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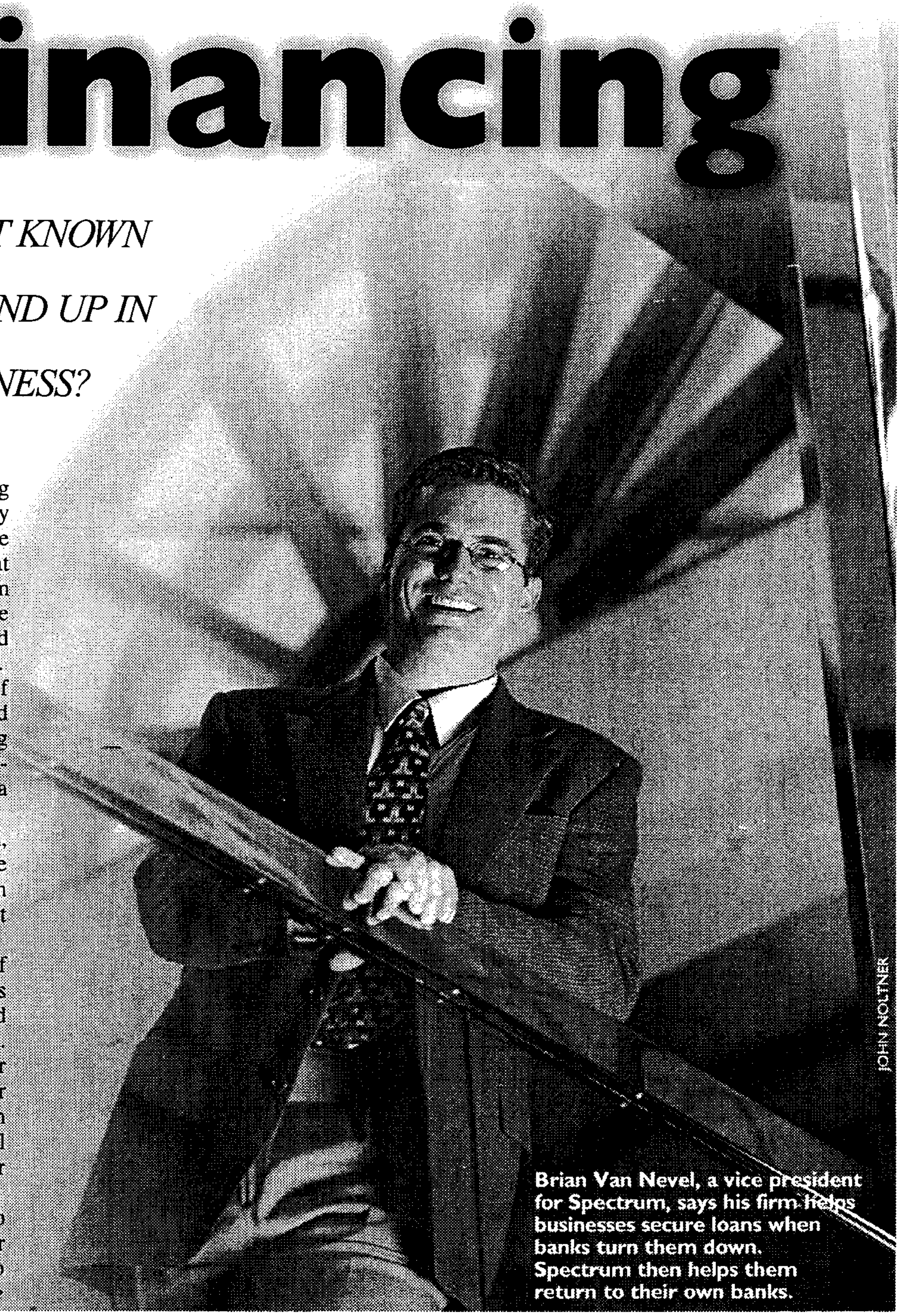
Soft-serve financing

HOW DID A FIRM BEST KNOWN FOR ITS ICE CREAM END UP IN THE FINANCING BUSINESS?


JOHN NOLTNER

Brian Van Nevel, a vice president for Spectrum, says his firm helps businesses secure loans when banks turn them down. Spectrum then helps them return to their own banks.

By Dan Emerson

Last year, when a small but growing Minneapolis metal-stamping company needed an infusion of capital to purchase equipment, the firm turned to a somewhat unconventional lender: Spectrum Commercial Services Inc., a low-profile holding of the Marshall-based food company Schwan's Sales Enterprises Inc.

High debt service due to the buyout of a previous owner and rapid expansion had temporarily rendered the manufacturing company unable to meet its bank's debt-to-net worth ratio requirements and, as a result, ineligible for a loan.

The bank referred its client to Spectrum, a nonregulated private lender that was able to provide the necessary financing at an interest rate somewhat higher than the cost of a comparable bank loan.

Spectrum is an operating division of Marshall-based Lyon Financial Services Inc., which is in turn a wholly owned subsidiary of Schwan's Sales Enterprises. It's a "collateral" or "asset-based" lender that provides alternative financing for companies that need it in place of — or in addition to — financing from traditional sources such as banks, insurance firms or real estate companies.

"Most of our loans are made to companies that can't get all of their financing needs met at a bank" due to

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limited cash flow, said Brian Van Nevel, a Spectrum vice president. "Typically, that might be because they are too new or are growing far too fast for the banks' comfort, or have had minor financial setbacks that cause traditional sources discomfort."

