# Asset-Based Lending

A Training Guide to Secured Financing

**First Edition**

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# Introduction to ABL

Over the years asset-based lending "ABL" has been know by various names. Originally, it was simply know as accounts receivable financing. That name did not accurately describe the wide range of financial services that were being offered. Most a/r financing firms additionally offered inventory financing, machinery and equipment financing and some even offered commercial real-estate financing.

One of the early pioneers in the a/r financing business was Commercial Credit Business Loans (CCBL). Headquartered in Baltimore Maryland, this firm was widely recognized as one of the leaders in the rapidly growing industry. With its growing success, CCBL later expanded nationwide opening offices across the United States.

As the need for financing from less than traditional banking sources increased, more firms began to offer a/r financing, with many major banks and others commencing operations. And, as the industry grew, a/r financing came to be known as commercial finance. This term served to differentiate commercial finance from bank lines of credit. The distinction became more and more apparent as commercial finance firms proliferated over the years.

Ultimately, commercial finance became known as asset-base lending, which is, of course, the term used today. In addition to commercial finance, major banks maintain ABL services. Some even have separate subsidiary firms to offer ABL programs in addition to normal banking services.

# What is ABL?

Asset-based lending is a loan that is secured by business assets. Typically, those assets are accounts receivables, inventory, machinery and equipment and occasionally real-estate. In addition, other corporate assets have occasionally been used as the basis for ABL loans, such as trademarks, patents and certain intangible assets. Businesses both large and small, use the services of asset-based lenders.

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Unlike factoring, which has traditionally served more selective industrial markets, ABL can be utilized by manufacturers, distributors, service firms and even some retailers. As long as the receivable base is deemed credit-worthy and aged within certain defined parameters, ABL is adaptable to most any circumstance. One major advantage that ABL offers is its flexibility and non-notification aspects. Businesses without receivables or tangible inventory, such as restaurants, hotels and certain contractors, generally will not use ABL.

To give you an introduction to asset-based lending, let's look at a typical example of an ABL transaction from a lenders perspective:

Example 1.

**Sample Company, Inc.**

**Revolving and Term Loan Facility**

(Amounts expressed in terms of eligible collateral)

| Collateral | Net Amount | Advance Formula / Borrowing Capacity | Net Cash Available | Gross Line / Maximum Availability |
|---|---|---|---|---|
| **Accounts Receivable** | $1.5M | 80% | $1.2M | $2M |
| **Inventories *** | $600K | 50% | $300K | $750K |
| **Equipment** | $800K | 75% | $600K | $600K |
| **Real-estate** | $700K | 80% | $560K | $560K |
| **Totals** | $3.6M | | $2.660M | $3.910M |

"K" = thousands of dollars

"M" = millions

* = Inventory evaluation is based solely on raw materials and finished goods eligibility

As can be determined from the above illustration, Sample Company, Inc., enjoys a gross ABL line of $3.91 Million. However, since the collateral expressed above has been reduced to eligible collateral only, Sample Company is at its full borrowing capacity under the determined formula.

The fixed assets are term loans and, as such, are not subject to revolving loan borrowing potential unless those assets are re-appraised at a later date and/or the loans are paid down somewhat.

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On the other hand, the revolving assets namely, accounts receivable and inventories, are a "snapshot in time." As the balances change (up or down), borrowing capacity will improve or decline based on those movements. The "availability" calculation, under formula, will vary as well as it takes into consideration changes in the ineligibles. Those changes can occur as a result of collecting over-aged receivables, disposing of obsolete inventories or other changes that affect the classification of those collateral items as eligible or ineligible. While it may appear that Sample Company has potential to draw down an additional $310K, consider that elimination of ineligible collateral has already been considered in the calculations. If there were no "ineligibles" to deal with, that would certainly be the case. Consider, as well that improvements in asset quality, increased sales, profitability, etc., are all criteria that would potentially generate and augment increases in the revolving lines of credit for Sample Company. It is also likely that profitability and net worth improvements could result in a higher advance formula being considered by the asset-based lender.

Prior to Example 1., it was mentioned that ABL offers many advantages and greater flexibility over a typical factoring arrangement.

A poignant advantage that ABL has over a factoring arrangement is the aspect of non-notification, which is a major selling point. Unlike factoring, the typical ABL facility will offer the confidentiality of assigning their accounts receivable without notice. This can be a critical component in the borrower's decision to utilize asset-based lending. This alone ranks very high among the reasons to enter into an asset-based lending relationship. Borrowers will frequently be more established, somewhat better capitalized and generally will have greater credit policies and receivables management procedures in place than firms found in a typical factoring relationship. All businesses will have a pre-disposition or phobia to an outside agency having unrestricted access to their customers. Therefore, an ABL facility offers the maximum borrowing potential against company assets (including inventories and fixed assets that are not ordinarily advance upon by most factoring firms or banks) while maintaining limited confidentially in the borrowing relationship.

Another major aspect of ABL is that it is considered by most to be a more sophisticated and streamlined borrowing method than factoring. Indeed, many borrowers may be on the edge of qualifications for traditional bank lending, but miss it by virtue of some unfavorable company or personal

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antecedents, failure to meet bank financial ratios or for a myriad of other reasons. Those borrowers can be "matured" to a traditional banking relationship through the services of a asset-based lender. For some borrowers, it then becomes a matter of improvement of the deficient items and then a move into less expensive bank financing. Other borrowers may enjoy greater flexibility afforded by a pure ABL firm's offerings and remain indefinitely with those lending firms.

It should be noted that asset-based lending does require greater monitoring and reporting on the assets than factoring. In addition, borrowing from a pure asset-based lending firm will likewise require more monitoring and reporting than a traditional bank loan or line would. The reasons are quite apparent and obvious. In the case of factoring, the factor has control over the cash and may even assist with the billing. The factor also has the luxury of notification, which means the customer remits with prior knowledge, to the factor and is fully aware of the factor's involvement. In addition, as pointed out earlier, the asset-based lender is lending against collateral other than receivables, which a factor is ordinarily not. The fact that an asset-based lender has more exposure dictates the need for more control, more monitoring and more detailed reporting. The further fact that the asset-based lender is advancing funds against multiple forms of collateral (in most cases) dictates the need for field examinations or audits that are basically unnecessary in a typical factoring relationship.

In contrast to a traditional bank loan or line, banks are generally less restrictive in regards to reporting than a pure asset-based lender. A traditional bank may even reduce reporting to what is termed "minimum reporting." This means that the client reports on the collateral on a monthly or semi-monthly basis or perhaps even less frequently. The reasons are simple; the bank is ordinarily over collateralized; has place more emphasis on cash flow earnings and equity; and is usually more involved in the personal collateral of the client company. In other words, a bank is usually involved with stronger borrowers, generally gets more collateral from the borrower and principals and generally enjoys the "cushion" of excess collateral not enjoyed by a typical asset-based lender.

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# Why Businesses Utilize ABL

We have already discussed various reasons that many businesses utilized asset-based lending relationships. Let's review them to refresh our memory.

First and sometimes foremost, is the aspect of non-notification. We realize that this is a major hot button for the more established, conservative borrower. Many firms simply do not wish to have an outside party involved with their customers.

Another major reason firms seek asset-based lending relationships is the great flexibility, borrowing capacity and sophistication afforded by a typical asset-based lending program. Asset-based lending opens up borrowing potential against assets that factors do not typically advance upon including: inventories, machinery and equipment and commercial real-estate. Asset-based lending is frequently better than traditional bank lines because it offers greater borrowing capacity/advance formulas against assets or by being less restrictive on ineligible criteria.

As in factoring, another basic reason to utilize an asset-based lending program is to augment cash flow. Asset-based lending is designed to enhance a company's day-to-day cash position. It's immediately obvious why most firms choose to utilize the services of an asset-based lender. Typically, they have several pressing needs that may include the following: payment obligations to creditors; payroll and associated obligations and seasonal or special accommodation needs.

There are other reasons that a borrower may select an asset-based lending program. The first two outlined above are basically self-explanatory. The last needs to be elaborated on. In a manufacturing environment, there could be a seasonal aspect to the client's business. An example, of course would be a firm engaged in toy manufacturing. Certain times of the year it is necessary to build inventory to meet the Easter or Christmas rush. With an asset-based lending relationship and a creative, flexible approach, it is possible that the lender would offer a seasonal over-advance or special accommodation to assist with the overhead, additional costs associated with buying raw materials, converting to work in process inventories and finishing into saleable

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finished goods.  It should be noted that pure asset-based lenders will generally be more flexible and accommodating than banks in the evaluation of collateral; particularly as it relates to seasonal and special accommodation situations that present themselves from time-to-time.  Often times, it is not only the feature of greater sophistication afforded by a pure asset-based lending philosophy but the aspect of being worked out of a traditional banking product into an asset-based lending relationship.  Obviously, there are many "near-bankable" companies that may have fit bank lending criteria at one time that are told to find another relationship elsewhere.  Most of these firms are referred directly to commercial finance consultants by a bank's workout or special assets department or by the commercial or business banker.

Many manufacturers, wholesale distributors, processors, service firms and even some retail/consumer oriented firms will utilize asset-based lending. More often than not, an asset-based lending relationship will not only include advances/loans against acceptable accounts receivables but finished goods and raw materials as well.  In addition, many facilities will include fixed asset accommodations such as loans on machinery and equipment (including vehicles, trucks, tractors and trailers) and/or commercial real-estate.  Work in progress and work in progress inventory is normally not acceptable for lending purposes since it is not in a finished state and cannot be sold as raw materials once it is converted or is in the process of being converted.  Also, it cannot be sold as finished product.  Unlike many factoring firms, asset-based lenders will ordinarily make funds available against several different business assets and, on occasion against certain personal collateral.

Unlike non-recourse factoring, asset-based lending does not include credit protection and collection services.  In addition, most asset-based lending relationships involve little or no direct contact with the client's debtors and others.  Asset-based loans are usually are more stringent to qualify for than factoring and usually involves an audit of the client's books and records, both at the pre-funding stage and on a quarterly or semi-annual basis.  More reliance is placed on the financial condition of the client and ability to repay the loan than in factoring.  In many asset-based lending relationships, the borrower will have a full-time qualified controller, director of finance or chief financial officer with a significant financial background.  This person is not only qualified to handle the day-to-day accounting and reporting functions, but is frequently versed in credit extension and collection techniques.  In many instances, the client company may belong to credit reporting agencies such as

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Dunn & Bradstreet, TRW, Equifax or Experian and utilize industry trade group credit information in basing their credit decisions.  Having qualified personnel and adequate access to outside credit reporting agencies therefore offsets the need to factor in light of their ability to adequately determine debtor creditworthiness.

Unlike factoring, most asset-based lenders do have restrictive financial loan covenants.  These relate to specific conditions the asset-based lender incorporates as part of th lending relationship and are formalized in the legal documentation.  Frequently, major banks and institutional lenders will place a client company in default if they violate these loan covenants.  Most often, such covenants will relate to minimum tangible net worth requirements, profit requirements, debt-to-equity ratios, capital expenditure maximums, officer salary ceilings, etc.  When client companies are in default, the asset-based lender will often times exit the relationship by notification to locate alternative financing.  Ordinarily, banks and the major asset-based lenders are more stringent in this exit strategy than a factor.

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# Who Utilizes ABL?

Asset-based lending is primarily used by formerly factored, formerly bankable and non-bankable businesses. The three are defined briefly below:

1. Formerly factored businesses. Typically, a business that may have utilized factoring due to its financial condition (not qualified for asset-based lending or banks) but has now grown and improved to the point that it is acceptable for an asset-based lenders criteria.

2. Formerly bankable business. Those firms that may have been acceptable to the banking industry at a previous point in time but have experienced a downturn or change in their financial condition or collateral that no longer conforms to bank lending parameters.

3. Non-bankable business. Those firms that are not financially acceptable to a conventional bank in terms of their balance sheet, type of collateral being offered, debt ratios, or other lending criteria.

Ordinarily, for a business to obtain and maintain bank financing that will support their receivables and other assets and allow them enough "cushion" to maintain momentum, the generally need to:

1. Produce audited or reviewed financial statements, demonstrating a consistent record of profitability and sustained growth;

2. Possess a strong collateral base, including accounts receivables, inventories, furniture and fixtures, real-estate, and other hard collateral;

3. Maintain a debt-to-equity ratio not to exceed 3:1 or better, depending on the industry involved and the bank's lending criteria. Despite the fact that banks routinely expect to see a strong receivables portfolio, banks generally will not be comfortable with the receivables as its only collateral. Most banks prefer hard assets or real-estate as the collateral over receivables.

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Many growing businesses fail to meet bank criteria for one reason or another. For example, bank financing often is unavailable to companies with short (three years or less) or no operating history. By contrast, a business may become a reasonable asset-based lending candidate if it can demonstrate the following:

1. It is providing reasonable credit extension practices to other businesses.

2. It has receivables, inventories, fixed assets of value to offer as collateral and those assets can be verified based on outside appraisal techniques.

3. It has the ability to absorb and service the debt associated with an asset-based lending facility, including any long term debt accommodations such as term loans.

