Asset Based Lending

What is an Asset-Based Loan facility?
Asset-based loans are revolving lines of credit that typically are secured by working-capital assets such as accounts receivable and inventory. Occasionally, even purchase orders, trademarks and intellectual property can be utilized. Asset based lenders rely on the value of the underlying collateral to minimize the loan's credit risk.

The revolving line amount available is governed by a formula, which is usually the sum of the accounts receivable outstanding plus the inventory and multiplied by a factor (usually around 80-85% for accounts receivable and 50% for inventory). The amount owed by the customers of the borrower (account debtors) and the inventory is monitored by the lending institution, and the submission of monthly accounts receivable aging reports and inventory listings are required.

Typically the accounts receivable and inventory assets will be structured as a revolving line of credit, while machinery and equipment can be used to structure a term loan with a fixed repayment schedule to coincide with the length of the asset-based loan (typically 1-3 years).

What is the best use of an Asset-based loan?
Asset based lending is most often used in financing a company's rapid growth when there is insufficient equity capital. "Five to ten years ago, asset-based financing was considered rescue financing and the lender of last resort," says Joyce White, the New York City-based president of Bank of America Business Capital. Today, many executives prefer asset-based loans because they lack the financial performance covenants imposed by cash-flow loans. Additionally, they provide flexibility for businesses in a growth spurt, because the loan amount can increase along with the borrower's inventory and receivables. An asset-backed loan can track the business growth.

Asset based revolvers are used for:

- Rapid or Hyper Growth
- Short Operating History
- Turnarounds
- Seasonal Sales Cycles
- Acquisitions or Mergers
- Shareholder Buyout
- Bankruptcy (Debtor-in-Possession)

Who provides Asset based loans?
Lenders can include the asset-based lending arms of commercial banks, small to large independent finance companies, floor plan financing companies, factoring companies and financing subsidiaries of major industrial corporations (UPS, IBM etc.) Asset based lenders are often referred to as secured lenders.

What's the difference of a finance company and a bank?
While both lend money to businesses, a bank is regulated by state and federal governments and has certain reserve requirements. Finance companies are not regulated in the same way and, as a result, can take on a larger diversity of loans and move faster in response to market changes and customer requests. A lender that is not subject to state and federal bank regulations is not required to risk rate its loans. However,

lenders who accept public deposits, such as commercial banks that also provide asset based loans, must risk rate their loans for the respective state and federal bank regulatory agencies.

Who uses Asset-based loans?

The asset-based lending financial services industry has exploded in recent years, and small businesses have fueled much of its growth. But household names, including Goodyear and Bumble Bee Seafoods, LLC, have used it in the past several years. According to the Commercial Finance Association, the total outstanding monthly average of asset-based loans jumped from $117 billion to $362 billion between 1994 and 2004. The users of asset based lending span a broad range of industries, with manufacturers represent approximately 31% of the total marketplace, followed by wholesalers (28%), and retailers (17%). By revenues, the large majority of these borrowers (71%) are under $50 million in size.

Publicly held companies use revolver credit facilities for the same reasons any company uses them—to accelerate cash flow and to optimize the use of existing assets to provide working capital. A revolving credit line often provides a much lower cost source of working capital than raising additional equity.

What is a Revolving Credit facility ("revolver") and how does it work?

A revolver is a loan which can be drawn down and repaid. With regard to an asset based loan, a revolver is secured by the borrower's liquid, current assets such as receivables and/or inventory. An asset based revolver accelerates cash flow by enabling a business to borrow against the future value of receivables and/or inventory that are expected to become cash in the near term. This acceleration of cash (or "advance") provides liquidity in order to take care of immediate expenses such as payroll, inventory, fuel and daily operating expenses.

What is the advance rate?

The advance rate is the percentage of the current borrowing base that the lender can make available to the borrower. Traditionally the advance rates will be 80-85% of accounts receivable and 50% of inventory, although there are factors that can influence these formulas upwards or downwards. Most receivables from completed transactions are eligible but pre-billing or progress billing is not considered. Other typical examples of ineligible receivables would include receivables 90 or more days past due, any intra-company receivables, certain government receivables and foreign source receivables. Treatment of inventory varies from company to company and from industry to industry. It would not be unusual for eligible inventory to include all finished goods and marketable raw materials. It would be much less common to include work in process, damaged goods, slow moving inventory, or certain specialized products that can only be sold to a limited number of purchasers. Many lenders seek advice regarding the appropriate advance rate from outside appraisal firms that specialize in assessing the collateral value of inventory goods.

What are the cost and fees involved?

The cost of an asset-based loans is influenced by the credit risk and collateral associated with the transaction.

When evaluating an asset-based loan, borrowers should assess the cost of financing in the context of the benefits to be received. Compared with other financing alternatives such as equity, asset-based lending is very cost effective and efficient. There is generally a commitment fee and closing fee. The commitment fee is paid in cash upon obtaining the commitment. The commitment fee is often credited toward payment of the closing fee, and the balance of the closing fee generally is paid from the proceeds of the initial loan. Each of these fees may range from one-half of 1% to 4% of the loan. Fees may vary depending on the calculated risk, credit- worthiness of the borrower, the type of situation being financed, and other considerations. For example, fees charged to a company that are in bankruptcy will differ from a fast growing company that is seeking to refinance its senior loan debt. Depending on the type of loan, some other typical fees may include: an administrative fee for monitoring and auditing the collateral, an unused line fee to compensate the lender for its cost to preserve the liquidity available to lend the borrower the maximum amount of their committed line, a prepayment fee to compensate the lender if the borrower decides to end the line thereby limiting the lender's projected income from the loan prematurely. Other costs which are the borrower's responsibility include the field examination and the borrower's and the lender's legal representation. The amount of these fees will vary according to each borrower's circumstances.

How long does it take to close an Asset-based loan?
The average timeframe you should expect for asset based lending transactions is a 4 - 6 week period from the date a proposal is accepted until the loan is funded. Naturally, depending on the complexity or type of facility it may take more or less time. Closing can take longer if extraordinary conditions such as significant inter-creditor negotiations or third party consents are required to complete the transaction.

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