EXPERT Q&A

Sponsors and management teams should be proactively monitoring and monetising their hard assets in the same way they do their real estate and financials, say Gordon Brothers' Norma Kuntz and Frank Morton

Leveraging hard assets for long-term resilience

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Q What is driving the growth of private asset-based lending today?

Norma Kuntz: Asset-based lending and equipment finance represent the latest wave of a more general shift from bank credit into private credit, largely as a result of the regulatory environment and general business environment. At the same time, we see a substantial increase in the private investor capital base. As a result, we continue to see a push for unique ways to put money to work in a manner commensurate with the desired risk reward profile, and asset-based loans and equipment finance deliver those attractive risk-adjusted returns.

Frank Morton: For asset-rich companies, asset-based lending offers a flexible way to make acquisitions, increase leverage, support growth or support turnarounds. Traditionally that funding came from banks, now it is increasingly moving into the private credit space. In addition, private credit can provide solutions for asset-rich borrowers in situations where they may not qualify for bank financing.

Q What type of industries can best make use of asset-based finance and what do you look for in a deal?

NK: In terms of industry, we have a deep history when it comes to retail and consumer products. We are also active in transportation and manufacturing – essentially any asset-heavy industry.

FM: We also work with intellectual property and real estate. What we love are multi-asset, multi-jurisdictional situations that allow us to look across a variety of asset classes in a single transaction. That provides flexibility and risk mitigation, and adds some complexity, which we like. Working with a single partner across multiple asset services also provides benefits to the borrower, simplifying the process to allow them to focus on running their business.

In terms of what we look for in a deal, it starts with gaining a deep understanding of the assets so that we can work with the borrower to give them what they are looking for in terms of structuring and quantum. Knowledge of the asset base allows us to do that. It also makes for a less risky loan.

Q How should sponsors and management teams be thinking about leveraging the hard assets in their portfolios as tools for strategic financing and long-term resilience with regard to the macro environment?

NK: There is a growing understanding of the importance of monitoring your hard asset portfolio – borrowing against those assets and selling the assets where appropriate. The environment that management teams are operating in today is undoubtedly complicated and having a good eye on your asset portfolio gives you one more lever to use when managing your business.

We partner with companies to advise them on their hard asset portfolio, helping them understand the value of their assets and what options are available to them to ensure that value is being maximised and then executing on that plan to lend against, monetise or even expand portions of the asset portfolio.

Everyone pays close attention to their real estate portfolio and financial portfolio, but it is critical that sponsors and management teams are proactive about getting the most out of their other asset portfolios as well. A retailer, for example, will almost certainly have some underperforming stores and a barrier to removing those stores is often the real estate. We can help management teams to resolve those real estate leases while helping sell the inventory. When you get rid of those stores, the enterprise value multiple of the business increases because you are taking away that underperformance.

However, it is important that management teams and private equity owners don't wait until they are already facing a problem. They need to be proactive and constantly monitoring, monetising assets and keeping that asset portfolio fresh.

Q What is it like for GPs and management teams to 'live' with ABL?

FM: The underwriting and monitoring process is a little different to a cashflow loan. There is much more focus on the assets themselves versus revenue and credit ratings, both at the stage of underwriting and in terms of ongoing appraisals.

In addition, asset-based loans are generally less restrictive in terms of covenants and, all things being equal, the quantums that can be borrowed are typically higher than would be the case with a cashflow loan, as well. Once the borrower has adjusted to the difference in information needed for the underwriting process, asset-based lending is arguably more borrower-friendly.

> *"There is a growing understanding of the importance of monitoring your hard asset portfolio"*
>
> **NORMA KUNTZ**

NK: It is important to understand what you are getting into with asset-based or equipment finance. Equally, though, it is important to understand the benefits. ABL is operationally more effective for portfolio companies, which is why it is so popular in the retail space and why it is being used more heavily across all asset-heavy industries today.

Q How sophisticated would you say the private equity industry is when it comes to leveraging the potential of portfolio companies' hard assets?

NK: Asset-based lending has been a feature of large buyouts, particularly on the retail side, for many years, although that financing has historically been bank-driven. Now it is moving more into the private credit space.

Leverage is typically a big part of the returns model for mid-market and even smaller buyout houses as well, and those that have a particular focus on retail or other asset heavy industries generally have a good knowledge of ABL. More generalist firms may be less familiar with this type of lending. It all depends on the size, experience and focus of firms, but overall, the benefits are becoming increasingly understood.

Q Given the increased attention that asset-based finance is receiving, how would you describe competitive dynamics, and what does this mean for pricing?

FM: Pricing has certainly become more aggressive and whenever a market becomes hot from a pricing perspective, structuring also comes into play to make the financing package as advantageous as possible for the borrower. The quantums being made available have also gone up. We are seeing lenders willing to go deeper into the collateral. Increased pressure on pricing, structuring and quantums are definitely all realities in the market today.

Q Do you expect the recent increased demand for ABL to continue? What is the medium-term outlook for this part of the market?

FM: A lot will depend on what happens with interest rates. A few years ago, when liquidity dried up and rates increased, availability went down a little. Now things are loosening up and pricing is far more aggressive. In the near to medium term, at least, we expect that to continue. ■