



Assets You Can Bank On

More companies are leveraging all sorts of collateral—from patents—to inventory—to raise capital.





These days, just about every industry is going through a period of significant change, and the asset-based lending business is no exception.

Offered by a wide range of commercial finance companies, including major banks and credit boutiques, asset-based lending has a long history of providing much-needed financing to companies unable (or unwilling) to borrow from a bank. Typically these include companies experiencing rapid growth, seasonal swings, a temporary downturn in demand, or those that lack the cash to finance a new business concept.

Now, a number of market developments are redefining asset-based lending. For starters, new competitors, such as hedge funds and private-equity firms flush with cash, are forcing traditional lenders to become more creative in how they structure these loans, including arranging loan covenants with flexible terms. In addition, as businesses of all sizes expand overseas, asset-backed lenders are following along, providing financing to help them in their efforts. Patents, trademarks, and other forms of intellectual property—once hard to value—are increasingly being accepted as forms of collateral. And thanks to the growing importance of health care to the economy, more lenders have begun working with borrowers in that industry, a sector that had traditionally been



seen as highly unpredictable.

Unlike traditional bank loans, “Asset-based loans are based not on the value of a company per se or its balance sheet, but on the collateral it has,” such as inventory, machinery, or other assets, explains Bruce Jones, executive director of the Commercial Finance Association (CFA), a New York City trade group. And it’s a business that’s growing: During 2006, \$489.3 billion worth of asset-based loans were outstanding, compared with \$420 billion the prior year, according to the CFA.

What hasn’t changed are the industry’s basics. As always, loans are based on a percentage of an asset’s appraised value. For instance, the so-called advance rate—or level of borrowing—for accounts receivables is typically 85% of liquidation value, while equipment fetches 80% and real estate will result in loans valued at about 75% of fair market value.

The Price of Globalization

Perhaps the most significant change the industry is experiencing is the result of globalization. As more potential borrowers move overseas, either by expanding their operations or buying international companies outright, “an increasing number of U.S. asset-based lenders are doing cross-border lending,” says Richard Kohn, a principal of Goldberg Kohn, a Chicago-based law firm and the CFA’s co-general counsel. There is no accurate dollar amount for this kind of lending, but as Kohn puts it, “It’s a sea change from just a few years ago.”

Bank of America Business Capital is one major player that has stepped up its global activity. “We finance the overseas subsidiaries of many U.S. companies,” says president Joyce White. She says



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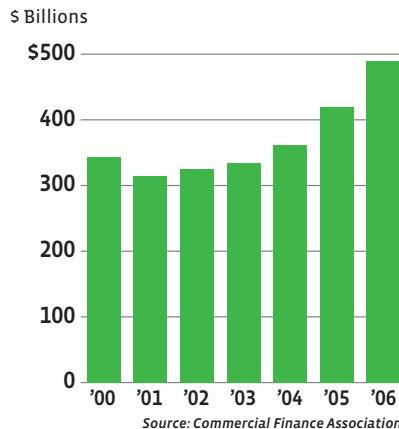
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that, with the bank's global footprint, and financial products such as loan syndications, treasury services, and loans with interest rate protection, Bank of America Business Capital can make asset-based loans to suit any kind of international expansion.

Another key change is the increasing acceptance of intellectual property as collateral. Two years ago, Bank of America gave Gibson Guitar Corp. a secured \$136.2 million credit line, using the Nashville, Tenn.-based company's trade names, including Epiphone, Baldwin, and Wurlitzer, as a portion of its collateral. Gibson CEO Henry Juszkiewicz says the company needed money for inventory and wanted to get its asset-based financing from the bank. The problem: Gibson's cash needs exceeded the amount that could be guaranteed with its existing inventory. So Bank of America Business Capital came up with "an ingenious solution," explains Jusz-

Billion-Dollar Boom

The U.S. asset-based lending industry has been on an upward trajectory since the economic downturn of 2001.



kiewicz. "They included the value of our trade names as well." By doing so, Bank of America was able to lend

Gibson all the money it needed.

Indeed, the increasing expertise of third-party appraisers to assess the value of intellectual property is another reason why lenders are more willing to consider this asset class as collateral, explains Warren Mino, president of Webster Business Credit, a New York-based subsidiary of Webster Bank located in Waterbury, Conn. According to Mino, over the past five years, Webster Business Credit has extended credit to a handful of companies using intellectual property as one of the primary forms of collateral. This type of financing is typically part of a complete collateral package that includes accounts receivable, inventory, machinery, and equipment.

Still, a trade name or a patent is considerably less tangible than, say, a piece of machinery. How do lenders tap the value of intellectual property if the borrower can't pay? In most cases, the company can sell the patent or trade name in a public or private sale. Or, says Mino, "They may sell it along with the inventory or a customer list." In some instances, if the value of the business is based almost exclusively on its intellectual property, the borrower may end up selling the entire company. Webster Business Credit primarily finances U.S. manufacturers, distributors, and retailers.

Lending to Health Care

A growing interest in lending to the health-care industry is yet another emerging trend. Traditionally, asset-based lenders have shied away from doing business with health-care companies, labeling them too complicated to deal with. "Reimbursement can be a moving target," says Randy Abrahams, president and CEO of Bridge Finance Group in Chicago. Government agencies set reimbursement rates for medical procedures, he explains, and frequently make

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But as health care has become more important to the economy, some lenders have started to embrace it as a new source of business. Bridge Healthcare is one such company, specializing in asset-based lending to health-care service companies, including hospitals and home health-care providers. Abrahams says Bridge has developed specialized systems for evaluating a borrower's financial situation that can accommodate the idiosyncratic nature of the health-care industry.

New entrants into the asset-based lending market, including hedge funds, private equity firms, and banks that were not involved in asset-based loans in the past, have spurred competition for business among lenders. "There's an unprecedented level of liquidity in the market," says Brian Cove, deputy executive director of the CFA.

The Money Chase

Leading borrowers of asset-based finance in 2006, categorized by industry.

- ◆ **Automobile parts and supplies manufacturers**
- ◆ **Food processors/manufacturers**
- ◆ **Metal goods manufacturers**
- ◆ **Retail—department stores**
- ◆ **Retail—lumber and other building products**
- ◆ **Retail—radio, television, consumer electronics**
- ◆ **Steel products manufacturers**
- ◆ **Wholesale—groceries and related products**
- ◆ **Wholesale—metal service centers**
- ◆ **Wholesale—motor vehicle supplies and parts**

Source: Commercial Finance Association

Increased competition has seen lenders offer increasingly innovative deal structures to attract new business. For instance, it used to be common to mandate that borrowers adhere to as many as four financial measurements, including what's known as a fixed-charge coverage ratio. That measure evaluates a company's ability to make payments using Ebitda, says Daniel Baker, a partner with Chapman and Cutler, a Chicago law firm. Now, in an effort to streamline the process, many lenders will require that a company adhere only to the fixed-charge coverage ratio.

The bottom line: For asset-based lenders, successfully dealing with today's changing times requires creativity—and a lot of flexibility, as well. ■

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