corporate financial management

ASSET-BASED LENDING

Using your assets

ASSET-BASED LENDING HAS LONG BEEN IN VOGUE ACROSS THE ATLANTIC, BUT INTEREST HAS ONLY RECENTLY TAKEN OFF IN THE UK. **GRAHAM BUCK** ASKS WHY IT IS NOW ON THE AGENDA OF MORE COMPANIES.

Executive summary

- Asset-based lending has been moving up the financial food chain, particularly since the onset of the credit crunch. As long as bank lending looks set to remain tight, companies and bankers will be searching for alternative ways of securing funding.
- Once only of appeal to companies in a tight corner, asset-based lending now looks ready to move into the mainstream.

Sal Settineri, managing director of capital markets at GE Commercial Finance, has no doubts at all about the virtues of asset-based lending. "It's a good product in good times and a great product in tough times," he says

According to The Financial Times, the sector is "rising up the food chain" and has managed to shrug off the effects of the year-old credit crunch that continues to plague the markets. The industry was estimated to be worth more than £191bn at the end of 2007 and has continued to grow this year.

Indeed, as *Table 1* shows, asset-based lending has been the platform for major deals during 2008, such as the £350m secured credit facility for Woolworths Group (see *Box 1*). Completed in January, it was the largest asset-backed loan deal in European retail history.

More recently, a protracted bid battle for TDG, the logistics group that runs Sainsbury's supply chain, ended after Wincanton pulled out, handing victory to Isle of Man investment firm and hedge fund manager Laxey Partners. The latter's £203m clinching offer largely consisted of a £165m asset-based package provided by Bank of Ireland's Burdale Financial unit, which observed that the complex transaction demonstrated the flexibility of asset-based lending.

MORE OF A SCIENCE There is nothing particularly new about asset-based lending. It is, after all, basically the issue of private loans secured on a pool of a company's physical assets, such as property, machinery and leasing agreements. Its origins lie in the concept of factoring receivables (still a major element of asset-based lending), and extending it to other collaterals, such as plant and machinery.

Development was held back in the 1970s when US deals characterised by cash flow lending took precedence, says Jon Norton, director of structured finance for Burdale.

"Looking at asset values was regarded as old-fashioned, in many cases because people no longer had faith in balance sheets," he explains.

However, groups such as GE Commercial Finance developed asset-based lending in North America, and over the past 15 to 20 years it has grown steadily more refined, becoming "more of a science", according to Settineri.

Less than 10 years ago, asset-based deals in the US were typically around the $100m (£55m) mark; even the very biggest did not exceed $300m. Today, the average figure is between $1bn and $1.5bn, with a couple last year testing $2bn.

EUROPEAN MARKET The European asset-based lending market has developed rather more recently, with greater involvement by investors facilitated by European banks participating in US deals. But uncertainty has limited lending and most deals have been much smaller than those across the Atlantic. A £175m asset-based lending facility arranged in February 2006 by Burdale and Lloyds TSB for furniture retailer MFI (now Galiform) was pioneering in "bringing several types of deal together in one", says Norton; and at £350m the Woolworths deal represented a major transaction.

More sizeable asset-based lending deals could follow in Europe. Interest has mounted "as more borrowers are affected by the increasing cost of debt and the reluctance of commercial banks to lend since the onset of the credit crunch", according to The FT.

The newspaper cited a recent survey of just over 100 UK-based accountants by business lender Venture Finance showing that far more companies had begun looking at asset-based lending in the past 12 months. More than half said it was attractive to their clients, compared with only 2% for a similar poll in 2007. It also found that interest in invoice finance had jumped to 29% in the past year, from 3% in 2007.

Venture Finance's managing director Peter Ewen says: "While the popularity of bank loans has remained static, our research supports the notion that the tightening of business credit is forcing businesses

to look around for other ways of raising funds."

But Kate Sharp, chief executive officer of the Asset Based Finance Association (ABFA), thinks it could be "premature" to assume that the credit crunch is the principal factor behind greater interest.

