MorrisAnderson & Associates Ltd.

Renaissance

The Newsletter for the North American Corporate Renewal Industry — Second Quarter 2005

Pitfalls of Mass Retailer Receivables: Workout Lessons Learned

By *Mitchell B. Rasky,* LaSalle Business Credit

Three years ago, I thought a company that sold exclusively to mass retailers like Wal-Mart, Target and AutoZone had the highest quality receivables. And as a lender, I thought I did not have to worry about the collateral quality of those account debtor's receivables. Now I know better.

The issue may not be the credit quality of the specific account debtors (although several mass retailers, such as K-Mart, have had credit problems). The issue is dilution—deductions from the gross receivable that reduces the amount ultimately collected. Typically, a lender would feel comfortable advancing 85% on receivables, provided that dilution is less than 5%. An audit of historical receivables of a supplier to mass retailers could very well show less than 5% historical dilution and qualify for a high advance rate. However, as I have learned, there are numerous items that can severely reduce the amount that is actually collected from mass retailers.

1. *Marketing and freight allowances*

Suppliers often provide mass retailers with marketing discounts to get product sold or to pay

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Lenders, Borrowers and the Cycle of Capital

By *Mark K. Gertzof,* Merrill Lynch Capital

Like all realms of the natural world, the corner we call commercial finance has a cyclical existence. Though the duration of its phases can vary, this cycle—broadly characterized as boom, bust, recession and recovery—is more or less constant, and generally flows in tandem with the cycles of the economy at-large.

In short, the movement of these interrelated cycles creates an ever-changing marketplace for financial capital; a point of exchange guided by the simple principle of supply and demand. In good economies, when companies are thriving and less of a credit risk, they tend to find a greater supply of available funding at more competitive terms. Conversely, as companies struggle through bad economic periods—or even down cycles of their own—they often find a smaller supply of capital and financing options.

The current cycle in which we find ourselves is unique in that it seems to have gone from bust to boom faster than any in recent memory, an ascent evidenced by multiple indicators—from the number of new lender entrants into the

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Deepening Insolvency: Coming to a Court near You?

By *Denise Seastone Kraft, Esq.* and *Mark D. Olivere, Esq.*, Edwards & Angell, LLP

One of the "hot" issues confronting readers of this newsletter and their clients is a theory of legal liability that has come to be known as "deepening insolvency." Potential litigation targets include, among others, directors and officers, lenders, financial advisors, turnaround consultants, workout specialists, accountants and attorneys.

Increasingly, bankruptcy creditors' committees and trustees are assessing whether they can assert "deepening insolvency" claims against such "deep pockets" to enhance recoveries or put creditors back in the position they were in. As a result, these claims are being alleged widely, often against vague factual backdrops, resulting in inconsistent—or at least evolving—judicial determinations, making it difficult to predict with certainty what may constitute actionable "deepening insolvency" in a particular situation and jurisdiction. Potential targets, therefore, need to become sufficiently informed and vigilant to ensure that they are best positioned to anticipate, avoid and defend against "deepening insolvency" claims.

What is "Deepening Insolvency"?

Thus far, deepening insolvency claims against lenders and professionals who manage, direct or advise companies typically allege that a company, while actually insolvent or within the "zone of insolvency," incurred, or was caused to incur, additional debt, and/or its corporate life was prolonged by artificially

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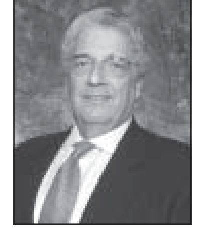
From the Desk of
Alan Glazer



On the surface, it appears as if the loan portfolios of lenders across the country are in great shape, as many work-out departments have been downsizing and their respective pipelines are at very low levels. However, we think this is the proverbial lull before the storm. Here's why:

1.) There is a glut of liquidity in the marketplace that is being provided by non-traditional lenders, such as financial sponsors and hedge funds. This is seen both as a positive in that these groups bought many of the problems from traditional lenders in the last problem loan cycle; and, as a negative in that many of these non-traditional lenders are now direct lenders, and the traditional lenders do not know how the non-traditional lenders will act/react when deals they are now in become problems.

