# Chapter 5

# ASSET BASED LENDERS AND FACTORS

## INTRODUCTION

Not every company has the characteristics to qualify for a bank loan. In this chapter we will discuss alternatives including (i) asset based lenders, (ii) factors, and (iii) note purchasers. These firms are highly diverse, each having their own specific preferences. This chapter discusses the circumstances in which each might be considered, the strengths and weaknesses of each alternative, and reasonable expectations as to cost.

## TRADITIONAL ASSET BASED LENDERS

Like banks, asset based lenders balance risk and reward. However, they analyze risk in a completely different manner. Banks want to know that a business is profitable, is willing and able to pay its bills on time, and generates cash on an on-going basis.

Asset based lenders are less concerned about whether you will be in business next year than whether the value of assets pledged as security will be impaired. For this reason, a company in trouble is much more likely to get funding from an asset based lender than a bank. That's not to say that commercial credit companies are unconcerned about revenue, profits and cash flow. They are. A healthy company is more likely to preserve and protect the assets and is less likely to go into default, sparing the lender the

burden of liquidating assets. The difference is in the balance. Assets based lenders are more willing to overlook some of the imperfections in credit history that banks are not.

Commercial credit companies cover a wide variety of companies that invest in leases, working capital loans, sale and lease back, and other special financial situations. Many do not fit neatly into the categories discussed above and every commercial credit company has a slightly different risk / reward profile. Unlike a purely asset based lender, commercial credit companies sometimes extend credit on the basis of both assets and a company's ability to generate income in the future.

They charge interest rates higher than banks, but cost much less than venture capitalist. In addition, commercial credit companies rarely demand equity in return for capital.

To understand the scope and breadth of asset based lending consider Figure 5-1 Examples of Asset Based Lending Characteristics which analyzes two highly diverse firms.

Figure 5-1 Examples of Asset Based Lending Characteristics

| Operating Parameters: | KRB Capital[1] Fort Worth | Transamerica[2] San Francisco |
|---|---|---|
| Transaction Size | \$50,000 to \$5,000,000 | \$10,000,000 to \$150,000,000 |
| Percent of eligible accounts receivable | 90% | 85% |
| Percent of eligible inventory | 65% | 75% |
| Percent of appraised liquidation value of machinery | 90% | 80% |
| Percent of Fair Market Value of owner occupied real estate | 85% | 65% |
| Working Capital loan terms | 2 years | Until assets are liquidated |
| Term Loans and Leases | 2 to 5 years | Up to 7 years |

Commercial rates are likely to be substantially higher than bank rates due to the increased risk. Most are based on the prime rate or the LIBOR (London Interbank Offer Bank) plus some number of points. Asset based lenders are likely to want to change the rate up or down every month to avoid interest rate risk. Like banks, they favor some industries and disfavor others. Unlike banks, their loan agreements contain minimal covenants and limited or no personal guarantees.