ASSET-BASED LENDING

THE WHY, HOW AND WHO

Using asset-based lending as a funding tool to support business growth

ABN·AMRO Commercial Finance

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Foreword from our sponsor

Introduction to asset-based lending from **Peter Ewen,** managing director at ABN AMRO Commercial Finance

> "Using ABL, as the **assets increase,** so does the funding, this means that **working capital automatically** adjusts to match the sales performance of the business."

Traditionally sitting just outside the mainstream, asset-based lending is on the rise, increasingly enabling ambitious firms to invest in everything from new premises to export opportunities. Now is the time for greater clarity on why you should consider it, how it can benefit business and who has the most to gain.

The funding you need is closer than you think

The reason asset-based lending is so widely used amongst sectors such as manufacturing, engineering and wholesalers is that these companies are asset rich – with often a lot of highly valuable property and equipment – and have huge amounts of collateral against which to borrow. This results in a low cost way to boost cash flow and invest in valuable new business opportunities.

However, the misconception that asset-based lending is only available to those with large quantities of physical assets is potentially damaging to other businesses which sit outside this bracket. The greatest asset of them all is held in your accounts department – not in the warehouse or factory.

Assets don't need to be as obvious as premises, vehicles or heavy equipment – they can be as simple as a bulging sales ledger. Too often I hear of company directors borrowing against personal property, even their family home, when the company assets alone could have provided more than enough collateral to secure funds at a good rate.

Responsive benefits to give you an agile advantage

Any growing business in need of capital may have a lot to gain from asset-based lending, not least from the cost of funding, which compares very favourably with other funding options. But the advantages don't stop there. If change is in the air, with either major transformation, or smaller peaks and troughs through the year, then borrowers can benefit from the unique flexibility of this form of funding.

Businesses experiencing strong growth are a prime example. When reinvesting surplus cash back into the firm, there's often very little flexibility in the short term to increase the level of working capital required. Using asset-based lending as the assets increase, so does the funding, this means that working capital automatically adjusts to match the sales performance of the business, whether through seasonal highs and lows or rapid growth. It's a level of flexibility that's hard to achieve through most funding sources and one which isn't restricted to domestic operations or trading alone. Asset-based lending can have enormous cross-border benefits, whether it's exporting to a customer overseas or a wish to align multi-local operations within a pan-European group. The world is getting smaller, and asset-based lending can enable a smooth and seamless joined up approach.

Speed is also of vital importance in most funding situations. When a company needs working capital, it often needs it quickly, to provide a timely boost that allows it to meet orders, deliver its services and maximise opportunities. In fact, the asset-based lending model is designed predominantly as a short term solution, to provide the financing companies need, when each need it. The flexibility of it means that structured working capital finance can be uniquely packaged much faster than a traditional business loan or overdraft.

Another advantage of asset-based lending is particularly relevant when looking to expand either organically or through an M&A strategy, when most traditional lenders are wary of committing funds without a proven track record of commercial viability.

Then the alternative to mainstream funding channels sits between attracting investor interest, and adopting a secured form of funding against assets. Choosing it in this situation provides a more holistic approach to funding intrinsically linked to the value of any new business or assets gained by the acquisition, whilst avoiding the need to give away equity. In this way, a successful expansion will be continually supported as it grows, providing ongoing working capital and headroom required to survive the often difficult post transitional phase.

Finance that's easier and faster to access

The decreased appetite for business lending from the banks, coupled with the impact of Basel III, has meant the search for accessible finance will increasingly turn to viable and trusted alternatives. The focus on current assets of a business and leveraging on these assets can often provide funding lines in excess of other, more traditional forms of finance, which often focus more on the profitability and cash flow of the business. This enables faster decisions to be made without lengthy and onerous covenants and personal guarantees to be constructed.

Compared to the other conventional finance, with new Basel III banking treaties and their impact on the utilisation of bank capital, the asset-based lending cost of funding lines are now competitive with overdraft rates and can be less by between one and two per cent. Where costs vary beyond this depends on the level of service, and therefore fee, required.

Understanding why, when and how asset-based lending can offer an advantage is the first step in helping more businesses to achieve objectives of secure, sustainable growth. This guide is designed to help you on your journey.

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A new generation of asset-based lending business leaders

Companies have had to become increasingly nimble and innovative when it comes to growth finance, and asset-based lending is providing many the flexibility they need, says Real Business editor Hunter Ruthven.