She points out that asset-based lending took off in North America 10 years ago, so much of the growth to date in this country simply reflects the UK following a trend, although recent deals here involving well-known names such as Woolworths could accelerate it.

Settineri says Europe's asset-based lending market has been growing. "Asset-based lending demands a reasonable amount of infrastructure, so that a company's assets and receivables can be valued," he says. "We're well placed for this, thanks to our factoring platforms across Europe, which give us an advantage in running these deals."

ABFA has already reported that cash advances by the asset-based lending industry grew by 30% in 2007. And the credit crunch could serve to convert more interest into actual deals. "Asset-based lending stands up very well when the economic climate is tough," says Sharp. "As there's little evidence of conditions easing in the near term, more companies will become interested, although it could be a while before they start coming on board in significant numbers."

To date, Sharp says ABFA has worked largely with companies in the manufacturing sector but has recently seen an increasing level of interest from the retail, recruitment and haulage sectors. But she warns that asset-based lending is not an ideal solution for every sector, citing large construction companies as an example of a sector where it may be less adaptable.

Asset-based lending may be, in Norton's words, essentially "a sophisticated form of pawnbroking" in the way it amalgamates stock and debtors. Burdale's more technical description classifies it as "senior secured debt providing funding solutions for businesses undergoing strategic change, be it through acquisition, restructuring, turnaround or organic growth".

Table 1: Major asset-based deals in 2008

Month	Deals
January	■ £23m cross-border senior secured credit facility provided to men's fashion brand Baumer by GMAC Commercial Finance. ■ £31m integrated refinancing package and new banking facilities provided to Scotch whisky group Burn Stewart Distillers by KBC Business Capital.
February	■ $500m syndicated asset-based facility for "a worldwide leader" in aerospace components, led by Lloyds TSB Commercial Finance. ■ £385m senior secured credit facility for Woolworths Group – the largest ever asset-based loan to date in European retail – structured and underwritten by GMAC Commercial Finance and Burdale Financial. ■ €45m invoice finance funding provided by HSBC Invoice Finance, enabling the acquisition of a European group by the UK arm of an internet security hardware and software provider. ■ £23m inventory facility provided to bookshop chain Borders (UK) by Landsbanki Commercial Finance, secured against book inventory in its stores and distribution centre. ■ £35m package provided by RBS Invoice Finance to Bairds Malt as part of total facilities of £60m provided by the Royal Bank of Scotland.
March	■ £65.5m credit facility provided to LPC Group, the UK's largest independent manufacturer of specialist paper products, by Landsbanki CF. ■ £45m credit facility provided to plumbing fittings manufacturer and distributor IBP by Landsbanki CF in an innovative pan-European multi-jurisdictional deal.
April	■ £330m financing transaction completed by Barclays Commercial Bank and Burdale Financial to support management buy-out of wholesaler and distributor Palmer & Harvey. ■ £25m facility provided to chemicals, oils and lubricants distributor Multisol Group by KBC Business Capital to conclude management buy-out.
June	■ Spare parts and components supplier Imperial Multipart's £20m management buy-out funded via a £15m package provided by KBC Business Capital.
July	■ Financing package of £165m arranged by Burdale Financial to facilitate Laxey Partners' buy-out of supply chain management group TDG. ■ £40m refinance completed by KBC Business Capital for AIM-listed sugar and bakery ingredients company Real Good Food, owner of Napier Brown, Renshaws and Haydens Bakeries.

Box 1: The Woolworths deal

Woolworths completed a £350m asset-backed loan deal in January this year, together with a separate loan of £35m, refinancing its bank facilities through a four-year package underwritten by Burdale Financial and GMAC Commercial Finance. The retailer does not own its stores and its outgoing chief executive Trevor Bish-Jones said its fixed-charge covenant would have made lending terms steadily more difficult to meet because of rising rents.