2.) Relaxation of lending standards. Leverage is substantially up and covenant restraints that favor the lender have been greatly loosened. A remark we often hear is that the institutional memory of the last cycle has disappeared and "we are back to same things."

3.) Interest rates are going up. Likewise "second lien loans" are also increasing. Both groups are certain these will have a negative impact on their portfolio, but are unable to articulate which companies or industries.

4.) Commercial Aviation and the Automotive Industries are perceived to be basket cases. To a certain extent, there is a commonality to the problems: commodity prices, which raise the fuel costs for airlines and depress demand for higher profit light trucks and SUV's for the automakers, as well as the general rise in commodity prices for steel, copper, natural gas and oil which affect these industries' profitability. In the automotive industry, the level of concern is highest at the Tier II and III—and to a lesser extent the Tier l level than at the OEM's. In the airline industry, the opposite is true; the concern is more at the airlines rather than the vast service network that supports them. There also seems to be a touch-point date that is developing: 2nd Quarter 2006. Refrain has developed that it is going to be uglier than ever at that point for the lending industry.

Take-away: We all have short memories, and lenders must be very careful in lowering their credit standards in exchange for volume. This economy is ok – but it's not great!

Alan J. Glazer
Managing Principal
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RENAISSANCE

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Since 1980, Morris-Anderson & Associates has been working with stakeholders to steer more than 1,400 underperforming companies toward operational and financial success. With an average of 25 years of real-world, line-management success, executives in finance, manufacturing, distribution and logistics,marketing and information systems are working in virtually every economic sector to maximize enterprise value.

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Recent Engagements

Automotive Stamper – Debtor Representation – CRO, Assessment, Operations Improvement, Financial Plan, Cash Management

Manufacturer and Retailer of Boxed Chocolates – Debtor Representation –CRO, Business Assessment, Lender Negotiations, Refinancing, Exit Strategy Analysis, Sale Negotiations and Bankruptcy Management

Semiconductor Manufacturer – Lender Representation – Operations Due Diligence, Plan and Industry/Market Assessment

Receivables Factor – Lender Representation – Internal Control Assessment, Cost Reduction Identification, Borrowing Base/ Collateral Monitoring Improvements

Aerospace Forging Manufacturer – Debtor Representation – Cash Management, Financial Modeling, Bankruptcy Preparation

Manufacturer of Refuse, Collection Equipment – Receiver Representation – Asset Sale of Distressed Business

Licensor of Mattresses and Bedding – Debtor Representation – Business Assessment, Due Diligence and Strategic Analysis of Financial Alternatives

Manufacturer of Backyard Storage Sheds – Equity Fund Representation – Due Diligence and Business Assessment Services, Sourced Debt, and Interim CFO and CIO Management Consulting Services

Manufacturer of Cosmetic Packaging – Debtor Representation – Risk Assessment Analysis, Cost Minimization and Value Maximization Models

Automotive Aftermarket Distributor – Debtor Representation – Financial/Cash Modeling, Asset Sales, Bankruptcy Management

Aerospace Metals Manufacturer – Debtor Representation – CEO, Business Assessment, Cost Reductions, Financial/Cash Modeling, Business Brokerage, Value Maximization Strategy

Convenience Store Retailer and Gas Wholesaler – Lender Representation – Business Assessment, Financial/Cash Modeling, Development of Risk Reduction Alternatives, Debtor/Collateral Monitoring

Marketing Communications Services Provider – Debtor Representation – Business Plan and Operations Assessment, Cost and Liquidity Improvements, Exit Strategy Analysis

Commercial Electrical Contractor – Debtor Representation – Business Assessment, Operations Analysis, Refinancing

Wholesale Distributor – Debtor Representation – CRO, Cash Management, Lender Negotiations, Exit Strategy Analysis and Sale Negotiations

Cabinet Hardware Manufacturer – Debtor Representation – Crisis Management, Cash Controls

Steel Fabrication and Erection Company – Debtor Representation – CRO, Plan Validation and Operating Improvements, Cash Forecasting

Apparel Retailer – Debtor Representation – Business Assessment, Financial Modeling, Business Planning, Lender Negotiations

