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Keeping Afloat

Gulf Coast Business Review - by Janet Leiser | Senior Editor

Asset-based lending that allows companies to borrow against accounts receivables is a fast-growing industry in the U.S. It grew 16% in 2005 to a record level of $420 billion.

Growth for Patrick Gloer's Tampa-based telecommunications company was quick and explosive as soon as he started it in February 2004.

Gloer 1 Inc. revenue was $600,000 its first year, and revenue is expected to hit $10 million this year. That's a 1,567% increase over two years for the national company that installs and services telecommunication systems, including cellular telephone towers.

The entrepreneur knew he needed capital for cash flow. He didn't qualify for a line of credit from a bank - Gloer 1 was too new, for one thing. Even if venture capitalists were willing to take a chance, Gloer wasn't interested. He wanted to retain control of his company.

He turned to **Diane Homa, principal of Fountainhead Funding LLC**, St. Petersburg. She helped Gloer obtain an asset-based revolving credit line from a finance company that allows the business to borrow on its accounts receivable. As Gloer's business grows, so does his access to cash to bridge the gap between his expenses and his customers' payments.

His firm is not a rarity. It's among a growing number of companies that use asset-based lending to ease the cash crunch. In 2005, the industry grew 16% to a record level of $420 billion, according to a report released July 27 by the Commercial Finance Association. In 1976, the first year the trade organization tracked the data, asset-based loans totaled $11.9 billion.

Gloer uses a type of asset-based lending, called factoring. The finance company loans his company about 80% of the value of his accounts receivables, while the customers then send payments directly to his finance company, called the factor.

"I could have had the growth without the factoring," Gloer says. "But it would have meant that I had to pull in outside investors. I didn't want to do that. You can get rid of a factor anytime you want."

Asset-based loans typically charge 12% to 14% interest, which is about 5% more than banks, **Homa** says.

Factoring costs more than other asset-based loans because the finance company must pay an employee to verify all invoices submitted by a company to ensure they're legitimate, or not cooked up, prior to loaning money on them. The finance company then collects all payments from the customers to repay the loan and cover the fees.

In regular asset-based lending, which can also include loans on inventory or other fixed assets, the finance company also accepts payments directly from the borrower's customers. But the finance company doesn't verify every invoice because the borrower isn't considered as high risk as those who turn to factoring.

Asset-based lending is a temporary fix for companies until they're big enough or profitable enough to qualify for a bank credit line.

"They'll want to get with a bank as soon as they can," she says, adding that most clients stay with her about 18 months to two years.

She declined to release Fountainhead's revenue or growth, but she says she has obtained asset-based financing for 39 companies in her four years in business. And she's a sole proprietor by design.

Bridging the gap

Homa's clients usually fall into three categories: Startups, hyper-growth companies and businesses trying to engineer a turnaround.

There's a plethora of requirements to obtain a bank loan, she says. To start, a business usually has to show a three-year financial history to qualify.

"A lot of these companies, particularly like staffing companies or IT outsourcing companies, they've got payroll to meet every week," she adds. "And they might be billing a big company, like Jabil Circuit or another one like that, but they don't get paid for 45 days. It helps bridge that gap."

At hyper-growth companies, sales grow faster than the company's line of credit.

"Banks look at historical data, while asset-based lending is looking forward based on your sales," **Homa** says.

"They can go out and sell a million-dollar contract and they know they'll be able to make payroll, buy materials, whatever it is they need to do," she adds. "As soon as they make the sale, they're going to be paid now, even though it may take 45 days before the invoice is paid."

In their shoes

Homa, a certified cash flow consultant who graduated from the University of Florida in 1977, knows first-hand what the companies go through, especially when they're feeling growing pains. She has started two companies, Audio Visual Innovations in 1979 and Advantage Indoor Advertising in 1996.

She says she has walked a mile in her clients' shoes.

"Some are in the desperate mode," **Homa** says. "When I had my audio visual company, we landed this huge state of Florida contract and we only had a certain credit

line. We were always coming up against our line of credit and couldn't ship the equipment. We didn't have the money. That was stressful. You'd have all these customers calling you, asking where's my VCR, where's my monitor?"

She sold her interest in the AV company in 1995 to partner and co-founder Martin Schaffel, she says. At the time, the Tampa business had about $10 million in annual sales. It now does about $200 million annually.

Hyper-growth companies have trouble getting bank financing even after they outgrow their status as a startup.

"They might be growing, but they're not showing enough profit," she says. "When you're building infrastructure, pouring all your money back into the business, you're still highly leveraged with a lot of debt."

The Commercial Finance Association's most recent report states that the growth in asset-based lending can be attributed to the nation's economic expansion, as well as greater acceptance of the factoring product.

In recent years, the industry has become highly competitive as hedge funds and equity funds compete with finance companies to offer asset-based loans, she says. The return for the lenders is often greater than they'd get elsewhere.

"They're doing crazy things to get deals," **Homa** says.

She predicts a fall out from the shaky deals followed by a tightening up of requirements.

"It's like real the estate bubble popping," **Homa** says. "We knew it was coming, we didn't know when."

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