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Reasons For Heartbeat To Incorporate

Chuck Lehnbeuter

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MEMORANDUM

TO: Landon Saunders
FROM: Chuck Lehnbeuter
DATE: May 22, 1981
RE: REASONS FOR HEARTBEAT TO INCORPORATE

Landon, below are the primary reasons which I see as the basis for our moving rapidly to incorporate Heartbeat as a legal entity separate from the Highland church of Christ.

1. Market Positioning

An incorporated entity apart from the Highland church of Christ will provide a more consistent positioning for Heartbeat in the secular market without threatening our religious constituency. Our current situation has a built-in exposure. There seem to be no compelling reasons why we should not eliminate this exposure.

2. Secure Heartbeat Funds and Protect Our Donors' Investments (see Exhibit A, pages 1-4)

Herald of Truth has a financial structure problem. Its overall debt situation is crippling. Its short term debt is only semi under control, because of Heartbeat. If in 1980 Heartbeat provides 21% of the cash during the year (see Exhibit A, page 5) but 100% of the current funds, when Heartbeat provides 30% of the cash (only two years away) we are going to be funding computers and buildings and delaying workshops, etc.

Granted that the attached exhibits show that the Herald of Truth made a strong comeback in 1980, it is still in a difficult position.

Add to this Joe Barnett's situation, Batsell Barrett Baxter's age, and Harold Hazelips disinclination to fundraising, and it appears that their future income stream is very uncertain. This, of course, adds to their exposure given their high level of debt.

3. Increase Financing Flexibility

Incorporation provides two basic advantages for Heartbeat along this line. One is the opportunity for credit line for general operations as they presently exist. While this should not be needed this year or the next, it is certainly a highly desirable safety feature. The second advantage is even more interesting. There is the real possibility of bank financing of inventories and receivables generated by the marketing of products to either of our constituencies. In fact, given some history with a particular bank, it is very likely that there could be bank project financing which would be particularly helpful in the area of start-up costs.

As to attempting either of the above while a part of the Highland church of Christ, my recommendation is definitely against it. I

believe that we are looking at donor guaranteed notes in either case. Somehow Proverbs 22:26-27 and my own instincts make this possibility very unsavory.

Another option technically exists; that being an asset secured note. However, the only viable asset would be the Pioneer Plaza building which at this point already has a second lien against it.

4. Auditing Complications

Heartbeat will want to claim as income any funds which will go directly to the New York City incorporation. In order to do this, whoever audits Heartbeat will also have to audit the financial records of the New York City incorporation. At the same time you will want to have separate audited statements for the NYC incorporation as a unique entity. The organization that audits Heartbeat will be the organization whose signature goes on these statements. Unless we incorporate, that signature will be that of Condley & Co. Given our goals with this organization, that seems to be a bit ludicrous.

5. The Time is Right

The financial situation over all the Herald of Truth is such that we can make a move. If we approach the change on the basis of the need for a change in our market positioning as an organization, I believe that our relationship with the Highland church of Christ and the Herald of Truth is such that this can be done. Who can tell what the situation will be at this time next year or the year after. I believe that it would be foolish not to move on this simply because there is not a clear and present danger that needs an immediate response.

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HERALD OF TRUTH/HEARTBEAT FINANCIAL ANALYSIS AS OF 1/1/81

(000's Omitted)

Prepared from Herald of Truth Audit Report 1/1/81

w/ HB pulled out
w/ HB pulled out

	HOT Current Fund	HOT Fixed Asset Fund	HB Portion	Net HOT Current Fund	Net HOT Fixed Asset Fund	Restricted Gifts Fund	Pioneer Office Plaza	HOT Total w/o HB
ASSETS								
Current Assets								
Cash & Temp.	264.9		172.7	92.2		85.0	14.2	191.4
Ppd. Exp.	1.5	12.7		1.5	12.7			14.2
Investments	145.6		33.8	111.8		47.4		159.2
Notes Rec.	21.9			21.9				21.9
Total Cur. Asts.	433.9	12.7	206.5	227.4	12.7	132.3	14.2	386.7
Other Assets								
Inventory	30.1			30.1				30.1
PP & E		342.7	28.0		314.7		827.5	1142.2
Total Oth. Asts.	30.1	342.7	28.0	30.1	314.7		827.5	1172.3
TOTAL ASSETS	464.0	355.4	234.5	257.5	327.4	132.2	841.7	1559.0
LIABILITIES								
Current Liab.								
Acts. Pay.	203.8			203.8			.4	204.2
Accrd. Exp.	1.1	.2		1.1	.2		2.8	4.1
Notes Payable	220.8	38.0	6.7	220.8	31.3		48.2	300.3
Cur. Leases		48.0			48.0			48.0
Total Cur. Liab.	425.7	86.2	6.7	425.7	79.5		51.4	556.6

