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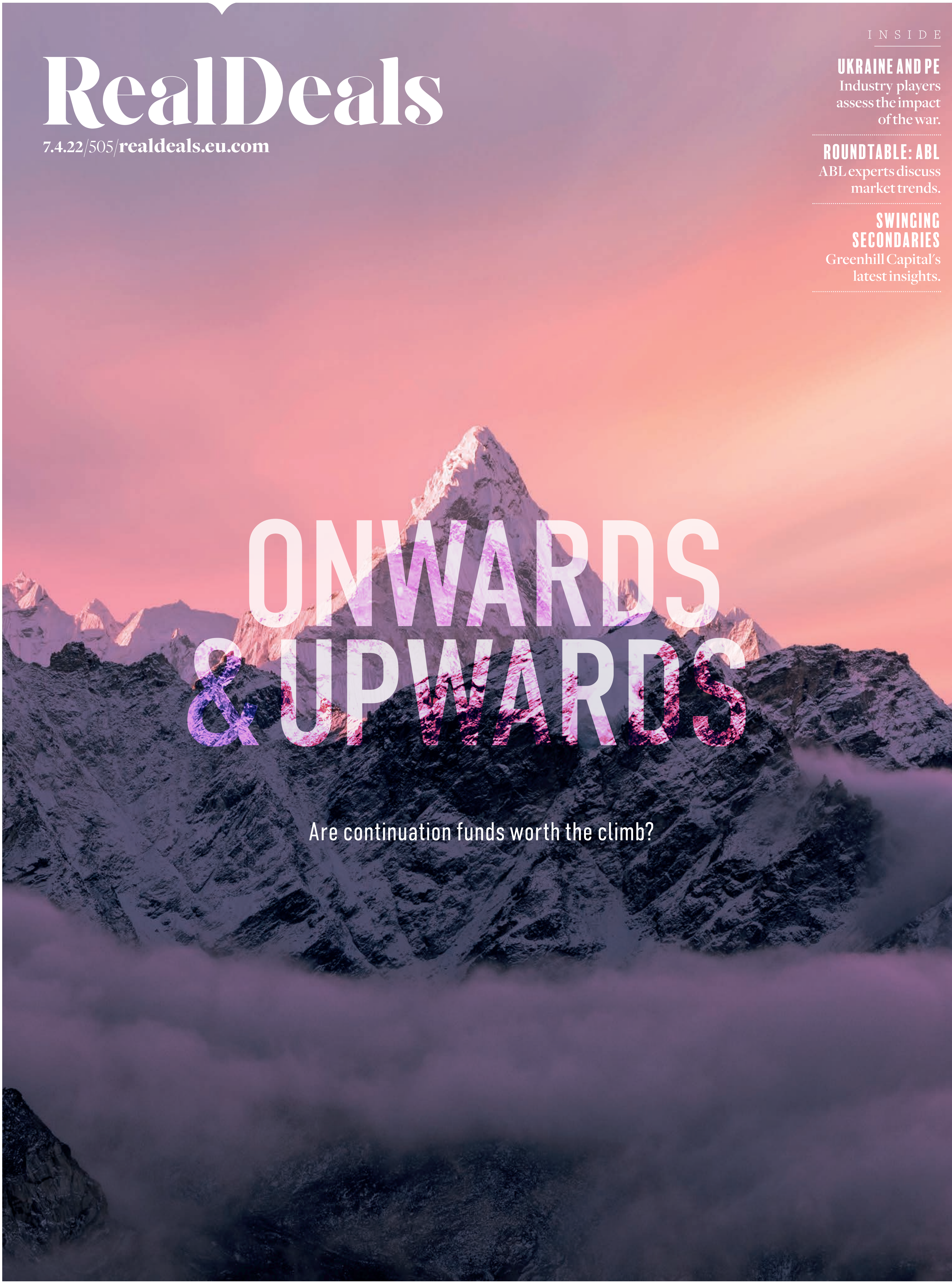

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INSIDE

ONWARDS & UPWARDS

Are continuation funds worth the climb?

ROUNDTABLE

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In a recent roundtable hosted by *Real Deals*, ABL experts discussed how the product has extended its offering from restructurings and traditional asset-heavy businesses, to M&A and buyouts; as well as how lenders can position themselves to win deals in a competitive lending market.

Photography by **Phil Bourne**

SPEAKERS

Mike Davison
Addleshaw Goddard

Katherine Weeden
ABN AMRO Commercial Finance

Tom Weedall
Blazehill Capital

Robert Wakeford
BREAL Zeta

Jon Hughes
IGF

James Cullen
Investec

Moderated by
Talya Misiri

Global M&A activity reached record highs last year, what was the ABL market like in 2021? How did lenders work to support high transaction volumes?

