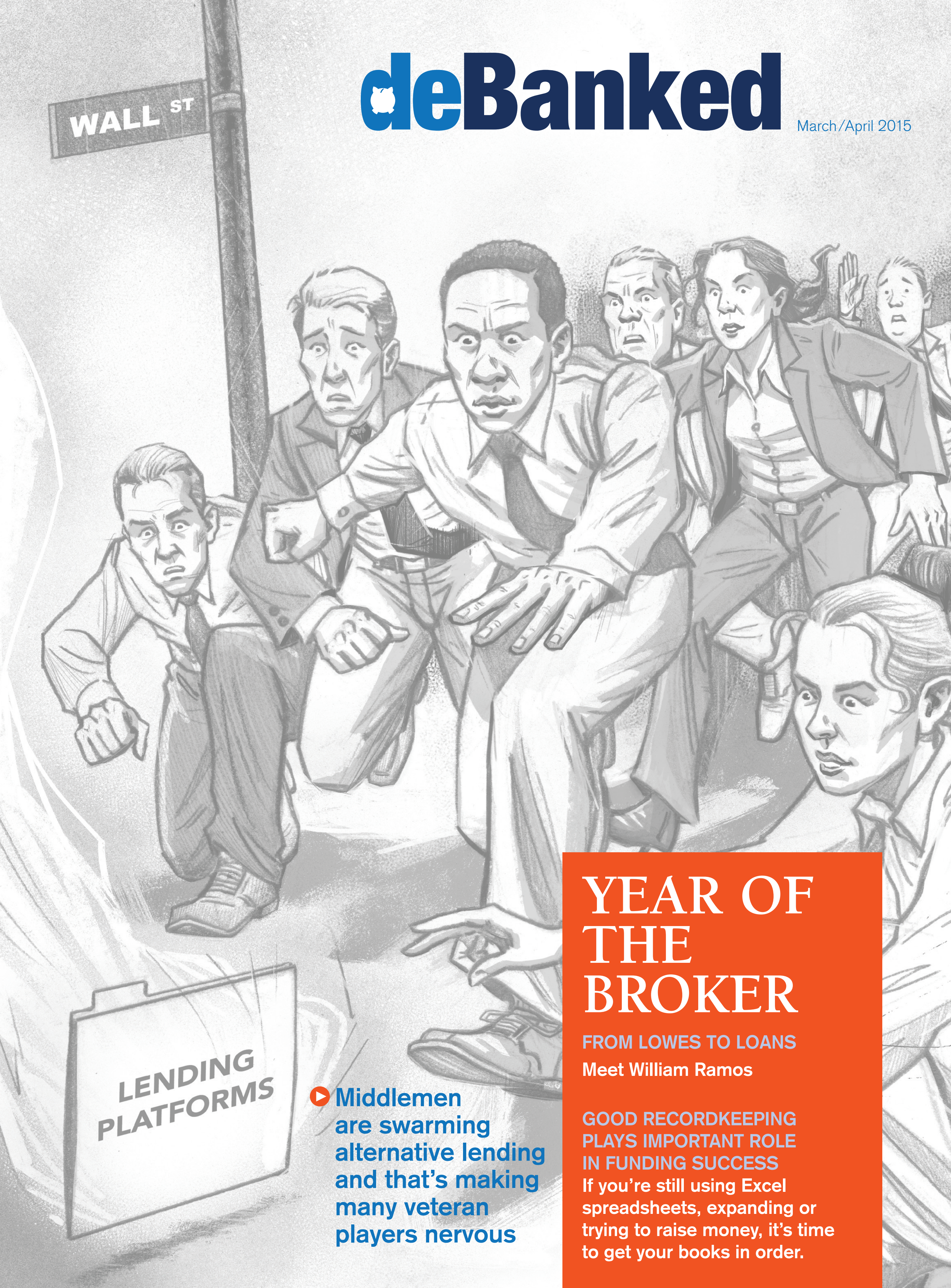
deBanked

March/April 2015



Middlemen are swarming alternative lending and that's making many veteran players nervous

YEAR OF THE BROKER

FROM LOWES TO LOANS

Meet William Ramos

GOOD RECORDKEEPING PLAYS IMPORTANT ROLE IN FUNDING SUCCESS

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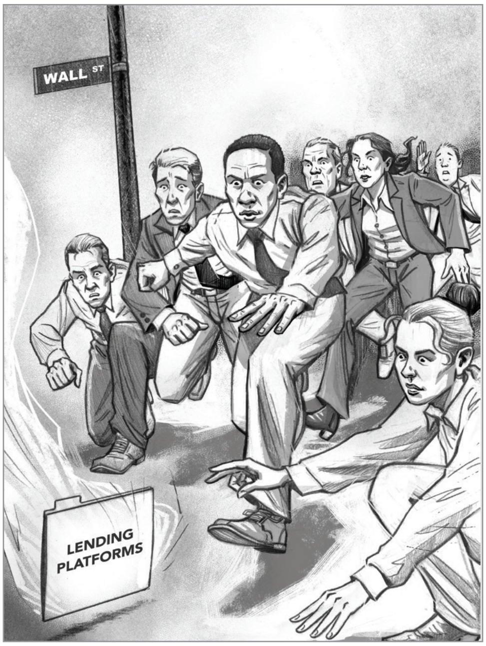

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PUBLISHER
Sean Murray

EDITOR-IN-CHIEF
Sean Murray

ART DIRECTOR
Deborah Barlay

SALES
212-618-1440

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Raharney Capital, LLC
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For advertising information or general inquiries, email info@debanked.com or call 212-618-1440.

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Letter From the Editor

BY
SEAN MURRAY

A single innocuous quote by one of this issue's sources is all it took to put everything in perspective. "2015 is the year of the broker," said Sendto's Amanda Kingsley. Could that even be possible if 2014 was defined by algorithms?

In the pages that follow, we investigate the impact that the OnDeck and Lending Club IPOs had on public awareness but from a unique angle. Loan volumes are up everywhere you look, but so are the number of middlemen that are trying to get in on the action. The broker business is booming.

Even the lending platforms leading the technology charge could best be described as brokers. They connect borrowers with investors for a fee. So too could the investment bankers who have been tirelessly making the rounds to assist with capital raising.

But it was when a 25-year old college dropout told me that deal-making afforded him the ability to go from taking the bus to work to driving a new Ferrari, that I became convinced that 2015 might indeed be the year of the broker.

This isn't to say that mistakes aren't being made along the way. The influx of inexperienced newcomers has created a complicated environment.

I was a broker once too. When I launched MerchantProcessingResource.com (now deBanked) back in 2010, I was still making deals myself. Through the blog and publication, I try to cover the wider industry from an insider's perspective. That often means rolling up my sleeves and experiencing it firsthand.

Just this past February we not only accepted a payment in bitcoin, but the agreed upon advertising price was actually set in bitcoin, not dollars. These are revolutionary times.

Many of the financial companies and systems we delve into might need banks, but they are not banks themselves. That is the essence of the industry we hope to capture. As technology improves, the world is becoming a little less banked.

And so with that, hello again. I'm back. I'm excited. I'm deBanked.