EXHIBIT A

	<u>HOT Current Fund</u>	<u>HOT Fixed Asset Fund</u>	<u>HB Portion</u>	<u>Net HOT Current Fund</u>	<u>Net HOT Fixed Asset Fund</u>	<u>Restricted Gifts Fund</u>	<u>Pioneer Office Plaza</u>	<u>HOT Total w/o HB</u>
LT Liabilities								
LT Notes		35.4	9.7		25.7		685.4	711.1
LT Leases		<u>44.0</u>			<u>44.0</u>			<u>44.0</u>
Total LT Liab.		<u>79.4</u>	<u>9.7</u>		<u>69.7</u>		<u>685.4</u>	<u>755.1</u>
TOTAL LIAB.	<u>425.7</u>	<u>165.6</u>	<u>16.4</u>	<u>425.7</u>	<u>149.2</u>		<u>736.8</u>	<u>1311.7</u>
FUND BALANCE								
Unrestricted	38.3		218.1	(168.2)				(168.2)
Restricted		<u>189.8</u>			<u>178.2</u>	<u>132.3</u>	<u>104.9</u>	<u>415.4</u>
TOTAL FUND BAL.	<u>38.3</u>	<u>189.8</u>	<u>218.1</u>	<u>(168.2)</u>	<u>178.2</u>	<u>132.3</u>	<u>104.9</u>	<u>247.2</u>
TOTAL LIAB. & FB	<u>464.0</u>	<u>355.4</u>	<u>234.5</u>	<u>257.5</u>	<u>327.4</u>	<u>132.3</u>	<u>841.7</u>	<u>1559.0</u>
<u>Net WK</u>	<u>8.20</u>	(73.50)	<u>199.80</u>	<u>(198.30)</u>	(66.80)	132.3	(37.20)	<u>(169.90)</u>
Current Ratio	1.02	.15	30.80	<u>.53</u>	.16		.28	.69
TL/TA	<u>.92</u>	.47	.07	1.65	.46	-0-	.89	<u>.84</u>
<u>FB/TA</u>	.08	.53	.93	<u>(.65)</u>	.54	1.00	.11	<u>.16</u>
LTD/TA	-0-	.22	.04	-0-	.21	-0-	.81	<u>.48</u>

HERALD OF TRUTH/HEARTBEAT FINANCIAL ANALYSIS AS OF 1/1/80
(000's Omitted)