4. Its systems and reporting capabilities are conducive to an asset-based lending facility for communication purposes.

5. Asset-based lending will improve the company's cash position and enable it to accommodate increased sales volume or accomplish other goals;

6. Business and personal antecedents, tax liabilities and other records (including formal due diligence searches) are acceptable to the asset-based lender.

Generally, as we have outlined in detail earlier, asset-based lending relationships are more flexible than traditional bank lines. A client seeking to increase a bank line of credit, for instance, may inevitably have to submit new documentation and updated financial statements, both business and personal, for subsequent review by a loan committee. Asset-based lenders are ordinarily quicker to respond to special circumstances and line increase requests than a bank. In addition, most asset-based lenders are more flexible as to borrowing criteria and forms of collateral than banks. Some asset-based lenders will also consider loans against off-balance sheet collateral such as personal real-estate or other assets for their clients.

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Conversely, many banks prefer asset-based lending transactions due to the fee income generated from such programs and the control over collateral afforded by asset-based facilities. This may be one reason so many banks have formed asset-based lending units.

Benefit Review:

- Non-notification. Borrowers prefer not to have outside involvement
- Limited verification. Most asset-based lenders have a "soft" approach to the verification in selected circumstances and may use non-invasive techniques.
- Reduced submission of information. Unlike a factoring arrangement, the process in which a borrower draws against an asset-based facility generally requires minimal reporting against accounts receivable and perhaps monthly reporting on inventory positions.
- Cost. Generally, asset-based lending is less expensive than a traditional factoring arrangement.
- Borrowing capability. The ability to borrow against accounts receivables, inventories, machinery and commercial real-estate which generally creates greater borrowing capacity against many other forms of financing.
- Special accommodations. Asset-based lenders are in a unique position to provide seasonal and special accommodations to borrowers.
- Overall flexibility. Asset-based lenders provide overall, a more flexible financing facility, due to less regulation, less restrictive loan covenants, loan committees and other scrutiny.

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# Differentiation Between ABL & Bank Loans

The primary difference between a traditional bank loan and asset-based lending is simply loan philosophy.

Most asset-based lenders base lending criteria on the overall quality of the collateral taking steps to carefully evaluate receivables, inventories and capital assets/fixed assets of the borrower. These steps will ordinarily include an audit of the prospective borrowers books and records and, if financing is being sought against fixed assets, professional appraisal firms will be engaged to appraise those assets as well.

Banks however, generally base their primary lending criteria on cash flow (frequently referred to as debt service coverage). Obviously, banks expect the collateral to be ample in the first place. However, they also expect sufficient cash flow. Bank rely heavily on cash flow; much more so than an asset-based lender. Banks will decline most borrowing requests if both cash flow and collateral are not within the individual banks parameters. Like an asset-based lender, banks will require professional appraisals of fixed assets in instances wherein such loans are being requested. Unlike asset-based lenders, bank audits are somewhat non-routine; the exception being separate and distinct bank departments or divisions that are set-up to specifically handle asset-based lending relationships.

Some of the ways asset-based facilities differ from a bank line:

- Ordinarily, there is no annual "clean-up" requirement, such as in a bank line.
- Asset-based facilities are not usually "over-collateralized" as in bank lines.
- Asset-based facilities are not usually covered by a specific assignment of personal collateral.
- Asset-based facilities are usually more generous in their advance formula criteria that bank lines.

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- Asset-based facilities are not subject to routine bank regulatory overview such as bank lines.
- Asset-based lenders do not key on personal credit histories, credit scores or other measures of personal credit as keenly as banks do.
- Bank lines are ordinarily somewhat less expensive, from a pricing standpoint, than asset-based facilities.
- Generally speaking, asset-based facilities are simply more flexible than traditional bank lines.

Let's elaborate a bit on each of the above items:

1. Banks will frequently insist that the borrower completely pay out the line to zero once per year. This places a difficult cash burden on the borrower to come up with the cash and be counter productive to the best interests of the borrower. This is frequently done to present a picture to the bank examiners of a zero balance account. It is more cosmetic for the bank than a benefit for the borrower.

2. It is not at all unusual to find a bank line that is secured by three, four or more times gross collateral than the borrower's indebtedness to the bank. Without question, banks are conservative in their lending philosophy. If the bank can have the cushion of excess collateral, so much the better. This is one reason firms depart bank financing and seek out asset-based lenders. It is not always the case of the bank kicking out the borrower, many times the borrower can increase their cash borrowing capacity by simply using the same assets under a more aggressive borrowing arrangement. This is true as the bank line may be more restrictive in its attitude about slower accounts but eliminating those over 30 or 60 days past due, whereas an asset-based lender may accept those accounts up to 90 or 120 days past due. Another example could be an unrealistic advance against inventories or elimination of inventories that asset-based lenders would accept.

3. Banks will frequently include personal real estate, common stocks and other assets owned by principals of the borrower as additional collateral. It is not unusual to find items such as primary residences, second/vacation homes, boats, automobiles, airplanes and other personal property items assigned to secure a bank line. This would be in addition to a personal guarantee that is ordinarily required by all

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bank lines. This then ties up the personal assets of the principal owners and the bank has these items assigned to them as well as corporate or business assets. In asset-base lending relationships, this is the exception rather than the norm.

4. Bank lines will ordinarily be much more restrictive in their advance formula criteria than asset-based facilities. It is not unusual, for example, to see advance percentages for eligible receivables of 80% to 85% in asset-based relationships. Conversely, it is usual to find 70% to 75% (or sometimes less) for bank advances on eligible receivables. It is also usual to find advances on eligible inventories as low as 25% for banks. Most asset-based lenders will advance 40% to 50% against eligible inventories. Moreover, it has been noted from time-to-time that some banks will restrict commercial real-estate loans to percentage advances less than standard asset-based lending formulas.

5. Bank lines are subject to various forms of regulatory control and scrutiny. Moreover, bank lines are subject to the bank's own loan committees. Many times, members of the loan committee may not have ever met the borrower nor have more than surface knowledge of the borrower's business, looking solely at a set of numbers to make their decision. Secondly, bank lines are subject to the bank's regulators. In addition, the comptroller of the currency has the right to examine bank lines. If a borrower should fall below the requirements of certain restrictive loan covenants contained within the loan documents, they will then find themselves subject to greater scrutiny and potentially placed on the banks "watch list." This means that every time a bank examiner walks in the door of the bank, he or she will ask to see the file on that a particular borrower. Naturally, this subjects the borrower and the bank to more scrutiny. Generally once a borrower is placed on the watch list, they are moved to the "special assets" section which is a prelude to being asked to leave the bank. There are numerous governmental agencies that oversee a banks operations and lending processes.

6. Bank lines are not conductive to a flexible approach as it relates to special accommodations and over-advances. As previously discussed, bank lines are simply subject to more scrutiny than asset-based facilities. For that reason alone, banks lack the necessary infrastructure

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or specialists to grant a special financial accommodations. An over-advance means that the collateral does not justify the loan in terms of the normal advance formula. However, it does not necessarily mean that there is no collateral to cover such an over-advance. In a banks case, there is still another instance wherein the examiners can call into question the practice. The best way a bank can avoid answering these questions is simply not to make these types of financial accommodations under any circumstances. Asset-based lenders have the capability to realize opportunity when it arises. Such opportunities may come from sales within the pipeline that will be invoiced which will cover the temporary shortfall produced by an occasional or seasonal over-advance. This use to be common practice in the apparel industry for example. The build-up of inventory necessary to service a backlog of orders for fall fashions may be a good example. By advancing a greater percentage against receivables, the manufacturer can acquire the inventory needed to produce goods against the orders. The entire cycle may only take 60 to 90 days and generally an asset-based lender will have enough experience within a specific industry to understand and accept the risk.

7. Banks tend to concentrate on a minimum set of standards not only for the company borrowing the funds but for the principals of that company as well. Banks frequently insist on a high personal credit score. Moreover, if there has been a slow payment history, derogatory information or a charge-off reported within an individuals personal credit history, it is doubtful this will be acceptable to the bank. Asset-based lenders take a more holistic approach to the evaluation while keeping an open attitude to explanations of such historical occurrences. There have been those asset-based lenders that have accepted borrowers with prior personal credit problems, including prior bankruptcies.

8. On the positive side, it can be said that bank lines are generally less expensive than an asset-based facility. Most banks are utilizing their own funds and can price products considerably more aggressively than most asset-based lenders. Sometimes, the difference is dramatic. Such an example may be a rather marginal borrower that has the luxury of a very decent pricing mechanism with the bank. Then, they find that the bank program is not adequate for their financing

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requirements. When a borrower approaches an asset-based lender, they may learn that the size of their loan and the maintenance required by the asset-based lender dictates a higher costing structure. The trade-off, of course, may be that the asset-based lender will have a vastly improved lending philosophy and greater overall flexibility to offer a borrower.

9. The bottom line is simple. Bank lines are not as ordinarily as creative and flexible as asset-based facilities. We have outlined only a few reasons that this is true.

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# Ideal Candidates

Various types of business entities utilize the services of an asset-based lender. Unlike factoring, which has traditionally serviced industries such as textile, apparel, furniture, transportation, temporary staffing, etc., asset-based lenders have a much broader client base because credit extension is not the key issue. Instead, asset-based lenders concentrate on the collateral, overall credit-worthiness of the entire customer base of the borrower and the ability to repay the loan accommodation.

Prospects that typically are attracted to asset-based lending (and thus good candidates) desire anonymity of dealing with a third party without their customers being aware of such a relationship. Without exception, they are generally more sophisticated in all facets of their business than a typical factoring prospect.

In asset-based lending, unlike factoring, account debtor verification is the exception rather than the rule. In fact, some asset-based lenders may never verify directly with the account debtor. After all, you should remember that most asset-base lending relationships are on a non-notification basis.

There are subtle and somewhat camouflaged ways in which the asset-based lender may choose to verify. This can be done using an accountant's letterhead so it appears that it is being done by the client's own accountant or by sending out routine audit verification from a bookkeeping service. Both of which are disguised to protect the confidential nature of the asset-based lending relationship.

How then, does a lender protect itself? First of all, by an audit prior to any relationship and secondly, by follow-up routine or special audits conducted at the clients site on a quarterly, semi-annual or more less frequent basis. When the pre-approval audit is done prior to funding, the asset-based lender is cognizant of the collection aspects of the prospect and has an idea of account turnover, days sales outstanding and other key barometers of the prospect's business. In addition, the asset-based lender reserves the right at any time to notify the account debtor base in the event the borrower defaults or the lender becomes uncomfortable with their collateral position.

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Moreover, since the lender has control of the cash through a lock box or depository arrangement, the daily cash can be seen, analyzed and the touch and feel aspect ascertained.  Finally, bear in mind, that generally, the overall quality of the client's financial condition is ordinarily superior to that of a factoring relationship.

With the different appetite for prospective clientele, asset-based lenders are able to service a very broad spectrum of the business community.  Suffice it to say that if a firm possesses the attributes outlined earlier, it can be considered as a candidate for asset-based lending.  The general appetite for an asset-based facility has increased from a minimum of $250,000 funds employed to higher minimums.  The low range now appears to be around $400,000, however, the vast majority of asset-based lenders require a minimum of $1 million in funds employed with larger asset-based lenders setting the standard at $5 million as the minimum transaction size.  Banks that have asset-based units tend to follow stricter minimum guidelines than banks that simply accommodate asset-based facilities.

A typical asset-based lending client exhibits greater business savvy.  They may be more persuasive in making a case for a larger credit facility based on present borrowing needs as well as future borrowing requirements.  That, of course is, where for forecasts and projected cash flow tools come to the forefront.  It is often the case that the asset-based lending client will present a case for a facility that exceeds the present borrowing capabilities of the existing collateral.  This can be the situation with a company that is in a growth mode, about to introduce a new product or service line, or has a justifiable backlog of work.  As we have discussed, a typical factoring arrangement will not include borrowing potential beyond the accounts receivables.  Asset-based lenders are frequently more generous against collateral that most banks.

When an asset-based lender first examines a potential prospect, it is routine to gage the prospect's borrowing capability against the supposed borrowing requirements.  Failure to meet the needs of the prospect is frequently the reason to deny funding.  For example, if the prospect needs funds over-and-above payout of the present lender to address accounts payable or tax needs, it is critical that adequate collateral be present to justify covering those needs.

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No new lender wants to “band-aid” a lending facility only to learn in 60 to 90 days that there were unforseen or undetected borrowing issues that did not get addressed. In case studies, we will examine some of these aspects.

Unlike bank financing, the absence of tangible equity is not an automatic decline as there are certain asset-based lenders that will accommodate even negative equity firms if they have sufficient collateral, business and personal net worth that they feel will support the loan. It should be noted that there are literally thousands of asset-based lending firms with varying appetites, minimum size requirements, industry preferences and lending philosophies to accommodate a myriad of loan requests. Some asset-based lenders will only advance on revolving assets such as accounts receivables and inventories; others will advance on both revolving and fixed assets (such as machinery, equipment and real-estate).

Lending parameters will vary sharply from lender to lender. Some major lenders are strictly “cash flow” (if the prospect does not cash flow, they will not accept the prospect). Others are “collateral” oriented in which they base the lending decision is based on the value of the collateral being offered. Still others are hybrid asset-based lenders; a blend of reliance on the collateral but concern with the ability to repay the loan or cash flow the debt.

