Funding the Cyclical Business

Acquiring the necessary working capital a business needs to grow and thrive in an uncertain economic climate.

A CAPSTONE CREDIT GROUP PUBLICATION

OVERVIEW

This white paper will discuss how small to mid-sized businesses can obtain the necessary working capital they need when they need it, and how Capstone Credit Group ("Capstone") can assist businesses by offering Contract or Single Invoice Factoring ("SIF") funding options.

PART 1

In this section we discuss what finance opportunities exist in a post Dodd-Frank regulatory scheme, its effect on Banks, and Credit Facilities.

PART 2

In this section, we will be discussing how businesses can use Contract or SIF as a Cash Management Strategy to bridge the working capital gap for firms in a cyclical business.

PART 3

In this section we discuss SIF, its benefits and advantages. A diagram of how SIF works is also provided in this section.

PART 4

This section provides a case study of how SIF benefited an actual client of Capstone.

PART 5

The last and final section of this white paper discusses who Capstone is and an array of financial products and services it offers to its clients.

PART 1 POST DODD-FRANK
WHY IS THIS A BIG OPPORTUNITY?

What is the Dodd-Frank Act?

The full name of the bill is the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”), but the name most often used is Dodd-Frank.

Dodd-Frank is a law that places major regulations on the financial industry and changes the way banks are legally allowed to operate. The act grew out of the Great Recession which began in 2008 and its intent was to prevent another collapse of major financial institutions which left unchecked would devastate the world economy again.

Dodd-Frank is also geared toward protecting consumers. Provisions of the act aimed at protecting borrowers from abusive lending and mortgage practices by banks and mortgage lenders.

Dodd-Frank became the law of the land in 2010 and was named after Senator Christopher J. Dodd (D-CT) and U.S. Representative Barney Frank (D-MA), who sponsored the legislation.

The bill contains some 16 major areas of reform and contains hundreds of pages, but for the purpose of this white paper, we will focus solely on its regulation of banks and how these new regulations impact small business lending.

How do the provisions of Dodd-Frank affect banks?

One of the main goals of the Dodd-Frank act is to have banks subjected to a number of regulations along with the possibility of being broken up if any of them are determined to be “too big to fail.”

To effectuate this, the act created the Financial Stability Oversight Council (FSOC). The FSOC looks out for risks that affect the financial industry as a whole.

The Council is chaired by the Treasury Secretary, and has nine members including the Federal Reserve, the Securities and Exchange Commission and the new Consumer Financial Protection Bureau or CFPB. It also oversees non-bank financial firms like hedge funds.

If any of the banks gets too big in the council's determination, they could be regulated by the Federal Reserve, which can ask a bank to increase its reserve requirement—the money it is legally required to retain from earnings (capital requirements) in the event of a crisis to maintain the bank’s liquidity and is not using for lending or business operating costs. Remember a majority of an ABK’s capital is owed to its depositors.

Under Dodd-Frank, banks are also required to have plans for a quick and orderly shutdown in the event that the bank becomes insolvent or runs out of money.

Additionally, Dodd-Frank has placed strict capital requirements on banks and increased scrutiny over credit decisions. Most large companies that rely on bank financing have had a relatively easier time accessing credit than most small to medium-sized business.

The Effect of Dodd-Frank on Credit Facilities

Small and medium-sized businesses that tend to rely heavily on bank credit, have come to experience tighter and tighter credit requirements in the wake of Dodd-Frank. In fact, according to an opinion poll released in early 2012 by the Small Business Authority, Main Street Alliance and the American Sustainable Business Council, 90% of small business owners nationwide agree the availability of credit for small businesses is a problem, and 61% agree it's harder to get a loan now than it was in years prior. This dilemma is a direct result of Dodd-Frank.

In fact, according to a refinancing study conducted by Standard & Poor's, an estimated $2.9 trillion in U.S. corporate debt is scheduled to come due from the second quarter of 2011 through the end of 2015. Accordingly, banks have begun dealing with a wave of corporate refinancing. Some experts believe that with demand for debt capital outstripping bank-lending capacity, an increase in competition for those funds will certainly lead to a rise in interest rates and lending to only those companies with the strongest balance sheets..

Larger, higher-rated corporations, that typically have more refinancing options available to them, may not feel the squeeze. Small and middle-market companies, however, particularly those with weaker balance sheets may find they have fewer traditional options for refinancing their debt in the coming years. Community banks still consider small business lending their main focus, but rates are typically higher and lending thresholds lower.   Many Community Banks have been forced to merge with larger financial institutions to cope with the Dodd-Frank legislation. Thus eliminating an important source of capital for small businesses.