Katherine Weeden: At ABN, we saw plenty of activity within the corporate space and completed on a good number of larger complex transactions and worked closely with our internal stakeholders to ensure the best possible outcome. We saw considerably less activity in the mid-market space where transactional activity was minimal and we saw fewer refinancing opportunities as businesses continued to benefit from government support offered during the pandemic.

As we've moved into 2022, we've seen the mid-market pick up again now and despite a slower start to 2022, there are still good levels of activity within the corporate space. However, a characteristic that remains is that caution due to continued global uncertainty, means that as a rule, deals are just taking longer to complete. Nonetheless, ABL remains as popular as it had been and if anything, it's likely to become a more appropriate funding option for asset rich businesses as interest rates rise and borrowers become more concerned about breaching financial covenants which are less prevalent within a traditional ABL structure.

Tom Weedall: We launched Blazehill Capital with the aim of supporting business recovery post pandemic. We specifically target those borrowers who are unlikely to access the level of liquidity and working capital support required from more traditional lenders. We're proud of the deal volume and businesses we've supported to date, providing them with growth facilities or additional working capital to help fuel recovery following periods of tough trading conditions.

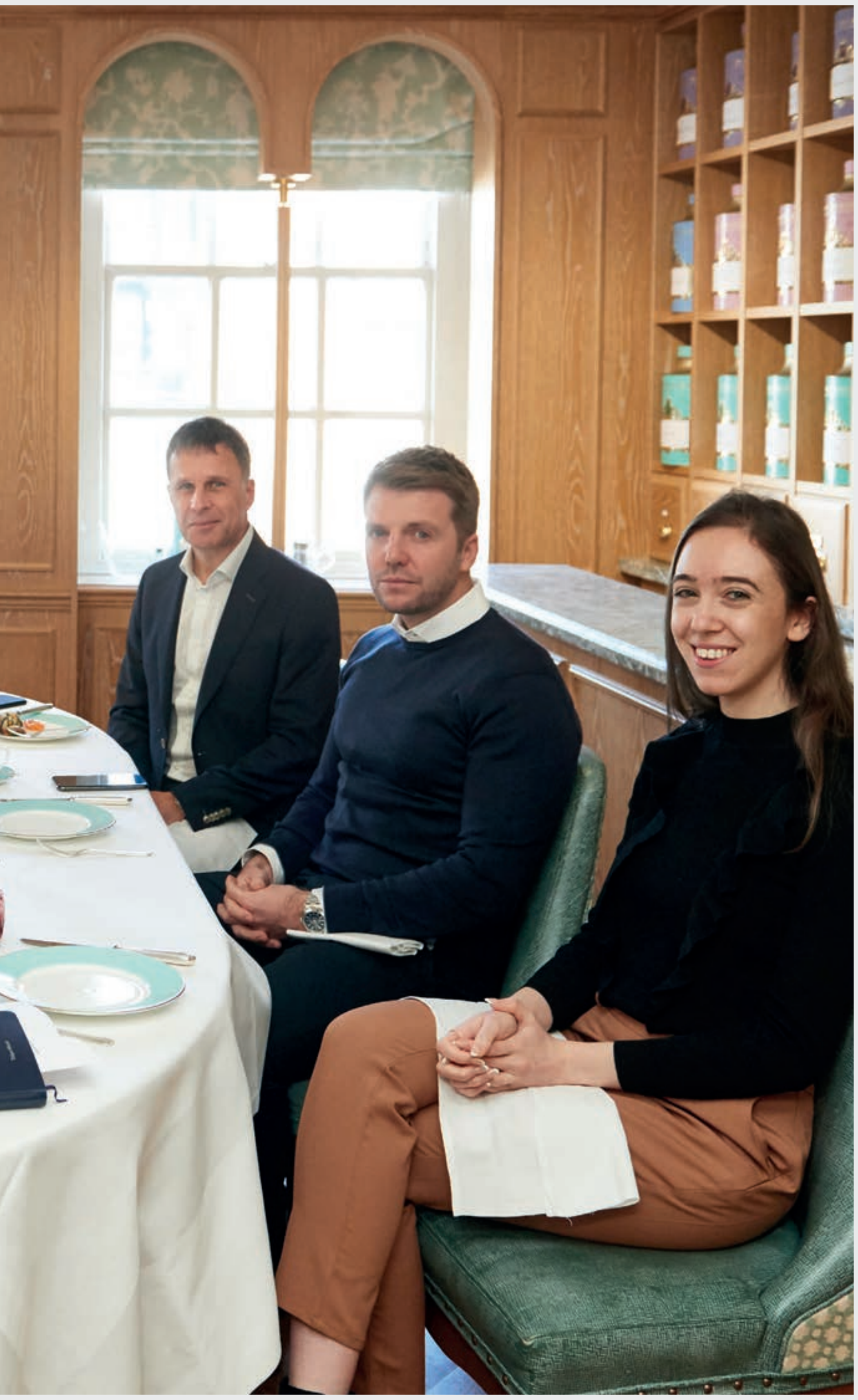
Robert Wakeford: 2021 was a record year for transactions; there were around $5.8trn global transactions written, and ABL has had a strong part to play in that. There's so much dry powder in the equity and debt markets that ABL has had to find a way to be a key solution for some of these deals.

