



his corner of *The Secured Lender* invites you to eavesdrop on a conversation taking place between several industry players about a different hot topic each issue. Pull up a chair and get ready to find out how Ivan Abrams, Robyn Barrett and Jim Quinn see the current market and hear what they had to say about challenges entrepreneurial finance and factoring companies face every day.



Brian Cove, Editor-In-Chief, *The Secured Lender*: I'll kick things off with a question you probably have been asked quite often in recent months. What kind of impact has the credit crunch that we've been experiencing since last summer had on your businesses?

Ivan Abrams, President, Abrams & Company: It has been quite significant since the first week of December. We have seen more deal flow in the past two months than in the previous 12 months combined.

And I would say as an add-on to that, I actually think this has been a healthy occurrence for companies we are speaking to, because some of them were getting access to quick credit scored and real estate backed loans that were masquerading as business loans. When the money was easy, many companies did not pay attention to their underlying operations in a way that allowed them to optimize the proceeds of funding they received.

The level of analysis that we do as part of our due diligence process can open up an owner's eyes as to what they should do with the money they get. Perhaps this is a small silver lining in the current cloud over the banking sector.

So this level of analysis is an important part of what we do. So I think that's actually something that's potentially positive that's come from all this.

Jim Quinn, Chief Sales Officer, LSQ Funding: I would also say it's been more lately, the deal flow did not increase in the fall as much as it has recently. I think it has taken a little bit of time for us to get to this point, but we are seeing a lot more deals now, we're seeing banks continue to tighten credit on the new loan requests so more turn downs are coming our way.

There's also been a lot of covenant violations of existing facilities so there have been more exit credits and special assets deals on the street, so all that business is really picking up for us.



Robyn Barrett, Managing Member, Factors Southwest: I've seen a little bit more business, I think from what I'm hearing from associates I have in banks it will probably be a lot more, especially the first half of 2008. Yes, the credit crunch is basically very cyclical and, when times are good, banks are very willing to lend, when it gets a little tight a lot of banks will start going through their portfolio and giving companies 30 days to leave. So we have gotten some good accounts from that.

COVE: So, have you seen a difference in the creditworthiness of the borrowers that are coming to you looking for your help?


ABRAMS: Sure, initially they are going to toss out or take a pass on some of the more difficult deals that may not even be eligible for funding from Abrams, but ultimately, they are likely to exit many deals that we consider to be excellent candidates for funding. This will obviously benefit us.

QUINN: I think part of the issue is that any time a credit is coming out of a bank in an exit situation or the business is not getting the increase that they're looking for, there's a little bit of adjustment as far as the alternative financing world for them.

COVE: Do you find that some of the new borrowers coming your way now are unfamiliar with factoring or asset-based lending? Is there a need on your part to educate them about your services?

ABRAMS: There is definitely an education process they must go through. Some of them are familiar with what we do, but, since the funding mechanism is sometimes a little bit different than what they may have used to previously, there is frequently a learning curve.

As we all know, one of the benefits of our services is that our funding amounts are typically a percentage of liquid collateral. This provides a protective ele-



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ment for clients in case of a liquidation. In addition, most of our engagements are structured as revolving credit facilities. These fluctuate up and down daily and clients can control the amount of money they draw against the line. This allows them to contain costs, since the majority of our fees relate only to money in use. These aspects of what we do are certainly things we educate clients about prior to funding.

QUINN: I think that there is always an education process with folks. It is interesting that factoring still has to be explained sometimes. It's been around for so long and it's such a big industry, but there still is always an education process associated with receivable financing.

The upside is the liquidity options available with A/R financing versus some of the restrictive covenants businesses are under at their bank facilities. So a lot of times when they realize the excess availability they can get based on that it is really a positive thing for us.

ABRAMS: I would agree.

COVE: So given the kind of increase in business that you're seeing, especially in recent months, how do you project 2008 to play out in terms of business for you? Do you think it will continue to grow?

ABRAMS: I think it should. Right now, there is an internalization process going on in the marketplace. It begins with us looking at potential deals. From there, it continues on with us sending out proposals and term sheets. We have done a lot of this over the previous few months.

I would expect sometime probably beginning in the middle of '08, there should be a significant uptick in the number of closings for us. A lot of that depends on what happens in the credit markets, but I would see this crunch continuing for at least a year, if not 18 months at this point.

QUINN: I would agree, I think it's going to go on at least 18 months. My

concern actually though is also for our existing portfolio, a lot of the growth of our company comes from the existing portfolio, and those clients who are growing. I think there could be an impact on the rate of growth of the existing clients because the economy is slowing as we enter a recession and the lift we have been getting from that in recent years may slow down. This should be offset, if not exceeded, by the new business opportunities that we will have a chance to go after.