Asset-based lending is on the rise, with many utlising one of the oldest forms of finance in the world. Having weathered the recessionary storm, when its perception was one of supporting failing businesses, asset-based lending is now becoming a capital choice for growing businesses throughout the UK.

From multi-million pound agreements to fund buyouts, to accounts receivables lines helping with the management of cash flow, firms around Britain are becoming more open to it.

In its purest sense, asset-based lending can be broken down into two forms: revolving with factoring and invoice discounting based on receivables and inventory on raw or finished goods and fixed-term loans against assets such as plant and machinery or property. More detail can be found on our infographic overleaf.

Figures from the Asset Based Finance Association (ABFA) reveal that the UK is leading Europe in the use of asset-based lending. It now represents 15.7 per cent of the UK's GDP, compared to a European average of 8.5 per cent. Its use in Europe in general is also on the rise, with the total amount written increasing in 11 out of the 14 member countries of the EU Federation of Factoring & Commercial Finance (EUF).

So what about its future? Today it is seen as the "first resort of lending", in contrast to its stigma of old. Asset-based lending is experiencing the same kind of boost being seen by the peer-to-peer and crowdfunding sectors, as the high street banks continue to rebuff the approaches of SMEs in search of capital.

To see how asset-based lending has helped businesses in the UK grow, this digital guide from Real Business has spoken to four companies that have first-hand experience of what it is like. From a range of sizes and sectors, the leaders at these businesses have shared their stories, motivations and advice.

It will also break down asset-based lending to give you a clear understanding of what different options are available, as well as what is required on an upfront and then day-to-day basis.

Access to finance is one of the most discussed issues in the British business landscape today, and awareness a key ingredient to simplifying this process. If companies are going to be able to embrace new challenges, each needs quick and simple capital.

We're really pleased to have ABN AMRO Commercial Finance as a partner – a firm which has great experience of helping exciting businesses with innovative funding packages.

Ongoing working capital and growth solutions

ACCOUNTS RECEIVABLE

Revolving funds needed to drive business forward without waiting 30/60/90 days

60% *Makes up at least 60 per cent of overall ABL package*

90% *Up to 90 per cent of invoiced value received upfront with balance on payment, minus fee – providing immediate access to working capital*

FACTORING

Reduces in-house headcount and takes away stress by including credit control, reducing late payment and allowing business to focus on growth strategy

INVOICE DISCOUNTING

Often offered on a confidential basis to firms with a well-established in-house sales ledger management team

BAD DEBT PROTECTION

An optional extra to either form of receivables finance to provide peace of mind and protection against customer insolvency

Growth acceleration and transactional support

REVOLVING INVENTORY

Funding against stock/inventory levels, usually secured by floating charge

30% *Up to 30 per cent on raw materials*

50% *Up to 50 per cent on finished goods*

FIXED-TERM LOANS

Funding utilising plant and machinery or property based on independent assessment of value on the open market within 3-6 months

60% *Up to 60 per cent on property*

80% *Up to 80 per cent on plant and machinery*

TOP-UP LOANS

A variety of loans including the government-backed Enterprise Finance guarantee and cash flow loans from the lender can enable the necessary funding required

Raising the money needed for a management buyout

Taking control of the direction of a company is an exciting issue, but requires fast and flexible capital

As a business that had been wholly-owned by a bigger plc, access to finance was not something manufacturing firm Ash & Lacy particularly had to worry about.

However, when it underwent a management buyin (MBI) during 2011, that situation changed and suddenly the business needed a significant amount of capital to not just get the buyin away, but also fund the growth strategy devised.

Based in the West Midlands, Ash & Lacy is in the business of metal building envelope systems. Clients include major supermarket chains such as Lidl and Argos, which employ Ash & Lacy to aid in the construction of both stores and depots.

According to finance director Andrew Waterhouse, up until 2008, business was good and turnover was roughly £3m a month for the first half of that year. However, towards the end of 2008, the bottom dropped out and trade seemingly went overnight.

"We were doing lots of distribution centres, and that fell away quite quickly. Because of that the business had to change, and at that time we started doing school building as part of the government's Building Schools for the Future scheme – and survived off that."

