Uptick in Asset Based Lending

The U.S. commercial finance industry witnessed another strong year in 2006. According to a survey by the Commercial Finance Association, a New York-based trade group for the industry, asset-based lenders experienced 16% growth, which is above average. This brings the asset-based lending industry close to a $500 billion milestone in terms of collective loans outstanding

An asset based business line of credit is usually intended for the same purpose as a standard bank line of credit, which is to allow the company to bridge itself between the receipt of payments from its billings and its daily operating expenses.

Asset-based loans are secured by the assets of a company such as accounts receivables, inventories, machinery and equipment and real estate. Asset based loans differ from conventional bank loans which are usually unsecured and primarily based on a borrowers' historical cash flow.

An asset based loan will generally encompass a revolving line of credit that fluctuates based on the ongoing accounts receivables balances that the business has. This requires the lender to monitor the company's accounts receivables amount.

"Community banks aren't equipped labor intensive oversight required, and bigger banks aren't generally interested" said Diane Homa, principal of Fountainhead Funding in St. Petersburg, which provides alternative financing, including asset-based loans.

Funding Purchase Orders

2006 imports from China alone were over $287 Billion dollars according to the U.S. Census bureau, Foreign Trade Division. Increasing globalization puts pressure on U.S. companies who wish to bring in goods from overseas, but lack sufficient capital to finance the transaction.

Often a company may find they need financing before they can ship and create a receivable for the order. Purchase Order financing or Trade financing, is associated with factoring and asset based lending, but is further up the financial food chain. Purchase orders are commitments from a company to acquire a particular quantity of product at a pre-negotiated price. Typically, the product is being brought in from overseas, which more often than not, requires the order to be paid in full before leaving the foreign port.

With a large purchase order from a creditworthy U.S. customer, a specialty commercial finance company might agree to issue a Letter of Credit to guarantee that the foreign factory producing the product will be paid upon completion of the order. "This helps companies take on orders they never would be able to process with just a limited bank line of credit or only an asset-based credit facility" says Homa.

Ms. Homa goes on to explain, "By using purchase orders as collateral, an importer would be able to leverage the PO, much like it leverages its accounts receivables. The lender issues a letter of credit to the manufacturer to enable production to begin. The lender then pays off the L/C once the finished product ships from the factory. The inventory then is delivered directly to the buyer at which time the asset based lender pays off the PO financing portion. Now the transaction either utilizes a factoring or ABL relation (based on accounts receivables financing) to finish funding the sale. It's a complete sales cycle without the borrower being required to use their own capital."

As you would expect, purchase order and accounts receivable funding is more expensive than bank lending. The cost of asset-based loans is based on the credit risk and collateral associated with the deal. When considering an asset-based loan, borrowers should evaluate the cost of financing relative to the benefits received. Compared with other financing alternatives such as equity capital raises, asset-based lending is very cost effective and efficient.

Asset-based lenders commonly look past financial statements to determine how much credit they are willing to extend. Therefore, borrowers can take advantage of opportunities in the market by being able to plan ahead or to take on additional business without hesitation.

For most companies eager to enjoy more revenue, the benefits will tend to offset the premiums associated with borrowing from the asset-based financial services industry.

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