

Neither a Borrower or Lender Be

Unless It's Nonrecourse, Below Prime and Unsecured

"Neither a borrower or a lender be, for a loan oft loses both itself and friend." —William Shakespeare

Profound words of infinite wisdom from the infamous Shakespeare. Yeah, sure. I'm confident he wasn't trying to operate a music retailing operation when he gave that piece of advise about borrowing money.

Do you think Shakespeare was ever forced to buy four month's worth of inventory and pay for it within 30 days? Do you think big bad Willy ever had to provide band instruments to a variety of schools, teachers and students on a rent-to-own basis, paying for them in full with only two months worth of rental income? Do you

think he had to compete with big-chain retailers, crumbling profit margins and ever-increasing overhead expenses? No, I don't think so! I think all Mr. Shakespeare ever did was hang around the house, get fat and leisurely write his torrid stories of love, life and murder, while amusing himself by doling out insulting remarks in an Elizabethan prose that no one dare admit they can't understand (i.e. "Thou dost operate your rude establishment of musical rampallion like that of a dissembling plume-plucked codpiece ruttishly mating a tottering dizzy-eyed rudesby, you venomed beef-witted scut!"). Yes, I think Shakespeare had it pretty darn easy compared to the plight of the typical music

retailer, who fights a battle every single day to generate enough cash to pay the constant barrage of bills and debts in a timely fashion. Who is this Shakespeare character telling us not to borrow? A paunchy, pribbling, spleeny, spongy, surly, tottering, mold-warped moron, no doubt.

Borrowers: Unmuzzled Swagerbellied Strumpets

A noble thought, not to borrow. But unfortunately, it's virtually impossible (or pretty damn difficult, at best) to grow a music retailing business without some degree of bank or institutional financing. Unless you've got a stash of personal cash hanging around to invest (a music retailer with extra cash? Hah!) or have been

at this retailing game long enough to accumulate tons of retained earnings, some form of bank financing may be the only solution available to successfully grow your music store.

By the same token, bank debt can literally put you out of business and on the street if you don't borrow wisely, responsibly and from the right sources. One of the most frequent questions I receive is "Where can I get financing from a lender who understands my business?" So, let's identify the financing sources who support the music instrument retailing industry—all two of them (just kidding).

Lenders: Rougish Reeling-Ripe Pumpions

The perception that many music retailers have is that borrowing, from any source, is the solution to all their cash flow problems. Imagine, for the moment, a hypothetical music retailer, we'll call him Romeo, operating his store profitably (which has little correlation to having money in the bank), who is creditworthy, fiscally responsible and in need of immediate cash. Will a quick infusion of borrowed funds solve all his immediate problems? Maybe so, but Romeo still needs to take into account a variety of considerations, both financial and non-financial, when choosing to borrow and from whom.

Whether they realize it or not, music retailers need more than just a banker willing to lend them funds. They need the right "kind" of financing, at the right "terms," for the right "circumstances"—this kind of lending can only come from experienced lenders with a proper understanding of how cash flows in music retailing.

Why do I say this? Retailers are financing rental instrument pools with short-term lines of credit. They're paying for leasehold improvements out of cash flow. They're financing increases in receivable and growing inventories with long-term debt. WRONG! Band instrument suppliers are offering fall dating on their invoices of

rental instruments. Who cares!?!? By October, valuable discounts are lost and there's never enough cash from rental income to pay these bills. Simply put, short-term assets (like inventory and receivables) that will convert to cash within the year need to be financed with demand notes and lines of credit. Long-term assets (rental instruments, store fixtures, leasehold improvements) need to be financed with long-term installment loans that amortize over three to 10 years.

Maybe our Romeo simply needs extended credit from his suppliers. Although vendor-backed financing may carry a higher interest rate, our retailer may find that option to be far less of a hassle than the lengthy, time-consuming process of obtaining an SBA guaranteed loan (especially given the onerous costs and loan covenants associated with SBA loans). Then again, an SBA guaranteed loan that lets Romeo keep his ownership interest may prove to be far less costly than letting his brother Othello become a partner because he needs \$25,000 before the end of the month.

Make no mistake: Obtaining the right financing is directly related to your banker's knowledge of your business, as well as the quality of the underlying information you provide them.