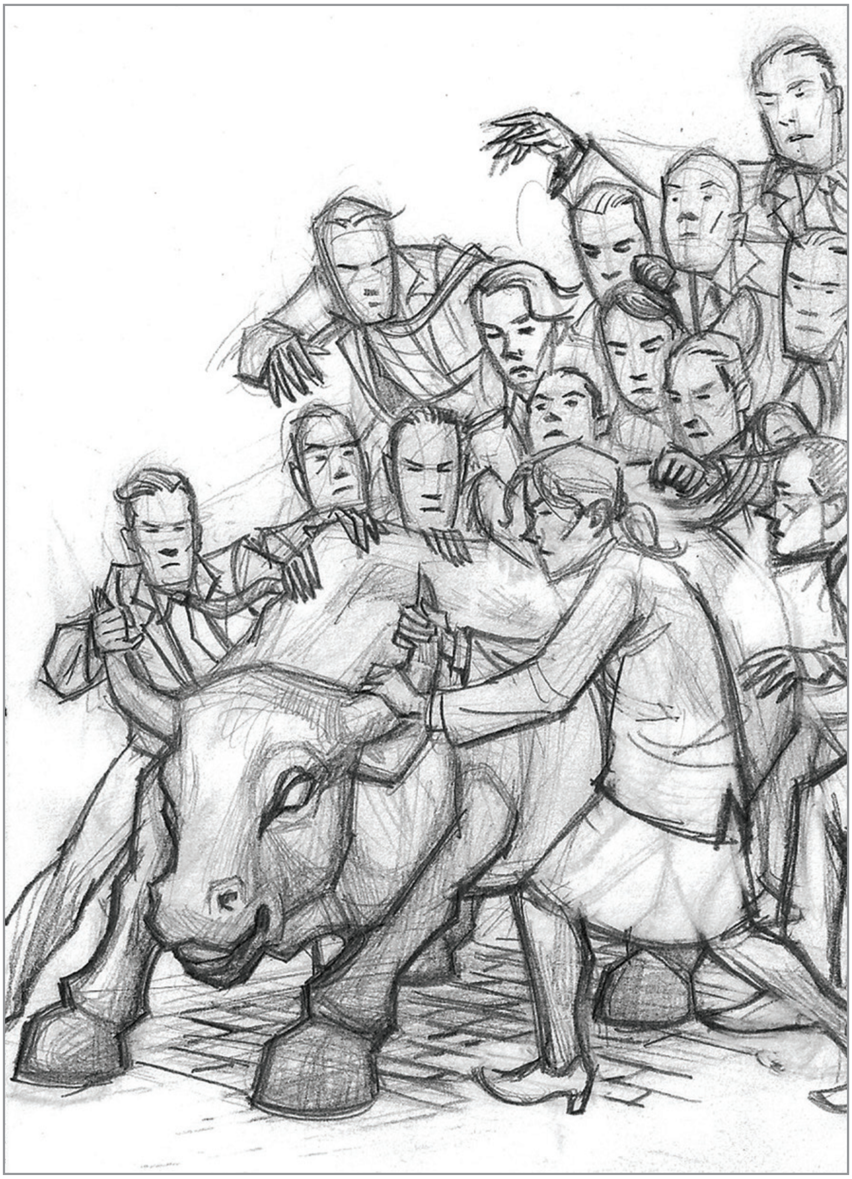
I hope you enjoy this issue.

–Sean Murray

YEAR OF THE BROKER

By *ED MCKINLEY*

A major influx of new brokers began reshaping the alternative business-financing industry early last year and gained momentum during the holiday season.



Many of the newcomers are fleeing hard times in the mortgage or payday loan businesses. Others are abandoning jobs selling insurance, car warranties or search-engine optimization.

"You have wandering souls trying to find their place in this industry, whether it be as a company or on their own," said Amanda Kingsley, CEO of Sendto, a Florida-based company that assists new brokers.

Though exact counts appear difficult to obtain, Kingsley professed amazement at the volume of new entrants. "I'm swamped," she said. "It's crazy."

Some of the new brokers discovered alternative financing in December, when OnDeck Capital's initial public stock offering raised $200 million and valued the company at $1.3 billion. The Lending Club IPO that raised $1 billion the same month also raised public awareness of alternative loans.

Mesmerized with those whopping figures, salespeople from other businesses began committing themselves to a new career in alternative finance. In a business with virtually no barriers to entry, it's easy to get started. To call themselves brokers, they just need a phone, someplace to sit and a list of leads they can buy online.

Virtually all of the entrants are pursuing dreams of lucrative paydays. Many even expect to make a fast buck with minimum effort.

If only it were that simple. Too often, the untutored new players are making mistakes simply because they don't know any better, industry veterans maintained.

"A lot of people think you can just walk in and be successful," said the sales manager of an established New York-based brokerage who asked for anonymity. "They don't know what it takes to run a company. They don't know what it takes to get a deal done."

Worst of all – either unknowingly or with evil intent – new brokers are stacking deals. In other words, inexperienced salespeople pile second or third loans or advances on top of original positions.

It's an approach that clearly violates the industry's standards, observers agreed.

In fact, virtually all contracts for a first loan or advance prohibit the merchant from taking on another similar obligation, noted Paul Rianda, an Irvine, Calif.-based attorney who specializes in payments and financing.

"I can't remember one agreement I've seen that didn't have that provision in it," Rianda said.

Violating that stipulation could provide grounds for a lawsuit, and litigation is underway, according to David Goldin, president and CEO of New York-based AmeriMerchant and president of the North American Merchant Advance Association (NAMAA).

Bigger funders would sue smaller funders because the latter appear more likely to take on riskier, more problematic multiple-position deals, said Jared Weitz, CEO at United Capital Source LLC, a New York-based broker.

Plaintiffs have a case to make because stacking harms the broker and funder of the first position by increasing the risk that the merchant won't meet the resulting financial obligations, Weitz said.

"The guys going out 18 and 24 months to make this a more bankable product are being hurt by the people coming in and stacking those three-month high-rate loans," he noted.

Deducting fees for more than one advance also impedes cash flow, adding another risk factor, Weitz said.

To further complicate matters, the company offering the second or even third deal sometimes moves the merchant's transaction services to another processor, Rianda said. That forces the firms that made the first advance to approach the new processor to stake a claim to card receipts, he noted.

So the companies with the original deal suffer from the effects of stacking, but the practice's shortcomings will haunt the stackers, too, observers maintained.

"It's not a model that's going to allow them to succeed," a broker who asked to remain anonymous said of stackers' long-term prospects.

Many hardly give a thought to staying power, according to Weitz.

"A lot of people entering this space think it's about fast money and not longevity," he said.

> ***A LOT OF PEOPLE ENTERING THIS SPACE THINK IT'S ABOUT FAST MONEY AND NOT LONGEVITY...***

Longevity requires that brokers build relationships with merchants, a process stacking undermines because too much credit can drive merchants out of business or merely prop up merchants already doomed to fail, sources said.

Yet stacking has become so widespread that it constitutes a business plan for some brokerage shops, said a broker who asked that his name and company not appear in the article.

It can begin when brokers buy lists of Uniform Commercial Code filings to find out what merchants have already taken out term loans or advances, said Zach Ramirez, vice president of sales and operations at Orange, Calif.-based Core Financial Inc.

The brokers then contact those merchants, many of whom are already over-extended financially, to offer additional credit or advances, Ramirez said.

Inexperienced brokers often resort to stacking because they don't know how to generate leads that can bring alternative lending vehicles to merchants who weren't aware of them.

Referrals from accountants or other business owners who deal with merchants can provide some of those greenfield prospects, Ramirez noted.