Injection Molder – Debtor Representation – Cash Management, Cost Reductions, Exit Strategy Analysis, Creditor Management

Fast Food Franchisee – Lender Representation – Cash and Financial Management, Business Brokerage

Metal Components Manufacturer – Debtor Representation – Cash Management, Assessment, Financial Projections, Business Brokerage

Trucking and Truck Leasing Company – Debtor Representation – Operations and Business Assessment, Strategic Alternative Analysis, Financial Modeling, Creditor Negotiations

General and Mechanical Contractor – Debtor Representation – Cash Management and Modeling, Vendor Relations/Resolution Planning, Organized Wind-Down or Sale of Selected Assets

Print Media Management – Sponsor Representation – Cash Management, Modeling and Vendor Credit Negotiations, Assist in the Sale of Excess Production Capacity and Plant Closure of platform affiliate

Grey and Ductile Iron Foundry – Debtor Representation – Transition New President, Refinancing

Manufacturer and Distributor of Over-The-Counter Pharmaceuticals – Debtor Representation – Operations and Business Assessment, Financial Modeling, Cash Management and Controls, Strategic Business Plan Assessment, Creditor and Investor Negotiations

Automotive Aftermarket Distributor – Debtor Representation – Marketing, Operations and Business Plan Assessment, Financial and Cash Flow Modeling, Projections, Liquidations Analyses, Creditor Negotiations

Giftware Distributor – Debtor Representation – Business Assessment and Refinancing of Secured Lenders

Textile Converter – Debtor Representation – Financial Review, Business Plan Development and Debt Restructuring

Medical Finance Company – Business Representation – Business Assessment and Valuation

Fragrance Distributor – Debtor Representation – Refinancing

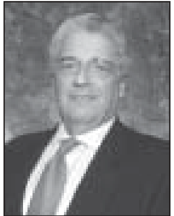
Window and Door Retailer – Debtor Representation – Assessment, Recapitalization, Alternatives

Farmland Dairies – Estate Representation – Unsecured Creditor Trustee

Investment Portfolio/Hedge Fund – Receiver Representation – Asset and Cash Investigation

News Desk . . .

Throughout 2005, **Morris-Anderson & Associates is celebrating its 25th anniversary**! Since its founding in 1980 by Daniel Morris and David Anderson, CTP, the firm has helped more than 1,400 companies through insolvency, turnaround and performance improvement. Please visit *www.morris-anderson.com* for a full list of the services offered.



Alan Glazer

Alan Glazer, based in NYC, has been elected Managing Principal of Morris-Anderson & Associates. Alan, a CPA and Arthur Andersen alum who has been with MA&A since 1984, offers extensive experience in turnaround/workouts, capital transactions, interim management and lender representation.

Congratulations, Alan!

(Note: See page 2 for Alan's thoughts about the current state of the industry.)

Baker Smith

Atlanta-based Principal **Baker Smith** is still on the lecture circuit. He participated in the "New Commercial Lending Vehicles and Trends: Understanding Complex Debt" panel discussion on April 30 at *ABI's 23rd Annual Spring Meeting* in Washington, DC. And he moderates the panel topic "Turnaround plan as the basis for building and maintaining the syndicate" at the *8th Annual Loan Markets & Syndication Summit* on June 7th in NYC.

Chicago-based Principal **Jim Ross** will speak to the Missouri chapter of the TMA on May 17th about how he more than doubled the value of Archibald Candy Corp. through a carefully planned pair of auctions.

Jim Ross

With no end in sight for the airline industry shakeout, a seminar on *Airline Bankruptcies: Opportunities, Risks and Defensive Strategies* was held January 25th at Dulles airport. The seminar was developed and co-sponsored by Morris-Anderson & Associates, Wiley Rein & Fielding and Morten Beyer & Agnew, and included a panel presentation by Atlanta-based Principal **John Kokoska**, Washington, DC-based Managing Director **Eric Murray**, Chicago-based Consulting Manager **Robert Wanat** and Pittsburgh-based Consultant **Mark Welch**.

