Give liquidity a lift

SIMON FEATHERSTONE EXAMINES ASSET-BASED LENDING AND ITS INCREASED IMPORTANCE TO EFFECTIVE CASH MANAGEMENT IN THE CURRENT FINANCIAL CLIMATE.

Executive summary

- Asset-based lending can help companies manage their cashflow more efficiently, boost their working capital and release funds for expansion.

The old adage of cash is king has never been more relevant than in the current downturn, which has brought cashflow issues into sharp focus. According to a recent report by accounting firm BDO Stoy Hayward, around one in every 50 businesses in the UK will fail this year alone, leading to tens of thousands of insolvencies over the next 18 months, as a result of poor cash management.

The treasurer's part to play in a company's success is arguably more crucial than ever. The role has shifted from managing tactical, routine treasury processes to activities that add shareholder value.

As organisations look to treasurers to reduce costs, enhance productivity and improve risk management, those in the position are increasingly looking at other ways of generating liquidity.

More and more firms are realising that a key means of strengthening cashflow is to manage the assets of a company more efficiently and effectively.

As a result, asset-based lending (ABL), which includes factoring and invoice discounting, is increasingly being considered as a vital treasury tool for managing cashflow, boosting working capital and releasing funds for expansion.

WHAT IS ABL? Typically structured as a revolving line of credit, an asset-based loan is traditionally secured and backed by tangible assets, such as accounts receivable, inventory, plant and machinery, and property.

Not surprisingly, interest rates on asset-based loans are often lower than rates on an unsecured loan or line of credit because of the security offered by the assets.

The secured nature of an asset-based loan allows funds to be injected quickly into a business, providing companies with rapid access to capital. It focuses the company on its working capital and its ability to fully leverage the asset base of the business.

Effectively managing funds in this way empowers a company to be fleet of foot, allowing management to enter new agreements safe in the knowledge that ABL will boost funds immediately and give them the breathing space to move forward confidently.

ARRANGING ABL When evaluating a company wishing to take out an asset-based loan, the lender determines the value of the business's assets based on thorough due diligence. The purpose of this is to predict the amount of funding the facility can generate. This is then compared with the actual cash needs of the company to ensure the cashflow requirements are met.

As part of the process, the provider analyses the company's books and records, including accounts receivable and inventory, and appraises fixed assets such as machinery, equipment and property.

The lender will conduct a site visit to see a prospective borrower's inventory first-hand and to assess the strength of the senior management team. The lender is then able to assess the company's value, weighing qualitative as well as quantitative factors, and provide a bespoke tailored facility.

ADVANTAGES AND APPLICATIONS The biggest advantages of ABL are its versatility and flexibility. In the current climate, there has been increased demand for ABL from a wide range of businesses, everything from SMEs to multinational corporations with complex cross-border requirements.

ABL delivers sophisticated solutions for a variety of scenarios including growth, buy-outs, buy-ins, mergers and acquisitions,

THE SECURED NATURE OF AN ASSET-BASED LOAN ALLOWS FUNDS TO BE INJECTED QUICKLY INTO A BUSINESS, PROVIDING COMPANIES WITH RAPID ACCESS TO CAPITAL. IT FOCUSES THE COMPANY ON ITS WORKING CAPITAL AND ITS ABILITY TO FULLY LEVERAGE THE ASSET BASE OF THE BUSINESS.

refinancing, turnarounds and public to private transactions.

For those looking to refinance, whether an existing package is expiring, restricting cashflow or not providing sufficient working capital, ABL is a popular choice.

Over the past decade, ABL has also established itself as an increasingly important source of financing for change events, which help a firm to gain scale.

Many businesses struggle to fund sizable deals through cash reserves alone and for those not wishing, or able, to take on traditional term debt, or release equity to a third party, ABL is an ideal solution for optimal leverage.

As the market becomes aware of the range and sophistication of transactions that ABL can support, it is being brought into the funding mix at an early stage in the transaction process.

It is rapidly becoming a frontline form of finance for many institutional investors and their portfolio businesses and can release the funds needed to execute buy-and-build acquisition strategies.

Its flexibility allows ABL to sit comfortably alongside debt and equity in a deal structure and can implement both value protection and enhancement strategies. Providers will also work closely with a business to structure the optimum set of facilities for the deal.

Funds can also easily be ramped up, should the enlarged company require additional headroom post-transaction in order to capitalise on new opportunities.

OVERSEAS EXPANSION AND EXPORTING Many UK companies with a competitive product or service are taking advantage of favourable exchange rates by entering international markets to drive growth during the recession.

However, the worry of multicurrency trading can be offputting. Part of an ABL facility can include currency facilities and funding expertise to address these concerns.

ABL is once again capable of bridging the gap between the completion of work and the receipt of payments, enabling management teams to execute international expansion strategies without it having a negative impact on the working capital cycle.

IDENTIFY AND MINIMISE RISK As a result of increasing concern about customer insolvency and the huge negative impact it can have on a business, more companies are using credit rating facilities offered by some ABL providers to identify potential risks where clients may default on paying invoices.

These enable ABL clients to obtain credit information on an unlimited number of current and prospective customers.

These services provide credit checks on millions of UK firms and are used to determine payment terms or credit limits for new clients. Data is collated from a number of sources including factoring operations which are provided by a number of major UK finance institutions.

An increasing number of companies are also including debtor insurance policies in their package of ABL facilities.

These agreements take the legwork out of spotting potential credit risk problems before they lead to a bad debt, which also frees up management time to focus on running the business.

Crucially, they ensure firms receive payment of outstanding invoices should a customer become insolvent, and protect against the full impact of a bad debt on cashflow.

The challenging economic backdrop has brought the issue of cash management into sharper focus for businesses and particularly among treasurers. The ability to manage and control capital closely is a necessity, and more firms are taking advantage of ABL tools along with debtor insurance and credit rating policies, not only to ensure peace of mind but to manage cashflow, boost working capital and release funds for expansion.

Although it is hard to predict exactly what will happen in the economy over the coming months, Lloyds TSB Commercial Finance is confident that ABL will continue to cement its position as a mainstream and highly effective financing tool for businesses, not only during the tough times but also when the economy is growing.

Simon Featherstone is managing director of Lloyds TSB Commercial Finance.
Simon.Featherstone@lloydstsb.co.uk
www.ltsbcf.co.uk

Lloyds TSB | Commercial Finance