Prepared from Herald of Truth's Audit Report 1/1/80

	HOT Current Fund	HOT Fixed Asset Fund	HB Portion	HOT Net Current Fund	HOT Restricted Fund	HOT Net Fixed Asset Fund	HOT Pioneer Office Plaza	HOT Total Without HB
ASSETS								
Current Assets								
Cash & Temp. Ppd. Exp.	<u>160.7</u>		<u>115.1</u>	<u>45.6</u>	59.4		1.1	<u>106.1</u>
Investments	1.3	25.4		1.3		25.4		26.7
Notes Rec.	112.4		39.4	73.0	2.4			75.4
	<u>22.3</u>			<u>22.3</u>				<u>22.3</u>
Total Cur. Asts.	<u>296.7</u>	<u>25.4</u>	<u>154.5</u>	<u>142.2</u>	<u>61.8</u>	<u>25.4</u>	<u>1.1</u>	<u>230.5</u>
Other Assets								
Inventory	27.7			27.7				27.7
PP & E		507.0	30.0			477.0	817.2	1294.2
Total Oth. Asts.	<u>27.7</u>	<u>507.0</u>	<u>30.0</u>	<u>27.7</u>	<u>-0-</u>	<u>477.0</u>	<u>817.2</u>	<u>1321.9</u>
TOTAL ASSETS	<u>324.4</u>	<u>532.4</u>	<u>184.5</u>	<u>169.9</u>	<u>61.8</u>	<u>502.4</u>	<u>818.3</u>	<u>1552.4</u>
LIABILITIES								
Current Liab.								
A/P	233.4			233.4				233.4
A/Exp.	95.6	.3		95.6		.3	5.7	101.6
Notes Payable	250.0	39.0	6.7	250.0		32.3	114.4	403.4
Cur. Leases		48.0				48.0		48.0
Total Cur. Liab.	<u>579.0</u>	<u>87.3</u>	<u>6.7</u>	<u>579.0</u>	<u>-0-</u>	<u>80.6</u>	<u>120.1</u>	<u>786.4</u>
LT Liabilities								
LT Notes		66.7	16.0			50.7	664.9	731.6
LT Lease		92.0				92.0		92.0
Total LT Liab.	<u>-0-</u>	<u>158.7</u>	<u>16.0</u>	<u>-0-</u>	<u>-0-</u>	<u>142.7</u>	<u>664.9</u>	<u>823.6</u>
TOTAL LIAB.	<u>579.0</u>	<u>246.0</u>	<u>22.7</u>	<u>579.0</u>	<u>-0-</u>	<u>223.3</u>	<u>785.0</u>	<u>1610.0</u>
FUND BALANCE								
Unrestricted	(254.6)	286.4	161.8	(409.1)		279.1	33.3	(57.6)
Restricted					61.8			
TOTAL FUND BAL.	<u>(254.6)</u>	<u>286.4</u>	<u>161.8</u>	<u>(409.1)</u>	<u>61.8</u>	<u>279.1</u>	<u>33.3</u>	<u>(57.6)</u>
TOTAL LIAB. & FB	<u>324.4</u>	<u>532.4</u>	<u>184.5</u>	<u>169.9</u>	<u>61.8</u>	<u>502.4</u>	<u>818.3</u>	<u>1552.4</u>
Net WK	<u>(282.3)</u>	<u>(61.9)</u>	<u>177.8</u>	<u>(460.1)</u>	61.8	(55.2)	(119.0)	<u>(555.9)</u>
Current Ratio	.51	.29	26.5	.25	∞	.32	.01	<u>.29</u>
TL/TA	1.78	.46	.12	3.4	∞	.44	.96	1.04
FB/TA	<u>(.78)</u>	.54	.88	<u>(2.4)</u>		.56	.04	<u>(.04)</u>
LTD/TL	-0-	.65	.70	-0-	-0-	.64	.85	<u>.51</u>

GUIDE TO ABBREVIATIONS AND TERMS

- Net WK: Net working capital, the difference between current assets and current liabilities.
- The most common measure of liquidity.
- It indicates short term financial strength, flexibility and ability to grow and invest out of operating funds without borrowing.
- Many "well run" NPO's are close to zero or are slightly negative in this category. If many were able to show pledge receivables as assets they would look stronger.
- Current Ratio: Current assets/current liabilities.
- Another measure of liquidity.
- Many "well run" NPO's hover at one or slightly less for the same reason Net WK may be slightly negative.
- TL/TA: Total assets/total liabilities.
- An indicator of long term financial strength and structure. Some debt is common. In many cases sound and advisable. How much you can bear is a function of the predictability of your income stream and expense stream and the nature of your fixed assets. Utilities run very high ratios. Advertising agencies run very low.
- FB/TA: Fund balance/total assets.
- Another indicator of financial structure. In profit terms, what do the shareholders own. For NPO's, what remains after the bills are paid. Negative numbers are problematic for NPO's and for profits alike.
- LTD/TA: Long term debt/total assets.
- The best indicator of long term strength and flexibility. An organization could have an awful working capital situation, but if its structure is strong once it gets over it then clear sailing. You're in real trouble if your short term outlook is bad and you have a high LTD/TA.

RELATIONSHIP OF HEARTBEAT AND HERALD OF TRUTH INCOME

HEARTBEAT

	<u>***Cash</u>	<u>HB Cash</u> <u>HOT + HB Cash</u>	<u>PSA</u>	<u>Total</u>	<u>HB Total</u> <u>HB + HOT Total</u>
1979	630K	.18	967K	1597K	.30
1980	859K	.21	758K	1617K	.28
1981e	1200K	.25	1200K	2400K	.34
*1982e	1500K	.27	1400K	2900K	.36
1983e	1875K	.30	1700K	3575K	.39

HERALD OF TRUTH (with Heartbeat)

	<u>Cash</u>	<u>HOT Cash</u> <u>HOT + HB Cash</u>	<u>PSA</u>	<u>Total</u>	<u>HOT Total</u> <u>HB + HOT Total</u>
1979	2947K	.82	823K	3770K	.70
1980	3272K	.79	942K	4214K	.72
**1981e	3599K	.75	1061K	4660K	.66
1982e	3959K	.73	1180K	5139K	.64
1983e	4355K	.70	1299K	5654K	.61

*Assumes 25% growth in cash and modest PSA growth after 1981.

**Assumes constant 10% cash growth and constant 119K PSA growth.

***Does not include Herald of Truth contributions.