And leads aren't the only area of cluelessness among newcomers, a broker who requested anonymity maintained.

"They don't know why a bank declines a deal or approves a deal," he said. "They don't know what's the basis for a good deal."

To teach new brokers those basics of alternative business financing, the industry should establish standard policies and technology, according to Kingsley.

A credential, perhaps something similar to the Certified Payments Professional designation created by the Electronic Transactions Association, sources said. To earn the credential, candidates would pass an exam to show they've mastered the basics of the business, they proposed.

NAMAA is considering such a credential, said Goldin, the trade group's president.

It's the kind of self-regulation that could forestall federal oversight, industry sources agreed.

But that might not matter, according to Tom McGovern, a vice president at Cypress Associates LLC, a New York-based advisory firm that raises capital for alternative lenders and merchant cash advance companies.

After all, McGovern noted, Barney Frank, former Democratic U.S. representative from Massachusetts and co-author of the Dodd-Frank Wall Street Reform and Consumer Protection Act, has gone on record as saying that piece of legislation focuses on consumers and does not govern business-to-business dealings like loans or advances to merchants.

That lack of regulation over B2B deals seems likely to continue, "especially in the world we're in now with a Republican Congress," said a broker who asked to remain nameless.

However, some members of the industry would welcome federal regulation as a way of barring incompetent or unscrupulous brokers.

An agency patterned after the Financial Industry Regulatory Authority, know as FINRA, could do the job, suggested a broker who requested anonymity.

Whether a government regulator or an industry-supported association should police the market, problems could remain stubbornly in place, some said.

Many doubt an association could build the consensus required for united action on some issues – stacking in particular.

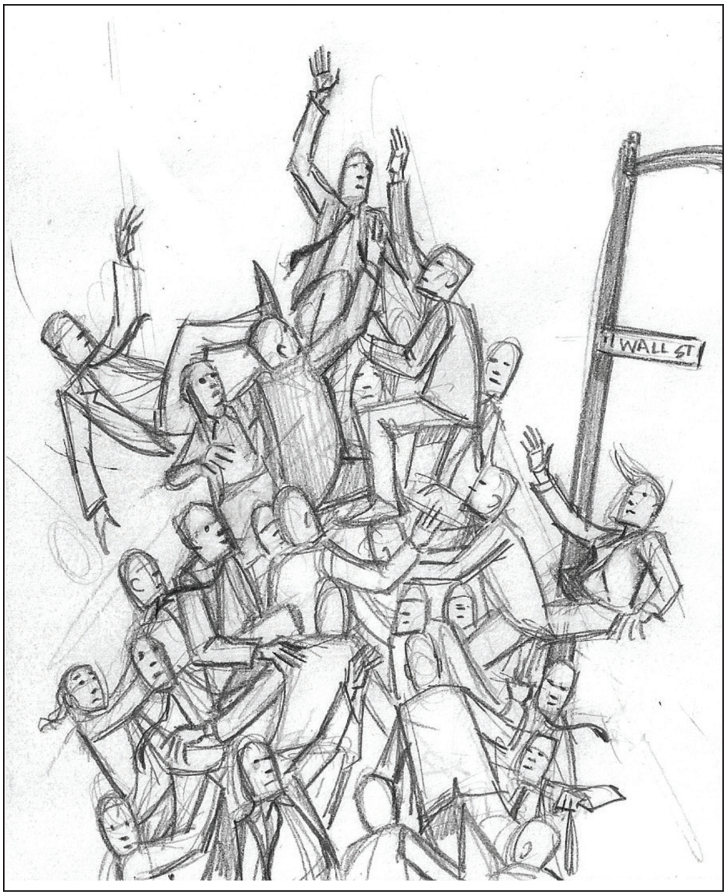
For one thing, cleaning up the business could reduce profits for brokerages that profit from stacking, noted a broker who asked that his name not appear in the article.

"Everybody wants to make money," he said. "Everybody's out for themselves."

Another barrier to agreement arises because some brokerages fear cooperation could expose their trade secrets, said Sendto's Kingsley.

Moreover, unscrupulous brokers want to keep their employees uninformed of the industry's potential for big profits, Kingsley said. That way they suppress compensation for an underclass of prequalifiers who work the early stages of deals, she noted.

Prequalifiers earn from $150 to $500 a week, depending upon the location, and don't qualify for benefits like health insurance, Kingsley said. Once they realize what a tiny portion of the profits they're



receiving, brokers terminate the prequalifiers and many go on to become brokers themselves, she observed.

Closers who take over from prequalifiers to wrap up the sale can earn up to 50% or occasionally even 60% of a brokerage house's commission – if the closer originates the deal and sees it through to completion unassisted, Kingsley said.

Eventually, closers realize they could keep all of the commission if they strike out on their own and become brokers, she noted.

In a way, the progression from prequalifier to broker or closer represents a market correction. And many seasoned industry participants believe market forces will also work out other problems the influx of new brokers is causing.

A large number of the new brokers simply won't last long because they don't understand the industry, they're stacking deals and they're signing up merchants that won't stay in business.

Meanwhile, funders are beginning to perform background checks on brokers to make sure they're dealing with reputable people, sources said.

Some funders protect themselves by simply declining to do business with new brokers, according to observers.

“GUYS AT COMPANIES LIKE ONDECK AND CAN CAPITAL ARE ONLY TAKING BUSINESS FROM BIGGER BROKERS THAT HAVE HEAVY VOLUME,” WEITZ SAID.

And many new brokers are learning the industry with the help of experienced brokerages that act as mentors and conduits and call themselves super brokers, super ISOs, broker consultants or syndicators.

“So what I'm saying is, ‘Guys, let's not compete. Let's grow parallel together,’ ” Weitz said of United Capital Source's relationships with new brokers. The company began working with new brokers in October 2014.

In such relationships new brokers get advice from the more seasoned brokers. The older brokers can also provide the newcomers with services that include accounting, marketing and reporting, he said.

New brokers can also benefit from the customer relationship management platform that United Capital Source developed, Weitz said.

The new brokers also capitalize on the older brokers' relationships with funders. Established brokers have earned better rates and terms because of reputation and volume, Weitz noted. Companies like his also know which lenders work more quickly and thus capture more deals, he added.

Older brokers can also steer new brokers away from newer funders that offer shorter terms and demand higher rates, Weitz said. Of the 30 to 40 companies that call themselves funders, only eight or 10 deserve the name, he contended.

The less-respectable funders place only a small amount of money in a few deals, he said.

Newer brokers become aware of their need for help from more experienced brokers when they see how many sales they're failing to close, Weitz said.

The new brokers also come to realize that the puzzle of running a brokerage office has a lot more pieces than they may have thought, said Kingsley.

The percentage of the commission that the older broker charges can vary, according to Weitz.

“If someone needs a lot of hand holding and a lot more resources, they would get a different structure,” he said.

While Weitz said his company plans to acquire only about 10% of its volume through new brokers, Sendto specializes in helping newcomers.

Sendto's Kingsley described the company as “a turnkey solution that provides training and placement of deals. It's for new brokers or sales offices that do not have what they need to be part of this industry.”

There's room for entrants because not all merchants know about alternative business financing, said McGovern.

The market can even seem like it doesn't have enough brokers in the estimation of experienced players skillful enough to find the many merchants who haven't been introduced to the industry, said Ramirez of Core Financial.

