June 2013

Restructuring Trends
Growth of ABLs

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What is asset based lending?

Asset based lending (ABL) provides the borrower with a revolving credit facility secured against its balance sheet assets. These assets range from working capital assets, such as trade debtors and stock, to tangible fixed assets such as plant and machinery and property. In exceptional cases intangible assets can be taken into account as security and ABL providers may also offer amortising term loans based on cash flow generated in the business to increase available funding.

The borrower reports asset levels to the ABL provider on a regular basis (ranging from daily to weekly or even monthly) and the ABL provider makes available a fluctuating line of credit dependent on asset levels. The calculation of available funding starts with total assets, deducts those that are not suitable as security for the ABL provider (ineligible assets), and then provides funding against the remaining (eligible) assets at an agreed percentage (advance rate).

Situations where ABL funding may be suitable

ABL is used in a wide range of situations and it is particularly suited to the following:

- To finance asset rich companies where a transaction or event (e.g. a buy-out) requires leverage in the business;
- To finance growth companies that need a significant investment in working capital and equipment to expand;
- To provide working capital finance for companies trading in commodity markets - fluctuations in prices require flexible credit facilities that can meet a volatile funding requirement;
- Businesses that need to fund a seasonal peak in working capital – they often require a peak level of seasonal funding that is disproportionate to the level of all year round profits when assessing debt capacity using an earnings multiple approach; and
- Situations where a business is going through restructuring and turnaround.

A cash flow lender assesses debt capacity by focusing mainly on the level of cash flow generated by the business. However, an ABL provider takes a different approach. The ABL provider is interested in the cash flow generated in the business but is also able to take a high level of comfort from the asset security available to it.

In recent projects we have helped clients maximise the opportunities presented by ABL funding in asset intensive businesses such as haulage and printing; in an oil and gas sector client whose working capital requirements fluctuate with underlying hydrocarbon prices; and businesses that sell seasonal products into retailers in advance of the Christmas holiday season. We have also worked increasingly with clients on financing structures where ABL is deployed as part of a wider package alongside senior lending, mezzanine loans and trade finance.

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Restructuring

In a restructuring situation cash generation may be limited, uncertain or even temporarily negative whilst losses are being stemmed and restructuring costs are being incurred. Conversely, the balance sheet and asset base may be relatively stable. The ABL provider's approach can therefore provide a stable funding package for the business whilst it focuses on cost reduction, efficiency and operational improvements.

The structure of ABL facilities can also be beneficial to companies with limited cash generation. This is because a majority of the funding package is often secured against working capital assets. The funding availability flexes to meet unexpected changes in working capital levels (e.g. a debtor paying a few days late or a delay in a major customer ordering stock). It also means that for a large proportion of the facility there will be no requirement for debt amortisation and this reduces the overall debt service burden on the business.

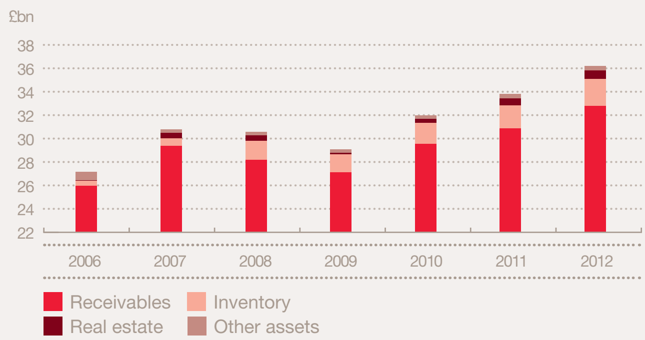
Finally, once the turnaround of the business is complete and the green shoots of recovery appear, ABL provides a platform to fund growth. Therefore businesses that first look to ABL as a funding package to support restructuring often retain it going forward, due to its flexibility and the additional liquidity it can provide.

We recently worked with a family-owned distribution business to source an ABL financing structure when their incumbent lenders did not have the appetite to support them based on their existing facility structure. We were able to reduce substantially the proportion of cash flow needed for debt service via a facility that provided funding against debtors, stock and properties.

ABL growth

The ABL market in the UK is growing rapidly as awareness of ABL as a funding proposition increases. The level of assets financed has increased by 33% since 2006, to £36.2bn in 2012. ABL is often competitive on price compared with alternative lending structures and the private equity community is increasingly aware of the other advantages of ABL facilities deployed in the right situations. In future, we expect to see increased use of ABL, both in restructuring scenarios and more widely.

Recent growth of ABL sector (assets financed)



Source: Asset Based Finance Association

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Design by The Design Group 21412 (06/13)