Waterhouse very much views the construction industry as first out and last back in when it comes to an economic crisis. In rebuilding the business, management decided to make the company independent and searched for finance mechanisms to support this.

"We needed roughly £7m and selected asset-based lending for a number of reasons. One was that we had lack of security in terms of fixed assets, we leased all of our premises. We also wanted funding that was quite flexible. The business was at the base of turnover so as sales increased we needed working capital to fund that," Waterhouse explained.

Ash & Lacy looked at venture capital but didn't want equity dilution or involvement of other parties. Waterhouse and the team didn't have any experience of asset-based lending so experienced quite a steep learning curve. With the first finance partner, it quickly became clear that it didn't understand the business and an "amicable" parting of ways was secured in 2013.

"We were the last construction firm in their portfolio and they wanted out – so did we. Starting to look for another funder, we were then better placed because of the familiarity with asset-based lending as a funding mechanism."

The company's second partner came with a clever software package that pulls information from Ash & Lacy's systems, meaning daily reconciliation can be provided rather than a "quite cumbersome and painful" monthly process.

Ash & Lacy's 2011 facility was just that, Waterhouse explained. "The whole admin of the facility was cumbersome, archaic in the way it was done. We're looking at refinancing now and one area of examination is where interest rates are – what are the advanced rates.

Waterhouse added that the business also needs to make sure its reserve set up is ok, as its covenance before hasn't been suited to Ash & Lacy's seasonality. Getting the right asset-based lending facility is key and now grows as the company's turnover does. If the basic limits are right, and growth potential build in, Waterhouse said that renegotiation is not necessary.

"The only disadvantage is that there is more admin than a traditional overdraft facility, and we're audited more regularly. In terms of forms of finance, it really does suit us."

On the advice front, Waterhouse recommended going into it with your eyes wide open. He also revealed that lenders will be keeping a close eye on the business. Because of this he suggested being aware of availability going forwards.

"Forecasting 6-12 months ahead is a minimum. If you have a problem coming, make sure you see it in advance and realise if it is something repayable on demand.

"I'd never say never in terms of looking at other options, something like peer-to- peer is new on the block. In terms of venture capital, I think the problem with that is lots of businesses don't want to dilute equity and get interference.

"Other than getting back to loans and overdrafts, for us in the next 3-5 years I can't see any other way than asset-based lending."

> "Ash&Lacy looked at **venture capital** but didn't want equity dilution or involvement **or other parties.**"

IN BRIEF

Business: Ash & Lacy
Sector: Construction
Headquarters: West Bromwich
Founded: 1864
Spokesperson: Andrew Waterhouse

Shunning the banks and securing finance for fast growth

Business need not always take that walk of fear to visit the bank manager - cap in hand.

Banks have been bashed, from pillar to post, since the collapse of Lehmans in 2008 and subsequent scandals that emerged in the form of remuneration, insider trading, currency rigging and government aid.

Business services company The Chemistry Group had been bootstrapped since inception, using the familiar combination of credit cards and re-mortgaged properties. Now a little over ten years old, founder Roger Philby decided that the speed at which he wanted to grow his firm meant needing to take on some outside support.

"Most entrepreneurs will tell you that banks are the devil incarnate. In ten years of my business, I've probably met my bank half a dozen times – they don't understand what business I am in," Philby explained.

"I wanted to grow harder and faster, and bank funding is not available for SMEs. Equity funding gives away a stake – not what I wanted to do."

The company's predicament will have a familiar feel to it for many entrepreneurs. With most of his customers being FTSE 100 or Fortune 500 firms, and despite the constant protestations from the public that these kind of companies should be paying smaller businesses earlier, Philby was still facing payment terms of between 60 and 120 days.

"The new funding allows us to make investments where previously we would have had to wait longer – we can seize opportunities in front of us," he added.

One of the biggest queries companies often have when it comes to asset-based lending is what kind of preparation needs to be done to comply. While Philby did have to do some tidying up when it came to signed statements of work and payment orders, he admitted that the company was a bit lax about that and is now in a better situation.

"Our lender gave us templates to work with, which we modified a bit – but were good at helping us to access funding by tidying up shop. Banks I couldn't speak badly enough about as, for a organisation which should have all the information needed as they deal with SMEs and entrepreneurs daily, they have no advice."