Under the new deal, the facilities were secured against the group's assets – in particular, the debtor book of its successful wholesale division EUK and the stock base of its 800 stores. EUK supplies supermarkets and other retailers with CDs, DVDs, computer games and books. Its success in winning new clients and growing its market share has also increased its parent group's working capital requirement.

Julie Fabris, Woolworths' group treasurer, and Stephen East, group finance director, said the appeal of asset-based lending lay in providing reliable medium-term finance that flexed with the business's working capital requirements. They believe it will appeal to a range of companies in the UK and that, while Woolworths' own £350m deal is unlikely to be dwarfed in the short term, more three-digit deals should follow.

But asset-based lending offers the major advantage of flexibility, enabling companies to meet specific needs. It has been used by companies for expansion, refinancing, acquisitions, management buy-outs and management buy-ins.

But Norton reports that since the onset of the credit crunch there is evidence of asset-based lending moving away from companies that are being turned around and becoming more mainstream. "A year ago, many treasurers wouldn't have considered it," he says.

In response to this interest, a flurry of new asset-based lending funds, with an average size of $170m, have appeared as hedge fund managers look for a way to make higher returns uncorrelated to the stock market. They join the handful of lenders that have pioneered asset-based lending, such as Burdale, GE, Lloyds TSB and GMAC.

In the US, asset-based lending funds have moved into the states hardest hit by the sub-prime fall-out, such as California and Florida, and given investors the opportunity to buy property at cut-price levels. Other asset-based lending hedge funds offer loans at a high rate of interest to developers unable to secure financing from the banks, with the right to seize the property if debt repayments are missed.

BANK-STYLE PRODUCT The main dealmakers have been a relatively limited group until now. According to Norton, the main clearing banks have "fantastic businesses" but their structures mean that each is contained in its own separate silo. "It's not often that a loan can sit over all of the company's assets, which is where the asset-based lenders come into their own," he says. "What we do differently, along with a handful of other lenders, is to cut through the different silos."

Add to this the fact that while asset-based lending should theoretically be easy to transact in Europe, enforcing security poses an obstacle due to differing national bankruptcy laws. This makes many lenders reluctant to accept companies in turnaround.

And while asset-based lenders typically take on businesses that involve a higher degree of risk than the main banks handle, asset-based lending is nonetheless a bank-style product with bank-style pricing, Norton adds.

Lenders base their forecast on how the business will perform over the next three years on the company's projections and, for those being restored to financial health, ensure that any cash during the turnaround period can be funded.

"Asset-based lending is different in that it offers safety in numbers," says Norton. "You need huge numbers of receivables. It also involves a great deal of control by the lender. For instance, we may require weekly reports on receivables and other items. But while it is an intensely monitored product, it can generate high levels of leverage and the covenants tend to be less strict."

In recent years, asset-based lending has proved a good solution for businesses being turned around, or that have a low or negative EBITDA (earnings before interest, tax depreciation and amortisation). Burdale's success stories include infrastructure group Jarvis and the wallpapers and furnishings group Walker Greenbank.

According to Adam Hewson, head of European capital markets at GE Commercial Finance, anecdotal evidence suggests that the companies seeking funds are typically not those that bank with the mainstream names. Many are in the early stages of development, restructuring, or undergoing a management buy-out. In many cases their finance department is limited, with no division between the roles of finance director and treasurer.

Does he foresee the greater interest leading to an influx of new players into the market? "Probably not, as only a limited number of lenders can provide the necessary infrastructure."

Not that all treasurers are convinced that asset-based lending is worthy of consideration by more companies. Stephen Pugh, finance director at brewing firm Adnams, says he has had a number of approaches about asset-based lending but has always been "a sceptic about leasing."

"I am told that Basel II rules give such financing an attraction," he adds, "but I've yet to see a clear explanation of why ordinary lending cannot be structured just as attractively and a demonstration that part, at least, of this benefit is passed back to the borrower."

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