Spectrum lends money "not only based on the financial condition of the company," Van Nevel says. "First and foremost we look at the collateral base of the company," including accounts receivable, inventory, equipment financing and real estate. "Then we look at the financial condition of the company and management."

The loans Spectrum makes to small companies are "story loans," Van Nevel says. "They tell us their story, why they are in the position they're in. We look into management's eyes to determine whether we think they can turn the corner. We don't want to be a lender of last resort. We want to be a 'bridge' source — work with a company for 12 to 24 months until they bridge the gap between where they're at and a position where they can turn the corner, improve their financial condition and ultimately return to their bank."

In some cases, Spectrum may work with a bank and client company on a participation basis, as it did to help finance a small Eden Prairie computer parts distributor that had been acquired by a larger firm. The fledgling company didn't have enough of a track record to fully meet the bank's loan eligibility requirements. But Spectrum's evaluation indicated sufficient management acumen and a phenomenal growth pace to make the company a solid bet, Van Nevel said.

At the bank's request, Spectrum provided 50 percent of the loan amount, and the bank supplied the other half. "So we grew with them for six months and in that time they met and exceeded every projection. [Then] the bank said to us, 'We think we can handle it now; you've been a great bridge.' " The company, "a true success story," will finish its first year with $4 to $5 million in sales, Van Nevel said.

Foods and financing

How did a company best known for its ice cream wind up in the commercial finance business? "Schwan's has always been an aggressive, growth-oriented company," Van Nevel said, pointing out that founder Marvin Schwan started the company 40-odd years ago "with 16 gallons of ice cream and one truck." Also, there's something to be said for the way Schwan's has grown using a network of small, rural-based suppliers. "We've dealt with so many different small companies over the years, we have a higher comfort level for this type of financing, which does deal with small to midsized growing companies," Van Nevel explained.

The company has "continued to look for opportunities to diversify our portfolio utilizing the strengths derived from the sale of our core products [frozen foods], our distribution system and capital base." There was "no genesis event" that led to the establishment of the Bloomington-based Spectrum in 1995, Van Nevel said. "It was just part of a continuing effort by Schwan's to take advantage of our strengths and move into the finance marketplace."

The company entered the commercial leasing business in the late '70s, and now owns five leasing companies under its Lyon Financial umbrella: Business Credit Leasing (established in 1979, leasing "small ticket" office equipment); Manifest Group (1988, office equipment); Secured Funding Source (a Sioux Falls, S.D.–based lessor of medical equipment, established in 1991); Universal Leasing (a tractor-trailer leasing company acquired by Lyon in 1995); and Stellar Financial (a 3-year-old lease portfolio management company).

Schwan's established its Bloomington-based subsidiary in 1995 as "a natural extension" of its leasing business, with "the prospect of earning decent returns in the financial sector," Van Nevel said. As a privately held firm, Schwan's doesn't make financial figures available, but Spectrum's loan portfolio has doubled in the last year, according to Van Nevel. "And we continue to have very aggressive growth goals over the next year, focusing on the five-state region but eventually expanding" as the firm has done with its leasing companies.

"It's in a constant state of flux because, if we're doing our job right, our clients are 'graduating' and going back to their banks. While we lose their business, we also gain business as we complete the circle for our clients. Eventually that means more referrals from banks who understand that the system works," Van Nevel said.

Given their greater degree of risk-taking, asset-based lenders typically also charge higher interest rates than banks — usually 2 to 8 percent over the prime rate, plus fees for ongoing auditing.

A relative rarity

As a food manufacturer and distributor that has diversified into small business finance, Schwan's is something of a rarity, said Kevin Kaufman, an assistant vice president with Richfield Bank and Trust, which refers small business clients to Spectrum. Companies in many industries have established lending companies, but those typically have served consumers rather than businesses.

In the past, corporations such as General Electric, Greyhound, Whirlpool, Weyerhaeuser, Ford Motor Co., Sears, Hawaii Power and Electric, the Des Moines-based High Vee food store chain and others have owned lending institutions — primarily consumer lenders, said Patrick Forte, president of the Association of Financial Services Holding Companies in Washington, D.C.

"Financial services can be a profitable business. People often want to diversify their investments, and if they are in a business that is at all cyclic, they may want to even out those cycles by being in businesses that complement their [primary] business," Forte said. It's relatively rare for a consumer-goods company such as Schwan's to become involved in the business finance area, he said.

Kaufman calls Spectrum "a key strategic partner for us; they fill a niche we don't have and allow us to maintain an ongoing relationship with a customer so we can be there for them when their financial picture changes. Spectrum knows not all of their relationships will be long-term; many may be only 12 to 24 months. They're comfortable with that."

Minneapolis-based Cargill is another firm that has diversified into the "non-prime" financing arena through its subsidiary, Access Financial, which writes mortgages on manufactured housing and other consumer financing.

However, Cargill apparently has been somewhat less successful than Schwan's in this area. Last month Cargill announced second-quarter earnings of $31 million, down from $307 million a year earlier, partly due to covering a $90 million loss recorded by Access.

Along with its earnings report, Cargill issued a statement saying it is reducing its involvement in the consumer finance business. No further explanation was offered, and Cargill officials declined to be interviewed for this article. ■

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