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# Pre-qualification

It’s critical to first learn and second to understand the general procedures that are employed to effectively qualify a prospect and prepare for presentation to various lender(s). The ultimate goal is always to bring your prospect to approval, closing and funding status.

Asset-based lending like all other forms of financing utilizes simple yet effective methods to determine the feasibility of qualifying for an asset-based lending facility. These methods are commonly practiced by business development and underwriting staffs throughout the asset-based financing community. There are four basic rules to remember when pre-qualifying a prospective client.

1. Work over the phone
2. Ask basic questions
3. Assess and justify the need
4. Competition

## Working Over the Phone

Most businesses these days can be done over the phone. The phone, fax and e-mail are invaluable tools in the pre-qualification process. Asset-based facilities very frequently involve fixed asset collateral as well as revolving loans. It may become necessary to physically view the collateral. If properly quizzed, the prospect will shed valuable light on the value of the collateral. It is then very possible to use this information to pre-qualify the prospect before spending the time and additional resources of a physical visit.

Since most asset-based lenders offer some form of inventory financing, it is frequently helpful to get a basis breakdown of inventories by telephone to aid in the pre-qualification phase. For example, if the prospect is seeking an “up-side down” loan, this may be an immediate deal-breaker and there may be a limited number of asset-based lenders to finance such a condition.

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An up-side down loan is a loan whereby the bulk of the loan is against inventories or fixed assets and the smallest portion of the loan, which may be disproportionate, is against accounts receivable. Most asset-based lenders insist on the bulk of the facility to be made against the accounts receivables, not the other way around.

## Ask Basic Questions

Before proceeding into your well crafted and canned presentation, you may first advise the prospect about your role as a commercial finance consultant. Including, the type of companies you have assisted and the products you have ready access to. After you have some rapport, it is time for you to assume control of the dialogue and begin the pre-qualification process.

There are several basic questions that need to be asked to determine the potential viability of the prospect. Some of the most effective questions to quickly determine feasability for an asset-based lending facility.

1. **Tell me about your business?**
   If the prospect is consumer oriented, meaning that sales are to individuals as opposed to companies, this may not be a viable asset-based loan candidate. If the business is a wholesale distributor, manufacturer, processor or commercial in nature, including certain service firms, chances are good that their customer base may make an excellent tool to borrow against.

   If a prospect tells you that they are engaged in purely retail COD basis such as a restaurant, theater or similar cash business, it is doubtful that this is a viable asset-based lending candidate. However, the business may have fixed assets in which to borrow against which may make it a candidate for an asset-based lender. For example, if the firm has capital or fixed assets such as machinery and equipment, commercial real-estate, a fleet of trucks and trailers, forklifts, etc., they may be a candidate for an asset-based term facility. Many asset-based lenders are industry specific such as retail chains (jewelry, shoe, furniture, etc.)

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Generally speaking, the emphasis is on the collateral and asset quality. Getting your prospect to quickly describe possible collateral is critical. Asset-based lenders place weight on the total assets of a company as opposed to simply the accounts receivables. However, emphasis should be placed on the accounts receivables, as the vast majority of asset-based lenders key the facility based on the accounts receivables. In addition, most asset-based lenders do not lend against inventory, real-estate, machinery and equipment or fixed assets as the primary borrowing collateral unless the accounts receivables make up the vast majority of the loan.

2. **Who are your customers?**

Once your prospect has satisfactorily explained their business, it should become apparent whether or not the accounts receivables will potentially lend themselves to an asset-based facility. Determining the credit quality of the accounts receivables becomes important. Is the prospect selling to highly creditworthy companies (i.e. Walmart, Target, Sports Authority, etc.) or are they selling to non-listed, non-rated "mom and pop" operations? Are their any concentration issues? Where are the customers located? Are their any export sales? Are their any sales to affiliated or related companies? Are their any officer or employee sales? Are their any contra account situations?

These questions will quickly lead you to determine if the accounts receivables have sufficient borrowing capacity.

3. **What are your terms of sale?**

This is where the rubber meets the road. Many prospects will sound as if they are qualified until you get into the accounts receivable aging report. For example, if they are giving net 30 day terms, it is reasonable to expect the receivables to turn within a certain time period. However, if the receivables are turning very slowly, say closer to 90 days, it may be cause for concern. Is the prospect giving any early payment discounts? Once you have established the terms, it's time to evaluate the aging.

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You can quickly ask your customer to give you the following figures from their aging:

| Current | 31 - 60 days | 61 - 90 days | 91 plus |
|---|---|---|---|
| $ | $ | $ | $ |
| % | % | % | % |

It will be easy to determine why the customer is having cash flow difficulties buy utilizing this information. You will also recognize if the average turn on accounts receivable is within normal industry standards. Anytime an aging has a high percentage in the 61 to 90 day column or 91 plus days column, it should warrant additional questioning. Most asset-based lenders utilize some form of a cross-age formula. A typical cross-age formula is 50 percent over 60 days or 25 percent over 90 days, will make the entire customer account ineligible.

4. **What is your immediate need?**
This is a critical question, since this is where you should learn the prospects primary motivation. Are they having problems with their suppliers or in making payroll? Are they in arrears or default on their loan agreement with their present lender? Are they delinquent on any tax obligations?

Often, a prospect may feel that their existing lender is too restrictive and the prospect is suffering from inadequate funding. Frequently, an asset-based lender or bank will restrict advances on the prospect's collateral to unrealistic levels, with or without justification. Many times a larger advance formula cures the problem. It is not uncommon to find may banks "over collateralized" by 5 or 6 to 1; meaning that certain assets are capable of generating additional working capital but are going untapped due to lender conservatism.

5. **How are you presently financing?**
This is equally as critical since you need to know what the prospect is currently using and what they are looking for. Are they self funded? Do they have an existing line of credit? What assets are pledged as collateral? What is the borrowing formula? Is additional collateral available to borrow against?

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Is there a problem with the existing lender? Why are they looking for new financing?

6. **What is your current financial condition?**
Obviously, from the tone of the conversation you will quickly ascertain how cooperative and forthcoming the prospect is. This will be a judgement call on your part. You may choose to forego any questions relating to the financial condition of the company if you determine a reluctance to divulge sensitive information about their financial condition. However, if the prospect called you, there should be little reason for a prospect to withhold any financial information.

There are asset-based lenders that will place primary emphasis on collateral values, not cash flow, profitability and stockholders equity. It is therefore your responsibility to determine viability on the surface from information presented. You should ask your prospect the following questions regarding their financial condition:

- Does the company have a positive net worth? If yes, what is the net worth?
- Is the company profitable? If yes, for how long?
- What is the total debt of the company? Will the proposed new facility retire all secured and unsecured loans and notes payable? If not, what is the disposition on the ones not being paid off?

From the response, you will be in a better position to determine if further questioning is warranted. This is the perfect time to inform the prospect that you will need a minimum of 3 years of fiscal financial statements and a copy of their most recent interim's. Remember that some of your prospect may not have a long operating history, in those cases, you have to take what you can get.

## Justification

The assessment of the prospect's needs versus availability is where you must make a preliminary decision based on your initial conversation if the transaction has some degree of validity.

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By now, enough information has been gathered to at least initially surmise whether this is a good candidate for asset-based lending. Is the prospect's request sensible? If the prospect is requesting a 100 percent advance on accounts receivables and 80 percent on inventories or similar unreasonable and irrational requests of that nature, it may be time to set the prospect straight on what products may be realistically available.

You will be in a position to make an assumption based on the information presented if the prospect is within the "ballpark." The receivables sound like they would be eligible, there is additional collateral to support the request and it seems like a viable opportunity. If the prospect is seeking a term loan, does it appear there are assets of value to support such a loan? Now, what do you do next?

Its simple, this is where you ask the prospect how much they are looking for versus how much they may reasonably receive? If we know the basic answers to the questions, we should now have a pretty good idea if the needs expressed by the prospect can be justified and if the transaction, at least on the surface, appears to be viable.

The caveat is whether the values expressed by the prospect are realistic. You probably will have not way of determining that in may situations because certain assets, such as inventories, machinery and equipment and commercial real-estate will need to be professionally appraised and/or evaluated. This will be performed at a later date. Your primary objective is for you to simply get a gut feel for the overall proposed transaction in regards to its viability and informing the prospect about realistic expectations.

## Are you competing?

It is always helpful to learn if the prospect is seeking financing form other sources. If they are talking with a competitor that you know cannot offer the services the prospect is seeking or is priced higher than others, it would give you a distinct competitive advantage. Let the prospect know that you feel you can help them. Your role as a commercial finance consultant is to find the absolute best lender for each of your prospects and you would like an opportunity to package and present their loan to asset-based lenders on their behalf.

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However, you maybe in the situation where the prospect has already received proposals ore is in dialogue with other asset-based lenders. In that event, you may consider asking the following questions:

1. **Whom have you been speaking with?**
   Again, this may give you a distinct advantage to know which lender(s) the prospect is having serious dialogue with. Once this is known, it can influence the way you present the product or aid in your pricing in some instances.

2. **Do you have a term sheet or proposal?**
   If the prospect has a term sheet in hand and is willing to share the contents, it can greatly improve your position. The existing term sheet(s) will serve as a benchmark in your search. Not only will you know who you are competing against, but what rates, terms and conditions they are proposing. Of course, you always run the risk of potentially upsetting the prospect by being too pushy.

   Many asset-based lenders choose to offer prospects proposals or term sheets which are subject to certain conditions and provide the lender with plenty of "outs" just in case the audit, evaluation or appraisal of assets or other matters surface that would make the transaction unacceptable to the lender.

   This is the appropriate point in preliminary analysis or discovery wherein the prospect's true interest may be determined. Most lenders will be willing to issue a term sheet but will require the prospect to make a deposit. This tends to cement the prospect in some fashion to the lender and eliminate a lot of shoppers. By now, your pre-qualification may have answered the question about competition. If the prospect has already paid a commitment fee or the like, it may be difficult to convince the prospect to pay another deposit or offer earnest money to obtain additional term sheets. However, from an asset-based lenders perspective, time is money and the a given asset-based lender may not go any further without additional compensation. In most cases, asset-based lenders will refund all or a portion of the deposit if they do not make the loan. Some asset-based lenders apply it to closing costs of the loan and some will not refund any of the deposit. A

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As a general rule, asset-based lenders ask for one-half to one percent of the line of credit being considered. Some of the smaller asset-based lenders will request a smaller, flat amount to serve as a deposit. Sometimes, this fee goes to cover the cost of the initial audit or field examination to qualify a prospect. Most asset-based lenders will have an audit fee that must be absorbed by the prospect and that is sometimes in addition to the good faith deposit.

3. **Is there something special you are looking for?**
   If there is something distinct about your prospects business, you will need to identify it quickly. There may be an ideal asset-based lender(s) who have experience financing your prospects industry. This may be a potential hot button that could be addressed once you learn what they are seeking in an asset-based lending relationship. For example, there are some asset-based lenders that specialize in government accounts receivables. If the prospect is engaged in a peculiar industry for example, they may better suited for certain asset-based lenders.

4. **What are your key issues regarding the lender you select?**
   Are there any conditions that must be considered or met for your prospect to consider or accept an offer? Is your prospect aware of a general asset-based lending pricing structure? Is cost the primary issue or is it borrowing capacity? It is always important to find out what key issue(s) will ultimately determine which lending firm the prospect wishes to align with.

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In your dialogue with your prospect, it is critical that you covey an understanding of the issues involved in a typical asset-based lending relationship. It is important that the prospect acknowledge and buy in to the procedures that are generally required in a typical asset-based lending relationship. Accordingly, certain information regarding the mechanics of the product and processes need to be made known.

## Billing Procedures

It is critical that the client understand what evidence of receivables will be required by the asset-based lender. This will vary from lender but most will require some weekly or more frequent reporting. Unlike factoring, where invoices are actually submitted, very few asset-based lenders want to see each individual invoice. The reason for the non-submission of invoices is because asset-based lenders generally do not provide financial reporting, they do not provide any credit or collection services and most asset-based lenders provide advances based on a "bulk" assignment of receivable collateral, not specific invoices.

It is important that you convey to the prospect that the business will be required to report more frequently than in a traditional banking product, but it is not an onerous requirement to continually feed information and detail to the asset-based lender.

## Borrowing Base & Reporting

Generally speaking, each asset-based lender will have their own unique policies and proceeders when it comes to reporting. Most asset-based lenders will require reporting that is more frequent and detailed than a bank, however as you know, it's a completely different product. Many bank lenders have minimum reporting requirements but most asset-based lenders want reporting on their collateral more frequently. By minimum reporting, the expectations are for bare bones information transmittal from borrower to lender. This may take form of a monthly recap or simple Borrowing Base Certificate.

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Some of the larger asset-based lenders will operate in this same fashion. It should be noted that the smaller clients with a weaker financial picture, may be expected to produce on a more frequent basis and in greater detail.

As a general rule of thumb, borrowers will report collateral details regarding their receivables at least twice monthly, weekly or more often in those cases where the lender perceives greater overall risk. Collections, sales credit memos, returns and allowances, etc., would be shown along with the outstanding borrowing base calculation. This is referred to as a Borrowing Base Certificate/Report or monitoring report (see following page).