John Kokoska

Eric Murray

Robert Wanat

Mark Welch

Welch will again speak about airline workouts at the TMA's *4th Annual Great Lakes Regional Conference*. The event runs May 19 and 20 at the Peek'n Peak Resort in Findley Lake, New York. Kokoska and Murray also revisit the theme when they cover "Managing the Aviation business in a Distressed Environment" at the *Aviation Suppliers Association 2005 Annual Conference*, which will be held June 25-28 at the Boca Raton Resort & Club.

Robert Morris

Chicago-based Managing Director **Robert Morris**, who will speak at the *2005 Dow Jones PEA DealSource Conference*, which runs June 7-8 in Chicago, has been selected as Co-Chair of the *2005 TMA Annual Convention*, which will run October 18-21 in Chicago. Bob's back-to-back speaking duties continue at the Financial Managers Society's *Finance & Accounting Forum*, which runs June 12-14 in Las Vegas, and the *21st Annual AIRA Bankruptcy & Restructuring Conference* in Boston on June 15th.

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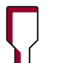

Robert Haldi

Robert Haldi, an experienced turnaround manager and specialist in finance and accounting, was recently awarded the Certified Turnaround Professional designation from ACTP.

Way to go, Bob!

ACTP
ASSOCIATION OF CERTIFIED TURNAROUND PROFESSIONALS

Morris-Anderson & Associates now boasts 12 CTPs.

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maintaining liquidity and concealing its true financial condition, causing damage to the company, its shareholders and its creditors. Asserted damages may include all unsecured creditor claims plus bankruptcy administrative costs, potentially amounting to many millions of dollars.

The Lurking Danger of the Unknown

State law determines whether a claim based on "deepening insolvency" may be brought against likely targets. At this juncture, however, it remains unclear whether a cause of action based on claims of "deepening insolvency" will be sustained. The most notable decisions on the topic have been rendered by Federal courts predicated upon their view of how a particular State might rule.

In 2001, the U.S. Court of Appeals for the Third Circuit (Delaware, Pennsylvania, New Jersey and the Virgin Islands) concluded that Pennsylvania *would* recognize deepening insolvency as a viable cause of action. *Official Committee of Unsecured Creditors v. R. F. Lafferty & Co., Inc.*, 267 F.3d 340 (3d Cir. 2001)(claims brought against equipment leasing companies). That same year, a Florida bankruptcy court refused to dismiss a deepening insolvency claim brought against financial advisors. *In re Flagship Healthcare, Inc.*, 269 B.R. 721 (Bankr. S.D. Fla. 2001). In August 2003, the Delaware Bankruptcy Court predicted that the Delaware Supreme Court would recognize deepening insolvency as an independent tort and not just a measure of damages in a case where it was alleged that lenders had forced the debtors to fraudulently continue their business for almost two years at increasing levels of insolvency. *In re Exide Technologies, Inc.*, 299 B.R. 732 (Bankr. D.Del. 2003).

The uncertainty surrounding "deepening insolvency" goes beyond whether a particular jurisdiction will recognize it as a viable cause of action. Even more troubling is the inability to predict *which* acts or omissions by a potential target a court might find sufficient to sustain "deepening insolvency" liability, particularly at a time when eager plaintiffs seek to bottom such claims on increasingly broad assertions. To the recent relief of the lender community, one prominent court has ruled that, contrary to the plaintiff's bald assertion, the mere extension of credit to an insolvent company is not actionable *absent* the lender's breach of a separate duty or commission of a tort such as that alleged in the *Exide* case. *In re Global Services Group, LLC*, 316 B.R. 451 (Bankr. S.D.N.Y. 2004).

When Does the Danger Arise?

At the core of "deepening insolvency" is the issue of insolvency itself. In many States, the fiduciary duty of a company, and of its officers and directors, has been held to extend solely to the company's shareholders unless the company is actually insolvent. However, courts in some States, particularly Delaware, have ruled that fiduciary duties to creditors arise prior to actual insolvency, at the point at which a company moves into the "zone of insolvency." *Credit Lyonnais Bank of Netherland, N.V. v. Pathe Communications Corp.*, No. 1150, 1991 WL 277613, *34 (Del. Ch. Dec. 30, 1991). Court decisions in Delaware that involve officers and directors duties are watched closely, because Delaware is the State of incorporation for over 500,000 corporations.

