collective wisdom®

SZABO ASSOCIATES, INC. VOLUME 17, ISSUE 3, SEPTEMBER 30, 2002

Dear Friends:

We've finally broken out of a very hot, dry summer here in Atlanta, and we're entering our beautiful fall season. When seasons change, I'm reminded of the cyclical nature of business. We are certainly enduring a long, difficult spell, but we know good times always return.

In these tough times, we cannot stress too much the importance of tightening up your collections calendar. Turn over for collection receivables that have aged 90 or more days or have proved difficult despite your best efforts. We will employ collection techniques that are effective in bad times while keeping the goodwill of your customers, many of whom will become great customers again when times get better. In the meantime, you will be able to focus your staff's efforts on more profitable pursuits—facilitating sales and collecting more current receivables.

Best wishes for a wonderful fall and a great holiday season,

Pete Szabo, President
Szabo Associates, Inc.

Be Prepared for the Quarterly Conference Call!

Public companies are preparing to announce their earnings for the 3rd quarter. Most likely, the conference calls that accompany those announcements will take some different turns than they have in the past. Analysts will ask questions that dig more deeply into the area of accounting measures, and they will grill company executives about the true nature and quality of numbers that appear on the balance sheet.

This level of inquiry will no doubt include the quality of the company's receivables. Even if a company takes a conservative approach with reserves to the high side, a large sum in aged receivables does not help paint a picture of sound financial health. Regardless of what is reserved, no company executive wants to answer the question, "What are you doing to collect your receivables?"

Companies Implement New Strategies

Companies eager to gain a favorable rating by Wall Street have been reevaluating their credit and collections processes and are implementing new strategies for deploying their resources to best advantage. The strategies flow from the realization that they have to draw the line on in-house collection efforts where necessary to most effectively and profitably use their credit and collections staff. By outsourcing collection of aged receivables, they are able to take a fresh and assertive approach to the credit side of the equation as a driver for sales. They are also able to make a more consistent effort to collect more current receivables, which not only improves cash flow but also contributes to the creditworthiness of existing customers for future sales.

These measures are part of much larger efforts to redeem the image of corporate America in a faith-shattering year.

Scandals Shake Investor Confidence

We are all aware of the troubling headlines: "Off the books" debt by a leading American company leads to bankruptcy and loss of jobs and retirement savings to thousands of employees. "Creative" accounting practices lead to the decline of a major accounting company. CFOs join CEOs on the hot seat. The President admonishes businesses to "come clean or else." The New York Stock Exchange and the Nasdaq Stock Market propose a reform plan for companies whose shares trade on their exchanges. The SEC orders hundreds of executives to sign

—continued on page 2

Be Prepared —

—continued from page 1

oaths attesting to the truthfulness of their books.

In the wake of corporate scandals and subsequent headline-grabbing events, the U.S. government and American businesses have been scrambling to restore investor confidence.

Government and Businesses Respond

The Sarbanes-Oxley Act of 2002, the Corporate Governance-Accounting Oversight Bill designed to combat corporate fraud, won overwhelming approval in both the House (423-3) and the Senate (99-0). The new law adds criminal penalties and prison terms for corporate fraud and document shredding, imposes restrictions on accounting firms that do consulting work for corporations whose books they audit, requires top company executives to vouch personally for the accuracy of their companies' reports, imposes new rules for financial analysts designed to prevent conflicts of interest, and establishes an independent board—with power to subpoena—to oversee the accounting industry.

As of August 29th, top officers of public companies must swear not only that new filings they submit are accurate but also that their companies have adequate internal controls and reviews to ensure that the executives receive accurate information. One of the most significant aspects of the new law is that a company's audit committee, not its executives, must now hire and fire auditors, a requirement intended to ensure that auditors have no conflicts of interest. Audit committees are also now required to monitor a company's internal controls.

Even prior to this new legislation, it became clear that the climate was already changing in company boardrooms across the country. With falling stock prices and legislative reforms looming, many companies were acknowledging that some of their past practices, while legal and consistent with "generally accepted accounting principles" (GAAP), would no longer be acceptable.

EBITDA Numbers Undergo Scrutiny

For many years, banks and investment banks have used "EBITDA" (earnings before interest, taxes, depreciation and amortization) in valuing companies for sale or determining how much debt it can comfortably assume. Generally, this approach makes sense because some industries by their nature carry a lot of debt due to capital expenditures. Others have significant intangible assets, such as licenses and goodwill.

Beginning in the late '80s, however, some companies began emphasizing EBITDA measures in public communications to investors, asserting that these measures offered a more accurate picture of their financial health than traditional net income. For almost all, profits appeared larger than they would have appeared using GAAP measures. Additionally and unfortunately, some companies used the alternative measures to purposely avoid disclosing information that might lead analysts and investors to devalue their stock. Companies that paid too much for an acquisition, invested capital imprudently, or assumed an excessive amount of debt could hide their injudicious activities and mislead investors with EBITDA numbers.

As a consequence, EBITDA numbers have now come under wide suspicion in the investment community and companies are placing a new emphasis in public communications on traditional and unambiguous GAAP measures. They are closely scrutinizing routine practices regarding the way some dollars are booked which, though not in defiance of the law, may not provide the transparency that has always been required but is expected to an even greater degree in today's environment.