For inventories, the reporting is less frequent; usually a monthly report will suffice. The borrower will report purchases, beginning inventory, freight in, cost of goods sold, sales, etc., and then show an ending inventory figure. The loan balance against the inventory will usually be shown as well. There are no reporting procedures, ordinarily, for fixed asset collateral. These loans are repaid on a monthly basis and subject to mortgage documentation and promissory notes. During an audit, a field examiner will be cognizant of any pledged collateral of a fixed assets nature and be governed accordingly in their observance. Routinely, certain tests of the collateral (particularly as it relates to machinery and equipment) will be made.

As outlined earlier, the documentation required in support of a borrowing base will vary with individual circumstances. However, a borrowing base is a relatively straightforward document and not very complicated.

Generally, all that is needed is a summary accounts receivable aging report that support the reported figures. There s no need to send individual invoices, bills of lading or other proofs of delivery or copies of purchase orders, etc. Ineligibles are set forth clearly and these accounts are not advanced against.

Some asset-based lenders require a more sophisticated borrowing base certificate in which areas for sales, returns, allowances, discounts, collections and other details are added. In those cases, the asset-based lender would ask for copies of a sales journal, collection reports and a cash receipts journal, or similar information.

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# BORROWING BASE CERTIFICATE

To: Lender's name & address

Pursuant to the loan commitment and agreement between us, the undersigned hereby certifies to you as of the below date, the following:

| | | |
|---|---|---|
| A. | Aggregate amount of accounts receivables | $________ |
| B. | Less ineligible accounts: | |
| | - More than 90 days old | $________ |
| | - Payable more than 60 days after invoice | $________ |
| | - Un-billed for more than 5 days | $________ |
| | - Foreign/Export sales | $________ |
| | - Accounts contingent on further action | $________ |
| | - Owed by an affiliate, subsidiary, employee shareholder, or other related party | $________ |
| | - Disputed, contra, or counter claim | $________ |
| | - Owed by an account debtor with greater than 30% concentration | $________ |
| | - Other ineligible accounts | $________ |
| | -Owed by an insolvent account debtor | $________ |
| | - Miscellaneous | $________ |
| | - TOTAL INELIGIBLE | $________ |
| C. | Net amount of eligible accounts (A - B) | $________ |
| D. | Aggregate amount of inventory | $________ |
| E. | Less ineligible inventory | |
| | - Obsolete items | $________ |
| | - Other ineligibles | $________ |
| F. | Net amount of eligible inventory | $________ |
| G. | Cap on inventory (predetermined amount) | $________ |
| H. | Current borrowing base: | |
| | - 70% of Item C plus the lessor of (1) 25% of item F or (2) item G | $________ |
| I. | Reserves for letters of credit, bankers acceptances or any other availability offsets | $________ |
| J. | Outstanding principal balance | $________ |
| K. | Maximum line availability (H - I - J) | $________ |

The undersigned hereby certifies, represents and warrants to (lender) the following:

1. The description of eligible accounts and eligible inventory and the values assigned thereto are true and accurate;
2. All of the representations and warranties contained tin the agreement or in any loan documents are true and correct;
3. The borrower is in compliance with all existing loan covenants.
4. No event has occurred, or would result from advances made in connection herewith, that constitute an event of default under the agreement;
5. The borrower will supply additional reports and financial information as reasonably requested.

Borrower Name ___________________________________

Officer Name/Title _____________________________________ Date ___________

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## Verification

Verification methods employed by asset-based lenders vary. The most important aspect of an asset-based lending facility is the non-invasive nature of the product. Asset-based lenders are more prone to utilize a sampling of the receivables to determine validity as opposed to a factoring arrangement where verification of the validity of the receivable may take place in the support documentation and/or a verification call to a accounts debtors payables department prior to issuing an advance.

An asset-based lender will place greater scrutiny on the overall financial condition and operations of a borrower. This is accomplished through detailed reviews of the books and records of the borrower, but also through independent evaluations through the use of field examiners.

The verification of the information suppled in a borrowing base is matched against specific tests to determine if the numbers presented are accurate. Generally, a borrower will be audited at a minimum of 1 time per quarter with an average cost of five to seven thousand dollars per audit.

## Collections

A majority of the asset-based lenders insist on controlling cash collections and will set up a lockbox in the lender's name or jointly with the client to insure funds that are collected are under the control of the asset-based lender. Unlike factoring, where account debtors receive a formal notice of assignment, asset-based lenders do not ordinarily follow this practice (however it is within their rights). Instead, remittance are sent directly to the lockbox directed to a specific account number. Rarely, will a asset-based lender allow the borrower to collect the funds and deposit them into an account controlled by the asset-based lender. Because there is no notice of assignment, the asset-based lender will often ask the client to send their customers what is commonly referred to as a "soft notification." This generally is a simple note on the invoice or a letter sent (or both) to direct payment to a certain bank and account number. The bank account is normally owned by the asset-based lender, but the account debtor may have no knowledge of the relationship.

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Debtors continue to make remittance payable to the borrowers company but is being mailed directly to the lockbox which is generally swept daily.

Typical “soft notification” language as placed on an invoice or billing document:

**Please forward remittance to Account #3422294**
**First National Bank, N.A.**
**For deposit advice and credit of (Sample Company)**

Because this is a soft notification without use of the lender’s name, you should find little objection from the potential client. Generally the client’s name will also be mentioned on the lockbox and thereby inhibit notification of the lender name altogether. The borrower can ordinarily receive a copy of the daily collections so they can update their books and records in the ordinary course of business.

For inventory and capital/fixed asset loans, asset-based lenders require monthly payments in the form of a draft of the borrowers bank account which repays the loan.

The collection of receivables is fairly standard for most asset-based lenders as well as the process in which payments are credited. Generally, most asset-based lenders will charge between one and three float days on the collected funds. Float days are the amount of additional time it takes a check to clear the bank. During this time, fees continue to accrue until the check clears. Because of the Check 21 Law, all checks are to be cleared within 1 business day. Some asset-based lenders will make exceptions to this rule, however it is generally reserved for large asset-based lenders with large borrowers with a strong financial stature.

The process is straightforward and direct. Very few things change insofar as the customers are concerned, other than paying to a numbered account, with remittance in the borrowers name. Account debtors remain unaware that there is a third party involvement and are definitely not aware that the lockbox is controlled by the asset-based lender.

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Asset-based lending offers many advantages over bank financing and factoring. In reality, the product is middle ground to both factoring and a banking relationship. The benefits of an asset-based facility are numerous and at the top of the benefits list is the non-invasive nature of the product and confidentiality.

Once you have outlined the product fundamentals and routine reporting procedures, your prospective client will ask additional questions or raise objections. The main question within your prospects mind will be whether or not they can operate within these parameters?

You should expect to hear one of the following:

1. The prospect will ask more detailed questions which is a prelude to submission of a complete application package;

2. The prospect will immediately pose objections to the product or mechanics;

3. If your prospect is motivated, they will inquire about the next step.

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# Common Concerns & Objections

Assuming you have reached the point whereby the prospect appears qualified, you may encounter the following three normal questions and/or objections:

## Cost

As with anything in life, cost is always an issue and more commonly in the world of commercial finance. If the prospect is accustomed to a conventional banking product which carries conventional bank pricing, an asset-based facility may give them "sticker shock," which is to be expected. After all, asset-based lending is a unique product which is priced higher than a banking program.

If a prospect has approached you, it is a safe assumption that they are not qualified for a bank line. If that is the case, then cost is a moot point as a conventional bank line is unavailable to them. Therefore, a prospect may not have the luxury of a fallback position by going back to a bank.

There are many rebuttals to cost are many, however a simple technique is to mention the products that may be available. An obvious product that the prospect would most likely qualify for is a factoring arrangement. The cost associated with a factoring program is likely to be more than an asset-based facility, more interaction with the factor and less borrowing capacity. On the opposite end is a bank line. An assumption that you can make is that the prospect has already traveled down that road and has been turned down. That warrants asset-based lending as a fair middle ground worthy of further discussion.

If your prospect currently has a bank line, your rebuttal needs to be crafted differently. Generally, most asset-based facilities are more generous on borrowing capacity. If a bank is not willing to increase borrowing capacity or is only looking at certain assets to borrow against, it is a simple matter that an asset-based lender can give greater borrowing capacity and offers a more flexible financing arrangement than a bank.

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If your prospect needs greater borrowing capacity (which can be significant if a comparison is made), than cost becomes a secondary issue as the motivating factor becomes borrowing capacity.

If your prospect is currently factoring it's a simple argument why asset-based lending is more cost affective with potentially greater borrowing capacity.

One thing that plagues asset-based lending and is often viewed by asset-based lending clients is "nickle & dimeing." Asset-based lending requires greater collateral monitoring and ultimately the client is picking up those costs. Additional fees charged by an asset-based lender will be a facility fee which is charged on the overall line amount which can range between one percent to 2 percent of the line amount charged annually, the usual audit fees charged quarterly, monthly lockbox charges, charges for reports, attorney or recording fees, etc. When its all added up, it can be a considerable expense. As a general rule of thumb, asset-based facility charges are somewhere between factoring and bank rates.

A tool that can be utilized is a pricing model presented to the prospect. This can show different elements of expenses the prospect can expect to pay the asset-based lender and reduces the overall cost to an actual APR which can clearly depict cost. Sometimes, prospects object to the cost, not due to the interest rate or service fee quoted, but because of ancillary expenses.

Once a logical presentation has been made about what the prospect is truly qualified for versus the realistic options available to them, asset-based lending rises to the top.

## Valuation of Collateral Calculations

This is an area that is as common as cost when it comes down to a prospects objections. The prospect will always think their collateral is worth more than you do. That's pride and human nature. There is no easy way to win this argument other than to fall back on the numbers one has to work with. The evaluation of the receivables and inventories are what they are. The appraisal of fixed assets having been done by an independent appraiser are what they are.

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How does one overcome this objection?  It is probably best to advise the prospect that like a balance sheet or aging of accounts receivables, the values arrived at are at a give point in time.  As the asset increases (such as an increase in sales), the asset-based lender can address that on a routine ongoing basis.  Unlike a bank with a scheduled loan committee meeting date, an asset-based lender can quickly react to changes in asset value.

## Availability Calculations

Availability is an area that objections are raised.  Prospects will argue about higher advances on receivables and inventory which is to be expected.  Asset-based lenders have specific guidelines on advance formulas and when the rules are bent by making accommodations on advance formulas, generally the asset-based lender ends up with the short end of the stick.  Often times a prospect will be "testing" the sales pitch.  They may know they are being unrealistic, but nothing ventured, nothing gained.  With a successful operating history with a borrower, an asset-based lender can re-visit the collateral and decide to increase advance formulas, dependent on dilution, profitability and other factors.  Chances are good that if the prospect had a bank line, than the advance formulas they were used to were less than the proposed asset-based facility.

Asset-based lenders are like any other lender in which they base availability appetites on past experiences and industry standards.  Again, an asset-based lender will be more flexible in advance formulas, borrowing capacity, collateral changes and response time than a bank.

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# Information Gathering

Once you have answered the prospects concerns and objections, it is time to request the necessary information in which you can properly review the transaction and develop a loan package for submission to various asset-based lenders.

The activities necessary to determine the viability of the proposed transaction from an initial phone or physical contact with the prospect until approval, closing/funding or as the case may be declining of the transaction.

A commercial finance consultant should consider adopting a similar due diligence and underwriting process as the writer uses which is outlined below:

Six major phases of due diligence and underwriting:

- Discovery and analysis
- Structuring of the facility
- Packaging of the facility
- Presentation of the transaction to the lender(s)
- Negotiation, rebuttal and discussion
- Approval, closing and funding

1. **Discovery and Analysis**

   While you were conducing your interview and performing the pre-qualification techniques outlined earlier, you were "discovering" and "analyzing" their request and how this may translate into a potential client relationship.

   Working over the phone, asking basic questions, researching the internet are all phases of due diligence and underwriting.

2. **Structuring the Facility**

   In the pre-qualification section outlined earlier, when you begin to assess and justify the needs of the prospect, question the presence of competition and formulate in your eyes if the transaction is viable, you may unconsciously structure the facility.

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3. **Packaging the Facility**

Once you have gathered the necessary information from the prospect and reviewed all support documentation, you should have ample information to present in an organized and professionally packaged format to your lender(s).

4. **Presentation of the Transaction**

This is basically self-explanatory. You can provide a narrative write-up which should be married with the loan package. This is then forwarded to the lender(s) for consideration.

5. **Negotiation, Rebuttal and Discussion**

Once the loan package is received by the lender(s) with time for preliminary review, you can expect a period fo time for negotiation with the lender on behalf of your prospect. This may be the turning point in the deal as the term sheet or proposal will usually get generated at this time. In addition, back and forth negotiation will take place directly with the prospect. This is a critical time for a commercial finance consultant. Any objections by either the lender or prospect must be rebutted or overcome. A considerable amount of discussion on key issues may surface. This may be the time in which the deal is made or broken.

