money

Bridging the gap

Spectrum fills the niche between bank loans and private equity

BY SHAWN REGAN

They say there are two types of people in the world: those who divide everything into two parts, and those who don't. Despite it being too clever by half, there may be something to this assessment.

If you are among those business owners and executives who see only two basic financing alternatives this side of your initial public offering — loans from the bank and equity from private investors — then perhaps you should consider the options offered by Spectrum Commercial Services in Bloomington.

Spectrum is the only company in the Twin Cities to offer both asset-based lending and factoring to small and mid-sized businesses. It is one of eight divisions of Lyon Financial Services Inc., a wholly owned subsidiary of privately held Schwan's Sales Enterprises Inc., the Marshall-based ice cream and pizza manufacturer and frozen food distributor.

Founded in 1995, 11-employee Spectrum serves the five-state area from Bloomington and 11 states in the West and South from recently opened sales offices in Denver and Dallas. "We're filling a niche in the middle by providing that bridge financing that many companies need between either a traditional, regulated bank loan or a venture capitalist who is looking for equity," says Brian Van Nevel, vice president of sales and marketing. "Private equity is almost never competitive when we start a relationship with a client. When someone comes to us, they've either just started in business or they've had some financial setbacks. The equity markets are not very kind at that stage. They're

Case study

Barbara Peterson is one of Spectrum's asset-based lending customers and president and owner of New Brighton-based BLS Carpet, a seller and installer of commercial carpets with 19 employees. She turned to Spectrum in 1997 on the recommendation of her accountant. "I was so new to the business the banks wouldn't touch me, and don't they regret it now," Peterson says. "They didn't like my cash flow, and I couldn't convince them that I was a good line-of-credit investment.

"We tried everything, but the interest rates were unthinkable, especially with the factoring companies. We also tried the venture capital route. I talked to a lot of groups, but when we'd get to the door, it would be shut. I was working with another asset-based lender and having all kinds of problems. Spectrum was very patient. If you play by the rules and do what you agreed to, it can be an answer. Now they've invited me to leave because I can be on my own and bank without their help. So color me happy."

Barbara Peterson, BLS Carpet: 651-639-1499

ERIC MOORE

Barbara Peterson of BLS Carpet with Brian Van Nevel of Spectrum: "The banks wouldn't touch me [but] Spectrum was very patient."

asking for a lot of ownership for very little money. Later in the company's life cycle, when it has grown and improved financially, then equity can be the end point of the progression rather than a bank, because for the ownership they're giving up, companies can then get what they think it's worth."

Van Nevel says there are three reasons why companies seem to be turning into non-bankable credits and becoming Spectrum clients. Businesses are doing well and are sinking money into bricks and mortar, new equipment or diversification. They get hurt because the transition costs more and takes longer than anticipated. They find themselves unable to fulfill customer needs, start losing some big accounts and "get into a downward spiral quickly," Van Nevel says.

Then there's succession planning — or lack thereof. The second or third generation of the founding family takes over the business but lacks sufficient experience. "As the succession rolls forward the shop isn't watched as closely," Van Nevel says. "Focus is lost, and the business struggles."

The third reason involves companies in industries like printing, machining and distribution, which are going through consolidations that produce larger, price-cutting competitors. "The smaller companies ... are often slow to respond to changes in the market and make the tough decision to reduce their overhead," Van Nevel says. "So they get into financial difficulties."

What Spectrum offers

Spectrum's bread-and-butter offering is its asset-based lending product. This is similar to a line of credit with a bank, but the client company puts up its accounts receivable, inventory, equipment and/or real estate as collateral. The monthly revolvers range from $250,000 to $5 million, with interest rates of prime plus 3 percent or more.

"Banks look at a potential transaction from the financial aspects first — cash flow, debt service, tangible net worth — and assets last," Van Nevel says. "But because we're dealing with businesses in more difficult situations, we look first at what the assets would be in a liquidation scenario. Also we watch it much more closely than a bank. On receivables, we'll check them daily or weekly against our borrowing-base certificates. And we're out at the company quarterly to do an onsite audit to verify the receivables, inventory and equipment."

Spectrum's fastest-growing product is factoring. Spectrum will purchase a client company's accounts receivable for up to 85 percent of their value (but they have to be less than 90 days old). Factoring usually fulfills a monthly need ranging from $25,000 to $250,000. The company is charged a per-invoice discount rate of 2 percent each month. When Spectrum collects on the receivables, it deducts its discount fee and what it originally paid for the receivables and sends the remainder to the company.

Van Nevel says factoring is a good option for companies with wide margins caught between customers who are slow to pay and suppliers who are reluctant to extend credit.

That monthly 2 percent fee makes factoring more expensive than an asset-based line of credit. "Two components make a company a factoring client rather than an asset-based client," Van Nevel says. "It's a smaller transaction, and there's more risk involved because either it's a newer company or the financial sophistication is not there."

Most of Spectrum's clients are referred by banks, and sometimes — when a bank will be unable or unwilling to provide all the funds a company wants — Spectrum will be brought in to handle the loan, with the bank in for 15 to 50 percent. A blended rate will be calculated that's higher than the bank's and lower than Spectrum's.

Van Nevel encourages companies to explore all their options. "Sometimes what's best is equity, sometimes going back to the bank for restructuring, sometimes it's the owners putting in more capital," he says. "And in exploring each type of financing — banking, asset-based lending, or venture capital — talk to more than one player. On any given day, someone else could be more knowledgeable, creative or aggressive than I am — hard as that might be to believe!"

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