Thus, officers and directors of Delaware corporations—and their advisors—potentially faced exposure to liability based on a fiduciary duty to creditors arising prior to actual insolvency. This led many to assume that creditors seeking redress against directors and officers, including through "deepening insolvency" claims, were best positioned to prevail by commencing suit in Delaware. Recent decisions, however, suggest that the tide of expansive exposure may be receding in Delaware.

In November 2004, the Delaware Court of Chancery revisited the amorphous concept of "zone of insolvency" and questioned whether it is being used improperly to expand to creditors fiduciary duties ordinarily owed to shareholders only. *Production Resources Group, L.L.C. v. NCT Group, Inc.*, 863 A.2d 772 (Del. Ch. 2004). Shortly thereafter, in a case involving the issue of a bankruptcy creditor's derivative standing, the United States District Court for the District of Delaware included in its decision the *Production Resources* language questioning the expansion of fiduciary duties. *Continuing Creditors' Committee of Star Telecommunications Inc. v. Edgecomb*, 2004 WL 2980736 (D. Del. Dec. 21, 2004).

While not reversing *Credit Lyonnais, Production Resources* and *Star Telecommunications* at the least suggest that the breach of fiduciary duties to creditors of Delaware corporations within the "zone of insolvency" is a moving target or that a claim for breach of fiduciary duties by creditors may not lie in every case in which a bankruptcy is filed. The decisions have certainly rendered less predictable the chance of a plaintiff's success in actions commenced under Delaware law. Ultimately, given the right case and persuasive pleading, a potential target's exposure within the "zone of insolvency" may be limited.

Conclusion

While the theory of deepening insolvency is being fleshed out in the courts, prudence demands constant vigilance, assessment of proposed actions against the backdrop of potential exposure, and swift acquisition of knowledgeable professional advice at the earliest warning signals.

__Denise Seastone Kraft__ is of counsel in the Litigation practice group, and __Mark D. Olivere__ is an associate in the Financial and Capital Markets practice group, of Edwards & Angell, LLP, a national law firm with more than 350 attorneys providing a broad range of legal services. Practice groups focus in the areas of financial services, private equity, and venture capital and technology. Resident in E&A's Wilmington office, Kraft and Olivere focus on bankruptcy and commercial litigation, including deepening insolvency actions. They can be reached at dkraft@edwardsangell.com and molivere@edwardsangell.com.

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marketplace, to the inflow of capital, falling credit spreads and increasing leverage multiples. While being able to identify cyclical trends in the lending markets is one thing, predicting the length of the cycle and operating within its constraints is another altogether. For a lender to operate effectively throughout all phases of the lending cycle—remaining competitive in the booms and acting rationally during the busts—it must conduct business with a complementary blend of experience, creativity and practical discipline.

Growing Market

The current upswing in the supply of debt capital has been caused by a variety of factors, one being lenders—both new and established—that are growing, or at least maintaining market share and asset size. For example, Merrill Lynch Capital has grown considerably from its inception three years ago, since that time arranging $12 billion in loans in the middle market and hiring more than 300 employees. This brief history of Merrill Lynch Capital is a telling indicator of the growth of the market itself in the past few years, and sheds considerable light on the supply/demand dynamics of commercial finance at both ends of the lending cycle.

> *...the second lien market has taken off...[and] has exceeded the industry's ability to devise standard intercreditor rights to govern these loans.*

Merrill Lynch Capital was started in early '02 with a core team of experienced lenders from other institutions such as Heller Financial. As we built the business—hiring employees, creating an infrastructure, building a portfolio—we were aided greatly by the current position of the lending cycle. At that time, with the economy in a recession and many traditional banks consolidating and tightening credit, the lending cycle was in a bust mode, and the supply of capital for buyouts, as well as for ongoing operations, was scarce.

Ironically, many of the credit issues surrounding this liquidity drought, in fact, had their roots in the previous lending cycle "boom," a period that ran up through the late 90's. During this phase, many lenders issued highly leveraged, aggressively structured loans to feed that period's furious LBO, acquisition and roll-up activity. The downfall of this lending strategy was rooted in a lack of discipline among lenders, who, in an ultra-competitive environment, heaped too much debt on undeserving companies and business models. As the recession took hold, many of these borrowers could no longer service their debt. Lenders, in turn, reacted to portfolio losses, most dramatically by shutting down the supply of capital for all companies, good and bad.