6. **Approval, Closing and Funding**

This is the point in time where the lender has competed their due diligence, any further underwriting, completed any necessary field examinations or audits and is in receipt of any independent appraisals. By now, the loan committee has met and decided if you have a transaction that is ready to fund. Be prepared if something is uncovered in the audit, appraisal or loan committee that causes a dramatic change from the original proposal. This is a critical point in the process in which professional expertise is required. Rely on your lender at this point.

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# Loan Package Composition

If you are satisfied that the prospect appears to be a viable candidate and that they generally understand and concurs with the fundamentals it is time to begin the underwriting of the loan package.

It is critical that the packaging and presentation phases of due diligence and underwriting be as through as possible with attention to detail. If properly packaged, it can be quickly presented to an asset-based lender. For most asset-based lenders, their potential interest in a facility will be governed by collateral. Asset-based lenders are not messanine or "air ball" lenders. Some are pure collateral driven, other are cash flow oriented and some dance in the middle. Larger asset-based lenders are generally cash flow oriented and will base their decision closely to a banking lending philosophy.

Your goal is to identify potential and viable candidates for asset-based lenders. Time spent on marginal asset-based transactions (under one million funds employed, highly specialized or single customer oriented inventory, no additional collateral or poor management) is generally time wasted.

1. **Application**

   Although most lenders have their own formal loan application that must be completed and returned by the prospect, a commercial finance consultant must utilize a generic application as he/she may not immediately know which asset-based lender to utilize. For that reason, many commercial finance consultants have generated a variety of applications that are acceptable to many lenders.

   All applications must have a location where an officer, owner or director is to execute on behalf of the company. It is important that at a minimum an application contains the following language:

   > The forgoing information is true and correct to the best of my knowledge and is given to (your company) or its agents, assigns, factors, funders or lenders to induce these agent's, assigns, factors, funders to consider entering into a financing relationship with this company. I hereby do authorize (your company) agents, assigns, factors, funders to verify and investigate any and all of the foregoing statements, including but not limited to, my/our creditworthiness and financial responsibility, in any way they may choose. I/We grant (your company) or its agents, assigns, factors, funders the right to procure any and all credit reports pertaining to any party listed in this application, including, but not limited to, all principals of the applicant's company. By my signature below, I am duly authorized by all parties listed above to grant this permission on their behalf.

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2. **Financial Statements**

In any asset-based lending facility, it is critical to have information of a historical financial nature as part of the loan package. Most asset-based lenders will require at least two fiscal years of reports and the most recent interim financial statement as part of the package. As a general rule of thumb, you should ask for a minimum of 3 years of historical financial information.

Some asset-based lenders that are considering a term loan may also ask for a 5 or 10 year spread in historical financial information. This will show salient financial information for trend purposes. IF the lender is making a 15, 20 or 25-year term loan on commercial real-estate, this will often times come into play. This is also an issue for some machinery and equipment for an asset-based lenders that is considering a 5 or 7-year term loan.

The prospect should include the balance sheet, income statement and any or all notes or attachments that an accountant may include in a prepared statement. This may also include a breakdown on cost of goods sold, separate schedules of G&A expenses, cash flow statements, etc. It is always best to get an original bound copy of the fiscal reports, not a photocopy (no pages of the report(s) should be missing).

On an interim basis, you should expect to receive a current interim financial statement, which may be in-house prepared or done by a bookkeeping service. It should not be more than 6 months old to be of value to the lender. Many businesses running Quickbooks or Peachtree or any other common form of accounting software, should be able to provide this information with a click of the mouse.

3. **Personal Financial Statement**

Because most prospective client companies are closely held, it is almost always a routine to include the personal financial statement (PFS) of the principals. A principal in most cases, is an officer/owner of 20% or more of the common stock of the applicant company. If it is a partnership, proprietorship or LLC, you must include all of the PFS's for these individuals.

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The PFS is helpful to the lender to determine the financial strength (or weakness) of the owners and potential guarantors. Remember, in most asset-based lending relationships, principals and owners will be expected to personally guarantee the loan facility. Another matter to keep in mind is that the personal financial statement should be within 90 days of the application date and properly executed by the individuals.

4. **Projected Income Statement/Balance Sheets**

Whenever a term loan is being requested or considered, this will always be a requirement. Even when the facility is to be a revolving loan, many asset-based lenders will request this.

An asset-based lender needs to have projections on the positive implications of the new lending relationship and how it may affect the borrowing relationship. If the prospect is projecting a downturn (planed reduction of product line, removal of certain sales, market conditions, etc.) or an upward trend (increased sales, new product line, etc.), the asset-based lender needs to be aware and plan appropriately.

The format that most asset-based lenders prefer to see is a month-by-month for the coming 12-month period, then perhaps an annual projection or forecast for the following year, sometimes up to 3 years or more. Outlandish or "pie-in-the-sky" forecasts/projections do not gain favor with the lender and may even prejudice the lending decision.

5. **Accounts Receivable Aging Reports**

Considering the weight of the overall facility rests with the accounts receivables, it goes without saying that a large majority of the attention will be placed in this area. Aging reports should come in the following formats:

- Detailed A/R Report. This lists all open invoices by number, customer, days outstanding, etc.
- Summary A/R Report. This simply lists the customer and the open balances.
- Invoice Date. Prospects should set their software to track receivables from the date the invoice was generated as opposed to only tracking it after the "due date".

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An aging report should always be within 15 days of its most recent reconciliation.  Any specific issues regarding a customers balance (high concentration, significant amount in the 60 or 90 day columns, retainage, disputes, etc.) should be highlighted and provided under separate cover.

Revolving loans on accounts receivables will be based on the overall credit quality and exposures of the individual account debtors. Therefore, full nomenclature of the debtors/customers is an absolute necessity.  The lender will preform behind-the-scenes credit investigation and evaluation of the account debtor base.

The only exceptions would be the rare cases of "stand-alone" inventory loans and when the lending facility is solely against fixed asset collateral, such as machinery or commercial real-estate.

6. **Accounts Payable Report**

The trade payable situation is always of importance to a prospective lending firm.  Whether the loan is against revolving or fixed asset collateral or both, the asset-based lender must insure that the prospect is in good standing with their trade creditors.  If, for example, payables are seriously delinquent, the asset-based lender must address whether or not the proposed lending facility will sufficiently cover the payoff of any such delinquency.  If not, the asset-based lender may be danger of jeopardizing its position in the overall lending relationship.

Contra accounts can also be identified against the accounts receivable aging report through analysis of the accounts payables.  A payables report should always be within 15 days of its most recent reconciliation.

7. **Customer / Vendor List**

It is highly recommended that the prospect provide a complete customer and vendor list.  In the event that the asset-based lender is unable to obtain the necessary customer information from the aging report, they can revert to the customer list.

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8. **Articles of Incorporation**

Always obtain a copy of the complete organizational papers. Utilize the following guidelines:

- Corporations. Articles of Incorporation;
- Limited Liability Company. Articles of Organization;
- Partnership. Partnership Agreement;
- Trade Names. Obtain any Doing Business As (d.b.a.) Or fictitious name filings;
- Foreign Corporations. Obtain Foreign Status Certificates from the State in which they have a physical location. For instance, a company may be organized in Delaware but operating in Florida. This is therefore a Delaware Corporation recognized by the State of Florida as a Foreign Corporation operating within its borders.

All information listed above should be submitted with any amendments or certifications by officers to reflect the amended structure.

8. **Narrative Description of Business**

The prospect should provide information regarding their business. This may take the place of a business plan, collateral marketing material, website information, etc. This should be enough information in which you can prepare a general outline of the prospects's business.

9. **Recent Resumes of Principals**

All lenders will want to know the experience level and background of any potential borrower. For that reason, it is recommended that the principals include or update their resume that concisely outlines their experience and background in thumbnail fashion.

10. **Optional Items**

Whenever a fixed asset/capital loan is being contemplated, the lender will always require an appraisal. Thus, if the prospect is requesting such a loan, it would be helpful to enclose any recent apprisal for review by the lender. Appraisals are generally acceptable up to 1 year old and should be rendered in the asset-based lender's name. Some asset-based lenders will accept a recent MAI Appraisal on real-estate or a recent FLV (Forced Liquidation Value) appraisal on machinery and equipment.

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Usually, this is based on knowledge and reliance upon the individual appraisal firm. If the asset-based lender has a comfort level with Norman Levy or Accuval, for example and the appraisal is less than 1 year old, some will not require a new appraisal.

Other items that may be optional and germane only to fixed asset loans, particularly real-estate are color photographs of the real-estate and/or machinery (inside and outside of the buildings and grounds) and company and personal tax returns for the last 3 years. Some lenders will also require copies of deeds and notes covering proposed real-estate facilities.

# Narrative Write-up

Once your prospect has submitted all of the necessary information you feel is required to evaluate the transaction, you will need to present the loan opportunity in the form of a narrative or client write-up. This is the critical explanation and outline of the transaction.

Generally, most senior underwriters or loan committee members will review a write-up before diving deeper into the information presented by the prospect. Information represented in a write-up is factual and based completely on the information provided by the prospect with emphasis placed on specific areas. Underwriters who have a history with a commercial finance consultant trust their initial evaluation of the transaction and will place weight on a well written write-up.

In order to write the best possible narrative, you will need to have all of the aforementioned information plus anything you feel would support the facility. One is dependent on other; you cannot prepare a quality write-up without all of the necessary elements.

Generally in a write-up the following items are generally explained in greater detail:

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1. **Historical Information / Nature of Business**
   It's critical that the asset-based lender understands the history of the business. How and when was the business started? How long has it been in operation? What type of legal entity is it? What is its primary product or service? Who owns the company? Ordinarily, a brief paragraph or two should detail this information at the beginning of the write-up.

2. **Type of Facility Being Requested**
   What is the prospect seeking? How large of a facility do they need? What collateral is available to support the request? Is there an existing lender that needs to be paid off or subordinated? This can also be accomplished in a brief paragraph.

3. **Disclosure and Disclaimer**
   Since lenders will be relying on the information you are presenting to them, it is critical that any asset-based lender or any lender for that matter understand your role as a commercial finance consultant. You need to be careful not to convey any possible indication or impression that you are presenting information in an absolute fashion. Bear in mind that asset-based lenders will be relying on the information that you are presenting to them.

   Typical disclosure and disclaimer language:

   > (Your company) does not guarantee, warrant or represent in any way the accuracy or completeness of client's financial statement's, financial information, aging of accounts, valuations of assets, or any other material herewith submitted for your review and hereby provides notice to you accordingly.
   >
   > (Your company) does not maintain facilities for verification f information through audit or other activity, belong to credit-reporting agencies (such as D&B, Experian, CBI, NACM, etc.), and hereby gives notice to lender that this shall be the lender's responsibility. All financial information is being submitted to you in the exact form received from the client and it will be the lender's responsibility to verify the accuracy thereof, including audit routine, if such is your practice.

   In those instances where there are significant financial issues to be dealt with, such as serious and continuous eroding operating losses, you may consider adding additional warnings alerting the asset-based lender(s) that this presents a negative circumstance that they need to be aware of.

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In practice it is considered a professional courtesy to inform the asset-based lender(s) of this situation prior to submittal of the actual loan package.

4. **Notice of Engagement by Prospect**
It is critical that any lender you are working with, that you disclose the nature of your relationship. The asset-based lender needs to be aware of your role and responsibilities in the transaction.

Below is typical lender notification:

**Notice of Engagement**

(Your company) has executed our standard Financial Services Agreement with the client company. Under terms of this Agreement, you as the potential lender, are authorized in writing to deduct and disburse the net fee due (Your company) from the proceeds of the initial assignment and/or funding. You are being provided a copy for your files and for disbursement activity upon funding.

**If there is any reason whatsoever that your firm cannot honor this Agreement and comply with this disbursement procedure, please immediately contact (Your company) and so advise. Otherwise, (Your company) will expect the spirit and intent of item 6 and the Agreement to be complied with.**

### Advanced Topic / Writers Point of View

It should be noted that on occasion you may be forced to submit prospects to lenders without your consulting agreement executed.

Competition will dictate how you approach a prospect and areas in which you will consider making accommodations. In those cases, it is best to inform the asset-based lender(s) not to contact the prospect directly. Instead, any questions that the asset-based lender may have should be directed through the commercial finance consultant. It will then be your responsibility to obtain resolution of those questions on behalf of the lender(s).

In the likely event that you reach advanced negotiations with the asset-based lender, you can then ask your prospect to execute your consulting agreement. Only then, do they become your client!

- T. Childers

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5. **Collateral Discussion**

Next, is the discussion about the "nuts and bolts" of the proposed facility. Just what does the collateral being offered look like?

Here you will set forth the accounts receivable aging information, concentration analysis, terms of sale, days sales outstanding and other pertinent information (including top customers and their specific aging status) for any revolving facility. Also, we will outline the proposed advance formula the prospect is seeking (provided it is reasonable for the prospects industry).

It is also important to outline salient categories of the inventories, such as finished goods, work in process and raw materials, taking time to carefully break out each category by recent dollar amounts. This will be the location where the proposed advance formula on inventory will be discussed and what inventory is stale, obsolete or worthless (to the best of your knowledge, if any), etc.