IN BRIEF

Business: The Chemistry Group
Sector: Management constultancy
Headquarters: London
Founded: 2003
Spokesperson: Roger Philby

"In a **6-8 week period** last year, The Chemistry Group **sold £1m of work** and were thus able to up the limits to **accommodate for the need to hire new staff."**

The Chemistry Group's set up means it can get 70 per cent of the invoice ahead of time, and then 30 per cent once it is paid. Interest is paid on the ledger alongside a service charge. The business does have to stick to some payment terms, so can't have clients consistently going over 60 days.

Philby can also chose whether or not to draw down money depending on the situation. "Bottom line is it's a very flexible way of securing finance for us," he added.

In a 6-8 week period last year, The Chemistry Group sold £1m of work and were thus able to up its limits to accommodate for the need to hire new staff. Now it's ledger is back to a normal run rate, demonstrating the funding line's flexibility, Philby said.

He does not have a full time finance team handling the agreement, only a member of staff working for a couple of days a week and a part-time bookkeeper.

The firm has found a form of finance away from the banks, just where it wants to be.

Escaping established draconian firms in favour of new players

Alternative finance is on the rise, and while not particularly new, asset-based lending is innovating and adapting

When it comes to finance and investment, crowdfunding is seemingly securing the majority of headlines. But while the funding channel seems relatively simple and has a good track record, that doesn't mean it works for all businesses.

Inspirium, a technical recruitment and resource company with clients including Network Rail and London Underground among its rail and telecoms customer base, is one such company preferring the asset-based lending approach.

Speaking to us, Inspirium company director Steve Olson explained: "Crowdfunding works in products more than anything else, but not as well in a labour resource provider like us. We looked at one provider briefly, and there was not much encouragement in terms of the funding and margins required."

The 2009-launched business has actually been factored since operations started, so asset-based lending has been part of the company's DNA – as it's grown to a turnover of £7.5m. "We're very lean – you have to be today. Our biggest cost is factory labour, so we're always looking at how to bring cost down," Olson revealed about operations.

The company became jaded and frustrated when working with a large bank on financials and looked for an alternative. As Olson put it: "They're stuck in the past, and quite draconian and out of touch with the changing world – especially around squeezed margins.

"We discovered a newer player, and they supported a fairly quick turnaround. They were very favourable and enabled the flexibility to drive the business forward compared to the larger established firms. There's a much more refreshing and realistic approach."

IN BRIEF

Business: Inspirium
Sector: Recruitment
Headquarters: Bedfordshire
Founded: 2009
Spokesperson: Steve Olsen

The new business relationship was forged in December 2014, with Inspirium securing a £3m invoice facility. Capital aside, there's a much more innovative approach applied from the partner, which includes getting business advice and opinions around strategy.

Olson detailed: "It allows us to grow our own business while we're at the helm with the best possible terms and percentage against margins – it's a closer relationship, personable and hands-on, so we have contact straight into the director level. An investor would have taken control."

The invoice funds secured go towards the payroll and supporting business growth, while still operating with a lean approach.

Having already completed some work on the build, the £14.8bn Crossrail project is one area Inspirium hopes to grow in. As it moves beyond construction and tunnelling and into technical, security and electrical works, Olson expects the existing £500,000 of business completed so far to grow fourfold over the next 12-18 months.

At six full-time staff and 250 subcontractors, Inspirium plans to grow across sectors by taking on extra sales staff in the first quarter of 2015, as well as by opening sites in London and the north west.

"Without the partnership, we wouldn't have been able to service that work. It's imperative, rather than stagnating the business. We've already approached them with another proposal, and their attitude is 'how can they help you?' rather than putting barriers in place," Olson admitted frankly.

"They provide a business support facility, not just funding. It's added value for money, which most companies will try at our level. It's nice – they recognise it's in their interest to grow us, whereas traditional bankers don't like to go outside their sphere.

"To summarise, the traditional firm views deals with a figure and accounts-based approach, and the new player deals as a business, trying to understand how to help us and grow."

Full steam ahead for Inspirium as it looks to make the most of big contracts like Crossrail.

Infrastructure investment in the fast moving tech sector

Think of the technology sector, and the first investment type popping into your head might be venture capital. But not so, for this firm.

The use of cloud computing by UK businesses is steadily increasing, with figures from industry body the Cloud Industry Forum suggesting that there has been a significant boost in the months to come following Microsoft's discontinuation of its Windows Server 2003 product in July 2015.