In the commercial finance world, the larger outcome of the recession of '01-'02 was that a large number of lenders became so busy recovering from the excess debt they had issued during the last boom that they stopped taking risk altogether. Many retrenched and tended to their portfolios. Others removed themselves from cash flow lending altogether; offering instead only fully collateralized asset-based credit facilities.

In the short term, the exclusive focus on asset-based was successful for many lenders, as the demand for these facilities increased in the economic down cycle. Many companies during this period were refinancing with new asset-based loans to ease covenant restrictions, and use their current and fixed assets to obtain the liquidity their cash flows could no longer secure. Additionally, many companies turned to asset-based loans to affect a turnaround, DIP or exit financing. The increased supply of asset-based lenders serviced an immediate need, but it—along with bank consolidation—also created a significant void for many cash-generating, credit-worthy companies in the middle market, not to mention equity sponsors sitting on significant unutilized funds.

In this void, new lenders to the middle market space—willing to offer cash flow and asset-based financing—were entering at a fortuitous time. With a disciplined approach to providing credit, coupled with the knowledge that many of the current negative issues were by-products of the economic cycle, these new lenders could build a successful model.

Entering the market during a lending bust was a successful strategy for Merrill Lynch Capital, and our business has continued to grow along with the lending cycle boom. But, the number of competitors offering senior debt has grown as well. Moreover, senior debt was not the only category to see new entrants in the boom. Notably, many hedge funds began to offer junior secured, or so-called second lien loans.

Second liens began long ago as a hybrid financing product, one that could stretch across the risky end of the senior spectrum to the safer portion of traditional subordinated debt. In the last year and a half, with an abundant supply of capital and terms that have been better than traditional mezzanine capital, junior secured has rather suddenly been transformed into a viable financing option in its own right. The explosion in the demand for junior secured has only been matched by the supply of money made available to meet it. Through the first half of '04, total second lien volume had doubled that for all of '03.

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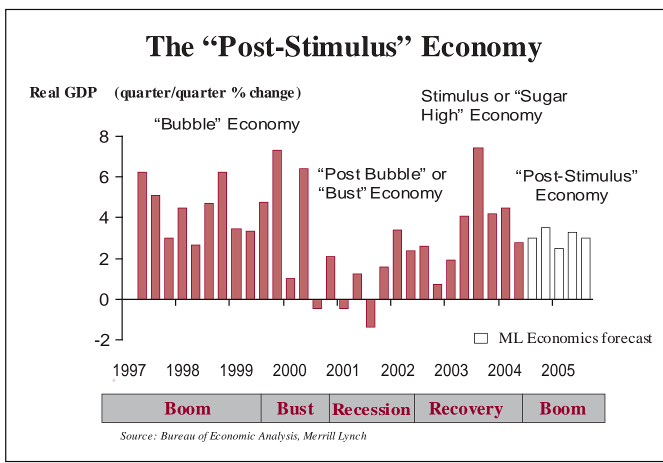
Today's Liquidity

All these factors have contributed to what is now shaping up to be one of the most liquid markets since the late 90's, with new entrants regularly adding to the supply of debt capital. The lending boom is very good news for borrowers



across the financing spectrum, as this generally means a period of abundant debt, available at competitive terms.

However, borrowers should still remain diligent in assessing their options, perhaps using the lessons of the last lending cycle bust to guide them. For if the lending cycle tells us anything, it's that what goes up will come down, and when the current boom cycle inevitably dips into recession, the effect on lenders and borrowers alike will have very much to do with the actions they take today.

For example, as mentioned earlier, the second lien market has taken off in the current recovery and boom phase in a way that hasn't been seen before. More and more borrowers are taking advantage of this tranche because of its favorable pricing and widespread availability. This rapid rise in usage, however, has exceeded the industry's ability to devise standard intercreditor rights to govern these loans. As today's second lien loans mature, this contractual agreement of how lenders—both senior and junior—can exercise their rights in the event of a workout will loom large for lenders and borrowers alike.