For the fixed assets, if we have the benefit of recent appraisals, we would outline when the appraisal was preformed, by whom, how it was valued and any opinions of value that may have been offered by the prospect, his bankers, accountants, etc.

A brief description of the fixed assets should be offered, even if we do not have the benefit of recent appraisals. In this manner, we provide the lender(s) with our general impression of the capital assets involved.

6. **Financial Discussion**

For many asset-based lenders, this is where the validity of the transaction is justified. As you are already aware, there are three types of asset-based lenders. The first is the cash-flow lender, second is the collateral lender and the third is the hybrid asset-based lender.

The larger and more sophisticated asset-based lenders are a different story. You will need to modify your write-up to suite multiple asset-based lender(s) with the understanding that minor touches to each individual write-up may make the difference. What is important to one asset-based lender may not be important to another and vice versa.

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Most asset-based lenders will welcome a professional write-up which outlines where the prospect has been and what the future holds. What the history of profitability or losses has been. If the prospect is presently losing money and why and more importantly what are they doing to correct the loss. If there was a recent downturn, what caused it? How does the prospect compare to the industry being served? What overall action has management implemented to correct the overall company situation.

In addition, this section should include comparative historical figures of salient financial barometers such as analysis of the balance sheet and income statement of a historical nature. Ordinarily, it is suggested that you include a comparative of two or more years on a columnar heading basis.

The key elements will include (in no particular order), but not limited to gross sales, gross profit margin, net profit or loss, key expense categories that bear investigation, depreciation, amortization, interest and certain key elements of the balance sheet such as net worth, total debt, current assets, current liabilities, working capital, trade receivables and payables and inventories.

The more financial information you present and explain here, the less you will ultimately have to answer and explain to the asset-based lender later on. Moreover, if there is something that is negative or positive, it needs to be presented here. Remember, no lender likes unpleasant surprises. You will earn respect and credibility that is critical to your success by being forthright, complete and concise in the presentation of your lending facility.

7. **Personal Financial Statements / Antecedent Discussion**

As part of the collected loan package, you will have copies of the owners personal financial statements. In addition, you may have learned about their backgrounds by the resumes or in conversations. If you had the client complete the application, the prospect will have divulged and explained antecedent history.

If we have knowledge of any suits, judgements, liens, prior

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bankruptcies or other critical information, this is the time to give detailed information relating to anything discovered. This forms one of the three C's of credit. Character, is a direct reflection of the character of the principals and is thus of great importance.

In addition, comments of a general nature should be directed concerning the elemental breakdown of the items on the PFS. Is it a liquid asset situation, with lots of cash, CD's, money market and brokerage accounts? Or are the assets centered in real-estate with large mortgages against them? If there is no true equity in the assets reflected on the PFS, what value is the personal guaranty? With if there is a need to rely on personal assets to shore up a potential over-advance or shortfall if the facility heads south? These are questions the lender will be asking when the personal financial statements are analyzed.

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# Preliminary Due Diligence

During the asset-based lenders formal underwriting and due diligence, many facets of the business will be under investigation. The nature of asset-based lending tends to have emphasis placed primarily on collateral with secondary emphasis towards cash flow.

You are aware of the three types of asset-based lenders. Regardless of their lending philosophy, they will always focus their attention towards the collateral as it will ultimately be the basis of the lending relationship. Once the collateral has been identified the asset-based lender must determine its potential value. This can be done in a number of ways and most are fundamental in nature.

1. **Accounts Receivables Analysis**

   Considering asset-based lenders place a considerable amount of trust on a prospects credit policies, procedures and receivables management capabilities, it is inherently important that the asset-based lender establish just how efficient the prospect is in these areas.

   Most asset-based lenders will accept a prospects aged trial balance or summary accounts receivables along with a master customer list as the initial tool for valuation purposes. The emphasis will be on the overall credit worthiness of the major customers reflected, with behind the scenes credit evaluation done through agency sources such as Dunn and Bradstreet and other credit reporting agencies. Ordinarily, no contact is made with the customer base.

   Generally speaking, asset-based lenders will not consider any receivable that is more than 90 days past due and depending on the balance over 90 days, it may exclude the entire account. In certain circumstances, some asset-based lenders may determine to extend the eligibility period to 120 days. Asset-based lenders generally will also utilize a standard cross-age formula. Cross age refers to a specific percentage of the overall receivable from an individual account debtor that is over a certain period of days. Generally, asset-based lenders utilize the Rule of 50.

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This means that if an account debtor has more than 50 percent of their total receivables balance over 90 days, then the entire account becomes ineligible. In a factoring arrangement, most factors utilize a standard cross age formula of 50 percent over 60 days and 25 percent over 90 days as grounds for making the entire account ineligible.

Those receivables will not be advanced upon and will be set as such on the borrowing base certificate. These accounts will occasionally be referred to as "margin accounts" or simply as ineligible. In addition, any inter-company, officer, employee or contra accounts will likewise be considered ineligible. Very few asset-based lenders will provide any eligibility on progress billing, retainage or other types of sub-contractor generated receivables.

A unique aspect in asset-based lending and factoring is the lenders right not to advance or reject or limit in amount any receivable it deems not to be creditworthy. This may include any account in which there is a large concentration. Often times, concentration becomes an issue as clients simply become too liberal in their credit decisions. Concentration limits are generally imposed regardless of creditworthiness to a certain percentage of total outstanding accounts receivables (OAR). This percentage or dollar amount will vary between asset-based lenders, but the general rule of thumb is any balance that is greater than 30 percent of OAR. For example, Wal-Mart and Target are perfectly creditworthy. If their balance makes up 50 to 70 percent or more of the OAR this could be a deal breaker. There is solid logic to this fundamental principle. If the prospect has built their business around serving a hand-full of customers, would they survive if they suddenly lost one or two of those customers? Is the overhead such that the company would sustain serious erosion of profitability if those accounts were lost?

There are certain hedges against credit losses incurred by insolvency, such as credit insurance. However, there are no such hedges against disputes. A fear most lenders have regarding concentration is the simple fact that if the debtor is unwilling to pay because of a dispute, claim, allowance, etc., how will the loan be repaid?

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On occasions an asset-based lender will limit not only the overall concentration percentage, but also reduce the advance formula. For example, instead of advancing 80 percent on all OAR, the asset-based lender may reduce the single account concentration to an advance, for example of 50 percent. This is simply another tool to limit a lenders overall exposure.

Another aspect of accounts receivable analysis is the question of how a asset-based lender protects itself in an ongoing relationship against poor quality of receivable collateral. Asset-based lenders control the cash collateral and will thus see the collection trends, be it on a daily or less frequent basis. Part of the reporting procedure will routinely include a borrowing base certificate or collateral reports on a weekly, bi-weekly or even on a daily basis, depending on the financial strength and credit quality of the client. Any dilution of the receivables has to be reported as a return, allowance, credit memo, etc., although it is done on a bulk reporting basis (unlike most factoring programs, which are done on a specific account basis). In addition, you will recall that asset-based lenders also require routine audit of the client's books and records. Their legal documentation also grants the asset-based lender the right to increase the frequency of audit/field examinations at any time the asset-based lender deems necessary. If the borrowers account executive detects a downturn in collections, serious dilution or the OAR or other unusual circumstances, the audit staff can be alerted and then decide if a visit to the borrower is in order.

All asset-based lenders generally will preform a pre-approval audit of the prospective borrower's books and records which also includes an extensive investigation of the OAR. In addition, most asset-based lenders will have "boot" collateral in addition to the accounts receivables, to support the facility.

The accounts receivable formula ultimately offered to the prospect will depend on the credit quality of the OAR, dilution thereof and the overall financial strength of the prospect and generally will match industry norms. Generally speaking, most advance formulas for asset-based lenders will not exceed 85 percent, with a typical advance percentage being 80 percent.

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Occasionally, smaller asset-based lenders will be amenable to more risk will advance as low as 50 to 60 percent to mitigate risk.

2. **Inventory Analysis**

Asset-based lenders are generally the best equipped within the commercial finance marketplace to offer borrowing against inventory. Because asset-based lenders have vast experience in lending against inventory, they have perfected methods to efficiently and accurately evaluate inventory. Asset-based lenders are generally very familiar with most industries and therefore have reasonable guidelines for specific industries as it relates to inventory.

The asset-based lender will determine if the inventory has universal salability to others, or is the inventory so specific that only a hand full of customers can utilize it? If it's not toothpaste or paper towels, what is the marketplace for resale? The last position an asset-based lender wishes to be in is to be the owner of inventory that has no usage or a narrow marketplace.

As a general rule of thumb, asset-based lenders will not advance against work in progress or work in progress inventories. The concern is that the goods are not in a finished state. Therefore, the goods would have marginal value in the marketplace.

In a manufacturing environment an asset-based lender will typically advance against finished goods and raw material inventories. Typically, advance formulas range from 25 to 60 percent of the independent appraisal value. As a starting point, most asset-based lenders are comfortable around a 50 percent advance level.

In wholesale distribution environments, an asset-based lender is only dealing with finished goods inventory. In those cases, the advance formula gravitates to the higher levels of 50 to 60 percent of the independent appraisal value due to the more saleable quality of the collateral.

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A major component in inventory lending is trust. How certain is the asset-based lender that they are dealing with a forthright and honest borrower? All asset-based lenders have many horror stories of inventory being sold "out-the-back-door," by borrowers and leaving the asset-based lender underwater.

As in receivables lending, asset-based lenders will require routine reporting via a borrowing base certificate (generally a line item) as to the status of the inventory. Like receivables financing, reporting can be done daily, or as infrequently as monthly, depending again on the individual borrowers circumstances and the confidence the lender has in the relationship.

Naturally, there are certain industries that do not lend themselves well to inventory financing. Examples may be perishable fresh produce and many of the food products groups, construction materials expended in the building process and similar intangible and non-saleable inventory elements.

In the evaluation process, another peculiarity that is more germane in asset-based lending is the matter of "upside-down" loans. This is where the inventory loan portion is larger than the accounts receivable loan portion.

As a general rule of thumb, you will find it difficult to find an asset-based lender who will make larger loans against inventory than accounts receivables. Generally, most asset-based lenders will limit inventory advances to no greater than 50 to 60 percent of the total OAR loan balance. Naturally, there are exceptions to this rule.

There are a handful of asset-based lenders and finance companies that will offer pure stand-alone inventory facilities. These are generally larger financial institutions that seek relationships with borrowers who have stronger financial standings. Often these lenders seek retail chain borrowers who seek multi-million dollars such as Zale's Jewelry, Whitehall Jewelers, Goodman's, etc.

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## 3. Capital Assets / Fixed Asset Analysis

Machinery and equipment, computers, vehicles and commercial real-estate are all examples of capital or fixed assets. Leasehold improvements would also fall into this category, although this is not ordinarily advanced upon by most asset-based lenders.

Routinely, fixed asset loans are terms loans, meaning the borrower repays the asset-based lender over a number of years at a specific monthly payment and interest rate (which frequently and more often times floats with the prime rate or LIBOR).

Most equipment loans are for 3, 5 or 7 years in duration. In addition, there could be a "call" or "balloon" note involved, meaning that the asset-based lender would re-negotiate the rate at a specific time interval. This is more an exception than the rule since most equipment loans are pegged to the current prime rate or LIBOR and adjust accordingly, usually on the first of the month following any increase or decrease in the measure.

Most commercial real-estate loans are like home mortgages. These will vary from as low as 10 to 15 years and up to as much as 30 years. Of course, there are exceptions to this as well. There are some asset-based lenders that make accommodation real-estate loans to existing borrowers. Rather than conform to extended payout periods, these can be as short as 3 to 5 years. More commonly, the bulk of commercial real-estate loans are subject to call or balloon features.

Advance formulas for equipment and real-estate will be determined by the asset-based lender after audit and after appraisal of the assets involved. Generally speaking, most of these loans are based on a percentage of the appraisal. Here it begins to get a bit complicated. What type of appraisal will the asset-based lender require? Incidentally, the prospective client or borrower will always be asked to bear the expense of any appraisal that the asset-based lender requires. All proposals or term sheets will be subject to evaluation and appraisal of the fixed assets if such is part of the overall lending arrangement/facility.

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It has become routine for asset-based lenders to require a forced liquidation value (FLV) or knockdown appraisal for any proposed equipment lending facility.  This means that the equipment is valued based on a bare bones basis: not in place, not running and sitting on the court house steps ready for auction.  Sometimes this is referred to as auction value.  This is by and large the most conservative barometer used by the vast majority of asset-based lenders.

Occasionally, orderly liquidation values (OLV) appraisals are used.  This means the equipment is in place, running and allows a specific time frame to be sold in the normal course of business.  It could be as long as a year but is normally a shorter time frame such as 90 days to 6 months.  This is a more liberal approach and must be surmised that the lender has more confidence in the financial strength of the borrower in accepting this basis for appraisal.

One reason many asset-based lenders offer a smaller advance formula for manufacturing industry clients is that the equipment depreciates more rapidly in value because of heavy usage in the manufacturing process than it does in a non-manufacturing environment.

Most equipment loans will have a term of 5 to 7 years and the advance formula will be in the 50 to 80 percent range, based on a FLV or OLV, as the case dictates.  A normal advance is 75 to 80 percent of appraised value.