ABRAMS: That is correct. On the asset-based side, I am also seeing growth in the technology sector, and in particular, Internet based-companies. This is a potentially strong market for us in 2008 and beyond. I have several speaking engagements coming up. One will be held at the law firm Lowenstein Sandler. I will be speaking in part about our dealings in this, and other markets, in the year ahead. I would also agree with Jim, that if you look at many of the industries in our portfolio, you may see a flattening out and reduced growth in the year ahead.

COVE: Are there any industries that, either as an asset-based lender or as a factor, you will not do business with?

BARRETT: Medical, construction and trucking. Most of these industries are usually served and best served by a factor or an asset-based lender that truly has a good knowledge of the industry and usually specifically only works on those industries.

ABRAMS: Since we pay primary attention to accounts receivables as an asset class, we tend to stay away from businesses that sell on consignment, generate significant unearned income, or generate receivables with high dilution rates or that have the potential to be offset at a later date.

Examples can be the construction trade and the cosmetics industries. Now, some cosmetics companies do not sell

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exclusively on consignment, but this is still something you need to look for if you are going to consider financing these types of businesses.

QUINN: Anything on consignment is a big issue, construction, subcontractors, progress billing, medical receivables and PACA situations regarding perishable products.

COVE: How much is fraud a problem for entrepreneurial finance and factoring companies? Is it something that you have to be on the lookout for constantly?

ABRAMS: Absolutely. When you are doing highly leveraged deals, it is always something you need to look out for. But we have good internal systems and protocols so, if it does happen, we usually catch it fairly early. That being said, I don't think you can prevent it entirely.

I should point out that there are differences between what Abrams & Company does, as an asset-based financing company, and what factors do as part of their funding engagements. In my experience, factors have a tendency to focus a little bit less on the balance sheet than we do, and I think this can sometimes result in a greater incidence of fraud. Still, we do leverage highly in many situations, so fraud is something we need to be on the lookout for in our business as well.

In instances when it has occurred, we have been fortunate enough to recover most, if not all, of our money in play, but as a caveat, I should also mention that I have found that the courts in New York, (and particularly the Federal Court system) have matured in the last 5 to 10 years. They have been far more responsive to us, as a financial institution, especially when a client has committed a blatantly wrongful act. This has been a positive change.

BARRETT: Fraud is always a problem because in the factoring industry where cash flow is tight you trust no one and are skeptical of everyone. Your clients

can be nice but at the end of the day you still don't trust them because the minute you put your guard down is the minute they are going to try something. So fraud is always an issue and it's something in our company that we are always on guard and looking for.

COVE: We hear from a lot of our members at CFA that the authorities are not responsive unless the money involved is a very large amount. Have you found that bringing your fraud situations to the attention of the authorities is helpful?

BARRETT: That doesn't work. You know, good luck. I tried going to the authorities one time when I just started my company and it was a joke, so no. A factor is better off recovering via additional collateral or personal guaranty.

I did have a client though that I didn't go after, but I do know that the attorney general did go after them on RICO charges.

But really, to get help from the authorities, the fraud has to be big dollars being stolen from a large public company or a large fraud scheme involving consumers.

ABRAMS: Making a moral point and going to the "authorities" (i.e., the attorney general), is not something we ordinarily feel compelled to do. We focus on the court system and recovery of our position. As I mentioned before, we have found the federal system in New York to be fair and intelligent much of the time.

QUINN: At the end of the day, it's the recovery position that we are most concerned with. We would want to prosecute as part of that, if necessary, but we really want to get our money back.

In the factoring business you need to have a very strong operations, monitoring and risk mitigation team. That's what distinguishes people who are successful in this business from those that can take some big losses.

Any time you are financing distressed

ARE THERE GOVERNMENT REGULATIONS THAT YOU, AS LENDERS, FACE THAT PRESENT IMPEDIMENTS TO YOUR ABILITY TO BEST SERVE YOUR CLIENTS?

companies, you need to understand that business owners can make some very bad choices in these situations. The more prevalent type of fraud is a diversion of funds from the lock box, rather than an invalid invoice. The lock box compliance component of this type of financing is a critical component of what you need to diligently monitor in order to protect yourself.

ABRAMS: I would agree with Jim 100 percent.

COVE: Do you find that the fraud is usually not premeditated but more often perpetrated by a client who finds himself in a desperate situation?