ABL is traditionally a very supportive debt structure for businesses going through change, and I think that 2021, where we were coming out of the pandemic, was definitely a year of significant change. One major macroeconomic event is following another at the moment, and I wouldn't like to predict where we're going to be in 12 months' time, given all the uncertainty in the world, but the markets are still high and there's still lots of money chasing transactions. So, it's an interesting time for sure.

James Cullen: Our core market relates to acquisition finance predominantly, given in the vast majority of our structures we blend ABL revolvers with cashflow term facilities. So, it was a great year of deployment into new deals and supporting growth in existing portfolio businesses. Whilst frenetic at times, we successfully streamlined credit and legal processes so this should stand us in good stead for future. Our ABL revolvers have played a key role in enabling working capital heavy businesses to 'bounce back' from the pandemic as activity has picked up – a crucial benefit of this type of structure.

Jon Hughes: We had a very strong year, with over 30 new clients closed. A standout feature over the last 12 months is that people who were getting on with transactions, whether it's in M&A or refinancing, wanted to minimise their execution risk and to ensure that the lender will stick to the commitment and deliver.

We've found people to be more flexible around the absolute level of liquidity, and more concerned to make sure that once they start the process, they're going to get through the end of it. Deal teams and advisors increasingly engage with valuers before they come to the debt providers, but even when they haven't, we have



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>
> **Mike Davison**

found sufficient capacity in the market for both appraisals and financial DD.

Did the pandemic impact the way in which ABLs operate? In what ways did lenders exercise flexibility and innovate to provide for sponsors?

Wakeford: At BREAL Zeta, we set out to do large, complex transactions. Whilst our pricing point is set appropriately for the nature of the deals we structure, we want to work with sponsors and businesses that are of superior quality and have good management teams, and for them to also want to work with us. To provide them an acceptable price point, we have pioneered a syndicated First In, First Out (FIFO) structure where we bring in a super senior lender as a partner to our debt facility. This is a seamless offering that provides the quantum and the pricing that businesses and sponsors are looking for. Given the super senior lender is a partner to our facility, and we have a pre-agreed set of lending principles, it takes away both the execution risk and legal complexity that arises from other multi-lender transactions.

Weeden: ABLs have certainly had to adapt in the last few years. Having worked in the industry for over 30 years, our core funding solutions have changed very little over this period. To support sponsors we have had to become more innovative and cognisant of the concerns sponsors have with ABL facilities and we have worked to create structures that give the required level of comfort to PE firms who can be unsure as to how ABL lenders may react during more challenging economic times. However, the desire to support and work with our clients was borne out in 2020 when ABN set up a task force specifically to work with clients impacted by the pandemic and implemented a number of measures which included showing flexibility around covenants and advance rates.

Weedall: You must innovate to make yourself stand out from the crowd. At Blazehill, we're constantly looking to apply the principles of ABL in a more flexible and pragmatic way. Take, for example, the recent deal we funded in the pet care sector. To maximise the funding quantum for the borrower, we bifurcated the security and shared the structure with another lender. They had priority security over the receivables and inventory, because frankly they are better set up to provide a revolving facility. We complemented this by providing a non-amortising term loan secured against fixed assets, generating significantly higher quantum than a traditional ABL lender would have got to on their own balance sheet. Structuring the transaction in this way,

Mike Davison

Katherine Weeden

> **A lot of houses like the disciplines that an ABL instils in the business and the reporting. That's something that they maybe didn't anticipate.**
>
> **Katherine Weeden**

meant that the borrower had access to greater liquidity and was able to invest in CAPEX and accelerate growth.

Mike Davison: Particularly as we come out of that difficult period, where there's been a lot of volatility in the market, it has been difficult for borrowers to give some of the traditional financial covenants when trying to obtain certain types of facilities. Whereas, for an ABL lender, they're not quite so concerned with recent trading patterns. Where an ABL is happy with the underlying collateral, there is less focus on some of the other requirements. So, there's a lot of common strengths, but also a lot of differences in the market. I think people have different specialisms and I still feel that for a lot of borrowers seeking a solution, maybe don't actually fully understand the breadth of solutions that are available within the ABL market. I think there's a lot of value in making sure that the messaging is right on ABL and understanding that actually, as a product, there are some real advantages.