The best advice for anyone looking to tap into the current highly liquid and competitive debt market is to choose a lender on the basis of what the relationship will mean today and down the road, rather than on a sole comparison of financing terms. As with any boom market, the field can quickly become crowded with non-traditional lenders who lack both the experience and infrastructure to manage loans long-term, and who often sell their loans at the first sign of trouble. The predictable quality of the cycle is that it is always moving toward a new phase of its existence, each transformation bringing with it both opportunistic lenders as well as those with the experience and long-term view to manage it through until it changes yet again.

MARK K. GERTZOF is a team leader at Merrill Lynch Capital, where he manages a geographic team responsible for bringing financing solutions to middle-market companies and private equity sponsors, as well as financial advisory and intermediary firms. Gertzof joined Merrill Lynch Capital after 13 years at Fleet Capital and BankBoston. He can be reached at mark_gertzof@ml.com.

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for shelf space, and one needs to know if the receivable is gross or net of these allowances. In many cases, receivables may be recorded gross and the marketing allowance may be shown as an operating expense. This is generally the easiest dilution to find, because it is normally stated in the selling terms.

2. *Return allowances*

Many mass retailers regard purchases as guaranteed sales with right-of-return privileges. Granted, the supplier is getting back inventory in this case, but because the product being returned could not be sold by the mass retailer, it probably is not readily saleable and the value of the inventory is much less than the receivable (which includes the supplier's gross profit). The main problem with this scenario is that suppliers may not be aware of these potential returns if they are not tracking the mass retailer's sell-through of their product.

3. *Roll-back credits*

Many mass retailers are proud of their pricing roll-backs. However, they often credit their supplier

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for those roll-backs. Once again, a supplier needs to know how their inventory is selling with the retailers.

4. ***Lifts***

   Suppliers may have to take another company's slow-moving inventory from the mass retailer to get or keep the mass retailer's business. This could obviously be an even more significant problem than #2 above, as the supplier is now getting back inventory that it may not be able to sell.

5. ***Shortage discounts***

   Mass retailers may take a credit for supplier shortages—so if a supplier misses or is late on delivery, the retailer may take a credit for missed sales. This is especially troubling for a supplier that is having cash flow problems and may not be able to meet the purchase order of the mass retailer.

6. ***Credits relating to the cost of getting a new supplier***

   A mass retailer may credit a supplier for the cost it has to incur for getting a new supplier to provide the inventory that the old supplier was not able to provide.

There are undoubtedly many other credits and allowances not mentioned, but it is obvious from even this short list that potential dilution can be much higher than what may have been the historical case. This is especially the case in dealing with a supplier that may be going out of business and is thus unable to meet mass retailer purchase orders. However, I have found that suppliers with excellent accounting records and systems are in a good position to argue these credits, and to ultimately collect on the receivables. A supplier with excellent records and controls should be able to do the following:

- **Know exactly what was shipped and billed**
  Invoices are matched to the bill of lading and purchase order to show that shipments complied with the customer's purchase orders.

- **Monitor the sell-through by the mass retailers on the inventory**
  Inventory that is not selling is potentially a return or credit. Suppliers that continue to ship mass retailers more slow-moving product will ultimately be hit with a huge product return.

- **Properly match all payments to the correct invoice**
  Short pays, which occur when the mass retailer pays what it believes is the proper amount net of discounts and allowances, need to be accurately marked on the receivable aging and quickly resolved by the supplier. To collect these short pays, a supplier has to be able to show that the product was shipped, billed according to agreed-upon terms, and the product was sold by the mass retailer. It is very difficult to collect on old short-pay debit balances.

MITCH RASKY has more than 20 years of experience in asset-based and commercial lending, encompassing a wide range of financing transactions, with particular emphasis in leveraged buyouts, turnarounds and deteriorating situations. Since 1999, he has been a senior lender for LaSalle Business Credit, where, in addition to generating new lending relationships, he is responsible for managing a portfolio consisting of troubled loans or deteriorating credits. He can be reached at mitchell.b.rasky@abnamro.com.

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