

EXPERT INSIGHTS



Asset based lending builds momentum among UK private equity

PHIL WOODWARD

Chief Executive, Leumi ABL



With asset based lending (ABL) gaining greater traction among UK private equity firms as an alternative debt tool, Chief Executive of the Leumi ABL team, Phil Woodward tells Paul Francis-Grey how and why the funding avenue is becoming increasingly adopted this side of the Atlantic. Yet, at a time when debt remains expensive and private equity is flush with equity, what does the future hold for the UK ABL market?

Asset based lending (ABL) has long been a staple form of debt used by corporates and investors in the US. By offering flexible financing that grows with the business, leveraging assets such as accounts receivables, inventory, and property, ABL is often considered preferable over traditional debt due to its covenant-light nature and core disciplines.

And over the last decade or more, the ever-evolving private equity firm has firmly embraced ABL in the UK. According to UK Finance, which represents 300 finance firms, there are 35,000 businesses across the UK that are supported by UK Finance's invoice finance (IF) and /ABL members. At any given time, IF/ABL members will be advancing over £20bn to their client businesses, UK Finance states.

Leumi ABL provides ABL services through a client-focused, solution-driven approach and was founded 18 years ago, during which time it has had firsthand experience of the product's growth in the UK. Phil Woodward, who heads Leumi ABL, stated that the business has completed over 100 private equity transactions with 85 firm. He stresses that it is a lending tool that offers a very flexible, progressive form of finance.

"The ability to provide finance for a business increases automatically and in line with the company's own growth because the assets create eligible collateral, against which we can advance funding." This applies to all assets on a company's balance sheet including the likes of accounts receivables, inventory, plant machinery, property, work in progress in some instances, and occasionally against brands, he explains.

"ABL is all about making the assets of the business work for the business. There's no requirement for any external security, and therefore it's a fairly simple and cost effective way of financing a business and future proofing it in terms of growth."

ABL in practice

While ABL is often a go-to tool for businesses in turnaround situations that need more funding than a more traditional financier can provide, it is also used in other situations that are better-suited to a forward-looking lending solution that is based on future financial potential. ABL offers this, whereas more traditional lending criteria is historically based.

Woodward says private equity backed businesses find the benefits of ABL as a means to grow through acquisitions, prepare for new, larger contracts, or buy new equipment as they undergo value creation processes under their new owners.

He adds how the private equity backed companies Leumi works with are typically growth businesses or businesses that need re-engineering to raise their financial performance in order to create or enhance value.

ABL is also used by well-performing businesses that need additional funding to support their growth and is useful for event-driven situations, such as MBOs or MBIs, where owners want to partially cash out.

The sectors to which ABL lends to is also broad.

Manufacturing, logistics, and distribution are areas where ABL works well as they have multiple asset classes eligible for funding, Woodward explains. ABL can free up working capital both against short-term assets such as inventory and account receivables and long-term such as plant & machinery and property.

Professional services businesses such as recruitment businesses are very much in the wheelhouse of ABL, Woodward says. An invoice backed up by a signed time sheet can be funded against, he explains adding how this is a sector in which Leumi is active and sees further growth behind.



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Other professional services sectors such as accountancy or law firms are more suited to traditional funding.

Given the variety of situations, lending cases and industries in which ABL is being used, lenders like Leumi face different challenges that require different approaches.

When working with private equity, for example, Leumi has two stakeholders - the portfolio company's management team and the private equity firm itself.

When providing funding to a portco, Woodward and his team naturally build a relationship with that company's management team due to their day-to-day dealings. Yet, Woodward recognises that the private equity firm is a really important stakeholder. "They will ultimately make the decisions and will likely have been our entrant into the portfolio company, either directly or via an advisor," he says.

Capital Vs opportunity

Despite its growing popularity as an avenue of funding among private equity, it is also a moment in time when the investment community is flush with more capital than opportunities.

Woodward acknowledges this junction that the asset class finds itself. "It's something we are discussing quite frequently when we meet with debt advisor private equity has significant amount of monies that are under deployed presently. It really comes down to the fact that ABL money is fundamentally cheaper than their own money. Using ABL in a private equity transaction could certainly help their returns calculations, and therefore, could be a benefit in their discussions when they're looking to make a purchase," Woodward says.

Challenges and change

The challenge for the UK ABL sector is to continue increasing awareness and create opportunities for growth.

"ABL as a product offering in the UK has moved quite considerably over the last 15 years, and certainly in the last five to 10 years. It has become a mainstream product used by debt advisors and corporate financiers in both the refinance and the transactional world for corporates," Woodward says while acknowledging growth is needed and expected to come from larger deals and more complex deals.

"Large corporates and debt advisors in the UK have latched on to using ABL in large takeover deals," he says. "I see growth coming from larger deals; more complex deals; and private equity led deals. The smaller end of the overall market is a space that does not seem to be experiencing much growth."

However, Woodward sees the level of deal flow as the biggest challenge for private equity ABL business.

As private equity deal flow recovers, Woodward anticipates a greater involvement between the investment community and the ABL sector, considering them perfect stablemates. Private equity firms are adept at running businesses and using the most appropriate financing tools suited to the business it is backing.

Private equity owned businesses generally have good amounts of equity invested and employ solid management teams with broad experience, Woodward says. They will have a strong CFO with an equally robust business plan and good levels of cash headroom and these are among the key elements a company should deliver when being considered by Leumi.

These are the same criteria that private equity looks for when evaluating potential investments. This alignment of interests is why the ABL sector likes working with private equity owned businesses, Woodward says. The two parties' goals and criteria are very much aligned, making it a mutually beneficial relationship.

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