And the big banks don't really want the business because the deals aren't big enough to interest them, McGovern said.

But the potential profits look promising to outsiders disillusioned with sales jobs in other industries.

Some experienced brokers even prefer to hire salespeople from outside the alternative financing industry, noted Kingsley. That way, they avoid employees who have picked up bad habits at other brokerage houses, she said.

Long-time members of the industry sometimes enjoy belittling new entrants who can seem clueless about the business they're trying to master, noted Ramirez of Core Financial. But he recalled the time not so long ago that he himself had a lot to learn.

And regardless of how unsophisticated they may seem, new players have a role, McGovern said.

“They are performing a service,” he maintained. “They're like the missionaries of the industry going out to untapped areas of the market – of which there are many – and drumming up business.”

To Kingsley, brokers in general – old and new – are beginning to earn the respect they deserve.

“A lot of people are afraid of the word ‘broker,’ ” she said. “I feel that 2015 is the year of the broker, and people should embrace what a broker can actually do. It's a great thing.”

FROM LOWES TO LOANS

By *SEAN MURRAY*

Non-bank financing changed William Ramos' life. Not as a borrower, but as a mover and shaker in the competitive world of financial deal-making. As an ambitious 20-year old, Ramos was working at both Lowes and ShopRite to try and put himself through Staten Island Community College. These were stepping stones, he told himself. He was dedicated to bettering himself, or more aptly to be the best at whatever he did.

Already on a path to success, he found himself growing impatient. The life of two jobs and school was a slow grind. Ramos wanted to do something big. He wasn't sure what it would be, but he was confident that his attitude combined with his strong work ethic would eventually lead him to great success.

And so one day, he made a promise to himself to go out and find that big thing rather than wait for it to find him.

It's a bit of an American Cliché to say that his lucky break coincided with a sudden bout of adversity, but that's exactly how it played out. Raised in the tough neighborhood of Brownsville in eastern Brooklyn, he didn't have the connections to step right into the business world. Instead, Ramos had to start his search on the ground floor with millions of others on Craigslist.

His luck began with an interview for a job in telemarketing, a role that meant being connected to an autodialer nine hours a day as an opener. Undeterred by the challenge, Ramos had a feeling that this is where it would all begin. "I'll do it," he said.

There was only one problem, they didn't want to hire him. The firm, which sold mostly financing products to small business owners, was very selective, even with cold callers. His interviewer at the time, who later became his boss, confirmed to me that he didn't think Ramos was the right fit after they first met. But Ramos was determined to change his mind.

After calling the firm repeatedly over the next week to convince them that he was up to the task, they finally acquiesced. It didn't mean he was in. It just meant it was time to put up or shut up. "They gave me a three-day trial period," Ramos said.

His former boss confirmed this relentless persistence.

39 working hours, 3,000 calls, and 3 days later, Ramos brought in two deals, one for $100,000 and another for $35,000. They both went through.

It was more than good enough to survive the trial and he was offered a job to work full time. With a starting compensation of only $250 a week + commission, he still had a long way to go. "I would be the first one in and last one out," Ramos shared with me. "I kept my head down and I wouldn't leave my seat unless I needed to use the bathroom or eat. All I would do is make my calls."

His former boss explained to me that Ramos had a knack for bringing in the firm's larger deals even from the very beginning. He was too junior early on to be making a lot of money, but they were very focused on developing his skills. The firm saw his potential and was committed to nurturing him.

Within the first three months he managed to save $700 and he used it to buy a Mercedes-Benz C240 from a co-worker. After a life of taking the bus to work, Ramos had reached his first milestone of success.

While it was obvious that he still harbors pride in that first car, it sadly became all that stood in the way of homelessness. He had sacrificed everything for this job including college. Unfortunately there would be just one more thing to lose.

Adversity struck when a series of unfortunate events suddenly left him without a place to live. Ramos' car was now both his ride and his home, though with the long hours he was putting in at the office, he might as well of lived at his desk. His boss took a special interest in his life and soon discovered just how much his young protégé was struggling.

"He was literally sleeping in his car," his former boss told me. "I offered to let him sleep on my couch

or at the very least let him stay in the office," he added. Ramos took him up on the latter and began sleeping at the office. At the same time his commission percentage was bumped up, which sweetened the potential and only encouraged him to keep going.

Always looking for an edge, he sometimes pretended to be a customer himself. "I would call up lenders as a merchant to hear what pitches their sales teams were using," he said. "I would then take that pitch, tweak it and make it my own."

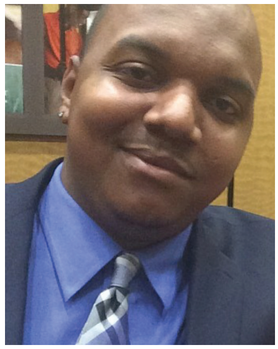
Soon he was regularly closing more than $500,000 a month in deal flow and his financial situation and lifestyle began to improve significantly.

A little more than a year later, Ramos had risen up to become a sales manager and was overseeing a team of five members.

Now some people in his shoes might've decided not to press their luck. He had taken a major gamble and it had paid off, so why do anything to jeopardize it?

But Ramos didn't leave everything behind to settle for *pretty good* and a middle class lifestyle. After two years, he gave his boss and mentor some bad news.

"I'm going off on my own," he explained. They parted on amicable terms and to this day still do business with each other. Ramos' last commission check there was for $15,000, an amount he had never imagined back in his Lowes' days.



In 2013 he founded Supreme Capital Group, a firm that primarily brokers merchant cash advances but will fund A paper deals on its own. With only two years in business, they are already on pace to generate more than $1.5 million in revenue over the next 12 months. He excitedly recalled a recent deal that generated $66,000 in commission. And that was just one deal!

He attributes part of his success to strong organizational skills. "I don't think brokers realize how important keeping track of all their data is," he said. He went on to explain that he can email the list of all his old leads and turn that into six to ten closed deals easily. He doesn't have to work as much as he used to, but he still does.

With 10 callers working for him now, he's not content with just being the boss. "I am still currently pounding the phones, doing email marketing, and sending out mailers," he said. "We use the mailers to follow up with merchants, and we get a great response from it," he added.

After working incredibly hard for several years, Ramos has at least found the time to play hard too. In the summer of 2014, he had made enough money to buy a white Maserati GranTurismo MC Sport Line, of which he shared several photos with me. He's since upgraded to a 2013 Ferrari California in a color he described as Pepsi blue. And while that might be the kind of car some people would dream of sleeping in, Ramos has said those days are long over.

He just bought a house in Mesa, Arizona where his fiancée grew up and he plans to relocate his office there. "It's already in the process of being built," he said.

Ramos is now just 25 years old. He said he regrets not finishing school and he plans to go back. But he wouldn't change everything that happened to him. He stressed more than once that asking questions is something he considers to be very important to success, especially in the business he's in. "For all the newcomers in the industry, my advice would be to work hard and ask a lot of questions," he said.

He was certain he had found the right opportunity almost from the beginning. "I knew that if I made those commissions the first week that I could make more," he said.

It wasn't easy.

William Ramos is the President of Staten Island, New York-based Supreme Capital Group.

GOOD RECORDKEEPING PLAYS IMPORTANT ROLE IN FUNDING SUCCESS

By *CHERYL WINOKUR MUNK*

CPA Yoel Wagschal recently started working with a syndicator who relied on Excel spreadsheets to track all his deals. The syndicator thought he had everything in tip-top shape, but it turns out that his system was hard for an outsider to understand and the data didn't reconcile with his bank statements.

