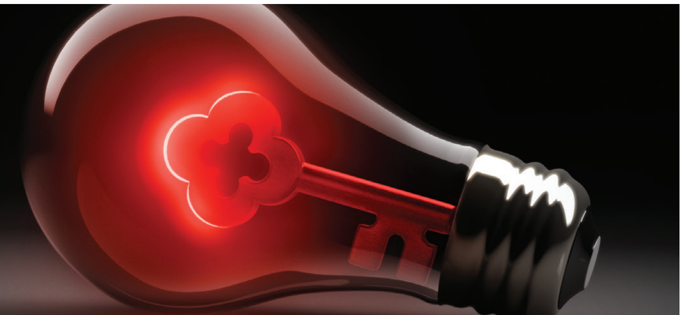

Optimize Financing with a Bifurcated Collateral Loan Structure

Given its advantages over cash-flow loans in covenant flexibility, borrowing capacity, and pricing, asset-based loans can be a powerful financing tool for many companies across a broad range of industries. By pairing an asset-based revolving credit facility with a cash-flow based term loan, many companies are able to expand their borrowing capacity further to meet a wide range of needs.

Flexibility and capital efficiency

The capacity of an asset-based revolving credit facility – the most common type of asset-based credit – is based on the borrower's current assets, typically accounts receivables and inventory. Funds are advanced up to a defined percentage of eligible accounts receivables and inventory, helping a company enhance its liquidity and working capital management. Asset-based loans provide companies with:

- Ready cash to support liquidity needs, eliminating the need to wait for the collection of receivables.
- Funding for companies in cyclical or seasonal industries by providing liquidity during slow sales intervals and periods of inventory buildup.
- Expansion capital to fund growth – both organic and via acquisitions.
- Capital to fund dividends.

Also, since an asset-based loan (ABL) typically doesn't include maintenance financial covenants as restrictive as those found in conventional cash-flow revolvers, borrowers have greater flexibility with asset-based financing.

Key Takeaways

Prospective borrowers should consider a bifurcated collateral structure with an asset-based revolver and term loan when making financing decisions.

Even if conventional financing is available, an asset-based facility and term loan can provide flexibility, pricing advantages, and borrowing capacity benefits over a cash-flow revolver.

The credit markets for bifurcated collateral structures are well developed and can often accommodate smaller deals involving fewer creditors.

Cash-flow revolvers versus asset-based revolvers

Typical Financial Covenant Package	Typical Cash-Flow Facility	Typical Asset-Based Facility
Senior debt/EBITDA	Yes	No
Tangible net worth	Yes	No
Fixed-charge coverage	Yes	Not unless excess availability < a certain threshold

Asset-based loans can be advantageous from a capital-efficiency perspective: Since it is usually secured with current assets rather than future cash flows, an asset-based loan has the potential for lower borrowing costs versus conventional loans.

"Even if a cash-flow revolver is available, prospective borrowers should consider an asset-based facility," said Gary Kidd, Senior Vice President, KeyBank Business Capital. "Companies can often get much more flexibility with an asset-based facility than with a cash-flow revolver that has more restrictive covenants. Although an issuer may be able to obtain a covenant-lite cash-flow revolver – one with fewer restrictions than a standard cash-flow revolver – it often is still more restrictive than asset-based credit. Typically, cash-flow revolvers spring a financial covenant test when usage is as little as 20-25%, while an ABL revolver typically allows issuers to use up to 90% of the facility before their fixed-charge coverage is tested. It's one reason why many private equity sponsors have embraced the structure. In addition, these covenant-lite cash flow revolvers aren't always available for anyone other than high-quality borrowers, whereas ABLs typically don't have maintenance financial covenants for the vast majority of issuers."

Pairing an asset-based facility with a term loan (pari passu or split collateral)

An asset-based revolving credit facility used to support working capital needs can be linked with a term loan to create an effective solution for a wide range of borrowers' needs. In a split collateral scenario, the collateral pledge is divided or bifurcated: Asset-based loans are secured by current assets such as accounts receivables and inventories, while term loans are secured by pledged assets, e.g., machinery, equipment, and real estate. Collateral structure (pari passu or bifurcated) can be an important choice for issuers who wish to tap into different credit markets. Sometimes it makes sense to work with the same group of lenders in both the revolving credit and the term loan, in which case it usually makes sense to employ a pari passu lien. At other times, different investors – either institutional investors or direct lender creditors – can be approached. In either case, term loans can be a powerful way for borrowers to take advantage of robust credit markets.