How does the PE market view ABL today, and have attitudes changed in recent years?

Cullen: Attitudes toward ABL are certainly changing, but there remains a large part of the mainstream PE market that still views ABL with caution due to perceptions of its 'uncommitted' nature. Our facilities ingrain commitment as we have material cashflow lending at work (sometimes as the majority of the structure), with the normal protections for borrowers, as well as the implicit desire not to 'self harm' on our side if there is a road bump. We value our reputation in the acquisition financing marketplace highly and work with sponsors collaboratively.

Davison: I think there's a lot more experience of using it, at different levels of the market, and I think people's experiences have been positive. If you look at the history of ABL in any situation, the experience that most prospective borrowers have is they are a bit nervous about using ABL As its unfamiliar and the reporting can seem daunting, but once they have tried it, more often than not, they they like it. We see a lot more PE houses using it successfully - and for the right types of deal - and there's greater awareness of the strengths of the product. Historically, it has been underused, but in the last five or six years, there has been incrementally more use of ABL on larger deals.

Weeden: There are a number of PE houses who are very comfortable with ABL and understand how it works and it's almost their go-to. I also think that there's a huge swathe that doesn't feel that way, and who may have only come across ABL because they acquire a business that already has an ABL facility.

Sometimes sponsors feel that the speed and complexity and additional DD required for an ABL may slow them down when there is a tight timeline involved. But, I think that once they do use it, they love it. A lot of the houses like the disciplines that an ABL instils in the business and the reporting. That's something that they maybe didn't anticipate getting with an ABL facility.

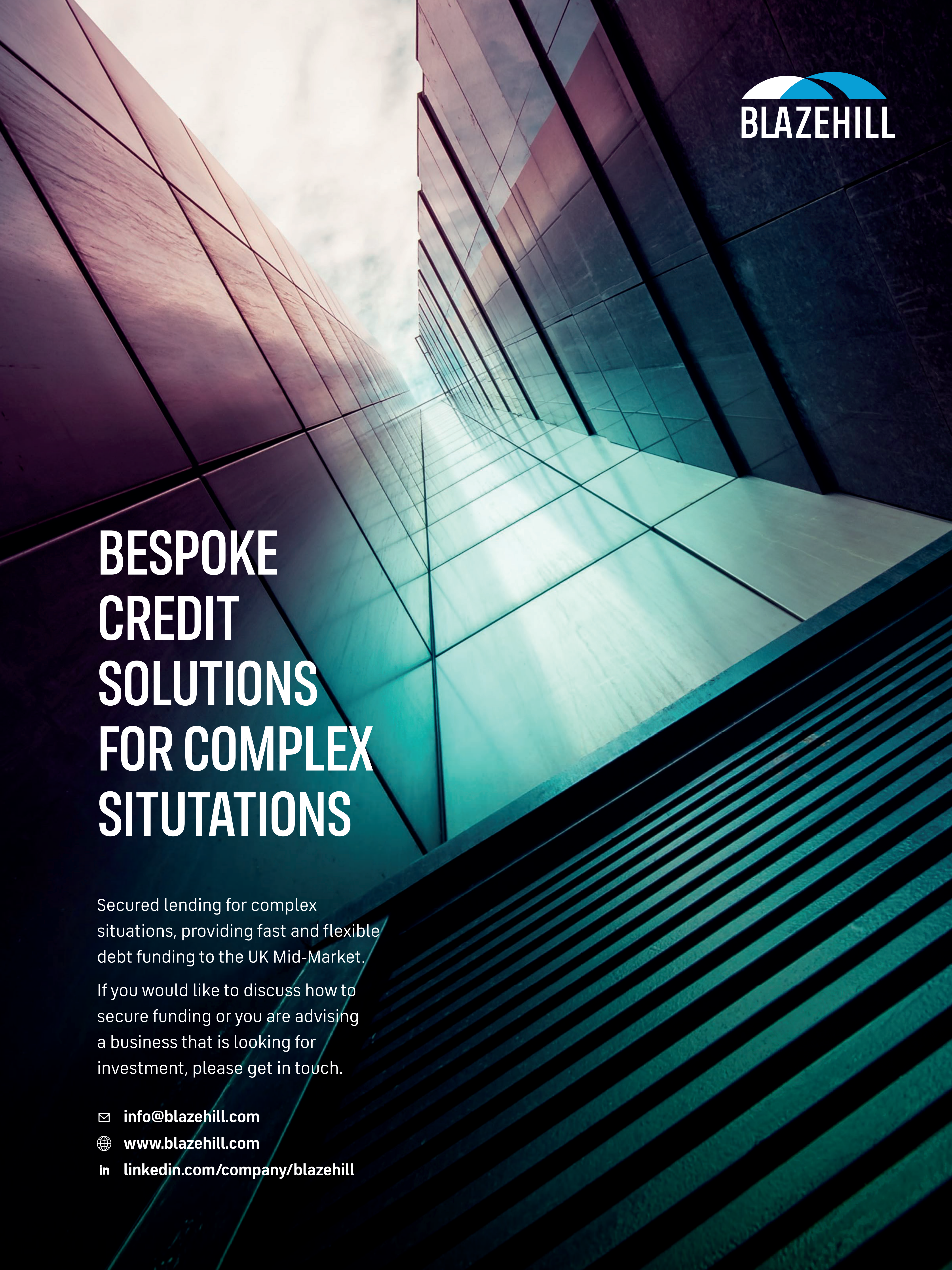
Hughes: I think that consistency about how we manage collateral has proven to people that this should be less of a concern for them. I also think that the advocacy from the wider sphere of influence, such as debt advisors, lawyers, and everybody else, helps to present examples that show how ABLs have behaved under certain stressful situations. The cost of ABL is also sometimes thought to be higher than it really will be in practice. We've probably all got a bit smarter about how we identify what our returns need to be and how we articulate that to the market.

