Farber
FINANCIAL GROUP

Working Capital Asset-based Lending: What is it and how does it work?

Asset-based lending, commonly referred to as ABL, is different from traditional bank lending because it is less focused on the credit score of a business or a business owner. Instead, asset-based lending is based on the collateral that a business has to secure a loan. Asset-based lending can include such financing methods as factoring and bridge lending, as well as working capital ABLs. Generally, accounts receivable (A/R) and inventory are the primary assets used for ABL financing as they can be easily margined and the loan facility can grow and reduce based on the A/R and inventory balances. A working capital ABL ensures that the ownership of the A/R remains with the company which differs from factoring where the A/R is actually sold to the factoring lender. The third alternative, a bridge loan, is a short term lump sum loan that does not increase and decrease with changes in the underlying assets[1].

A working capital ABL is usually suitable for businesses with consistently high growth, and/or those that have experienced a bump in the road or are in a distress. With an ABL facility, the lender is not as concerned about debt to equity ratios as it is focused on the strength of the A/R and inventory.

An asset-based lender will normally require the potential borrower to go through a rigorous assessment which examines the viability of the business and the potential collateral. This due diligence will include a field exam at the borrower's offices to review their accounting practices and internal control processes with specific focus on the inventory and A/R. An appraisal will also be done of the inventory to determine the net orderly liquidation value (NOLV) as well as the market value. Once the field exam and appraisal are complete, the loan agreement will be drawn up by the lender's lawyers. Normally the entire process, from the initial meetings with potential lenders to the funding, takes anywhere from 2 to 6 months to complete.

With a working capital ABL, a lender will normally fund up to 85% of the gross accounts receivable; if the A/R is insured, then the lender will lend up to 90%. From this loan amount deductions are usually taken for any customer programs or holdbacks, credit invoices and A/R over 90 or 120 days (depending on the industry).

---

1 See our articles: "Bridge Financing: what is it and how does it work?" and "Factor Financing: What is it and how does it work?" on www.farberfinancial.com

Farber
FINANCIAL GROUP

Inventory is funded based on a percentage of the NOLV, cost or market value. Deductions may be made for inventory held abroad, defective and obsolete stock.

Other deductions would also be made for priority payables (such as HST and source deductions) in order to determine the net loan amount or availability.

Lenders will generally fund on a regular weekly basis after receiving A/R and inventory reports and an Availability Calculation in a prescribed format. Monthly and sometimes daily reporting is also required.

Working capital ABLs are offered by both traditional banks and non-bank lenders. Interest rates for an ABL are higher when the funds are obtained through non-bank lenders but these lenders tend to accept a higher risk level as well. In all cases, the cost of borrowing is generally higher than a traditional bank loan as there are monthly monitoring fees and costs associated with regular field exams and appraisals that may be required by the lender.

Small Transaction Financing

Farber's Small Transaction Financing group specializes in arranging loans from $100K to $3M and leases from $5K and up. We arrange financing for businesses that are either experiencing growth, a bump in the road, or are in distress.

Please contact Barbara Cowper, CPA, CGA at 416.496.3760 or bcowper@farberfinancial.com