The size of the ABL term loan is usually driven by a percentage of:

- The appraised net orderly liquidation value, or NOLV, of the pledged machinery and equipment, or M&E.
- The appraised fair market value of pledged real estate.

The size of a split lien term loan is typically based on the degree of reliability of the underlying cash flows of the business and the financial leverage of the issuer.

Asset-based credit and term loans: Opportunities and considerations

Asset-based facilities are used across a wide range of industries, including manufacturers, distributors, wholesalers, retailers, and select service businesses. Even some industries that had been considered less conducive to ABL structures such as healthcare and technology have frequently utilized ABL deals. Candidates for asset-based revolvers and term loans should have a meaningful amount of accounts receivable and inventory – that's the first and foremost consideration. In addition, prospective borrowers generally:

- Use effective accounting and information systems
- Have a willingness to provide some additional reporting
- Desire flexible and less costly capital

Asset-based lenders require borrowers to provide detailed reporting to monitor changes in the underlying pledged assets. To verify the value and quality of collateral and the accuracy of financial reporting, lenders typically conduct field examinations and appraisals.

"Borrowers often find that the reporting is not as difficult as they imagined it would be," Kidd said. "Many companies are already tracking the information lenders want as part of their existing financial management framework. In addition, reporting requirements may be less for higher-quality companies, and audits and appraisals can be less frequent as well. As the market has developed, these requirements have become less demanding and typically are only required once per year unless excess availability is tight."

One misconception that's becoming less prevalent is that asset-based lending is only for lower-quality companies. "More and more companies are discovering that asset-based revolvers coupled with term loans can heighten borrowing capacity, improve liquidity and provide flexibility," Kidd added. "Financial executives at companies that are rich in current assets owe it to themselves to take a close look at ABLs and bifurcated collateral financings."

Another misconception is that some companies believe they don't have the size to do a syndicated asset-based revolver and term loan deal. However, the landscape of asset-based finance has changed considerably over the last several years. Today, financings don't have to be structured using a broad syndicate -- a club of investors can be assembled to handle smaller deals. The institutional market now consists of an assortment of providers, including banks, debt funds including affiliates of private equity firms, and one-off lenders with access to capital. Importantly, the broad syndicated institutional market has become increasingly accepting of bifurcated collateral loans involving asset-based revolvers and term loans.

Asset-based loans can be even less restrictive than so-called covenant-lite cash-flow revolvers.

Asset-based financing from KeyBank Business Capital

KeyBank Business Capital has the experience, resources and expertise to help companies by providing asset-based financing solutions. Raising nearly $2.5 billion in asset-based loan commitments year to date in 2017, KeyBank has played a major role in helping a number of middle-market and large companies in a variety of industries meet their financing requirements. KeyBank Business Capital is a nationally recognized asset-based practice providing origination, structuring and servicing of senior credit facilities. We support clients through underwriting and arranging senior secured asset-based credit facilities by balancing client needs with market conditions.

KeyBank Offers Distinct Advantages for Our Business Clients	
Commitment to long-term client relationship management	Companies may utilize asset-based credit for a period of time to meet a specific need, move to a cash-flow solution later, and perhaps move back into asset-based lending after that. Whatever the credit facility used and the changes that take place over time, KeyBank's relationship managers stay involved to ensure continuity and maintain the institutional knowledge of the company.
Industry specialists	By tapping into KeyBank's specialty groups, our Relationship Managers gain valuable information on market trends and developments. As a result, our teams are well positioned to provide clients with relevant and actionable insights on their markets and sectors. For example, industry-leading payment and cash management solutions enable clients to efficiently and effectively optimize cash flow and reporting that works seamlessly with our asset-based lending solutions.

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To learn more about how KeyBank Business Capital can help with your needs,
visit key.com/businesscapital.

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