What types of businesses is ABL most suited to now? How has ABL evolved to move away from only lending to traditional, asset-heavy businesses?

Weedall: The market has evolved significantly over the last 20 years, from simply providing traditional factoring and invoice discounting facilities against vanilla receivables. Most ABL deals now involve lending against multiple asset classes and it's up to us as an industry to keep pushing this forward. At Blazehill, we're able to provide funding leveraged against recurring revenues, such as SaaS where the software is mission critical, attrition rates within the customer base are low and therefore the predictability of 'sticky' repeat revenue is high. These businesses are high growth but in their early years can be cash burning as they reinvest in R&D. Therefore, traditional cashflow facilities struggle to generate the same quantum of funding as a Blazehill facility where we structure against a multiple of recurring revenue.

Another example of how we're trying to evolve the ABL product offering is the recent deal we completed in the entertainment sector. We provided a working capital facility to a record management company, structuring the funding against the royalty income streams of the various music artists' copyright owned by the borrower.

Hughes: At IGF, we initially consider whether we think we can add any value to their business with the facilities we can provide. After that, we frequently have to adapt what we do to work with them – so that both parties get what they expected. Even when we are financing AR only, we've funded businesses that wouldn't collect out in the way that you would expect a traditional invoice finance customer to work.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Tom Weedall

There's more focus on business viability and the strength of the management team. PE comes into that because, generally they are objective and you can have grown up conversations about how each party will behave if things don't work out as planned.

We recently financed a large construction industry business; which is not common for us, but when we analyse the way that the receivables and work in progress converts to cash, it performs really well. So, you can see that if you properly apply the core disciplines that you have in an invoice finance facility, it gives you great visibility on how the business is performing, which allows you to manage your risks and advance rates.

Wakeford: ABL is always going to be a great product for those traditional asset-rich businesses that it has always worked well for. If you're going to step outside of that tried and tested method, you need to have a close understanding of the business and the risk that you're taking and how you should manage them appropriately.

Hughes: Definitely, if you're going to break the rules, you better understand what they are and why they are there. If you don't, you're probably not going to like what happens next.

> **We certainly have an appetite to provide cross-border facilities, albiet each foreign jurisdiction presents unique challenges.**
>
> **Tom Weedall**

How suitable is ABL for mainstream buyouts today?

Wakeford: I think when ABL is the right solution, it will be used and I think everyone's comfortable with it in the buyout market. We've got about £500m in our pipeline at the moment, and I'd say about 60 per cent is related to PE-backed leveraged buyouts. We provide a combination of ABL plus cash flow lending to give businesses the quantum that they're looking for and there's a huge volume of those types of transactions around. ABL has moved to support this market during a period where the restructuring market has been quiet.

Davison: In terms of buyouts, there's a good awareness of where ABL can sit. There's a lot of familiarity with the documentation and with the issues, the workarounds and how to approach working together. There are still some sectors where ABL tends not to be as commonly deployed and there are sectors where it's a great choice.

Cullen: It's very suitable, although we find that in the vast majority of cases, funding ABL alone is not enough to satisfy the total debt requirement to impact the buyout. So, as well as funding a permanent element of financing through the ABL lines, we layer cashflow lending tranches on top, according to classical leveraged finance principles (sustainability of earnings / free cashflow). Whilst others may seek to do this by finding a funding partner, we provide this as part of the same structure, delivered from a single team and avoid intercreditor complexity.