Larger banks are less inclined these days to make smaller loans unless the business hands over most or all of its banking business. Even companies with an existing bank relationship in the form of a loan or line of credit are coming up short when requesting a refinance or credit line increase.[1]

In recent years, bank lending has become increasingly costly and banks are now requiring even more of the businesses they lend to. Among the typical requirements involved in underwriting most state and Federal SBA loans, the prospective borrower will be required to submit at least three years of audited financial statements and demonstrate an annual net income and profitability. Most of these loans can take anywhere from 10 days, to 6-12 months to process.

As traditional financing becomes increasingly unavailable and more costly, many businesses are now turning to alternative means to support their working capital needs. One such alternative is factoring.

[1] See "New Challenges (and Solutions) for Managing Working Capital" By Nic Perkin-abfjournal: http://www.abfjournal.com/articles/new-challenges-and-solutions-for-managing-working-capital-by-nic-perkin/

PART 2 FACTORING AS A CASH MANAGEMENT TOOL

As discussed earlier, the imposition of Dodd-Frank has greatly impacted the ability of banks to provide credit facilities to many businesses, including those within certain industries, e.g. the construction industry. While maintenance of operational expenses wasn't quite an issue in years past when the real estate market was at its peak, construction firms have had to turn to alternative financing options in order to sustain and grow their businesses more recently.

For companies within the $2 to $20 million in sales range, obtaining working capital to sustain operational expenses and execute growth initiatives in the current business environment can be difficult. There are solutions. One of which is Factoring.

Factoring as a cash management and growth strategy

The use of factoring as a cash management strategy can be an effective tool to bridge this significant working capital gap for construction firms. Through factoring, companies are able to self-sustain, take on higher volume contracts to grow, and strengthen their firms ability to operate with increased cash flow.

Currently, most construction firms finance projects on their own, as most contracts specify "paid-when-paid." In order to maintain their business and manage increased costs, these firms need significant working capital lines of credit in order to maintain their existing customer base.

Private finance companies, like Capstone, have created finance programs, around factoring, specifically designed to help construction firms and similar businesses by assisting them with their working capital needs. Factoring allows construction firms to take on higher volume of contracts, grow their business and retire debt more quickly. In addition, factoring helps strengthen the firm by increasing its cash flow. [2]

[2] Working Capital: Factoring supports contractor growth as U.S. construction spending set to rise, by Joseph F. Ingrassia is managing member of Capstone Capital Group, LLC

PART 3

SINGLE INVOICE FACTORING (SIF)

Benefits and Advantages

WHAT IS SINGLE INVOICE FACTORING (SIF)?