As in inventory lending, the asset-based lender must be vigilant in knowing the borrowers industry.  If the borrower defaults and the lender must seize the collateral, can the loan be liquidated from the sale of equipment?  The lender needs to know where to unload the equipment if the situation arises.  Therefore, the lender must preform proper due diligence and have an adequate exit strategy.

Most commercial real-estate loans are based on fair market value (FMV) appraisals.  Many asset-based lenders require that the FMV appraisal be preformed by a graduate of the Master Appraisal Institute (MAI) and be certified.  This accreditation is almost as recognized as a CPA designation.

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Many broad spectrum lenders have come to expect that commercial real-estate must be formally appraised and that the signatory of the appraiser must be designated as a MAI appraiser with stamp and seal actually affixed to the cover letter from the appraiser to the lender.

As a general rule of thumb, most asset-based lenders would prefer to have additional boot collateral of real-estate than actually advancing against it. There are many asset-based lenders that do not offer any real-estate accommodations or loans. In those cases, it is sometimes necessary to bring in additional real-estate lenders to handle the real-estate portion. One major fear of most asset-based lenders is being forced to liquidate a piece of real-estate in an unfamiliar area and perhaps over an extended period of time in an event of default.

For any fixed asset/capital loan facility, it is most frequently a requirement that the prospect meet the debt service coverage (DSC) requirements of the asset-based lender. The asset-based lender is committing to a financing facility that could last anywhere from 15 to 20 years or more (in the case of real-estate) or 5 to 7 years in the case of equipment lending.

Debt service coverage is arrived at by using the historical or present day net income, depreciation, amortization and interest burden, annualizing those numbers and then determining what the new debt service will be under the proposed new loan facility. This differs from earnings before interest, taxes, depreciation, and amortization, (EBITDA) in that DSC is a measure of the prospect's ability to repay the proposed debt.

Compare it to qualifying for a home mortgage. Most consumer lenders will require the applicant to earn 1.5 times the mortgage payment. For commercial real-estate loans and equipment loans, the bulk of lenders are looking for 1.25 to 1.30 DSC ratios. This means that the DSC has to be 1 1/4 times or more the annualized payment for principal and interest.

It is arrived at by dividing the new debt (principal and interest) into the total net income, depreciation, amortization and interest on an annualized basis.

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This is where many potential capital loan borrowers fail.  It should be noted that some aggressive lenders will also consider non-recurring and extraordinary expense items in the calculation formula for DSC.

4. **Financial Evaluation of Prospect and Management**

Once the pre-qualification of the prospect has been completed, audit results returned and any necessary inventory or fixed assets appraisals completed, it is necessary for an asset-based lender to concentrate on the financial qualification of the prospect and its management.

Pre-qualification techniques generally will give an asset-based lender a good "gut-feel" regarding the prospects overall qualifications for an asset-based facility.  This gut feel sets the stage for further resources such as the ordering of audits or field visits, inventory or fixed asset appraisals.  There are no fixed routines when an asset-based lender begins its evaluation of a prospect and its management from a financial perspective.

In order to more clearly understand how asset-based lenders evaluate prospective clients, it is important to understand the evaluation process, how ratio analysis is utilized if at all and other aspects of analysis that come into play.  If an asset-based lender determines that the prospect has passed general pre-qualification tests as well as collateral valuation, including appraisals from an independent basis, now is the time for an asset-based lender to concentrate on the financial picture.  Not only is an asset-based lender concerned in the financial condition of the prospective borrower, but that of the owners/management of the firm.  There is a considerable amount of reliance placed on the principals of the prospective borrower and their personal antecedents.

Ratio analysis plays a role in asset-based lending which is dictated from an individual asset-based lenders individual lending philosophy.  If an asset-based lender has a policy of restructuring its lending facilities to firms with a maximum debt-to-worth (DTW) ratio of no greater than five to one, it is fairly common that prospects in excess of that ratio will not be eligible.

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The role of a commercial finance consultant is not to pigeon-hole a prospect, but only to determine its overall potential for an asset-based facility. Not all companies are created equally and each has its unique financial challenges and opportunities. There are literally, thousands of asset-based lenders in the United States with an equally diverse appetite for transactions.

Early in the accounts receivables evaluation process, the asset-based lender will calculate another critical ratio called days sales outstanding (DSO). This ratio is utilized to determine how frequently the accounts receivables turn or pay. This is a critical area to focus on. Determining the DSO over a 2 or 3 year period will show a specific payment trend. This is critical for an asset-based lender so it can effectively price the transaction to meet income and yield parameters, but if done correctly, it is also a sales tool, as an asset-based lender can price accordingly to meet the prospects requirements.

We have already talked about DSC, EBITDA and other ratios. Another critical ratio is the working capital ratio and is almost always determined by the asset-based lender. The working capital ratio is determined by measuring the relationship between current assets and current liabilities. Most banks prefer to see two or even three to one (2:1 or 3:1) ratios, meaning the firm has two or three times more current assets that current liabilities. This is still another measure of a firm's solvency or insolvency as the case may be. Most asset-based lenders do not enjoy the luxury of two, three or even four times the current assets than current liabilities. More often than not, asset-based lenders see the exact opposite with current liabilities that exceed current assets.

A company that has more current liabilities than current assets is not an automatic denial. In certain circumstances, this may be an ideal opportunity for an asset-based lender to suggest the re-structuring of a prospects debt. For example, the prospect may have approached the asset-based lender seeking a pure revolving relationship, but in reality needs additional help in the form of a fixed asset or capital loan.

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This occurs in cases, where a bank has forced a borrower to re-classify term debt as current by calling the loan and thereby making it a demand note (now a current liability on the balance sheet instead of its original classification as long term).

Another very common scenario where the working capital ratio is distorted as negative would be those instances whereby the prospect has high accounts payables or trade debt. Moving from a traditional banking relationship into an asset-based relationship can often times produce greater borrowing availability which can help reduce or even eliminate outstanding accounts payables, the net affect may be the immediate improvement in the working capital ratio.

Profitability is always a key measure of any prospect's performance. In fact, this may be the most important measure of all. There are those asset-based lenders that will offer facilities to entities with losses or even negative equities. There is of course, a price to pay for these types of facilities as there is greater risk to the asset-based lender and therefore they seek greater reward. Generally, these types of facilities require higher fees, increased monitoring, restrictive loan covenants, and perhaps less aggressive advance formulas.

Industry analysis is frequently utilized to measure how a prospective client compares to industry standards in many categories but none more important than profitability. If the prospect is losing money, the asset-based lender will want to know why? If the industry on average reports X percentage as a gross margin and the prospective borrower is below this, the asset-based lender will want to know why? What gross margin is the prospect reporting. If depreciation and amortization is added back in, will it make a difference? Is the company profitable with non-cash items removed?

Asset-based lenders also take into account the impact of the present day economy. If the prime rate is low, for example and the prospect continues to loose money, what will the outcome be in the event the prime rate is increased? Is it possible for a prospect to make the DSC when their rate is adjusted upwards as a result of a prime rate or LIBOR rate increase? Has a downturn in the economy affected sales in a negative fashion?

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Asset-based lenders preform a in-depth analysis of a prospect's financial statements and overall condition.  A financial statement is like a photograph, a snapshot in time at any one given point.  As such, it is subject to change, sometime for the better, sometimes for the worse.

It is routine for most asset-based lenders to require at lease two years of fiscal financial statements in revolving loan situations, together with all income statements, statements of cash flows and all notes and attachments plus most recent or interim financials.  Expense analysis will be preformed in many instances, with some asset-based lenders placing many restrictive loan covenants (RLC), governing officer salaries, capital expenditures, etc.  If these expenses appear to be outside of industry averages, the asset-based lender will discuss any issues in greater detail.  In the case of fixed asset loans/capital loans, it is routine to require the last three years of Corporate Tax Returns complete with any notes or attachments.  Regardless of the loan request, we recommend that you obtain a minimum of three years worth of historical financial information.

Since the principals of a prospective borrower are usually composed of two or three key officers and may be considered a closely held firm, personal financial statements (PFS) are required.  Generally, a personal guarantee of the owners or majority shareholders is required.  Therefore a personal financial statement should be submitted.  Personal financial statements should be within 90 days of completion and never more than 1 year old.

In addition, if a fixed asset/capital loan is being requested or reliance is being placed on personal and company collateral, it is usually required that the prospects furnish a minimum of three years of personal tax returns.  Since a personal guaranty (PG) is only as strong as the financial strength of the grantor, an asset-based lender will generally verify the personal credit history of the guarantors.  This means that credit reports will be obtained on those officers listed.

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## 5. Borrowing Base

Evaluating the potential borrowing base is the critical component necessary to determine the potential borrowing capacity. The actual borrowing base calculation is quite simple. There will be a "X" dollars available under the formula for each component, therefore simple multiplication will determine the cash borrowing base.

After identifying the eligible collateral to borrow against for each eligible collateral component it is a matter of simple addition for each category therefore calculating the cash borrowing availability.

The prospect will have determined a usage of funds in which you will have prepared a "Source and Usage of Funds." Determining the borrowing availability will give you a general guideline if the potential borrowing capacity will match the expectation or needs of the prospect.

In asset-based lending circles, there are two types of borrowing bases:

- Revolving lines of credit (receivables and inventories)
- Term loans (fixed assets)

Commonly used terms like "gross line of credit" or "gross revolving line of credit." This may relate to an overall accommodation tied to the asset value of the collateral and not to actual cash. Therefore, a lender may quote a $2 million gross revolving line of credit, but the cash loan may be, for example, only $1.2 million. This does not automatically mean that the lender only granted a 60 percent advance. It simply means that the line was established for $2 million, based on current asset information and financial analysis. This line may be subject to revision either upward or downward as circumstances evolve or changes in the borrowers financial condition improves or deteriorates.

Occasionally, an asset-based lender will quote a cash line of credit. In this case, the net advance is simply the reference point, meaning the cash generated is a result of the application of the agreed upon advance formula.

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Once the borrowing base has been determined and the cash availability number reached it will become clear if there is enough availability to meet the needs of the prospect.  If the number is not adequate, some asset-based lenders may be creative to look "off-balance sheet" at personal assets or forms of guarantees of payment from other outside sources to bridge the gap.  This is commonly referred to as a "shortfall."

Asset-based lenders are often times "underwater."  This is a common occurrence among asset-based lenders as there has been more advanced to the borrower than cash collateral will support.  In these cases it generally becomes apparent in the borrowing base. Occasionally, this may become a hurdle to a prospect that is trying to maximize borrowing capacity.  Asset-based lenders have the capability to grant temporary over-advances on receivables or inventory or perhaps look to increase advance formulas against other collateral.

Below, you will find a sample borrowing base certificate:

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# BORROWING BASE CERTIFICATE

To: Lender's name & address

Pursuant to the loan commitment and agreement between us, the undersigned hereby certifies to you as of the below date, the following:

| | | |
|---|---|---|
| A. | Aggregate amount of accounts receivables | $________ |
| B. | Less ineligible accounts: | |
| | - More than 90 days old | $________ |
| | - Payable more than 60 days after invoice | $________ |
| | - Un-billed for more than 5 days | $________ |
| | - Foreign/Export sales | $________ |
| | - Accounts contingent on further action | $________ |
| | - Owed by an affiliate, subsidiary, employee shareholder, or other related party | $________ |
| | - Disputed, contra, or counter claim | $________ |
| | - Owed by an account debtor with greater than 30% concentration | $________ |
| | - Other ineligible accounts | $________ |
| | -Owed by an insolvent account debtor | $________ |
| | - Miscellaneous | $________ |
| | - TOTAL INELIGIBLE | $________ |
| C. | Net amount of eligible accounts (A - B) | $________ |
| D. | Aggregate amount of inventory | $________ |
| E. | Less ineligible inventory | |
| | - Obsolete items | $________ |
| | - Other ineligibles | $________ |
| F. | Net amount of eligible inventory | $________ |
| G. | Cap on inventory (predetermined amount) | $________ |
| H. | Current borrowing base:<br>- 70% of Item C plus the lessor of (1) 25% of item F or (2) item G | $________ |
| I. | Reserves for letters of credit, bankers acceptances or any other availability offsets | $________ |
| J. | Outstanding principal balance | $________ |
| K. | Maximum line availability (H - I - J) | $________ |

The undersigned hereby certifies, represents and warrants to (lender) the following:

1. The description of eligible accounts and eligible inventory and the values assigned thereto are true and accurate;
2. All of the representations and warranties contained tin the agreement or in any loan documents are true and correct;
3. The borrower is in compliance with all existing loan covenants.
4. No event has occurred, or would result from advances made in connection herewith, that constitute an event of default under the agreement;
5. The borrower will supply additional reports and financial information as reasonably requested.

Borrower Name ___________________________________

Officer Name/Title _____________________________________ Date ____________

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# Approval & Closing

Once the lender and potential borrower have reached a "meeting-of-the-minds" and the necessary due diligence has been completed and reviewed, there are few final tasks that must be completed prior to the release of funds.

