The ultimate value-add

Leumi ABL's chief executive *Phil Woodward* and risk director *Steve Ive* explore asset-based lending's evolution into a flexible and durable debt solution

Larger businesses in the UK are increasingly turning to asset based lending (ABL) to secure working capital and fund growth. Why is that?
Phil Woodward: Because, fundamentally, ABL is more flexible than senior debt; the facilities are pegged against the assets on the balance sheets. The funding adapts to the needs of the businesses more so than a senior debt facility, which is put in place at a point in time, and then stays in place until the end of the review period. Generally, we can provide higher levels of funding and that enables businesses to budget better.

ABL facilities require pre-lend due diligence, do you think this is off-putting?
Woodward: We have found that debt advisors often commission these reports before putting the deal out to the market, so much of the work is already done. These days, the market is very much alive to due diligence requirements. If they were to go to a senior debt facility, fairly extensive financial due diligence would be required, which is often more expensive and far-reaching. In comparison, our facilities can be easier to put in place.

Steve Ive: Previously, ABL was almost an afterthought. When a senior debt process failed, debt advisers would frantically turn to ABL and then the requirement for ABL-specific due diligence was problematic. Now, debt advisors are far more aware of the benefits of ABL and the type of businesses it is applicable to.

> The ABL industry has become very adept at working with management teams and private equity houses in turnaround situations and understanding the dynamics of what is required to bring businesses back to health
>
> **Phil Woodward**
> *Leumi ABL*

Because most ABL players look at a deal in the same way, the due diligence requirements are fairly generic. That process can also add value to a potential purchaser, because you are effectively assessing the quality of assets being acquired. It is a value-added process, rather than a hurdle to get through to provide debt.

How cost-effective is ABL compared with traditional senior debt?
Woodward: Thanks to the quantum of debt that we are able to provide, ABL is very cost-effective. It means that a private equity house often does not need to put in as much equity commitment themselves. If we can decrease the amount of private equity capital required from day one, it can make the deal more attractive to a private equity firm.

Ive: Assets that underpin an ABL facility can move, so historically there was always a worry that the asset base would reduce before completion and would not generate the funding required on day one. But we can now provide term lending and cashflow lending on top of the ABL structures; these mitigate against that risk and we generally structure with good levels of headroom versus senior debt as well.

How resilient is credit appetite within the ABL sector during periods of uncertainty?
Woodward: Because we are asset-based and largely secure we are more comfortable remaining in

> We pride ourselves on working with stakeholders to maximise the outcome for all parties

Steve Ive
Leumi ABL

situ, or indeed going into a situation where there are financial problems. The ABL industry has become very adept at working with management teams and private equity houses in turnaround situations and understanding the dynamics of what is required to bring businesses back to health.

Ive: ABL structures are not reliant on a client's future profitability or cash generation, which makes a big difference to the underwriting criteria we use. We can securely lend into circumstances where the historical financial performance has not been particularly positive and provide a funding line to facilitate a turnaround plan.

ABLs have historically deployed quite rigid strategies in the event of distress. Is that still true?

Ive: Historically, there was a fear that an ABL strategy would pull the plug. Now, we are funding through the capital structure, so there is an alignment of interest for all parties to preserve equity value and find a solution. We pride ourselves on working with stakeholders to maximise the outcome for all parties. Our facilities can be used not just to fund the initial transaction, but also to cater for working capital going forward. You can almost future-proof the funding of the business to cater for the growth forecast on day one; you do not get that level of flexibility within a senior debt facility.

Woodward: ABL also allows for bolt-ons. Because we are asset-backed, as long as the assets of the business being bought are fundable, we have more fleet of foot when working with private equity houses to acquire them. It does not require a significant amount of financial due diligence or a lengthy credit process.

How can ABL integrate into wider debt structures?

Woodward: We have done a very good job at building relationships with debt advisors. They have been able to bring together different facilities to provide the answer to certain problems posed by private equity deals. We work alongside credit funds, so if there are gaps in our offering that we cannot plug we can look to partner with other parties. This stretches where an ABL can get to on its own, but it also helps use the benefits of ABL to drag the cost of capital down on the overall debt package that has been put in place; so the private equity fund gets the best of both worlds.

Are there any further benefits that ABL structures offer private equity companies?

Woodward: ABL's ability to pull a club together and put forward some sizable facilities has been very attractive to the market. There are a number of deals in the UK market now worth hundreds of millions, with multiple ABL players counted within that total. Businesses like such clubs, because if one provider has a change in credit appetite it is easier to replace one lender, out of say, five, as opposed to finding one lender to manage a very large facility.

Ive: Legal documentation around ABL deals has developed so it is increasingly aligned to the Loan Market Association, which private equity funds are used to seeing. Concepts around permitted discretions and permitted payments are much more flexible.

As well as providing cheaper funding, we give private equity funds the ability to pay down their exposure quicker than they would otherwise, meaning they can redeploy that capital elsewhere. ●