Some 61 per cent of British businesses still run on some form of the product, and in possibly the most significant IT refresh of the 21st century to date' an average of 14 1,000 servers per day are likely to be transitioned.

Undoubtedly, many businesses will take this time to move server workloads to cloud services. And one of the businesses likely to benefit from this is cloud hosting and cloud computing Infrastructure-as-aService (IaaS)services firm Memset, which has seen some phenomenal growth show for its efforts.

During the recession, the Surrey-based company managed to maintain growth at 15-20 per cent and hosts "20,000 of Britain's websites", with customers including the BBC's Top Gear programme, Lush Cosmetics, Arsenal Football c] Club, Debenhams, and Hilton Hotels.

The company has also seen four consecutive years of 99.992 per cent continuous uptime, with a low record of only 0.021 per cent failed requests.

But this has meant spending large sums every month on server equipment to cater to the rising demand experienced.

"Despite having had a steady and profitable year, the best offer we got from a bank was a £200,000 loan, providing that it was left on account with them. But the main point was that they wouldn't lend capital without a personal guarantee, and they all gave us conflicting advice," said Ken Smith, commercial director at Memset.

This seemed to be a recurring pattern, and founder Kate Craig-Wood noted that the route of selling equity simply wasn't in the equation. "We love what we do so are not bothered about selling in the near term."

That's when the company stumbled across asset-based lending, whereby it gained the money to draw down on server equipment.

"We secured a £400,000 facility to draw down on," Smith explained. "We already had a leasing facility provided by Dell, but a data centre would allow us to round everything up and submit them en-masse instead of sourcing separately.

"We've been converting an old British Aerospace building at Dunsfold Aviation Park in order to build extra office space and a data centre. The data centre will be a 'green facility' on the ground floor and will go a long way in providing savings on running costs. For this, we needed a total spend of around £1.8m. We funded around half from our own internal cash generation, and raised the balance via several HP/ leasing companies, so circa £900,000.

"The company offered £600,000 (although not all of this was for the data centre), and the balance came from several other banks. None of these facilities required a guarantee (we made this plain from the outset) and most were fairly straight-forward, mainly because of Memset's good track record and financial strength.

"So our staff were transferred once the first floor was completed."

He also mentioned that making the facility as secure as possible was high up on their to-do list. This is due to the fact that Memset has IL3 pan-government security accreditation, putting it in a position where the company is able to host G-Cloud, the government's cloud service.

Besides the government contract, Smith explains that "cloud storage is becoming an integral part of any IT strategy", so it wants to take advantage of other opportunities.

"Asset-based lending has given us some leeway in the fact that we had the opportunity to continue growing, which might not have happened if we had managed to acquire a loan from a bank," he explained. "The deal we made also included a one per cent government 'cash-back' sweetner."

Smith went on to say that there were only really three disadvantages. "We were tied in to a three to five year deal, so early repayment is unattractive. And, more often than not, when it comes to asset-based lending, the interest rate is relatively expensive – circa 8-12 per cent depending on provider," he explained, for anyone unware of how rates work.

"Lastly, you need to insist that you acquire title to the equipment at the end of the term. If you don't the contract generally rolls over into a secondary period, which means you risk effectively paying twice."

IN BRIEF

Business: Memset
Sector: IT services
Headquarters: Surrey
Founded: 2002
Spokesperson: Ken Smith

Is this the right funding for you?

While we've given you an idea of some of the businesses that are using asset-based lending to bolster operations, it helps to see where you might fit into the spectrum. Below, we've had a look at five different situations and explained how the finance option can be effective.

Asset-based lending providers have a diverse range of businesses contained within portfolios, so reach out to ask where this kind of finance might suit you.

Startup business: If you are in the infancy of building your business, asset-based lending can be a great way of providing capital for those crucial early purchase such as premises, equipment, R&D and even staff. While this kind of company might not have any physical assets to leverage, intellectual property and early orders can be utilised.