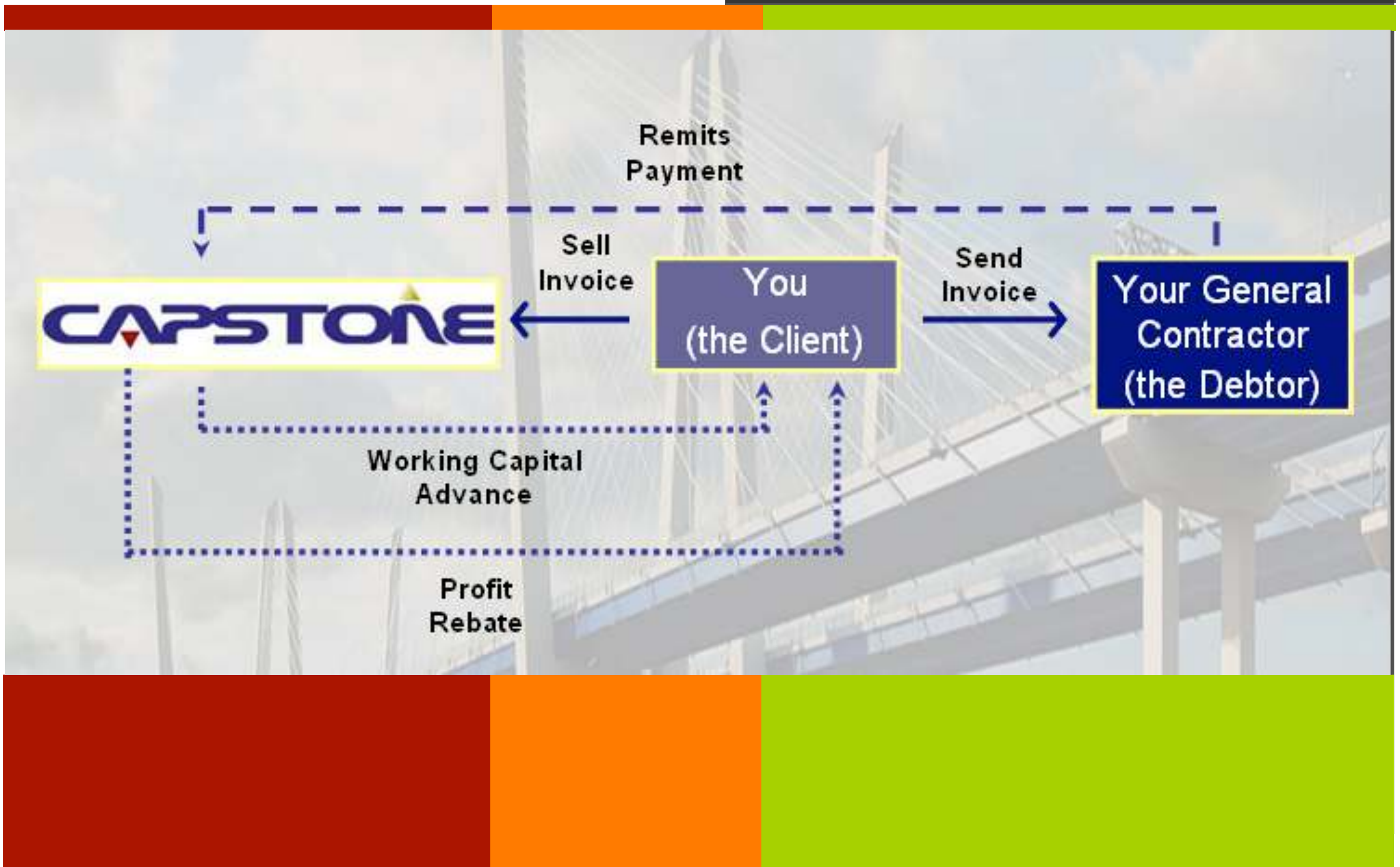
In general terms, SIF is a business funding option that allows businesses to sell their accounts receivable that are due from creditworthy customers. This type of financing is helpful when a company is waiting for a large payment from a customer but needs the money immediately. SIF differs from regular factoring services in that only one invoice, or a schedule of invoices, are purchased versus a typical factoring arrangement where a two or three year contract is required. Under the typical factoring format a client must sell all of its invoices to their factor. It lacks in the flexibility offered by SIF and is often more expensive in the long run. As such, SIF allows firms to factor accounts receivables on an as-needed basis at their discretion.

HOW SIF WORKS

Essentially, the money that a customer owes a business is considered an "outstanding invoice" – also referred to as an "accounts receivable." In factoring, when a business requires the money from that invoice immediately, a third party, called a "factor," comes in and purchases the outstanding invoice. In this case, Capstone would be the factor. Depending on the business and the nature of the transactions, typical account receivables can age between 30 and 90 days before the customer's payment is received.

From there, it is up to the business to make sure the transaction is completed. Sometimes, depending on the service you choose, the factor company will manage collection of the invoice.

Below is a diagram which details exactly how SIF works:



Some of the Advantages and Benefits of SIF

SIF has been successful at positioning companies for growth as it allows firms to sell one or many invoices for cash flow and only when needed. The proceeds of the invoice purchased are applied by the factor company, in this case Capstone, to insure that all subcontractors, vendors and suppliers are paid in exchange for their lien releases. Depending on the given month, the need to factor may increase, decrease, or become non-existent. As there are no volume requirements or associated fees, single invoice factoring is a true on-demand cash management strategy.

In addition to providing contractors with the ability to fund ongoing operations, factor companies, such as Capstone, give companies the ability to bid with confidence on new opportunities. The clients of Capstone know when certain underwriting criteria is met, Capstone will provide assistance should the contractor run short of working capital during the course of the performance of their new or existing contract.

For subcontractors, in particular, there are many challenges of managing operating expenses when extended payment terms are routinely negotiated into subcontracting arrangements.

As one can see, SIF provides many benefits. Some of these benefits include, but are not limited to, allowing the business to meet payroll obligations, increase cash flow in order to pay suppliers and creditors in a timely fashion; in addition SIF gives the business the confidence to bid for additional work. Unlike other types of credit facilities, SIF is much quicker and easier to obtain. A business can obtain the working capital it needs as long as they have a bonded job in hand or have a customer that is credit worthy. Capstone will purchase a portion of the contract and there is no maximum limit. The terms are fairly straightforward in that the financing is “non-recourse”, and full payment is achieved by way of receivable collections. The best part is that processing time of the initial transaction takes anywhere from 48 hours to 7 business days!