Financing: Swag for Churlish Boil-Brained Bum-Baileys

Although the list of industry financing sources remains somewhat under-publicized, there's a bigger reason why many retailers experience problems in locating the right kind of financing—most bankers don't understand the unique, but important, financial aspects of music retailing. And guess what—generally speaking, it's not their fault. When assessing the creditworthiness of a music retailer, lenders are often misinformed because they're furnished with misguided or outright distorted financial statements. And who's preparing this erroneous information? Their most trusted advisor—their accountant.

Accountants: Thou Froward Fen-Sucked Frustilarians

There's a few "quirks" that exist in the reporting of the typical music retailer's financial affairs. At the end of their fiscal year, business owners usually ask their accountants to assist in the preparation of financial statements (consisting of a balance sheet and income statement at a minimum). Although most CPAs and accounting firms understand the basics of financial statement preparation, many are unaware of how to properly report certain aspects unique to music retailing.

For example, when a music retailer rents musical instruments on a rent-to-own basis, proper financial reporting of this activity may require certain adjustments to their client's financial records. First, rental instruments should be reclassified from inventory to fixed assets and depreciated accordingly. Second, the depreciation life used for rental instruments should properly match the cost of that instrument pool (a.k.a. depreciation) to the rental income it generates. Third, monthly rental payments should be recorded as income as they're received (not all up front at the signing of the rental contract). Finally, rental income (and all other sources of income like repairs, lessons, delivery, etc.) should be reported separately from sales.

Failure to use these quirky, but important, reporting techniques can easily distort financial statements and cause an overstatement of income, profitability and various tax liabilities. Moreover, it can lead the music store owner and any reader of those financial statements into a false sense of security about the financial viability of the business. In turn, this can unfairly confuse a banker into granting a loan request when there is no financial basis to do so and/or structure a loan repayment schedule that is detrimental to the business.

The moral of the story? Make sure both your accountant and your banker have a strong understanding of the nature of music retailing; how

"THE LOAN RANGERS" MUSIC RETAILING FINANCING SOURCES

	BANK OF AMERICA	BGE	BOMBARDIER	DEUTSCHE
Lender Name	Bank of America Speciality Group	BGE Financial Corporation	Bombardier Capital, Inc.	Deutsche Financial Services
Address	Mail Stop GA-7-903-04-11 1355 Windward Concourse Alpharetta, GA 30005	115 North Neil St, Suite 315 P.O. Box 558 Champaign, IL 61824	Inventory Finance Division 1600 Mountain View Drive Colchester, VT 05446	4 Park Plaza, Suite 2020 Irvine, CA 92614
Phone	(888) 290-6233 Ext 9159	(217) 351-7380	(770) 887-9860	(949) 225-2081
Fax	(800) 825-8804	(217) 351-6380	(802) 654-8426	(949) 475-1093
Toll Free	(888) 290-6233 Ext 9159	(888) 457-7070	(800) 776-2838	(800) 999-6400
Contact Name	Rick Ketchem, Nat'l Music Sales Executive	David A. Kraft, Senior Credit Manager	Joseph Zanca, Director of Sales	Jim Satterberg, Nat'l Accounts Manager
Contact E-mail	rickketchem@bankofamerica.com	dave@bgefinancial.com	joa_zanca@bcgroup.com	jim.satterberg@db.com
Web Site	www.bankofamerica.com	www.bgefinancial.com	www.capital.bombardier.com	www.db.com
Type of Financing				
Installment loans	Yes	Yes	Yes	Yes
Lines of credit	---	---	---	Yes
Floor plan / asset-based lending	Yes	---	Yes	Yes
Receivable factoring	---	---	---	Yes
Assets Financed				
Inventory	Yes	---	Yes	Yes
Accounts receivable	---	---	---	Yes
Rental instruments	---	Yes	---	Yes
Fixtures & leaseholds	---	---	---	---
Special Notes	Custom tailored inventory and retail financing programs, administered from one central office staffed with people experienced in music retailing	Provides rental instrument financing for Yamaha Musical Instruments dealers, as well as payment processing services on rental / rent-to-own programs	"Hands-on" lender, with sales force that meets "face-to-face" with its retailing customers to provide a lending, leasing and asset management services	Largest international financing source to the music retailing industry that offers a wide of variety inventory and business financing solutions

