An option to examine

JENNIFER CARRUTH ATTENDED THE ACT'S ASSET-BASED FINANCE BREAKFAST SYMPOSIUM TO FIND OUT WHY THE FINANCING MODEL IS INCREASING IN POPULARITY.

Asset-based financing is making its way into Europe at an increasing pace. Traditionally most popular in the US, asset based-lending is a finance option whose benefits UK companies are now starting to assess.

At the ACT's asset-based finance breakfast symposium held in October, and sponsored by Burdale and Bank of Ireland, Melanie Richards, a Partner at KPMG, said that companies should examine the asset-based lending market before going ahead, counselling caution given the credit conditions currently prevailing.

"You have to look at the type of assets you want to base the lending on, such as receivables, property, plant and machines, and inventory and work in progress," Richards said. "As long as you have enough assets, you're not going to be living with financial covenants."

She went on to point out that the "devil is in the detail" and that costs and limits should not be the only aspects to come under consideration, but whether asset-based lending is operationally and strategically flexible. According to Richards, the future of asset-based lending has an important role to play in the funding of corporates and "would be particularly relevant once the recent credit crunch is over". It seems likely that there will be more focus on assets and a growing interest in secured loans.

Asset-based lending is senior debt provided and secured against all the assets of a business in a single structured funding package. Assets can include land, buildings, plant and machinery, in addition to the traditional loan collateral of stock (inventory) and debtors (accounts receivable). In some cases, intangible assets such as brands or goodwill may also be taken into account.

Asset-based lending is therefore more akin to a multi-asset borrowing base facility and differs from plain-vanilla single-asset finance such as invoice discounting or stock finance.

This approach allows companies with a strong asset base to provide a greater level of security to the lender. As a result, the amount of finance that can be raised is bigger than what would normally be advanced by conventional lenders, and on generally more attractive terms.

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In turn, as the asset-based lender is usually secured across all aspects of the business, they will be interested in its success as a whole, rather than just concentrating on cashflow or ease of realisation of a specific asset.

"One of the main worries about the management of asset-based lending is headroom," says Jon Norton, Director of Structured Finance at Burdale, which is part of the Bank of Ireland. Headroom is the facility availability (calculated as the collateral multiplied by the advance rates) less required debt.

Norton pointed out that asset-backed lenders forecast the company's headroom for at least a year and said: "Companies don't go bust because they break a covenant. They go bust because they run out of money."

In an asset-based lending facility, a company can draw the lesser of the facility limit or the availability. If you take the gross assets, deduct assets ineligible for lending, then multiply the net assets by agreed advance rates to generate the availability, the difference between the drawn amount and the availability is the headroom. If the drawings need to be higher than the availability, then the company is bust.

Norton said that one of the reasons for the growth of asset-based lending in the US was its use in the lower-risk part of the capital structure. Frequently asset-based lending, secured against stock and debtors, is used to provide flexibility and lower cost than traditional leveraged buy-out debt. The market in the US evolved from underperforming companies choosing heavily structured, higher-margined asset-based lending deals (driven by credit-tightening environments) into a flow of covenant-lite deals for profitable companies driven by innovation in refinancing, higher volumes and lower margins.

Ian Robson, Group Finance Director at Ashtead Group, recommended asset-based lending: "The monthly reporting of the borrowing base is potentially onerous but quickly becomes a regular routine for finance teams, and the all-encompassing security package involves a lot of legal work initially but it doesn't prove a problem in operation."

According to Richards, the recent credit crunch may have an impact on any decision to move to asset-based lending: "As borrowers find life more difficult, asset-backed lenders have an opportunity in both the corporate and leveraged markets to fill the gaps. While mid-market leveraged finance appetite is stronger among banks than it is for larger deals, banks are pushing club deals and lowering debt, and pricing across both markets is going up, making asset-based lending facilities potentially more attractively priced."

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