Wagschal, who heads an accounting firm in Monroe, New York, comes across this problem frequently these days. It's been exacerbated by the exponential growth of the alternative funding industry in recent years. There are a sizeable number of alternative funders that started out small and have grown by leaps and bounds, yet they are still using rudimentary systems to keep track of their business dealings. In most cases, funders want to do the right thing, but they don't always know how or the extent of what's involved. Unknowingly these funders may be setting themselves up for financial or legal troubles.

"Sooner rather than later you are going to find yourself swimming in the Atlantic Ocean without any plan on how to get out of there," Wagschal says.

Although newbie funders may be able to get by with simple tools and minimal staff, more sophisticated efforts are required once they are doing multiple transactions a month. It's one thing when you are tracking a few daily deals on a spreadsheet. It's quite another when you're trying to keep track of all the moving parts for hundreds of deals.

What's more, there's a lot of slicing and dicing of data that goes into properly understanding your existing business and growth possibilities. If you don't use the right tools to help you keep precise records, it's nearly impossible to understand the fundamentals of your business in order to grow. Excel, while a useful tool, has its limits, and funders who rely exclusively on spreadsheets don't get the benefits of other more sophisticated options that have become available to them in the past few years. Manually entering data also increases the possibility of human error, which can lead to thousands upon thousands of lost revenue for a funder's business.

THE PITFALLS OF NOT KEEPING GOOD DATA

Keeping good data is especially important to funders who want to take on additional investors or who are considering a sale at some point. Kim Anderson, chief executive of Longitude Partners Inc., a strategic advisory firm in Tampa, Florida, works with a number of funders that are looking to facilitate additional growth by bringing on outside investors. Many of these companies find themselves scrambling because they don't readily have access to the kind of information potential investors want.

Not keeping good books can also inhibit a funder's ability to expand into additional markets. Say a funder wants to introduce a new product or migrate a product offering to a different vertical. Companies that don't analyze their data effectively may have a hard time understanding what part of their existing portfolio would be the most appropriate or profitable segment to introduce the product to, Anderson says.

> ***THERE ARE THOUSANDS OF PAGES OF RULES ON HOW BANKS HAVE TO CLASSIFY PERFORMING AND NON-PERFORMING LOANS. NONE OF THAT EXISTS FOR THIS INDUSTRY, WHICH IS COMPLETELY UNREGULATED...***

Potentially impeding growth is bad enough, but funders that don't keep proper books can also find themselves embroiled in legal or tax troubles. Some MCA providers, for instance, have faced stiff penalties for treating transactions as loans on their books instead of the purchase and sale of future income.

"If they are showing the revenue recognition in the exact same way that loan industry companies are doing, then they are setting themselves up to be judged

in the same way that a loan company would," says Christina Joy Tharp, a staff accountant in Wagschal's office. If you're using the same accounting methods as lenders, you could be deemed a predatory lender by multiple enforcement agencies, even if that's not your intent, she says.

The strength of your business can also be significantly impacted by how you classify performing and nonperforming loans or receivables. "There are thousands of pages of rules on how banks have to classify performing and non-performing loans. None of that exists for this industry, which is completely unregulated," says Alex Gemici, managing director and head of M&A at World Business Lenders, an alternative lending company in Manhattan.

As a result, funders don't have a universal way of keeping their books. Many funders believe that as long as they are collecting sporadic payments, a loan or receivable should be classified as performing. Gemici strongly disagrees, saying this approach sets up a funder for potential failure given that the default rate for loans/receivables is about one in five. "It's one thing to show on your books that loans or receivables are performing, it's another when you run out of cash," Gemici says.

CHOOSING AN OUTSIDE PROVIDER

Recognizing that Excel spreadsheets can only carry a funder so far and that out-of-the-box software probably won't be a complete solution for alternative funders, a small number of companies have stepped up to provide customized solutions for the industry. MCA funders—where the perceived need is greatest—are a particular focus for these providers.

Benchmark Merchant Solutions, a processor in Amherst, New York, is one such company honing in on the MCA funder space. In 2014 the company launched MCA Track, software that's designed to help MCA funders with their recordkeeping needs. It also helps them keep track of their income for tax purposes.

Among other things, MCA Track allows funders to view their performance at a glance. It shows them, for example, how merchants are performing, how the funds are allocated according to syndicator, the status of a deal, open cash advances, closed cash advances and defaulted cash advances. Funders can also get profitability data and other types of big picture information about their business as well. The software costs about $2,000 a month depending on the user's size.

Benny Silberstein, chief operating officer of Benchmark, says the software was created because the processing company found that funders were often asking Benchmark to get data for them, especially when there were discrepancies. It can be real headache for funders to wade through inconsistencies with merchants, syndicators and ISOs, Silberstein says. "I can't begin to tell you how many times funders asked us for a list of all the payments they'd received."

PSC of Port Washington, New York, is another company trying to help MCA funders keep better records and manage their business more effectively.

For a monthly membership fee, the company offers a front-end to back-end relationship management solution that allows funders to track all their contacts, documents, deals and commissions. Daily reports provide detailed data and summary information about an MCA's funding business. The data includes the actual advance amount, the right to receive amount, the factor rate, processing fees, daily debits and credits, commissions paid to outside brokers or their own people, other management fees, ACH fees, wiring fees, payments, missing payments, collections information and participation with other syndicates.

The product has been on the market for about two years and the monthly fee varies according to a funder's size, says Tom Nix, director of sales for PSC. He declined to be more specific about cost.

"The companies that are small and just starting

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out—if they are just doing a few transactions a month—they could probably get by using a spreadsheet. But that's only feasible if you have a few transactions that you're doing per month. Once you're growing, when you get up to 10, 20, 30, 100 deals, the management of data becomes truly uncontrollable," says Nix, who has seen a number of funders struggling to stay afloat or exit the business entirely because of their inability to keep good records.

"If you don't have the right information and understand it, you're going to give money to someone and you won't [necessarily] get it back," Nix says.

It's possible for funders to set up their own infrastructure, but it can be costly and some feel it detracts from their ability to generate new business. That's why Anthony Mannino, president of Nulook Capital in Massapequa, New York, chose to work with PSC. He researched the idea of doing all the back office and data collection on his own, but he decided not to reinvent the wheel since it would have meant hiring additional staff and would divert the company's attention away from its primary focus—bringing in new business.

"A service provider like PSC gives us the ability to grow our company controlled and in a much quicker manner than we ever could than if we had to build our back end on our own," Mannino says. "It takes most of the responsibility off of my company so we are able to focus on just growing the business and growing the sales."

> **IF YOU DON'T HAVE THE RIGHT INFORMATION AND UNDERSTAND IT, YOU'RE GOING TO GIVE MONEY TO SOMEONE AND YOU WON'T [NECESSARILY] GET IT BACK...**

CloudMyBiz Inc. in Los Angeles is another company trying to service the alternative funder market, providing customized CRM systems for both lenders and MCA providers.

The CloudMyBiz system relies on a platform called Salesforce and is customized to the funding industry. It helps funders with the various facets of origination, underwriting and loan servicing. It helps them generate and track leads, automate funding workflow, understand and manage their deal pipeline and daily funding activities, collect and schedule recurring ACH payments and track syndication partners.