QUINN: Yes, I would say that's the typical rationale.

ABRAMS: I agree.

QUINN: And sometimes it's done by someone other than the principal.

ABRAMS: That's correct.

QUINN: In some cases there's an office manager or someone else who is committing the fraud unbeknownst to the principal who is not monitoring the business as closely as they should, and it goes undetected internally at their

shop for a long time. A lot of times we'll discover it on our end and bring it to the principal's attention.

COVE: Is that something you assess when you are looking at prospective clients, the kind of internal controls they have?

QUINN: That's part of it. The competency of the internal staff is something else that we look at as far as deciding what is a good prospect and client opportunity for us. That goes into the evaluation.

If you have an incompetent team of folks running the company or running the books, that makes our job a lot more difficult.

And just one last thing on the prosecution piece for you, Brian, and Ivan alluded to it, but it is considered still a sort of white-collar crime.

ABRAMS: Right.

QUINN: And it's not a violent crime, and I think the authorities, from a prioritization standpoint, focus on violent crimes and homeland security. Inevitably investigation and prosecution resources are stretched in terms of fighting these types of crimes.

ABRAMS: Sure. As it relates to the legal process, what I would say is painful, is the amount of time it takes for a case to be resolved. Part of the problem is that each judge has so many cases in play. This is certainly a more profound issue in the state, as opposed to the federal court system. That being said, it is still difficult for us to deal with the amount of time it takes to bring any case to its conclusion, because as time marches on, legal fees and interest pile up. This can be an excruciating experience.

QUINN: Amen.

BRIAN COVE: Are there government regulations that you, as lenders, face that present impediments to your ability to best serve your clients?

BARRETT: No. In Arizona a finance company can basically just go out and hang up a sign and start factoring. In

some states, such as California, there are many more regulations and a finance company would have to be bonded and go through a period of waiting prior to funding the first transaction.

So here in Arizona it is very easy to do business.

ABRAMS: For us, there haven't really been any recent government regulations that have negatively impacted our deals in a meaningful way.

With regard to bankruptcy issues, which certainly come up in from time to time, the best advice I can give, as a financier, is that lenders need to be vigilant watching their collateral positions and advance rates so they don't get trapped into being required to return monies to a trustee at a later date.

QUINN: Agreed. I think it's in a factoring arrangement you have an ownership lien position on the A/R. In an ABL facility, most of the time the A/R is classified as collateral for a loan. In the end, nothing replaces good vigilant monitoring of all the collateral on a regular basis.

COVE: Have any of you ever been hit with a preference claim in bankruptcy cases where you have been faced with the situation of having to return some of the payments you received to a bankrupt debtor's estate?

ABRAMS: Sure, we have been hit with claims over the years. Again, as asset-based lenders, our funding is structured as a loan, and not as a purchase of assets, so, as long as we can show payments have been made within normal terms and that advance rates have been appropriate, usually preference claims get dealt with in a favorable manner.

BARRETT: No, because being a secured lender, it would be extremely rare that that would happen. If you are running your factoring company correctly and you are funding on earned, confirmed invoices and you are not doing any kind of overadvances, then you really shouldn't be subject to preference claims.

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COVE: Does the business that you are in, both factoring and asset-based lending, still have an image problem? While both kinds of lending have evolved over the last decade, do you see that misperceptions about the kinds of services you all offer remain prevalent?

BARRETT: We are constantly fighting image issues and constantly correcting people because people immediately think that if you say the word “factor” that a company is having cash-flow issues. The business world just assumes factors are the lender of last choice. So we were talking about education, it’s educating the public and people that, no, factoring isn’t and should not be your lender of last choice. Most factors don’t want to be the lender of last choice. Factors don’t want to lend to severely cash flow-strained companies that have few, if any, options. If a company can use factoring correctly, then the company can grow, succeed and then move on to the next level, being a traditional banking relationship.

So if it’s used correctly, factoring is an extremely wonderful tool to get a company cash flow so they can grow.

ABRAMS: I certainly see that people have misperceptions about what we do. I think when it comes to asset-based lending and factoring, people often lump the two together incorrectly. Factoring fees, for instance, often dwarf any of the fees associated with an asset-based lending arrangement. People often need to go through a bit of an education process to understand this. I think it is essential for all finance companies to focus on the value they provide, beyond the funding. This means finance companies should not only talk about the cash they might provide, but also focus on the important analysis they do as part of their ongoing due diligence process. Much of this work forces us to look at the underlying operations of a business, and,

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it often opens a client’s eyes to how the proceeds of our funding may be best utilized to facilitate profitability.

