our product into the market quickly. When we use a distributor or independent sales reps it is easier and faster to sell into the book trade than into some of the other types of markets mentioned above that require a finished product before making a buying decision.

The Cash Predicament

Let's create an example of starting a new trade book publisher. We have cash and ideas. When we follow our new venture over a year or two, we will find that in the process of producing new titles and making sales, our new publisher has gradually converted all of its cash into accounts receivable, inventory and prepublication costs.

Hopefully our accounts receivable and inventories will now be larger than the cash we started with. Yet, other bills are now due, we need to print more books and there is no cash left in the till. If we are lucky enough to have a bestseller, we may have to pay two or three printing bills before our first A/R is collected!

This is where asset-based lending comes in—to bridge the gap between accounts receivable that won't be collected until some time in the future and the bills that have to be paid today.

What is Asset-based Lending?

Asset-based borrowing should be viewed as a short-term working capital loan and not as a long-term investment capital source. Lenders do not want to own your business or be supplying investment capital. Asset-based lenders do provide working capital.

Typically, asset-based borrowing is a revolving line of credit with a financial institution based on the value of an asset, such as accounts receivable, up to a defined credit limit. Asset-based lending arrangements are generally a simple and good source of cash for a small business to fund their seasonal working capital needs and growth of current assets.

The difference between a revolving line of credit and a term loan is that a term loan only provides cash one time and then requires monthly debt service payments, while cash availability on a revolving line of credit will increase and decrease in relation to the asset base that the company is borrowing against, typically accounts receivable and inventory.

As an asset-based *borrower* the company must understand the lender's reporting requirements, interest rates and fees, loan covenants and the asset-based loan securitization. It is very important to choose an asset-based lender that will be your business partner.

Choosing an Asset-based Lender

When a company decides to start asset-based borrowing it is of paramount importance to choose a lender with a quality reputation in the local business community. When looking for potential lenders seek out local commercial banks or specific asset-based lenders who loan on A/R, inventory, etc.

The lender must have the desire and the ability to understand the publishing industry, your publishing company and the business cycles of your borrowing base. Lenders make loans on what they understand and the publishing business is different from most other businesses they lend to. Accounts receivable are collected slower and there are returns. Inventory only has limited value if the title does not have ongoing sales and the lender has no way of selling that inventory as they would a building or vehicle. Plus, after a title is published, prepublication costs are expensed rather than capitalized, removing the revenue and cash generating assets from the balance sheet. Lenders find these circumstances difficult to evaluate.

An asset-based lender loans money to make money so read the loan documents closely and understand what is required from your publishing company. Asset-based borrowing agreements will specify what asset the company is pledging as the collateral base for the revolving line of credit. Generally, business owners will also have to provide personal financial statements and personal guarantees in addition to pledging the assets of the company. The borrowing agreement will generally renew annually. The loan agreement

will contain loan covenants that must be understood, reviewed on a regular basis and followed by the borrower.

Interest and Associated Costs

While asset-based loan costs vary from lender to lender, most loan costs include a non-refundable commitment fee, minimum monthly outstanding loan balances, interest fees, and annual renewal fees. Additional loan fees may include out of formula or covenant compliance fees, unused line of credit fees, and loan termination fees. The fee structure of every loan is different as some lenders will charge more in loan interest and not charge for audit fees and unused line of credit fees, while other lenders will have low interest fees and charge for all the other services.

How it Works

The asset-based borrowing formula is what tells both the lender and the borrower what is available to borrow against. The borrowing base can be accounts receivable, inventory or other liquid assets. For publishers it will most likely be accounts receivable. The eligible borrowing base is current accounts receivable, which means invoices less than ninety days old. Then the eligible borrowing base is reduced by the lender's required reserve requirements, ineligible assets and interest payments when due.

Keeping ineligible assets as low as possible is they key to maintaining the revolving line of credit borrowing base as high as possible. Ineligible assets include old accounts receivable, inventory or other liquid assets, customer concentrations higher than 10% of the customer sales base, customer's lack of creditworthiness, out of country sales or inventory, affiliated or common shareholder transactions and consignment sales and inventory.

After determining what is available in the borrowing base you will complete the lender's "Borrowing Certificate" form, which shows the current borrowing base, the availability on the revolving credit line, and the amount of the advance requested. The borrowing certificate must be signed by an authorized representative of the company. Upon presenting a properly completed borrowing certificate and having the advance approved, the lender should fund the advance request within 24 hours.

Borrowers must provide weekly, monthly and annual reporting. Weekly requirements are sales, collections and ineligibility analysis. Monthly requirements involve internally generated financial statements with detailed accounts receivable and accounts payable. Annual requirements include tax returns, corporate resolutions and any major changes in the business such as inventory damage.

Even with all the internally generated reports, the lender will want to send out their own auditors on a regularly scheduled basis. Lender's audits are routinely done quarterly and on-site at the company. A quarterly audit includes a review of employer federal and state employee tax filings (Form 941 and state tax forms), a search for unrecorded liabilities, bank statements to insure all deposits are going to the lender, reviews to insure that major

borrowing agreement covenants are within guidelines, and interviews with the key company employees and the owner.

Revolving lines of credit are repaid by all payments collected against the pledged assets being sent to a lockbox controlled by the lender. All non-collateralized funds received by a company, such as, corporate tax refunds, insurance settlements, and proceeds for the sale of assets are generally required to be deposited with the lender to reduce the outstanding loan balance.

After going through this process you will truly understand that a lender always gets their money back plus interest, one way or another!

In the next articles of this series, we will discuss managing inventory and purchasing, followed by risk management.

The Siburg Company, LLC is a boutique consulting firm specializing in the areas of financial and operation consulting, business development and mergers and acquisitions.

Daniel R. Siburg, CPA, CVA
Managing Director

Dan is the Managing Director of The Siburg Company, LLC and has experience as both a President and Chief Financial Officer. He has helped companies to improve operational functions and organization to manage costs and increase revenue streams, while implementing strategic policies and procedures that focus companies on profitability.

Howard W. Fisher
Associate

Howard has had success operating four publishing companies. He has founded, built and sold two successful trade book publishing companies, one to a major newspaper chain and one to a major New York publisher. Howard now is a consultant for The Siburg Company, LLC in the areas of business development and mergers and acquisitions.

We invite you to contact us.

The Siburg Company, LLC
6347 E. Windstone Trail
Cave Creek, AZ 85331
Phone 480.502.2800
Fax 480.502.2804
www.TheSiburgCompany.com