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3 Key Things All Asset Based Loans (ABL) Lenders Look For When Approving A Loan

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[Note from author - I published this article a few years back. It's been updated for the impact of COVID-19].

ABL financing is the dominant form of financing in the non-traditional financing marketplace. According to Thomson Reuters, ABL's totaled just under $20 billion dollars in just this first quarter in 2020 in North America.

These loans are ideally suited for a business that for some reason do not qualify for traditional bank financing. Some traditional banks do have ABL divisions, but their minimum loan sizes may be out of reach for smaller businesses (ie: customer concentration, short track record, credit report issues).

ABL financing incorporates any type of loan where assets have been pledged as collateral to secure the loan and includes financing products such as factoring and bridge financing.

When approving loans, ABL lenders are primarily interested in the following 3 key considerations:

1. The orderly or forced liquidation values (OLV or FLV) of the assets being financed

Asset based lenders primarily lend against tangible assets or collateral that can be relatively easily sold off or liquidated if the borrower runs into financial difficulty and the lender must sell off the assets that were used (pledged) as collateral for the loan to get their loan repaid.

For assets such as plant and equipment or real estate, ABL lenders generally require an orderly or forced liquidation appraisal (often referred to as OLV or FLV values) and will lend up to a certain percentage (often 75%) of these values.

For accounts receivable (AR), ABL lenders tend to lend between 60%-90% of the face value of the AR, after making allowance for discounts, warranties and returns. AR insurance can increase this advance rate percentage.

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Some lenders will also lend against inventory, but with a focus on finished goods that are saleable and generic raw material. Many require an appraisal of the inventory. The percentage lenders would advance against it is primarily driven by the saleability of the inventory (ie: the closer to being able to recover cost in a liquidation scenario, the higher the advance rate). Lenders do, however, factor in the costs to liquidate and if material could significantly reduce their advance rates.

ABL lenders do not finance assets such as leasehold improvements, prepaid expenses, computer software or assets that depreciate rapidly in value over time.

In light of COVID-19, we are seeing a divergence in FLV values of assets. Assets used, for example, in the manufacture of PPE are holding their values. But assets such as restaurant equipment would have decreasing FLV values. Homes pledged as collateral are also coming in at lower appraised values than one might have seen just 6 months ago.

2. Business viability

Many businesses that require ABL financing solutions have hit a bump in the road or are going through a challenging time. As a result, ABL lenders do a careful assessment of the viability of the business.

They typically do a detailed review of the business plan, assess the adequacy of management, the strength of the accounting/finance department and the ability of the business to operate if any key employees leave.

In addition, the solution provided by ABL lenders is a working capital solution and as such, they do not generally fund operating losses. Many will want to make sure the business has access to additional debt or equity funding in the event losses are being forecasted.

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A due diligence field exam is also often a financing condition where the ABL lender either sends its own or a third-party due diligence team in to assess the viability of the business.

With COVID-19, ABL lenders will only consider lending to businesses that are still operating. They are also having a more granular look as to how a business's end customer is doing and will want to understand the impact this pandemic will have on both the demand for the business's goods or services as well as their access to labour, particularly for manufacturers.

3. Exit plan

ABL solutions are expensive relative to traditional bank financing and are generally designed to be shorter term solutions (anywhere from 12 to 24 months).

ABL lenders want to understand before they advance their funds, how they are going to get repaid. Will the business qualify for refinancing with a traditional lender? Does the business plan and cash flow projections support the business reaching this refinancing point? Does management have the skills and the contacts to refinance the business when required?

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In light of COVID-19, they are also recognizing the length of time to refinance could be at the longer end of the range given traditional banks are also managing their existing clients and some appear to have a limited appetite to consider providing financing solutions to new customers.

Using a professional independent advisor to advise and navigate this process can save someone lots of headaches if they select a lender that is not adequately funded.

In conclusion, ensuring one has addressed these three key aspects will dramatically improve one's chances of getting approved for an ABL financing solution. Readers should also be aware, however, that not all ABL lenders are created equally. Some are well capitalized and have funds to deploy, while others tend to only raise funds on a per-transaction basis. Some provide financing on all asset types, but not all. They also often have minimum loan sizes which can disqualify an applicant from getting approved. Using a professional independent advisor to advise and navigate this process can save someone lots of headaches if they select a lender that is not adequately funded.

At Isaacs Advisory, we have extensive experience advising, structuring and sourcing a wide range of traditional and non-traditional financing solutions of $100K to $1M. We can also refer you, our clients, to other lenders or advisors for larger financings. For more information, please contact Adrian Isaacs at (416) 835-4511 or aisaacs@isaacsadvisory.ca.