Asset Based Lending
A Blessing and a Loss of Control

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Asset Based Lending Topics

- Why businesses use asset based lenders
- Defining types of asset based lending
- Choosing an asset based lender
- Asset based borrowing agreements
- Loan costs
- Borrowing against the assets
- Borrowing base eligibility and ineligibility
- Asset based lender’s reporting and audits
- Paying back on the line of credit

Asset Based Borrowing

A Blessing and Curse!

Types Of Asset Based Borrowing

Revolving line of credit - A variable line of credit with a financial institution that is generally based on the value of an asset, such as accounts receivable, up to a defined credit limit maximum.

Why Businesses Use Asset Based Lenders

- Customers slow-pay invoices
- The industry a business services is complicated by seasonality
- Cash is used to fund accounts receivables, inventory and capital equipments costs
- A business can have two or three payrolls before the first A/R invoices are collected

What Happened To All The Cash

- Inventory
- Capital Equipment
- Account Receivable
- Payroll
- Administrative Expenses
- Selling and Marketing Expenses
- Facility Expenses

Why Asset Based Borrowing?

- Asset based lending arrangements are generally a simple and good source of cash for a small business to fund themselves
- Cash availability increases and decreases in relation to the asset base (Accounts Receivable, Inventory)
- Term loans for banks only provide cash one time and then require monthly payments

Know The Lender

The Right Asset Based Lender Is A Business Partner.

The Wrong Asset Based Lender Will Own Your Business.

Choosing An Asset Based Lender

- Reputation in the local business community
- Lender’s desire and ability to understand your business and the borrowing base
- Lender’s reporting requirements
- Interest rate and other fees
- Loan covenants
- Loan securitizations

The Basics of Lending

Asset Based Lenders Loan Money to Make Money!

Asset Based Borrowing Agreements

- Company pledges a liquid asset to a lender as the collateral to the borrowing agreement
- Owner’s have to provide personal guarantees in addition to pledging the company’s assets
- Borrowing agreements generally renew annually
- Loan covenants need to be understood, reviewed regularly and followed by borrower!

Bank’s Are Lending Institutions

A Lender Always Get Their Money Back Plus Interest.

One Way Or Another!

Loan Costs

- Non-refundable commitment fee
- Monthly interest payments on outstanding loan balance with minimums
- Renewal fees
- Audit fees
- Out of formula fees / covenant compliance
- Unused line of credit fees
- Loan termination fees

The Borrowing Based Formula

- Borrowing base can be accounts receivable, inventory or other liquid asset
- The eligible borrowing base is CURRENT accounts receivable invoices, inventory or other liquid asset (less that 90 days old)
- Generally 80% of eligible borrowing base, less lender reserve requirements, ineligible assets and interest payment when due

Ineligible Assets

- Accounts receivable, inventory or other liquid assets older than a predetermine time
- Customer concentrations generally over 10%
- Customer’s lack of creditworthiness
- Out of country sales or inventory
- Affiliated or common shareholder transactions
- Consignment sales or inventory

Asking For An “Advance”

Advance Requests Are Like Asking Your Parent For Your Allowance

Lender “Advance” Requirements

- Normally every time the company wants an “Advance” on the revolving credit line the borrower is required to fill out a “Borrowing Certificate” which states the amount of the advance requested, the current borrowing base and availability on revolving credit line
- The “Borrowing Certificate” must be signed by an authorized representative of the company

Lender Reporting Requirements

- Lenders generally require an ineligibility analysis on the asset base be done weekly or on a monthly basis
- Internally generated financial statement on a monthly basis
- Copies of the company’s annual corporate tax returns (audited statement preferred)
- Corporate resolutions when passed
- Any major change in the business

Lender Audits

- On a quarterly basis asset based lenders will send an internal auditor to the company to audit the borrowing base, review liabilities and insure that major borrowing agreement covenants are within guidelines
- Verify that all federal and state employee taxes withheld are paid current and all tax filing have been filed
- Review Owner’s salaries and draws

Loan Repayments

- All payments collected against pledged assets are generally sent to a lockbox controlled by the lender
- All non-collateralized funds received by the company, such as, corporate tax refunds, insurance settlements, proceeds from the sale of assets or any other types for money received are to be deposited with the lender

Banking Is About The Relationship

Remember:
Know Your Asset Base Better Than Your Lender or Your Lender Will Own Your Asset Base

Lender Obligations and Rights

- To have funds available to the borrower
- The lender is not responsible for the condition of the borrowing base or company’s well being in any manner, shape or form
- The lender has the right to “cure” on any loan default by the borrower including that the loan be repaid in full - “on demand”
- The lender can seize and restrain by court order the continuation of business

Questions and Comments?

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