1. **Verification of Assets**

   Once the assets have been appraised by an independent agent and the value determined, many asset-based lenders will perform an internal verification procedure, similar to a "walk-through" on a residential home purchase. Generally an asset-based lender will re-verify the collateral through various methods (phone calls, personal contact with the appraisal firm(s) or auditors, personal visits to the prospects business or physical inspections of the collateral).

   For accounts receivables, an isolated or blind phone call to the account debtor base utilizing a "cover story" may be utilized to verify the accuracy of the receivables value and position. Great care is take during the process not to divulge the nature of the relationship.

   Verification procedures are done prior to the release of funds as a final check to determine collateral value and position. If these verifications are not completed, an asset-based lender exposes themselves to a potential over advance, which may immediately put the loan underwater and the asset-based lender in financial jeopardy.

2. **Commitment Letter**

   Occasionally, an asset-based lender will not only issue a term sheet, letter of intent or proposal, but also a commitment letter. This is a declining practice, however it is still commonly used when real-estate is stand alone or is part of the borrowing formula.

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3. **Loan Fees**

Various fees and charges that are part of the lending facility will have been discussed and agreed upon. These fees may include, but are not always limited to:

- **Facility Fee**. Payable to the lender and usually due at closing. This generally will be expressed as a percentage of the overall lending facility or line of credit in most instances. Many asset-based lenders will charge a flat amount on a one-time basis; others will charge an annual or reoccurring line or facility fee on the one year anniversary of the closing in addition to the initial facility fee charge.

- **Audit Charge(s)**. Payable to the lender and due at closing. Occasionally this fee is paid in conjunction with the term sheet or proposal prior to the audit or field examination that is done early in the underwriting process. Ordinarily, asset-based lenders will charge fees of up to $750 dollars per day plus expenses for each auditor on site. In addition, audit fees are agreed upon and charged by the asset-based lender for routine follow-ups audits and field examinations preformed after the initial funding and during the ongoing relationship.

- **Collateral Management Fee**. Payable to the lender on a monthly basis as the relationship proceeds. This is a flat amount or percentage of the gross collateral under management by the asset-based lender. It is usually expressed as a percentage of the receivables and inventories and will vary from .25 percent to 1.00 percent per month or more.

- **Interest Fee**. Payable to the lender and charged on a monthly basis on the funds in use. This is generally expressed as a percentage and is almost always tied to a charge above the prevailing prime-rate of interested charged by the lead New York banks.

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- **Legal & Documentation Fees**. Payable to the lender and charged for preparation of documents, searches of public records, attorney costs and fees, recording fees, etc.

- **Lockbox Fee**. Payable to the lender or sometimes directly to the bank who maintains a lockbox for the benefit of accepting collections from the client's debtors.

- **Appraisal Fees**. Payable to the lender in most cases. This is usually for appraisal of fixed assets and/or inventories. Usually, the lender will engage the appraisal firm and the prospect agrees to the cost(s).

- **Miscellaneous Fees**. These will vary between asset-based lenders. Often there are sundry expenses that are germane to a particular lender or collateral situation. For example a survey may be required if real-estate is considered. Another example may be a flood insurance certification or ongoing wire charges for each advance made to the borrower.

4. **Documentation Preparation**

Asset-based lenders may utilize in-house or external council for preparation of the formal loan documents. Most asset-based lenders have "boiler-plate" documents which may be customized to meet the requirements of a piticular borrower. Generally, asset-based lenders will utilize internal staff to schedule a "closing" date and time.

Generally, most asset-based lenders will utilize the following documents to facilitate a transaction:

- Loan Agreement
- Security Agreement
- Certification of Officers
- Personal Guaranty / Corporate Guaranty
- Corporate Resolution / Certificate of Incumbency
- Bank wire instructions
- Borrowing base certificate
- Financing Statement(s)

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Upon execution of the documents, the asset-based lender may immediately release funds via wire transfer into the borrowers bank account.

## Day-to-Day Activities

Depending on the type of asset-based relationship and the overall financial condition of the borrower, the asset-based lender will develop a pre-determined lending posture based on a overall risk assessment. This affects the release of funds or any special accommodations of a sundry or unusual nature.

If an asset-based lender has a strong degree of confidence with the borrower, funds may be advanced in receipt of evidence of the Schedule of Assignment via a verbal request. A client that has a diminished financial condition may experience a limited amount of flexibility and more stringent evidence of collateral prior to the issuance of an advance.

Asset-based lenders will wire or ACH funds directly into the borrowers bank account. A phone call, e-mail, fax or other communication may be accepted as authority to transfer funds. Directives may be put in place in which advances are made immediately upon the assignment of collateral arriving at the asset-based lenders location.

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# Glossary

**ABL**
Acronym for Asset-based Lending.

**Account Debtor**
The entity responsible for payment of an invoice. Alternatively referred to as "customer."

**Advance Formula**
Commonly used to describe the agreed upon percentage that is applied as the borrowing base for various forms of collateral.

**A/R**
Acronym for accounts receivables.

**Assignment**
A transfer from one party to another of title and/or interest in a payment obligation such as a commercial receivable and, in the asset-based lending industry, a term used to describe a financing transaction.

**Audit Fee**
Most asset-based lenders charge for the time and expenses of an independent auditor to examine the books and records of a prospect. This is usually charged for the initial audit and in most cases additionally charged quarterly or semi-annually as follow-up to review collateral position and compliance.

**Back Room**
The section of an asset-based lender where the general administrative functions occur, such as invoice or sales journal processing, accounting, reporting, written verifications, borrowing base calculations, etc.

**Borrower**
In the asset-based lending industry, this is the entity pledging collateral and in turn receives funds or advances from the asset-based lender.

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**Commitment Letter**
Issued by some asset-based lenders to confirm rates, terms and covenants of the facility for financing arrangement that has been previously discussed, negotiated and agreed upon.

**Concentration**
Concentration refers to a certain percentage of receivables that exceed a predetermined number. Most asset-based lenders prefer concentration levels not to exceed 30 percent.

**Contra Account**
An account in which a payable owed to a party is offset by a countervailing receivable due from the same party.

**Credit Memo**
1) An accounting adjustment which reflects a return, overcharge or similar event, thereby reducing or eliminating the amount of a receivable payment by an account debtor; 2) a document sent to an account debtor evidencing such an accounting adjustment.

**Customer**
An alternative term for "account debtor" preferred by some asset-based lenders.

**DBT**
An abbreviation for "days beyond terms," as in the number of days beyond the due date that an invoice remains outstanding.

**DSC**
An abbreviation for "debt service coverage," a financial ratio measuring a borrower's ability to meet payments on a loan after paying expenses. The ratio measures the number of times loan principal and interest are covered by net (after tax) income.

**DSO**
Calculation utilized to determine the average number of days receivables remain outstanding before they are collected.

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**DTW**
Debt to worth ratio and also commonly referred to as Debt to Equity Ratio. This is a measure used in the analysis of financial statements to show the amount of protection available to creditors. The ratio equals total liabilities divided by total stockholders' equity.

**Debtor-in-possession ("DIP")**
In a chapter 11 bankruptcy filing, a bankrupt commercial entity that retains control of its own business affairs and assets for the purpose of managing day-to-day operations, rather than relinquishing control to a court appointed trustee.

**DIP Financing**
Financing that is provided to a debtor-in-possession.

**Due Diligence**
The process by which an asset-based lender determines the overall feasibility of a prospective client relationship. A typical due diligence procedure generally includes but is not limited to the following: (1) a search of the public records to identify existing or potential claims and filings against client assets; (2) verification of clients accounts receivables; (3) credit analysis of the client's financial situation and that of the major account debtors; (4) audit of the client's books and records, including visits to the prospective borrowers facility. Often times, due diligence is referred to as underwriting.

**EBITDA**
An abbreviation for **E**arnings **B**efore **I**nterest, **T**axes, **D**epreciation and **A**mortization. Another ratio analysis that is commonly used by lenders to determine the borrowers historical ability to repay debt obligations.

**FLV**
An abbreviation for **F**orced **L**iquidation **V**alue. This is the cash price or other consideration that can be received in a forced-sale of assets, such as that occurring when a firm is in the process of going out of business. Typically, the forced liquidation value is less than what could be received from selling assets in the ordinary course of business. This is often referred to as "knock-down" value.

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**FMV**
An abbreviation for **F**air **M**arket **V**alue. This is an amount that could be received on the sale of an asset when willing and financially capable buyers and sellers exist and there are no unusual circumstances such as a liquidation, shortages or emergencies.

**Facility**
An asset-based lending term which refers to the lending arrangement between an asset-based lender and the borrower. Occasionally this may be referred to as "transaction facility," "lending arrangement," or simply the lending program. Many banks will refer to this as a "line of credit."

**Facility Fee**
A fee usually expressed as a percentage of the overall loan/line amount charged by a lender as a cost of granting the facility. This is also referred to as a "line fee."

**Factoring**
1) to purchase accounts receivables at a discount from their face value; 2) a company engaged in the purchasing of commercial accounts receivables.

**Float Days**
An additional number of days that finance charges continue to accrue until payments received from an account debtor clear the bank.

**Funding**
Also referred to as advances by some lenders. This is a term used to describe the process of providing an advance(s) to a borrower.

**Inter-Creditor Agreement**
An agreement between tow secured creditors setting forth their respective rights and interests in the same collateral, as in the agreement between a commercial lender, bank, factor or finance firm when providing financing to the same client or borrower.

**Inventory**
Merchandise or supplies on hand or in transit at a particular point in time.

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**Inventory Analysis**
Evaluation by audit technique and/or independent appraisal of the elements of a borrowers inventory.

**Invoice**
A statement of the amount due a trade creditor for completed or delivered services or goods. An invoice represents a legally sustainable debt.

**Invoice Proceeds**
Money actually paid by an account debtor in satisfaction of an invoice as opposed to money merely owed against invoices.

**LC**
An abbreviation for a **L**etter of **C**redit. A credit instrument issued by a bank guaranteeing payments on behalf of a customer to a beneficiary, normally to a third party but sometimes to the banks customer, for a stated period of time and when certain conditions are met. There are three types of LC's

1) Irrevocable Letter of Credit
This cannot be cancelled before a specific date without agreement by all parties involved.
2) Confirmed Letter of Credit
Carries the endorsement of both the issuing bank and its correspondent, guaranteeing payment of all drafts written against it.
3) Standby Letter of Credit
This is a contingent (future) obligation of the issuing bank to make payment to the designated beneficiary if the bank's customer fails to preform as called for under the terms of a contract.

**Lien**
1) a legal document recording the existence of a security interest; 2) a perfected security interest in specified collateral.

**Lockbox**
A type of bank account set up by a lender to which payments from account debtors mail invoice proceeds. Bank personnel deposit the collections and then disburse payments pursuant to an underlying tri-party agreement.

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**OLV**

An abbreviation for **O**rderly **L**iquidation **V**alue. This is the value given to assets by an appraisal firm based on examinations and market characteristics and is expressed usually as the time it takes to orderly dispose of assets that have been acquired as a result of loan default or liquidation.

**Offset**

Reduction or elimination of an invoice balance due to the existence of a mitigating circumstance such as a credit or contra account balance, dispute or other objection to payment.

**Over-advance**

An advance which exceeds the predetermined formula percentage normally in effect between a borrower and lender.

**Perfected Security Interest**

A security interest, notice of which has been properly filed pursuant to RA9 of the Uniform Commercial Code and in accordance with the procedures set forth under State statutes.

**Proposal Letter**

A letter from the lender to the prospective borrower setting forth the general terms and conditions of the proposed lending facility.

**Recourse**

The typical arrangement utilized in an asset-based lending facility under which the prospective borrower retains responsibility for all non-payment or credit losses caused by insolvent account debtors. Asset-based lenders generally do not offer non-recourse arrangements which are commonly found in factoring transactions.

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**Restrictive Loan Covenants**
Language in a loan agreement by which the borrower pledges not to do certain things. These covenants prohibit a borrower from selling or transferring assets, defaulting, officer salary restrictions, DTW ratios, or stating specific actions that would diminish the value of the collateral or impair the value of the lender's ability to collect the loan. Failure to comply with covenants may cause a lender to accelerate the loan or call (demand full payment) of the loan.

**Security Interest**
A legal right to recover an asset from its owner when said owner fails to fulfill obligations or defaults under a lending relationship.

**Sweep**
The act of clearing funds from a lockbox account for disbursement by a creditor who established the lockbox on behalf of the client company.

**Tax Lien**
A public notice of taxpayer liability which, when filed in the appropriate jurisdiction by State or Federal tax authorities, secures the taxing authority's priority claim to the taxpayers assets. This lien will automatically supercede any secured or unsecured creditors filing.

**Term Sheet**
See (Proposal Letter)

**UCC-1**
This is the necessary legal document when properly filed in an appropriate jurisdiction(s) pursuant to RA9 of the Uniform Commercial Code, perfects a security interest in a debtor's collateral.

**UCC-3**
A document used to terminate, assign, amend or subordinate a security interest, which has been previously perfected by a UCC-1.

**Uniform Commercial Code**
A body of laws governing commercial transactions, which has been uniformly adopted in all 50 States.

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**Verification**
The process by which a lender determines the general validity and Collectability of account debtor balances prior to an initial and subsequent advances made against accounts receivables.

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