FINANCE AND COMMERCE

DOLAN MEDIA COMPANY www.finance-commerce.com Friday, July 3, 2009 Periodicals Postage Vol.122, No. 131 $1.50

FOCUS ON Finance&banking

Want a loan? Bring collateral

With commercial credit markets still virtually frozen, asset-based lenders beginning to pick up the pace

BY MARK ANDERSON
Staff writer

Plenty of businesses felt a chill over the past nine months as they sat with their bankers, poring over balance sheets, and heard the quiet suggestion that they might want to look for a different lender.

Steve Stoup

Slumping sales and declining product values kept many businesses from staying current with their debt service, and the result was that risk-averse banks couldn't renew or open new loans.

But many of those spurned borrowers still found a credit option in asset-based loans (ABLs), a product that puts hard collateral on the table – usually receivables or inventory – and invites lenders into a much closer relationship with borrowers as they watch over the value of that all-important collateral.

That scrutiny may get a little close for comfort, but it keeps credit flowing and the business wheels turning.

"We're like the Statue of Liberty for the business world," according to Brian Van Nevel, a founder and principal at Spectrum Commercial Services, an asset-based lender in Bloomington. "Banks tell their customers they'd better start looking for an asset-based lender, and we're there saying 'give us your tired, your hungry, your poor.'"

The product that Van Nevel and his colleagues in the asset-based world offer started as a high-priced loan of last resort, but has matured into a flexible, conventional and cheaper loan over the past two decades – used now for expansions and M&A investments as well as traditional inventory and operating costs.

Demand is still driven by a couple of basic characteristics, however, said Brett Beugen, business-development manager in the upper Midwest for Wells Fargo Business Credit, the bank's asset-based lender: "Typically, borrowers are either highly leveraged or they've had heavy losses. And there are dramatically more companies in both of those situations now."

Those companies called on local asset-based lenders in droves this winter and spring, to non-depository lenders such as Spectrum or ABL units in a community or regional bank.

"Volume is way up for us," said Steve Stoup, senior vice president for development and marketing at Fidelity Bank in Edina, one of the few community banks that count asset-based loans as a specialty. "Our active prospect list is about 30 percent higher consistently this year over last year."

Part of Fidelity's asset-based portfolio is filled with companies that are highly leveraged but performing well in high-volume, low-margin businesses.

But much of this year's growth has come from companies who were shown the door by a previous lender when sales dropped and loan payments slowed, Stoup said.

Demand grew fast enough at U.S. Bank's asset-based group in the upper Midwest that it was forced to add marketing staff, despite the bank's hiring freeze, according to Chris Schaaf, vice president and head of the group: "Our marketing people can't keep up with the calls they're getting. We're very, very busy."

Schaaf's boss, Sam Philbrick, who leads the asset-based business from Boston, said new business grew 20 percent in 2008 across the U.S. Bank franchise, and that pace continued during the first two quarters of 2009.

Those reports indicate how many would-be borrowers are knocking on ABL doors, but lenders say a handful of factors keep this a decidedly mixed market.

Many borrowers in asset-based portfolios are paring away at expenses and cutting back on their use of credit lines, offsetting the revenue gains that new borrowers provide.

And despite the demand for new credits, many asset-based lenders are staying on the sidelines. Major non-bank lenders such as GE Capital and CIT virtually stopped lending during the fourth quarter of 2008 and early in 2009 when securities investors and hedge fund lenders that funded their loans stopped investing.

Their pullout dried up not only the loans they made to business customers, it also stopped the lending they did to smaller asset-based firms such as Spectrum, which rely on credit lines from big

Asset-based loans: up, down, now up again

Year	Volume increase (%)
2004	8.4
2005	16.0
2006	16.5
2007	11.4
2008	8.3
1Q 2009	(1.7)

Asset-based lending grew steadily as lenders and borrowers gained comfort with the products and recognized their advantages: larger borrowings and fewer covenants. But the bottom dropped out of the market in late 2008 and early 2009, along with the rest of the capital markets. Borrowers returned in the second quarter, and lenders are coming back, too – carefully.

Source: Commercial Finance Association

lenders. Spectrum has a continuing secured loan commitment from Wells Fargo Foothill, Van Nevel said.

Consolidation among some of the big asset-based lenders – such as the combination of LaSalle Bank and Bank of America, Wells Fargo and Wachovia Corp. and PNC Financial and National City Bank – also reduced credit to borrowers, at least temporarily.

By the start of second quarter of 2009, those lenders were beginning to return, but very carefully.

"I'm seeing competitors coming back, but only on strong credits," said U.S. Bank's Schaaf. "Everybody's looking for high-quality loans to make, and that means a lot of borrowers still can't find a lender," he said.

Pricing is also on the move.

For a long time, business owners paid dearly for that lender-of-last-resort service, paying much higher rates than conventional cash-flow commercial loans. That margin narrowed dramatically in recent years, as lenders gained new tools and techniques for managing collateral and capital flooded the market.

"Pricing had gotten too aggressive," Schaaf said. "There were too many lenders and they weren't pricing adequately for the risk they were seeing. Spreads were sometimes the same as for a conventional loan."

A modest risk premium has returned, though.

Asset-based borrowers now pay 0.5 percent to 1 percent more than they would for a conventional bank loan at U.S. Bank, Schaaf said, much of that coming in the form of fees and appraisal costs. And all-in prices on those loans are between 1 percent and 1.5 percent higher now than they were 18 months ago, he said.

At Spectrum, Van Nevel has boosted loan prices to reflect a 20 percent increase in what his firm pays for funds, as well as the increased risk in the credits Spectrum takes on –and the additional time his lenders spend keeping tabs on the value of the collateral backing those credits.

"We're monitoring on steroids," Nevel said. "This year, we're going to have to earn anything we make this year."

Mark Sheffert, principal at The Manchester Cos., which advises troubled businesses on turnaround strategies, said it does look like asset based lenders are returning gingerly to the market.

"They're out beating the drums for business again. And if you've got a company with good solid assets in an industry that isn't getting hammered, there's credit available. But there's still a lot of caution out there."

And that caution is justified, Van Nevel said.

"We're talking to people who've had dramatic decreases in sales. You can talk about green shoots as much as you want, we're seeing a lot of stress, and we're not seeing signs of recovery out there. There's no bounce yet."

Reprinted with Permission of Finance and Commerce.

For subscription information, please call 800-451-9998.
Story ideas should be directed to the editor at 612-584-1526.

FINANCE AND COMMERCE