MANUFACTURERS LOOK TO ASSET-BASED LOANS AS A STABLE SOURCE OF FINANCING

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Like borrowers of many stripes today, manufacturers have plenty of financing options from a growing array of sources. However, ever more complex supply chains and the inevitability of an economic downturn sooner or later emphasize the need for manufacturers to know their lenders — and for their lenders to know them.

Madelaine Chocolate Co. had to close its New York City chocolate factory after it was flooded by Hurricane Sandy in the fall of 2012, shortly before the all-important holiday season began. Most lenders would have canceled the company's $8 million line of credit. However, as reported in *Crain's New York Business*, asset-based lender Gerber Finance was sufficiently comfortable with the chocolate maker's management that it waived interest payments and actually increased the business's credit line.[1]

CLOSE RELATIONSHIP A PLUS IN TOUGH TIMES

That level of intimacy is desirable for any type of lender–borrower relationship, and it is essential for asset-based lending (ABL). ABL depends on the current value of the assets, and lenders tend to be much more involved in monitoring the borrower's business than typical cash-flow lenders. Their understanding can be a major plus in stressful times, but borrowers must also have a solid understanding of their lenders.

That lesson was learned by numerous manufacturers during the most recent financial crisis, when they found themselves in desperate financial straits because many lenders, especially those new to the market that had competed mostly on price, shrank their books or had to close them altogether. Today, alternative lenders ranging from private equity firms to specialty lenders have similarly jumped into middle-market lending over the last few years, in search of returns in the current low-interest-rate environment.

"Borrowers should look for lenders who will be with them through the economic cycle; many didn't have those types of partners in 2008 and 2009 and were severely hurt by it," says Bob Trojan, CEO of the Commercial Finance Association (CFA), which represents more than 300 asset-based lenders.

In fact, borrowers should specifically ask lenders how long they've been lending to middle-market manufacturers, whether they've been through the economic cycle, and about the depth and breadth of their credit teams' experience, Trojan advises. They should look for lenders who can do "in-the-box," routine deals but also have the wherewithal to aid with transactions that require some additional underwriting, either through an affiliate or an experienced third party, he says.

Leverage of six times or more and irregular cash flows that may insufficiently cover debt obligations are red flags that typically prompt more creative solutions, he says.

ABL TRENDS

ABL enables borrowers to use their inventory, accounts receivable, and increasingly other types of assets to unlock capital. Asset-based lenders — commercial banks and increasingly alternative lenders including business development corporations (BDCs) and hedge funds — typically work very closely with borrowers. The lenders monitor the borrowers' assets routinely, because they are providing financing based on the value of those assets as they move through the supply chain and manufacturing process.

Technology has dramatically changed the credit markets and especially asset-based lending. It has enabled asset-based lenders to monitor the underlying asset much more efficiently and automated much of the previously burdensome operational and administrative tasks. And because the lenders work closely with their borrowers, and asset-based loans are ongoing facilities, the rates tend to be attractive compared to other forms of credit.

"It can actually be cheaper for borrowers to go down the asset-based route because the relationship provides lenders with greater certainty that the assets are there, and a better understanding of when the business needs help," Trojan says.

Significant players in the ABL space often provide a more complete lending solution, he says. Clients can talk to a team of bankers to determine their current credit needs, based on the current phase of the credit cycle, ranging from cash flow loans to highly structured asset-based facilities.

Historically, manufacturers of retail products, such as jewelry and clothing, were the biggest users of asset-based lending. Now it's much more diversified, Trojan says. He notes that a wide range of industries now tap this funding source, ranging from steel manufacturers to temp agencies to government contractors.

Another significant trend has been for smaller manufacturers to extend their supply chains overseas. Both cash-flow and asset-based lenders can play financing roles to support this move, but technology has enabled asset-based lenders to provide attractive rates because they can monitor each link in the chain. In fact, as a result of technology, lenders financing those supply chains can be smaller or regional institutions, without branches or other significant operations overseas. Some feet on the ground are necessary, Trojan says, "but with greater technology, the lender really just needs partners who know how to work with companies inside China, India and other countries."

1 "Sandy and the Chocolate Factory," *Crain's New York Business*, Dec. 21, 2012, http://www.crainsnewyork.com/article/20121221/SMALLBIZ/121229974/sandy-and-the-chocolate-factory

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