Are ABLs resistant to offering cross-border financing arrangements? Why aren't there many on offer at present? How are ABLs structuring these deals?

Weedall: I think competition in the market pushes us all to try and differentiate and provide funding solutions that others can't. More and more deals have an international aspect to them, and you need to be able to offer a complete solution where possible.

We certainly have an appetite to provide cross-border facilities, albeit each foreign jurisdiction presents unique challenges based on its ability to grant security over business and assets. We know there are territories that tend to closely mirror the UK's legal framework and they can be simple to structure robust funding solutions. We're currently looking at new funding opportunities both in Italy and Germany.

Fundamentally, like with any funding structure, if you're going to stretch and lend against assets in a different jurisdiction, then you need to understand how that legal framework operates and how you can enforce your security to recover your investment against those assets if required.

Hughes: We're specialists in UK ABL. We like to support UK businesses and we will extend to finance their full range of activities where possible. We've got facilities that we fund in Singapore and in the US and we also work with partners in Europe. Even where you have a lender with a wider international footprint, you are likely to be working with the local specialist team to get the best solution based on the specific local conditions.

Nonetheless, you need to be as imaginative as you can. So for instance, where we have found a UK business that we want to finance, but which has a non-UK component that can't be covered, we've used cash flow stretch to recognise the value of those assets to make a deal work.

STRUCTURED ASSET-BASED LENDING SOLUTIONS

BREAL Zeta is a specialist asset-based lender, providing businesses with hand crafted solutions to power their ambitions.

We work with private equity houses, corporate finance advisers and accountancy professionals to provide structured, multi-jurisdictional ABL facilities up to a £150m hold level that deliver working capital and corporate structuring solutions. Our team has extensive and proven experience delivering lending that supports a business's requirements. In addition, operational turnaround support can be provided as required.

We offer funding to mid-market businesses seeking facilities up to £150m. Funding situations include supporting transactions, restructuring and additional working capital. The funding will be secured against any balance sheet assets with additional cash flow loans considered where required.

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Acquisition

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Nynas

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BREALZETACF

> We're not trying to compete with the mainstream ABL market, rather we're lending in an innovative way.
>
> **Robert Wakeford**

Robert Wakeford

One of the features in all facilities is that you may find that you're more willing to do things with six months or a year's experience with a client, than you may have been at the outset so the ABL facility can evolve or develop. That certainly supports the relationship with PE owners, when they come along and want to do something different - we may then be more willing to do that.

Wakeford: We've just completed a corporate carve-out that is a sponsor-backed business operating internationally, with funding provided directly in Australia, US, Canada, UK and Poland.

I think the level of due diligence necessary for these cross-border transactions is a lot more intense, so the bar is set higher to really make sure your credit risk is acceptable.

For me, the multi-jurisdictional asset-backed deals are in some ways safer than providing stretch cash flow lending, where it's still lending against an asset. You've got the right advice, you've got the right diligence, and you know what your contingency plans are. With a good understanding of local law, the intricacies of the assets being lent against, you should be able to structure a good, secure deal.

Weeden: We offer funding solutions from both the UK and NL, which support businesses who require cross-border facilities such as a single group structure, which involves debts funded through an SPV in the Netherlands, or via bilateral facilities in various countries in which we have a presence. Given the complexities around legal documentation, exit routes and the structures themselves, having local expertise and experience in those countries is essential and sets us apart. This has come more into focus since Brexit when we have seen a number of businesses looking to set up subsidiaries within Europe in order to minimise some of the negative effects caused to their businesses by the UK's departure from the European Union.

Is ABL being used as a refinancing option? How is this being done and what are the benefits of this?

Weedall: As an ABL solution is secured against the assets, we're able to take a more pragmatic view on the underlying cashflows or short-term financial performance of a business. Therefore, we're able to take a measured assessment and provide a refinance option from a traditional leverage product that requires stable cashflows. Through that refinancing, ABL can provide businesses with that necessary breathing space via new working capital facilities allowing them to correct or execute a turnaround plan, whilst setting appropriate collateral covenants alongside key financial performance metrics.

I think ABL should be commended rather than sometimes scorned for some of the refinance transactions it completes, providing businesses with the critical support during tough trading periods.

Weeden: Following the pandemic where business may be suffering from suppressed earnings and more volatile financial performance, we are likely to see businesses look to refinance from a traditional leverage product to a more appropriate ABL structure where the focus is more centred on asset and operational performance with less onerous financial covenants. This may be relevant as management teams become increasingly concerned about covenant breaches with potential increases in interest rates and this is where ABL comes into its own.