You could buy the Salesforce software and use it out of the box, but it provides only the basic functionality that funders need to run their business properly, says Henry Abenaim, principal consultant at CloudMyBiz. That's where CloudMyBiz comes in by customizing the software for a funder's specific business requirements. The fee varies widely, depending on the funder's specifications, he says, declining to be more specific.

About two and a half years ago, Creative Vision Studio LLC in Long Beach, Calif., which had focused on the merchant credit card processing industry for more than a decade, also started offering a CRM system to MCA providers. The software is called Bankcard Pros CRM and customers can use it for merchant credit card processing, MCA or both. The software automates the data entry, underwriting, approval, funding and payback process from start to finish, says Robert Hendrix, the company's chief executive. Funders also have access to 17 different management reports so they can track the performance and profitability of their entire portfolio per month.

The company charges an upfront fee of $4,000 to $5,000 to use the software, which is customized to a particular client's business. There's a $399 monthly fee after that. While it may seem costly to some funders, Hendrix says the software pays for itself within a month because of the efficiencies created. Importantly, the software eliminates the possibility of costly human mistakes that can occur in manually updating daily payments on a spreadsheet. "One little mistake can cost funders $2,000 to $3,000, even up to $10,000. They can be very costly mistakes," he says.

It is, of course, possible for funders to keep good books and records using homegrown systems and personnel, and funders need to carefully weigh their options, taking into account that doing it right will probably require a meaningful investment in infrastructure and personnel. Whether they do it alone or hire an outside vendor, the important thing for funders is to collect the data and be able to evaluate it and display it in a way that makes sense to them, their customers, tax preparers, potential investors and others who need access.

Funders also need to remember that being successful in the business over the long term requires them to do more than simply capture accurate data. Beyond that, funders need to be able to manipulate the information in a way that helps them understand the nuts and bolts of their specific business, says Anderson of Longitude Partners.

"They may be able to produce enough financial information to complete an accurate tax return, but when it comes to understanding their operating metrics, they may not have collected or evaluated all of the right information to answer questions about what really drives the growth or sustainable profitability of the business," he says.

A Q&A WITH LENDINGROBOT

SEAN MURRAY (SM): I'm a casual Lending Club investor that has purchased more than 2,000 notes. I like to think that I've been pretty good with my picks but I feel like the rush to get the most attractive notes has only gotten more competitive. I've also got a perennial issue of idle cash and the pressure to put it to work on the platform can feel like a burden when I'm busy with everyday life. I feel like I can do better but I have reservations about relinquishing control.

I noticed in January that you raised $3 million from Runa Capital, which caught my attention.

So for both myself and our readers, can you explain in a nutshell what LendingRobot does?

EMMANUEL MAROTE (EM): First off, that 'burden' is the exact reason why we started LendingRobot, as my partner and I were feeling it as well! We automate the whole investing process (decision and execution) to simplify access to marketplace lending for individual investors.

(SM): I think one of the biggest concerns for casual investors is the question of who physically possesses the cash. Obviously they have already come to accept that Prosper or Lending Club will hold their cash, but what about a service like yours? Do investors send you the money to invest it on those platforms?

(EM): That's a very valid point. As of today, we do not have what the regulator calls 'custody' of the money. Our clients wire the money on the platform, they give us a programmatic access to their account there so we manage it for them. There is no way we can touch their money, and when the money is wired outside of the platform, it has to go back to the original bank account anyhow.

Emmanuel Marot is a polymath and serial entrepreneur.

A French 'grandes école' graduate with a major in Computational Finance, Emmanuel started his career in product marketing at Apple. He also worked for the French intelligence agency to modernize the handling and presentation of highly classified information and acted as freelance graphic designer.

At age 26, he created his first company, a Web agency that he grew up to 15 people while keeping the net operating margin above 30%. The company created the first virtual reality cd-rom (Guinness book of records, 1995) and produced mobile Internet services as early as 1996. After selling it, he co-founded a larger communication agency, with 400 employees and an annual turnover of 30 million Euro. In 2000, Emmanuel patented a novel way to access mobile sites and created his 3rd company, which Microsoft acquired six years later. Emmanuel orchestrated the move of the entire operations to Redmond, WA, and became Director, Mobile Search at Microsoft.

He left in 2008 to research algorithmic trading, predicting market reversals from search engine queries. In parallel, Emmanuel did multiple executive consulting engagements for startups and corporations. He began to focus his work on the design of algorithms to automate decisions, and co-created Eventiles, an iPhone application that crafts meaningful stories from bulk pictures.

In 2013, he combined his interests in finance and algorithms and co-created LendingRobot, a solution for marketplace lenders to automate and optimize their investments. Emmanuel passed the Series 65 Investment Adviser law exam in January 2014.

(SM): How do you bill for your fees? Do you need to provide bank account information? Credit card?

(EM): Since we cannot touch our client's money, we need another way to charge our fees. We use credit card. Up to $10,000 we do not charge anything and clients don't even have to enter a credit card.

(SM): What is the difference between your service and Lending Club's Automated Investing?

(EM): As the issuer of the notes, Lending Club cannot offer an 'unfair' advantage to some investors, therefore their automated investing cannot be used to get access to the most popular assets. Obviously, it's also entirely based on their own credit model, and one cannot benefit from a second layer of risk modeling. At last, we tend to offer more features, such as additional filtering criteria, cascading investment rules or cash-flow forecast. We posted a comparative explanation a while ago that is still somewhat valid: http://blog.lendingrobot.com/post/69219879518/lendingclub-re-introduces-prime

(SM): If I use your service, can I cancel it at any time?

(EM): Absolutely, no setup or entry fees, no exit fees, no minimum usage period.

(SM): There seems to be correlation between a borrower's home state and the default rate, can I filter out certain states with your service?