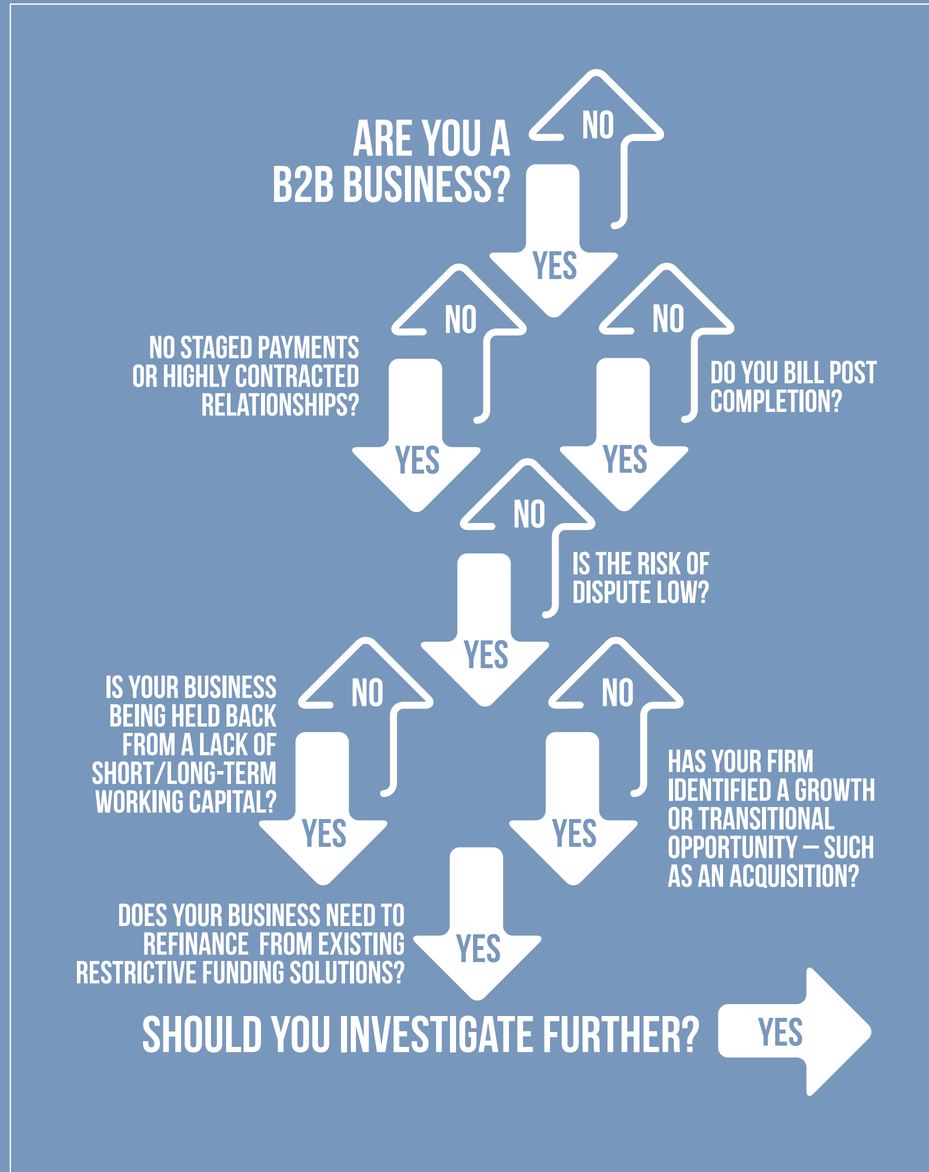
Growing business: Finance is one of the key factors that is cited as holding back a firm's potential growth, but asset-based lending can be effective as a temporary or long-term solution. From financing mergers and acquisitions, acquiring a new office space or covering the early costs of expansing overseas, a variety of channels are available.

Business refinancing: A long-term banking partner or equity backer may not be providing the kind of flexibility required by a senior management team. Asset-based lending here can help to buy out a large shareholder or consolidate existing facilities.

Turnaround: A struggling business might feel like the tides are flowing against it, but asset-based lending can often leverage assets either sitting dormant or previously never thought of as having worth. While a bank might be saying no to extending an overdraft or granting a new line of working capital, asset-based lending has the flexibility to do just this.

Succession: Making sure the business passes on to the next generation or leader is becoming increasingly hard in today's economic climate. While a successor might not have all the capital lined up to allow you to go sailing off into the sunset for retirement, asset-based lending can be used to finance such a deal and then provide capital for new projects.

On the following page are a few **short and simple questions** that would be useful to ask yourself as a starting point...after that the **opportunities are limitless**.



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