The market is increasingly growing in the ABL space, what are new market entrants and existing firms doing/offering to set themselves apart?

Weedall: Certainly from Blazehill Capital's perspective, we're using the ABL standards and applying them in a less rigid, more commercial way where appropriate. So, yes, we need to understand what the asset value and collateral is, but ultimately, we're looking at what quantum is required by the borrower and how do we get to that number. We are guided, but not restricted by, the principles of ABL to help us structure the funding against the assets and then apply some further flex to bridge the funding gap if required. We're able to work on both senior and junior security basis and can partner with other lenders when required to complement and add to their structures.

As we exit the pandemic and focus on providing enhanced working capital and growth facilities, we want to maximise liquidity for our borrowers by providing non-amortising funding structures where appropriate and minimise monthly debt service burden.

Wakeford: We're a fairly new lender, having been set up two years ago to do large, complex structured ABL transactions from £20m to £150m. We've built a very strong, experienced team, and are now 30 people. Within our team, we've got a real breadth of experience and a diverse group of people to really understand the businesses we work with. We're not trying to compete with the mainstream ABL market, rather we're lending in an innovative way.

Weeden: Whilst I think it's more difficult for the more heavily regulated ABL providers to be as innovative as some of the newer lenders, I think the onus is on us to be come up with flexible structures, for example those that that allow us to work alongside alternative debt providers to provide a greater debt quantum where required.

Davison: I think lots of providers are finding their specialism and they're adapting to how people are developing in the marke. At the smaller end, many are looking at the fintech side of things and the low costs and apparent simplicity that comes with that. For

Jon Hughes

James Cullen

many ABLs, it is a question of really knowing a particular market or sector and using that to stretch what extra value they can offer. [...] I suspect we're going to see new opportunities develop as a result of what blockchain can do for inventory lending and goods in transit, for example.

How has ABLs' approach to ESG developed? Are LPs putting more emphasis on ESG considerations?

Weeden: ESG is a huge focus for ABN, and the firm was the first to issue a green bond to the Dutch government. In the UK, we have our own KPIs on sustainable finance and the sort of businesses that we want to support on their transition to sustainability.

We're aiming to increase the volume of sustainable assets within our ABL book substantially by the end of 2024 and we are looking to achieve that by either funding sustainable assets through lease and ABL facilities, but also by providing sustainable products such as an ESG framework where we link the discount margin of a facility to ESG related KPIs which, if met will see the discount rate ratchet down.

ESG is front of mind with more and more of our clients and we rarely see a management presentation that does not feature ESG goals. ABL lenders who, by the very nature of how they operate have more regular dialogue with their clients are well placed to assist with ESG goals.

Cullen: ESG has never been higher on the agenda, and we are proactively developing our framework – in terms of new business assessment, a dedicated team of experts and also in our debt structuring (e.g. ESG-linked margin ratchets, the savings from which are ploughed back into client ESG initiatives).

ESG relative to ABL is interesting due to ABL's particular relevance to 'old world' industries more likely to be seen classically as lower on the ESG scale. Our frame of reference is less on this classical view, and more around what businesses are doing to 'move the dial' en route to becoming more ESG-friendly.

Hughes: Our management team owns a large share of our business, so our focus on ESG has come from looking at ourselves and thinking about what kind of business we want to be. We question whether we want to be involved in certain businesses that aren't in line with our own beliefs.

> **ESG relative to ABL is interesting due to ABL′s relevence to 'old world' industries seen as classically lower on the ESG scale.**
>
> **James Cullen**

COMMENT

Transforming ABL administrative operations

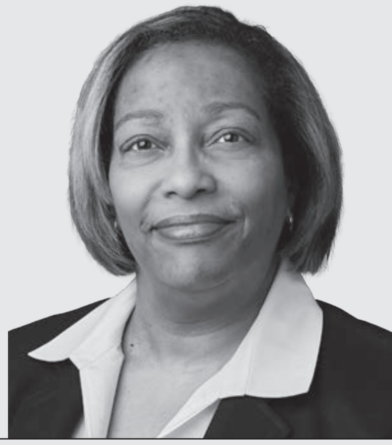
Alter Domus' Ellen Cook, head of asset based lending in North America, and Amit Varma, director of operations DCM Europe, discuss key hurdles that ABL lenders face.

Like Netflix moving from a DVD-by-mail business to a leader in streaming content or Ørsted transitioning from oil and gas to wind farms, asset-based lending (ABL) has undergone a remarkable transformation of its own. Once considered more or less a "creative financing" tool for mom-and-pop businesses facing a cash crunch, ABL loans are now viewed as a normal, even common, source of non-bank funding for all sorts of business purposes, including expansions and acquisitions.