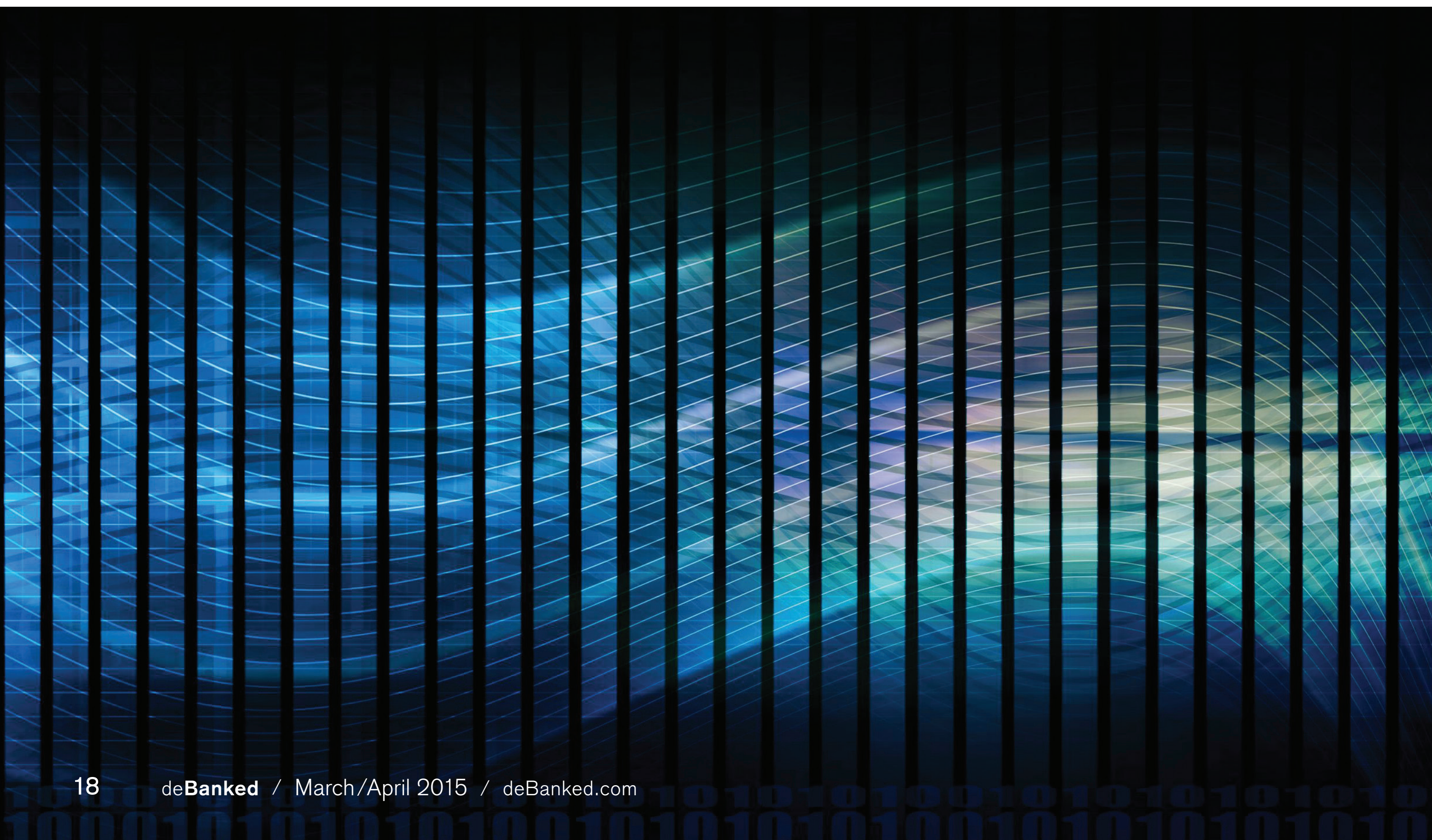
(EM): Yes, not only do we offer over 25 different filtering criteria, but it's possible to mix them freely. Some clients start with our own proprietary model, then add extra criteria, such as '36-months', or 'Exclude Nevada'.

(SM): What did you guys do before founding LendingRobot?

(EM): Tons of stuff! My partner and I met at Microsoft, which we both joined after selling our respective startups. We decided to create something together even before knowing what to do. Incidentally, we started the company with a very different project (see http://www.eventiles.com/). As mentioned above, we started LendingRobot out of personal need.

(SM): What's the smallest amount someone can allow LendingRobot to manage if they just wanted to try it out?

(EM): Right now, our smallest client has... $66.49 invested! That being said, we recommend people to invest at least $5,000 to be diversified enough.

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REVENUE RECOGNITION FOR THE MCA INDUSTRY

By *YOEL WAGSCHAL, CPA AND CHRISTINA JOY THARP, STAFF ACCOUNTANT*

The accounting of MCA companies must not show their transactions in a way that cash advances can be seen as loans. As we all know, a lot of people in the law enforcement community wish to compare MCAs to lending companies. They would like to conclude that MCAs are lending money on a higher interest rate than is currently allowed by law.

When our firm speaks to clients in the MCA industry who continually use the loan method of accounting, it makes our firm very nervous for them. We see that MCA companies are unwittingly affirming what those law enforcement communities want to allege.

By keeping your accounting books on an established lending method of accounting, you are setting up your company for lawsuits while simultaneously setting up the industry for scrutiny. There is one thing we all must agree on: MCA companies must strive ***against*** accounting procedures that will ultimately classify them as loan sharks. If a MCA company is unsure as to how to set up their accounting so as to reflect MCA standards, please contact a knowledgeable CPA who can guide you appropriately.

In general, revenue is recognized when a specific critical event has occurred and when the amount of revenue is measurable. Every American business recognizes revenue and gains when goods and services, merchandise, or other assets are exchanged for cash (or claims to cash). However, there are a number of issues with the old US GAAP way of revenue recognition, especially for MCA companies.

A lot of companies are struggling in their attempt to establish the right path for their specific industry. What happens is that certain companies in the same industry conclude differently than other companies and this leads to inconsistencies in reporting. This is why the accounting standard setters now feel a need for new revenue recognition standards. As most accountants are aware, the new standards will be put into practice over the next two years.

Unfortunately, although the new standards reach a wide variety of industries they have not specifically addressed the MCA industry. The MCA industry has its own challenges in accounting for revenue, specifically the 'right' way to account for purchasing future sales. Whenever the topic comes up it soon turns into a hot debate regarding how and when to recognize revenue.

Going into all of the nuances would be too complex and truly each side of the argument may have merit. The real issue is ***when*** revenue should be recognized. One option is to recognize revenue at the time of funding. The other option is to recognize revenue on an ongoing basis (pro-rate when funds are being collected).

Here we will go back to our initial example and show the difference between the two options. All we need to change is journal entry C and journal entry D.

Here are the original entries, which show immediate revenue recognition:

(C) WE PROVIDE FUNDS TO THE MERCHANT:

DEBIT: Accounts receivable	100,000	
CREDIT: MCA Cash		70,000
CREDIT: Revenue		30,000

(D) DAILY ACH FROM MERCHANT (X 100)

DEBIT: MCA Cash	1,000	
CREDIT: Accounts Receivable		1,000

Here we use the deferred method, which show ongoing revenue recognition:

(C) WE PROVIDE FUNDS TO THE MERCHANT:

DEBIT: Accounts receivable	100,000	
CREDIT: MCA Cash		70,000
CREDIT: Deferred Revenue		30,000

(D) DAILY ACH FROM MERCHANT (X 100)

DEBIT: MCA Cash	1,000	
CREDIT: Accounts receivable		1,000
DEBIT: Deferred Revenue	300	
CREDIT: Revenue		300

There are two other methods, both of which are completely incorrect and both of which our accounting firm has seen in use. The first incorrect method is when revenue is only recognized at the end – when the contract is completely paid off. This method could get your organization into real trouble. For instance, what if the contract is renewed? In those terms, a contract could renew over and over and the MCA company would never recognize the revenue. This could lead to the IRS charging you (even criminally) for tax evasion.

The second incorrect method is the loan method. This method calculates each payment's interest and principal (similar to a conventional loan). As we outlined above, using the loan method of accounting only sets your MCA company up for scrutiny and legal action. Your own books could be used as evidence to show that your company is violating usury laws.

In conclusion, if it looks like a duck, quacks like a duck, and swims like a duck – it's a duck! Be sure your accounting books do not paint the portrait of a loan company. Simply calling yourself a MCA company is not enough – you must ***be*** a MCA company through and through.

The preceeding opinion was submitted by Yoel Wagschal, CPA, 845-875-6030, cjt@ywcpa.com

STACKING: IS IT TORTIOUS INTERFERENCE?

By *ROBERT COOK, CATHY BRENNAN, AND KATE FISHER*, ***HUDSON COOK, LLP***

STACKING - the practice of entering into a cash advance transaction or loan knowing that the merchant already has one or more open cash advances or loans with a competitor - is causing a rift among merchant cash advance companies and small business lenders.