	G.E. CREDIT	NAT'L MUSIC FUNDING	TEXTRON	TRANSAMERICA
Lender Name	General Electric Commercial Finance	National Music Funding	Textron Financial Corporation	Transamerica Distribution Finance
Address	201 Long Ridge Road Stamford, CT 06902	4095 Avenida De La Plata Oceanside, CA 92056	701 Xenia Avenue South, Suite 300 Golden Valley, MN 55416	2400 East Katella Avenue Anaheim, CA 92806
Phone	(877) 217-9415 Ext.1	(800) 981-6874	(800) 328-0724	(208) 429-9484
Fax	(877) 217-9415	(888) 660-0798	(763) 847-1896	(800) 851-6059
Toll Free	(877) 217-9415 Ext.1	(800) 981-6874	(800) 328-0724	(800) 238-4611
Contact Name	Wade Freed	Dwight Pace, V.P. and Division Manager	Dan Lusk, V.P. of Sales	Brian Hathhorn, Nat'l Sales Manager - Music
Contact E-mail	wade.freed@gecapital.com	dwright@nationalmusic.com	dlusk@tfc.textron.com	brianhathhorn@transamerica.com
Web Site	www.gefunding.com	www.nationalmusic.com	www.tfc.textron.com	www.transamerica.com
Type of Financing				
Installment loans	Yes	---	Yes	Yes
Lines of credit	Yes	---	Yes	Yes
Floor plan / asset-based lending	Yes	---	Yes	Yes
Receivable factoring	Yes	Yes	Yes	Yes
Assets Financed				
Inventory	Yes	---	Yes	Yes
Accounts receivable	Yes	Yes	---	Yes
Rental instruments	---	Yes	---	---
Fixtures & leaseholds	---	---	---	---
Special Notes	Financing arranged for seasonal inventory requirements and business expansion by providing full range of asset-based and cash flow loans	Rental instrument lender who will finance all rental contract receivables up-front, and handle all billing, collections and payment processing tasks	40 year old lender and Fortune 100 company, providing both traditional and specialized financing solutions to niche markets	Subsidiary of \$50 billion asset parent, dedicated to providing custom designed inventory financing programs



revenues are earned; how often inventory turns and at what margins; as well as the related timing of cash flowing in and out of your business. (For a more in-depth discussion of banking basics, dig up the Sept. '99 *Think Tank* titled "The Frog and the Princess Banker.")

Music Industry Lenders: Mewling Ill-Natured Malt-Worms

Thankfully, there are a handful of financing sources whom are both familiar and willing to enter into both traditional and unique financing arrangements with music retailers. I call these saviors "The Loan Rangers." These organizations have dedicated various resources to serving the ever-changing needs of music retailers. On the opposite page, you will find a list of some of the music industry lenders we've come across in our travels. This list is by no means all encompassing, nor is it meant to overshadow the very fine local and regional bankers that we and our clients have come to love. It is a list of a few lenders, varying in size and service, who have committed themselves to understanding how music retailing works as well as creating unique financing vehicles to help music retailers based on their understanding and experience.

Music Retailers: Loggerheaded Hasty-Witted Joitheads

Whether you chose to do business with an industry financing

source or your local banker, every lender will need to evaluate the creditworthiness of a potential borrowing customer. They'll want to know how an injection of borrowed funds will be used, repaid and secured. To that end, requests will be made of you to provide certain financial documents, including CPA-prepared financial statements, aged payable and receivable reports, financial projections and forecasts as well as a business plan. They will always ask for the personal guarantee of owners and officers. Accordingly, be prepared for a high level of due diligence, as the people lending to you are also in the business of making money by charging a high enough interest rate, securing worthwhile collateral and effectively controlling their risk.

So to you, Sir William, I shall not rejoice in the pearls of your Shakespearean wisdom on borrowing and lending. Instead, I say dear fellow, thou art nothing but a mangled, ill-breeding, shard-borne maggot pie. As John Lennon sang on the album *With the Beatles*, "Money, it's what I want."



Alan Friedman, CPA, provides accounting and financial services to music industry clients. He is a frequent NAMM University speaker, and can be contacted at 860-521-3790 or alan@fkco.com.

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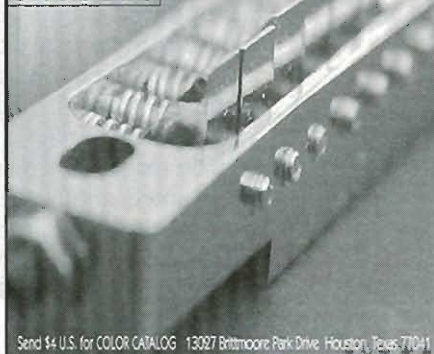
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