USE YOUR ASSETS

Asset-based finance offers many advantages to businesses, including flexibility, funding diversification and cost-effective pricing, writes Sarah Perrin

Asset-based finance (ABF) is a growing form of flexible funding used by companies large and small. "In its simplest form, ABF involves companies using their unpaid receivables and other assets as a mechanism for unlocking cash," says Kate Sharp, chief executive of the Asset Based Finance Association (ABFA).

In the UK, there are two well-known receivables-based products: invoice discounting and factoring. "Both provide a business with the ability to draw money against its unpaid sales ledger," Sharp says. "The financier effectively uses the unpaid sales invoices to secure the borrowing." Both factoring and invoice discounting offer immediate availability of funds of around 80-85% of the

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invoice value. The key differences are that factoring includes provision of an outsourced sales ledger and collections service, plus the option to transfer the risk of debtor failure to the financier. “Invoice discounting is similar to factoring, but is for companies that prefer to carry out their own credit control,” Sharp says. “It provides funding, together with the option to insure the debtor risk, and can be provided on a confidential basis without disclosure to debtors.”

A third product is increasingly available under the ABF banner – asset-based lending (ABL). “Where invoice discounting and factoring are revolving cash flow facilities, ABL solutions would normally offer a combination of a revolving cash flow facility based upon receivables and stock, and an amortising loan secured on other assets within the business,” Sharp says. “Generally speaking, ABL tends to be more of an option for mid-sized and larger businesses. It delivers sophisticated solutions for a variety of scenarios, including growth, management buy-outs, management buy-ins, M&As, refinancing, turnarounds and public-to-private transactions. Depending upon the required size of the ABL facility, it’s not uncommon for several providers to work together as a syndicate to increase the lending power.”

ABF growth

ABF is a growing segment of the funding marketplace. According to ABFA data, the industry in the UK and Ireland supported clients with a total turnover of £254bn in 2012, up from £104bn in 2002. While overall UK net lending contracted by around 3% in 2012 compared with 2011, total funding advanced to clients by ABFA members increased by 6% to stand at £16.7bn at the end of last year.

The popularity of ABF reflects its strengths, such as its flexibility. “Funding via ABF is generally directly related to sales growth and so grows in line with the business,” says Sharp. “This gives the user the added benefit of not having to constantly rearrange funding lines.”

Lenders have also developed their offering over the years. “Our ability to lend against assets has improved considerably,” says John Bevan, Barclays’ head of trade and working capital for the UK and Ireland. “We use external advisers to help us value assets as necessary, and we have – through advances of technology – more sophisticated ways of managing these types of facilities so they are less cumbersome for clients to use. There is also a capital efficiency advantage from a lender’s perspective; because these are secured facilities, as a lender you have greater flexibility and are able to provide a greater quantum of funding, and possibly to a lower grade of credit.”

Acceptable assets

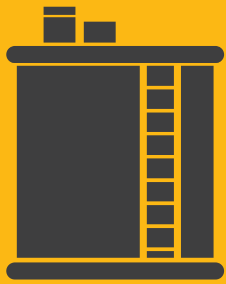
Receivables are by far the most common asset class used for ABF facilities, followed by stock and plant and machinery. Property can also be used as security, as can intellectual property and a company’s brand. “The brand is not the most common asset to lend against, but we are seeing its use on an increasing basis across the market,” Bevan says. “Companies have a cocktail of assets and leverage against what works best for them.”

The ability of banks to offer ABF in different jurisdictions does vary, however. “In general, the core of most asset-based finance provision in Europe is based on receivables,” says Bevan. “True, integrated all-asset lending against all asset classes is less common in Europe than in the US or the UK, but it is growing.”

Sharp confirms this analysis. “Differing legal environments make the provision of ABF somewhat complex,” she says. “Overall, invoice finance is available across all European countries, although with different restrictions. For example, in Germany, invoice discounting has been very slow to grow

FLEXIBLE FUNDING

A major strength of ABF is its flexibility. Berwick-based Simpsons Malt, which supplies malted barley to brewers, whisky distillers and food makers, was looking to increase production and improve its facilities. It obtained a tailored funding solution provided by Barclays and Lloyds TSB, which included an ABL facility making full use of the company's property, stock and inventory assets. The facility works well for the business, which has seasonal fluctuations, as it provides flexibility around additional working capital and enables continued business investment.



because of a requirement to offer full bad debt protection on all individual debts."

The funding of other assets also differs across Europe. "While it is usually possible to take security over different assets, the ease with which that security can be realised on the insolvency of a client varies greatly and has served to restrict multi-asset ABL facilities in various European jurisdictions," Sharp notes. "Overall, the UK legal environment is among the most supportive, accounting for why the UK is by far the largest European market for factoring and ABL."