On one side are companies that only originate first-position deals. These companies generally include a clause in their contracts prohibiting the merchant from obtaining another merchant cash advance or loan until the company receives all of the future receivables it has purchased or is fully repaid. First-position companies view stacking as a threat to recovery of money advanced or loaned to merchants. On the other side are companies that routinely offer second or third-position deals. These companies argue that merchants with adequate cash flow to support additional advances should be free to obtain them.

In the last several months, at least two first-position companies have sued their stacking competitors, claiming that stacking constitutes tortious interference with contractual relations. These cases may ultimately result in a decision as to whether a stacker is liable for damages to a prior-position company when a merchant defaults. Although it varies by state, a claim of tortious interference with contractual relations claim generally includes all of the following elements:

1. The existence of its valid contract with a third party;
2. The defendant's knowledge of that contract;
3. The defendant's intentional and improper procuring of a breach; and
4. Damages.

See White Plains Coat & Apron Co. v. Cintas Corp., 8 N.Y.3d 422, 425 (2007).

So when is advancing money to a willing merchant "improper" under the law?

No reported court decisions have tackled stacking, let alone discuss whether interfering with a prior merchant cash advance or loan contract is improper. In fact, few cases discuss this issue at all. According to Section 767 of the Restatement Second of Torts, the tort of tortious interference does not have hard-set rules. The issue in each case is whether the interference is improper under the circumstances and whether, upon a consideration of the relative significance of the factors involved, the court should permit the conduct without liability, despite its effect of harm to another. In other words, it is a fact-intensive analysis.

The New York Court of Appeals put it this way: "At bottom, as a matter of policy, courts are called upon to strike a balance between two valued interests: protection of enforceable contracts, which lends stability and predictability to parties' dealings, and promotion of free and robust competition in the marketplace." *White Plains Coat & Apron Co. v. Cintas Corp.*, 8 N.Y.3d 422, 425, 867 N.E.2d 381, 383 (2007).

Because there are no reported court cases addressing stacking, we can only look to cases between other types of businesses to see what courts have said about "improper" interference. Maryland's highest appellate court has held that inducing a breach of contract, even for competitive purposes, is improper. *Macklin v. Robert Logan Associates*, 334 Md. 287, 303 (1994). In contrast, New York courts have concluded that improper interference is conduct that goes beyond a minimum level of ethical behavior in the marketplace.

In the *White Plains Coat & Apron* case, a New York-based linen rental business sued a competitor in federal court for tortious interference with existing customer contracts. White Plains claimed that it had five-year exclusive service contracts with customers and that, knowing of these arrangements, Cintas induced dozens of White Plains' customers to breach their contracts and enter into rental agreements with Cintas. White Plains alleged that Cintas trained its sales reps to convince its customers to abandon their contracts with White Plains even after the customers told Cintas that they had contracts with White Plains.

White Plains sent Cintas a letter demanding that Cintas stop soliciting and servicing White Plains' contract customers, enclosing a list of customers allegedly solicited improperly. When Cintas refused to stop pursuing its customers, White Plains sued.

The court granted summary judgment for Cintas

and dismissed the complaint. The court held that because Cintas and White Plains were business competitors, Cintas' legitimate interest to make a profit was a defense to White Plains' lawsuit. According to the trial court "the only answer ... is to go out and do it also to the other guy."

White Plains appealed to the Second Circuit Court of Appeals. Because there was an important open state law question regarding whether economic self-interest was a defense to a tortious interference claim, the Second Circuit certified the following question to the New York Court of Appeals, New York's highest appellate court: "Does a generalized economic interest in soliciting business for profit constitute a defense to a claim of tortious interference with an existing contract for an alleged tortfeasor with no previous economic relationship with the breaching party?"

The New York Court of Appeals said no, holding that economic self-interest is not a defense. However, the court explained that business competition in and of itself is not a tort, stating that:

"[W]e note that protecting existing contractual relationships does not negate a competitor's right to solicit business, where liability is limited to improper inducement of a third party to breach its contract. Sending regular advertising and soliciting business in the normal course does not constitute inducement of breach of contract. A competitor's ultimate liability will depend on a showing that the inducement exceeded 'a minimum level of ethical behavior in the marketplace.'"

In a Florida case, *Azar v. Lehigh Corporation*, 364 So.2d 860 (Fla. Dist. Ct. App. 1978), a Florida appellate court upheld a restraining order against a former salesman of a developer after he allegedly tortiously interfered with the developer's contracts. Lehigh Corporation developed and sold real property in a large development project in Lee County, Florida. Part of Lehigh's promotional campaign brought prospective purchasers to see the development and stay at the only local motel at Lehigh's expense. Lehigh's former salesman, Leroy Azar, would follow prospective customers to the motel and persuade them to rescind their contracts for the purchase of property and to purchase property from him at a lower price. Azar spotted customers by following people down the street and observing whether they were carrying big envelopes full of Lehigh sales literature. He then would then seek out the customers in their motel rooms and offer to handle the rescission of his contract if the customer would move out of the motel and buy a lot from him. Azar also equipped his car with a large sign advertising the sale of his lots and followed Lehigh's tour bus full of prospective customers.

The trial court granted the restraining order against Azar. Azar appealed, arguing that customers had a legal right under federal law to rescind their contracts within three days and that he was merely providing them with an opportunity to be relieved of their contract and to obtain comparable property for lower prices.

In upholding the trial court's restraining order against Azar, the appellate court explained that there is a narrow line between what constitutes vigorous competition in a free enterprise society and malicious interference with a favorable business relationship. The court also quoted the following passage from a well-known treatise:

> *Though trade warfare may be waged to the bitter end, there are certain rules of combat which must be observed. . . . W. Prosser, Law of Torts (4th ed. 1971) at 956.*

The appellate court explained that the issue is whether the subject conduct is considered to be "unfair" according to contemporary business standards.

How courts will treat stacking among competing merchant cash advance companies and lenders

A claim brought by a first-position MCA company or lender may not be the only legal concern for a company that engages in stacking. Regulators could become involved if they believe aggressive stacking unfairly harm merchants. The Federal Trade Commission ("FTC") and most state attorneys general can enforce unfair and deceptive trade practice acts even in B2B transactions.

A merchant may be harmed because the stacker imposes so large an aggregate obligation on the merchant that the merchant's business fails. Or, a merchant may be harmed if a first-position MCA company or lender declares a default under the first-position contract when the merchant accepts the stacker's offer. Arguably, the merchant could have protected herself from such a default by refusing the offer that caused the harm. However, a regulatory agency may be sympathetic to the plight of an unsophisticated merchant that failed to understand that the stacker's offer could harm her relationships with the prior MCA company or lender.

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remains to be seen. The analysis of what is "improper" interference versus vigorous, but acceptable, competition will be based on the specific facts of each case. In the meantime, merchant cash advance companies and lenders that engage in stacking should consider applicable state law, including case law, and whether their conduct could be considered improper under the circumstances.

Robert Cook, Cathy Brennan and Kate Fisher are partners in the Maryland office of Hudson Cook, LLP. Robert can be reached at 410-865-5401 or by email at rcook@hudco.com. Cathy can be reached at 410-865-5405 or by email at cbrennan@hudco.com. Kate can be reached at 410-782-2356 or by email at kfisher@hudco.com.

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