PART 4 SIF A Case Study

For the past decade, Capstone's client, a painting subcontractor located in California, had been operating its business and generating growth potential despite the economic challenges of the past five years. In recent years, the firm began experiencing increased delays in payment of its invoices.

The firm noticed that their general contractors had gone from paying invoices every other week to a cycle of 45 or 60 days past the standard 30 day invoice terms. As the business continued to grow, the firm had larger payroll commitments with an increasing list of unpaid invoices. The lack of working capital made it difficult to meet its payroll obligations, buy supplies and pay vendors.

Determined to shift the pendulum, firms like this painting subcontractor are driving interest in alternative cash flow solutions, such as factoring to help manage through negative business cycles and the constant, cash flow demands of extended payment terms.

Cash Flow Crunch

Throughout the $27 billion painting industry, subcontractors continue to face a difficult business environment. For the past five years, painting contractors have been impacted by plummeting construction markets causing decreased demand for services.

With the economy now improving, analysts predict increased opportunity for both residential and commercial construction, providing more work for painters. Even with increased demand, firms struggle with continued cash flow demands to meet obligations while working to increase bids and work volumes.

Despite various efforts by the U.S. Government, small business lending by traditional banks has remained at record lows. In addition, legislation such as Dodd-Frank has impacted the ability of banks to provide credit facilities to many businesses, including those within the construction industry that fail to meet certain criteria. Simply put, banks have moved away from providing credit facilities to smaller contractors.

Pendulum Shift with Factoring

In the construction industry, any payment disruptions from the general contractor to subcontractors have a ripple effect through the subcontractor's firm. Cash flow demands run throughout the lifecycle of construction projects and continually involve many companies.

For subcontractors, factoring has become an integral part of an overall financial strategy.

Painting Subcontractor + Single Invoice Factoring

In March 2013, the painting subcontractor chose factoring as a business strategy to increase available working capital. Within ten months, the firm factored 52 invoices ranging from $7,000 to $75,000 and was able to increase business volume by an additional 15% in 2013.

In fact, with the additional working capital available through factoring, the firm has secured an additional $300,000 in contract backlogs for the first quarter of 2014.

According to a manager of the painting subcontractor, "Traditional financing can be a slow reacting process, whereas factoring can provide a quick response, when needed."

The success of implementing single invoice factoring offered by Capstone on large commercial contracts has allowed the company to expand into other factions of the painting industry, including custom homes and homeowner associations (HOA).

The firm now focuses on planning the execution and performance of contracts, while bidding on new work as opportunities are presented.

Financial Strategy

Since the financial crisis, there has been a void of capital available for medium to small-sized construction companies, inclusive of painting contractors.

Under current market conditions, most subcontractors wait between 45 and 60 days for payment from their general contractors or project owners. With such dating, subcontractors are essentially financing the project, as most contracts specify paid when paid. In order to maintain their business and continue from job-to-job, subcontractors need significant working capital lines of credit to sustain themselves.

Capstone's factoring program is structured to reduce or eliminate typical financial covenants found in most factoring programs, while providing the needed working capital to subcontractors. As a business strategy, single invoice factoring has not only provided sustenance for subcontractors, it has positioned Capstone's construction clients for growth.

> "Single invoice factoring allows us the flexibility to choose which invoices we want to factor during the month, if any at all," according to the painting contractor. "This allows us to grow our business without worrying about additional payroll costs prior to funding, which can be 90 days on a new job," he continued. "It can be especially important on prevailing wage jobs where payroll costs skyrocket."

Capstone is a private finance company, headquartered in New York City, which focuses on accelerating client cash flows.

Capstone provides client-specific solutions through Factoring Services, Purchase Order (PO) Financing and Domestic and International Trade Financing. The services provided offer results to construction trades, service companies and wholesalers.

Combining client assets and resources with their advanced logistics platform, Capstone provides customer outcomes through the following entities:

Capstone Business Funding, LLC specializes in Single Invoice Factoring (SIF) or Spot Factoring, for firms in need of immediate cash. SIF provides flexible, no contract invoice selling in exchange for working capital from Capstone Business Funding.

Capstone Capital Group, LLC provides Trade Financing, PO Financing, and short-term, asset backed loans for clients. Capstone Capital Group delivers guaranteed bank payment instruments to global manufacturers and suppliers in exchange for promised distribution of presold merchandise to its clients.

Capstone Credit, LLC focuses on discount and collection Factoring and Purchasing Accounts Receivable from clients.

For more information on how Capstone can help, please contact us:

Email :info@capstonetrade.com or
Call: 212-755-3636 or 347-821-3400

Speak with a representative today.