Nevertheless, industry insiders expect ABF to continue growing around the world. "Outside of the US and Europe, markets are developing rapidly – as illustrated by China leaping up the rankings over the past three years," Bevan says. "Most of the lending in these markets is carried out in the form of factoring secured on the debtor book, rather than all-asset lending." In terms of client sales volume for factoring, for example, China now represents the largest marketplace, ahead of the UK and France. The US dominates in terms of all ABL, however, where in excess of $70bn in funding is provided in this way.

Business types

Businesses of all sizes can use ABF, but it is more suited to some than others. "Asset-based finance is suited to asset-rich companies, potentially with challenging cash flows, those with highly seasonal trade, companies going through a period of rapid growth or that are highly cyclical and have been heavily affected by the recession," Bevan says.

In terms of sectors, ABF is widely used in manufacturing, as well as the distribution, services and transport sectors. It is also appropriate for typical pharmaceutical, wholesaling and engineering companies. "Attractive sectors [for invoice finance] are where a good or service is being provided, and there can be no dispute about whether the service has been provided," explains Warwick Long, head of UK receivables finance at HSBC. Recruitment agencies are perfect examples. PageGroup (the rebranded Michael Page) this year secured a £50m facility with HSBC Invoice Finance to support growth plans, including international trading.

"When you move into construction and industries where there are staged payments, it becomes trickier because

ADVANTAGES OF ABF

- No other form of finance will provide as much cash against a firm's assets: a receivables-based facility could generate around twice as much funding as an overdraft.
- Pricing is competitive, as funding is secured against business assets.
- ABF is highly suitable for growing businesses as the funding grows in line with sales, eliminating the need to constantly rearrange funding lines.
- ABF offers businesses the option to add value through cost-effective outsourcing solutions, such as credit control and debtor insurance.
- The range and variety of ABF facilities means there is a solution for businesses of all sizes, across many industries, and at different stages of the corporate life cycle.
- Funding decisions are based on the inherent strength of the business (ie the product and the customers), not just on the strength of the balance sheet, making it available to a wider range of potential businesses.
- ABF facilities are based on the actual purchase of the debtor balances, with much less emphasis on asking for any additional security such as personal guarantees.

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there is more room for dispute about whether a service has been provided in its entirety or not," Long notes. "That said, fundamentally, we are looking at funding businesses that are viable, successful and growing, so we make sure we take a wider view on the strength of the business. It's not just about looking at the assets and how much we can lend against them."

ABF attractions

ABF offers many advantages for businesses (see Advantages of ABF box, left), including encouragement of sound management practice. "The covenants tend to be linked to business disciplines," Sharp says. For example, ABF covenants may focus on debtor and stock turn, rather than some form of profit ratio. Businesses are therefore incentivised to monitor and manage these carefully.

Businesses also have access to the expertise of their asset-based funders. "An overdraft is a service provided at a bit of a distance, whereas with ABL and receivables facilities, we get really into the mechanics of how a business works," says Long. During the due diligence process when arranging a facility, for example, the funder might identify weaknesses in systems and controls around the debtor book. "There may be a shortcoming in the invoicing that, in the event of a dispute, could lead to non-payment," Long says. "We can advise businesses on the strength of their processes and documentation to reduce that risk. It's very much a partnership, and what works for us should work for the company as well."

That partnership continues once the ABF facility is up and running. "We have daily contact with many of our clients," says Long. "Our job is to get close and add value. A business might be a first-time exporter, for example. We can hold their hand, talk about the challenges and provide insight into their debtors. So it [ABF] tends to be an interactive service, though it depends on the client. Some prefer a straight IT-based solution." The associated IT systems now are extremely slick and keep evolving. In May, HSBC launched a smartphone app, enabling client businesses to draw funds or request credit limits on their customers while on the move.

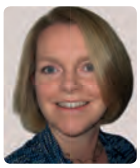
There are potential limitations with ABF, however, and issues to consider. Factoring and invoice discounting are not available for companies with complex or highly contractual receivables. Asset-based solutions can also be more complex than traditional loans and overdrafts, and businesses need to compare the offerings of different providers carefully to make sure they get the best deal for their needs.

WHAT INFORMATION DO LENDERS REQUIRE?

When considering an ABF application, lenders will seek to build a comprehensive view of the business. They will typically look at:

- **Financial strength – profit and loss, and balance sheet;**
- **Trading history and financial performance over a period of time;**
- **Strength of the management team and the product or service offered;**
- **Quality of relationships with buyers and suppliers;**
- **Detailed information on the debtor book;**
- **For all-asset lending, valuations of other assets such as stock, plant and machinery, and property; and**
- **The strength of systems and controls in relation to the debtor book, stock, etc.**

As for associated risks, Sharp says: "Businesses need to be sure that the arrangement they are entering into is right for them. They need to understand how it will work in practice and the obligations it will place upon them. If used correctly, however, ABF can help a client business mitigate the real and pressing risks associated with late payment and other restrictions on cash flow."



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