CEOs Allocate Resources

Company officers, whose ignorance of wrong numbers in their companies is, by oath, now inexcusable, are devoting more attention and corporate resources to getting the numbers right. Many corporate governance experts foresee the creation of new intra-company infrastructures to ensure that the numbers are correct. A chief executive of one large entertainment corporation has had personal discussions with division heads and even required them to sign letters attesting to the truthfulness of their division's numbers.

And, while company officers are making fervent efforts to ensure that their numbers are accurate and truly representative of their companies' financial health, they also want those numbers to be attractive to long-term investors. For many that means they must reduce their debt.

Credit Managers Play Critical Role

This kind of pressure from

above will, no doubt, work its way down to credit managers. The credit manager's responsibility for maintaining quality receivables in his or her organization and assisting sales in their efforts to make deals happen will become more important than ever. Receivables that have aged to the point of little or no chance of collection will attract a higher degree of scrutiny by controllers and division heads mandated to present a true financial picture of their organizations and to help make that picture attractive.

Now is the time to take proactive measures to help improve your company's bottom line. Beef up your efforts to improve communication and cooperation with the sales department to meet organizational goals. Recognize the pressure on sales staff to make aggressive efforts to bring in advertising dollars, but also expect sales to understand credit's responsibility for risk management and receivables collection.

Make sure procedures are in place to accommodate borderline customers, such as cash or partial cash in advance, weekly credit extension, placement on a watch list, personal guarantees, etc.

Review your collections procedures to ensure that they are effective and implemented on a strict schedule. The <u>chance</u> of collecting a six-month receivable is about 57%, and the <u>chance</u> of collecting a one-year aged receivable is a mere 29%. Having a substantial amount of dollars in these categories of receivables may be unacceptable to division heads challenged to present an honest and favorable report to top executives.

This may also be a time that your business department resources are stretched beyond their ability to maintain the high level of quality expected for your receivables. If your staff has made its best efforts, beginning at 15 days past due, to collect an account that has broken a number of commitments or has aged to 90 days, it is time to consider turning it over to a third-party collector. This is particularly critical if the account is in a volatile type of industry. If a receivable ages 120 days, immediately turn it over for collection and redeploy your resources into more profitable activities! The end game is, after all, to collect the money, using every means available.

This has been a challenging year for American business. A slow-to-recover economy, plummeting stock prices, and faith-shattering scandals have brought a new sobriety into corporate boardrooms. Even though opinions vary widely among company executives and analysts about the need or effectiveness of legislative reform, most all would concede that investor confidence must be restored. To that end, we all must do our part with diligence and optimism, while looking forward to much better times ahead. ♦

Calendar of Events

October 5-9
Advertising Media Credit Executives Association
Annual Conference
Tampa, Florida

♦

December
Szabo Employee Holiday Party
Atlanta, Georgia

"WINONA, THAT $300.00 YOUR EX-BOYFRIEND BERNIE OWES YOU IS WHAT WE CALL AN 'AGED RECEIVABLE.' UNFORTUNATELY, HONEY, <u>UNLIKE</u> FINE WINE BUT <u>JUST LIKE</u> BERNIE, THE LONGER IT HANGS AROUND, THE MORE SOUR AND GOOD-FOR-NOTHING IT GETS!"

The Szabo Difference:
Information You Can Trust

To any businessman, it's no news that some of their potential customers are less than straightforward when it comes to presenting their financial condition. So how do you avoid getting burned when a client's balance sheet goes up in smoke? There's no sure way to avoid credit risk, but you can minimize your risk by getting all the information you can get your hands on.

Many Szabo clients rely on us for information that can help them make collection of overdue accounts easier or even unnecessary. You're not likely to find another collection service that can offer clients more width and depth of information that can be of value in evaluating the financial health of a prospect.

Good information about a prospect begins with the proper application form. At Szabo, we're familiar with the most effective forms used to judge the creditworthiness of a variety of different kinds of businesses. Our representatives can help you tailor your forms to these standards, not only to spot credit flaws but also to avoid misunderstandings that can plague future collections. We can also help you by pointing out "red flags" that might show up on the completed application that your prospect returns to you.

Of course, actual performance is generally the best test of a company's financial well-being. At Szabo, we have a massive and growing database of our own experiences with more than a quarter-million advertisers and agencies. While your prospect might not be on the list, you may be able to benefit from information about similar types of companies in similar situations.

You may also benefit from a comparison of your prospect or customer's financial characteristics and credit performance with industry norms. We've been a part of the media industry for more than three decades. We take an active part in many industry organizations. And we collect both formal and informal data on a daily basis. Your Szabo representative has access to information that can help you determine if your customer's record is out of line with the average.

As important as formal information is, the most valuable resource we can offer our clients is the "collective" experience of our Szabo representatives. We make hundreds of contacts each day with companies who market an astounding variety of products and services. Our people develop a sense of where risks lie, and where new risks appear to be developing.

Anytime you have doubts about a credit situation, one of the best things you can do is discuss it with your Szabo representative. And the best time to do it is long before a problem has a chance to develop. ♦

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