The market in the US has grown at a compounded annual 7 per cent rate since 2011, and portfolio yields regularly exceed 10 per cent, according to the Secured Finance Network. Even in 2021, a year when the global economy had everyone guessing more than usual, non-bank ABL outstandings increased 6.9 per cent between the second and third quarters, they reported.

What's driving the growth? Ellen Cook, Alter Domus head of asset based lending, North America, credits an enabling environment, as well as the fact that there's ample upside for borrowers and lenders alike.

"The flexible legal framework that provides ABL lenders with a pathway for obtaining priority lien status on the buyer's collateral has been huge in accelerating an acceptance of ABL lending," Cook says. "But it's just part of the picture. Borrowers like them because they're quicker to obtain, less expensive, and less restrictive than traditional bank loans.



"They're particularly attractive to young, undercapitalised companies — and these days, more and more businesses fit that profile."

As for lenders, ABL loans generally present less risk. Because the loans are collateralised with an asset — most commonly inventory, equipment, outstanding invoices, and accounts receivable — if the borrower defaults, the asset can be liquidated.

Piling on complexity

If there is a downside for lenders, though, it's this: their very nature makes servicing ABL loans complex and often burdensome.

As Cook notes, because the loans are predicated upon a margined percentage of the collateral's value, monitoring those values is an enormous daily task, requiring considerable administrative heavy lifting.

If that were the only issue, it might be manageable for many lenders.

But, on top of that, rules that limit investment concentration risk often mean lenders have to bring in co-lenders or co-investors to make large loans. In addition, the ABL revolver requires each lender to maintain adequate liquidity to fund loan drawings. And, just to add another layer of complexity, ABL lenders generally have control of the borrower's cash. This often forces borrowers to schedule loan advances based on the reporting cycle of the collateral, which in turn requires the lender to analyse the collateral to determine if there's enough money to fund the request.

"Few lenders have the staff, budget, infrastructure, or bandwidth to overcome these hurdles," Amit Varma, director of operations DCM Europe at Alter Domus, says. "Just having to service daily advance requests and review, validate, and process daily collateral information can be overwhelming.

"Some lenders think the only way to manage operationally is to divide the responsibilities between co-lenders or to staff up and invest in infrastructure," he adds.

The problem is that those options prevent them from fully enjoying the economics of the entire debt capital structure.

To take full advantage of ABL lending opportunities, an outsourced administrative solution is often a better choice.

Better decisions, bigger benefits

Cook and Varma say there are four key hurdles ABL lenders face:

- Lack of staff to review and validate daily collateral information and identify potential issues with collateral performance.
- Lack of a collateral monitoring system to process and provide data for credit monitoring purposes.
- The high cost of deploying a monitoring system to run the book of business.
- The cost and time involved in hiring, managing, and retaining enough experienced people to oversee the daily operations of the loan and its collateral.

Alter Domus makes it easier to overcome each one.

"Through our specialist teams, Alter Domus has vast experience providing back-office services for ABL loans," Cook says. "By leveraging our proprietary operating platform, RadarOne, we can take on the substantial administrative functions associated with ABL lending, enabling our clients to make better credit decisions and maximize their benefits."

The process begins with onboarding, which is as much about providing guidance as it is setting up a system. In addition to reviewing all credit, operational, and legal documents, Alter Domus experts provide insight into servicing requirements, as well as underwriting support, helping to define and structure the borrowing base and requirements.

From there, Alter Domus teams perform daily and monthly activities to help clients manage the intricacies of ABL loans on a real-time basis, including:

- Collateral monitoring: This involves reviewing and validating borrowing base certificates and supporting backup, as well as recording all loan and collateral activity and providing customised reports.
- Loan servicing: Processing loan advances; calculating, billing, and collecting all interest, principal, and other fees; reconciling cash advances; confirming borrower payments or capitalizing monthly charges; preparing audit documentation.
- Money movement: Moving money to and from borrowers.
- Participation settlement: Includes rebalancing the borrower's loan across the participating lender group and calculating, billing, and paying all amounts due to participating lenders.

Having a dedicated company to handle these responsibilities isn't just about making the work day easier, Varma says. Historically, lenders who've mastered the additional administrative burdens of ABL find them among the most durable loans in their portfolios.

"They're revered by credit officers for their low loss rates, even during some of the most challenging credit cycles," he says.

Whether those challenging credit cycles wax or wane, regardless of how markets change or who gets the next corporate makeover, there's no question that ABL has staying power. Lenders just need the right partner to transform their administrative operations and keep them going too.