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Asset Based Loans

A loan from a Schedule A Bank is one of the most common methods of financing found in Canada. And because it is usually the cheapest type of financing available, it is also the most difficult to obtain for companies experiencing financial difficulties. This is especially true during the current economic crisis. Schedule A Banks are not in the business of financing losses. They usually require a year or two of profitability before considering financing a company that has been losing money.

So what are the alternatives available to those companies who are either: (a) Not currently with or cannot qualify for a Schedule A Bank loan; or (b) With a Schedule A Bank but are asked to leave due to operating losses and/or loan covenant violations?

Asset Based Loans (or "ABL's") are similar in nature to a conventional loan from a Schedule A Bank. Advantages over traditional loans from Banks include:

1. Asset based lenders are more concerned with the asset values securitizing the loan rather than the profitability of the company;

2. Often there are no financial covenants;

3. In some cases, personal guarantees from the borrowers are not required;

4. The amounts advanced as a percentage of current asset values are usually higher.

The disadvantages of ABL's when compared to a traditional Bank loan include the following:

1. Since asset based lenders are more concerned with the asset values securitizing the loan, they monitor them more closely than a Bank would. Most require weekly rather than monthly margining reports;

2. Because asset based lenders carefully analyze the assets securing the loan, they are more cognizant of set-offs and charge-backs that will reduce the borrowing base and the amount of funds advanced;

3. Due to the additional scrutiny involved, monitoring fees are much higher;

4. The interest rate charged is higher.

When factoring in set-up fees, monitoring fees and interest costs, the all-in rate for an ABL can be anywhere from 5% to 15% higher than a traditional Bank loan.

ABL's are a great financing option for companies who have strong liquid assets that turn on a regular basis. However, companies using an asset based lender must have efficient internal reporting systems to provide the lender comfort that the asset values reported are accurate. This would include posting invoices and cash receipts on a daily basis in order to update accounts receivable and having a perpetual inventory system in place so that inventory values are updated when goods are purchased or sold.

Asset based lenders are more patient than Schedule A Banks but will not fund losses indefinitely. In order to accept a new customer who is no longer qualified for a traditional Bank loan, the company must have a well documented restructuring plan, indicating what management's strategy is to improve results. The lender will expect financial forecasts (complete with an income statement, cash flow and balance sheet) to accompany and support the assumptions inherent in the plan.

In the long run, most companies will endeavour to return to a traditional financing arrangement with a Schedule A Bank since the cost savings are significant. But during the turnaround period when a company is more cash flow sensitive than interest rate sensitive, an ABL can provide the additional cash flow to satisfy the increased working capital requirements. That in itself will assist in mitigating some of the additional interest and monitoring fees charged by the lender.

Aries Advisory Group has significant experience in assisting clients in the management of their turnaround strategies. We can assist in the development and preparation of a restructuring plan and in the identification and negotiation with an alternative lender. We can provide objective input and will ensure the plan is sound and meets potential lenders' criteria for lending into turnaround situations. If you have a restructuring or refinancing need, please contact us at info@ariesag.com or at (416) 467-7878 to see how we can help.