QUINN: I would say, in general, yes, there is an image issue at times. But I look upon other professions that suffer some of the same types of impressions. I think of the legal profession or real estate agents where you can have a few bad apples that tarnish the reputation of those industries. I think like most things it’s sort of an 80/20 rule where most of the folks are conducting themselves with high degrees of integrity and ethics and some aren’t. The ones that aren’t are the ones that cast aspersions on the entire profession and industry.

But I think from corporation to corporation it starts with a type of culture in that company, as far as the integrity and ethics at the top of the organization and throughout the executive team as far as indicating that is the way that they’ll do business, how they go to market and how they treat their clients. And I think the consultative point that Ivan made regarding how to really work with these businesses to best utilize the financing to grow their businesses successfully so they can move on, is what really distinguishes one type of financier from the next.

ABRAMS: Through the use of our funding, a client recently informed us that he was able to reduce his cost of purchasing, on one of his more significant items, by approximately 18 percent. This might very well offset the entire cost of our financing for the entire year. So when you can really find value like this, and you do it repeatedly, for other businesses, and across sectors, you tend to put our industry in a more positive light.

QUINN: And that’s an important point because a lot of times we’ll have to help educate our clients on how to negotiate trade discounts and other cost of goods discounts. Most

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of them are offered at 2/10 from their suppliers right now, but they can negotiate larger discounts because of the cash basis they can put themselves on with A/R financing. A lot of times they can offset a good portion of the entire fee by leveraging that cash effectively.

COVE: So it sounds like you have to spend time educating potential clients about how your services can benefit them.

QUINN: They have never been on a cash basis so they don’t know what it’s like to be cash flush. They are inexperienced in knowing how to use the proceeds effectively.

BARRETT: I think also most of the companies using factoring are probably financially challenged because I’ve had the same issues and discussions with most of my clients. Most of these clients do not know how to best utilize cash and how to plan for growth. Most prospects don’t understand they can offset the cost of factoring by utilizing the increase in cash flow to take advantage of vendor discounts and other cost-saving opportunities.

ABRAMS: That’s correct.

QUINN: These are entrepreneurs who are usually very good at providing a particular product or service. They are risk takers in terms of starting their own businesses, and they may not have the financial savvy to understand how to use the cash effectively.

BARRETT: Yes, but you have to be a little careful about lender liability though, too.

ABRAMS: You are absolutely right, and we understand that there exists a fine line, because you can’t get involved in anything remotely akin to running a client’s operations, and we don’t.

QUINN: We demonstrate how other companies have used the increased cash flow effectively and that is part of the education process that they can take advantage of.

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COVE: As we wrap this up, what do you see as the biggest challenges facing entrepreneurial finance and factoring companies in the coming year?

ABRAMS: I would say capturing and maintaining the increased deal flow we should see in 2008 and the first half of 2009.

QUINN: I would agree with Ivan. I also think for some of the companies that operate with warehouse lines and lines of credit, their capital availability might dry up a little bit this year, as well.

The portfolio growth of existing clients, I think, is a concern as far as the growth that you would normally get in a more robust economy. In addition, we may also experience a slowdown in the A/R turn from our existing account debtors.

BARRETT: I agree with that, especially with the way the credit markets are these days and everyone is a little nervous, and banks are extremely skittish. I know down here in the Southwest where a lot of the economy is driven by real estate, we've got a lot of banks with troubled borrowers.

The typical entrepreneur now can't get the cheap financing the way they did in years past. For example, by getting an advance on a HELOC on their house. Now entrepreneurs have to go towards traditional financing or alternative financing like factoring. So that's good for us, for entrepreneurs it's not so good because they have fewer capital choices.

I think we are also going to see receivables turnover slowing down either because companies are nervous and they're hoarding their cash, or companies are just having a difficult time.

ABRAMS: With regard to the integrity of receivables, and the collection process, we recommend credit insurance policies for a significant number of clients in our portfolio. This provides protection in cases in which a client has to deal with, not just a delay in payment, but no payment at all.

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COVE: But in spite of these challenges you all expect to have a pretty good year in 2008?

ABRAMS: I do.

QUINN: I think the upside opportunity outweighs the challenges.

BARRETT: I think we all can agree we're going to see a pretty good deal flow coming from banks. Banks are getting nervous about the economy and want to clear out some accounts. I think a lot of these deals we'll be seeing won't be as much troubled as just not bankable.

COVE: Well, I hope you all have a lot of success throughout 2008. Thanks for taking the time to share your insights with our readers.