

Analyse du financement sur actifs

5^{ième} CONFÉRENCE AVANCÉE SUR

LE FINANCEMENT
ET LES
SÛRETÉS

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Hôtel Intercontinental – Montréal



Distinctions between ABL and traditional lending

Asset Based Lending (ABL) is a specialized form of secured lending based upon the tangible assets of a company whose values are verified through independent appraisals and in-depth due diligence.



Distinctions between ABL and traditional lending

- Asset Based Lenders look at:
Assets / Management / Financials
- Higher, more aggressive advance rates than loans conventional bank loans
- Advance rates established based on the orderly liquidation value of assets
- Increased flexibility, without restrictive covenants



Distinctions between ABL and traditional lending

- Interest rates and fees marginally higher than traditional loans
- Close monitoring to appropriately manage the loan and collateral position
- Tailored solutions to meet seasonal or peak borrowing needs
- Support through good times and bad



Uses for Asset Based Lending

- Tailored solutions to provide increased access to working capital to support:
 - Business cyclicality
 - Rapid growth
 - Seasonal bulges
 - Enhance supplier relationships (take advantage of trade discounts)



Uses for Asset Based Lending

- Alternatives to raising more expensive forms of capital (equity):
 - Acquisitions
 - LBO / MBO
 - Succession planning – withdrawal of equity
- Solution to facilitate a viable turnaround:
 - Formal / Informal reorganization
 - Inconsistent cash flow



Borrowing Base and Eligibility

Accounts Receivable

- Receivables from: Canadian and US Corporate accounts plus Foreign accounts (where credit insurance is in place)
- Advance rates up to 90% subject to any *dilutive factors* (rebates, returns, advertising allowances, etc.)
- *Reserves* include: unpaid deductions at source, taxes, salaries and vacation pay, rental for leased premises with no landlord waiver, 30-day goods, etc.



Borrowing Base and Eligibility

- Ineligible Receivables include:
 - Contra accounts
 - Affiliated (*inter-co*) receivables
 - Unassignable governmental receivables
 - Non-trade receivables
 - Advance/Consignment/Contractual billings or “Bill and Hold” accounts
 - Non-credit insured foreign accounts



Borrowing Base and Eligibility

Inventory

- Typically includes all finished goods and marketable raw materials
- Advance rates up to the lower of 65-75% of cost or 85% of Net orderly liquidation value (NOLV)



Borrowing Base and Eligibility

- Ineligible inventory includes:
 - Work-in-progress
 - Slow moving
 - Obsolete
 - Consignment inventory
 - Packaging materials
 - PMSI related inventory
 - In transit



Borrowing Base and Eligibility

Fixed Assets

- Typically includes Machinery & Equipment
- Advance rates up to 80%-85% of NOLV or 100% of forced liquidation value
- Real estate loans sometimes included



Due Diligence

- Every ABL transaction has to survive a thorough due diligence process.
- Contrary to traditional bank financings, ABL due diligence will always include:
 - Field examination
 - Inventory appraisal
 - Management Information System (MIS) Assessment
 - Debtor analysis
 - Legal due diligence



Field Examinations

- Initial field examinations and most ongoing reviews performed by third party professionals
- Performed by accounting auditors
- Prospect's external auditors will not be retained to perform the reviews (even if referred prospect)
- Initial review includes historical information (18 to 24 months)



Field Examination

- The focused areas include:
 - Determination of dilution included in accounts receivable collateral
 - Identification of sales processes, terms of sales & credit procedures
 - Billing practices & collection procedures
 - Inventory production process & flow



Field Examination

- The focused areas include (cont.):
 - Inventory test counts & cost tests
 - MIS reporting capabilities
 - Analysis of potential priority claims
 - Analysis of concentration risks & vendor pressure



Field Examination

- Field examiner's report enables ABL lender to:
 - complete underwriting process
 - understand prospect's existing:
 - accounting operations
 - internal controls in place



Inventory Appraisals

- Completed by third party professionals
- Determines NOLV on inventory collateral
- Evaluator uses various assumptions based on current market conditions for the type of inventory



Inventory Appraisals

- NOLV based on estimated liquidation period required, net of sales costs (i.e. rent, advertising, salaries, insurance, etc.)
- Demand & product mix will influence NOLV
- Evaluator also considers selling opportunities (i.e. normal channels of the prospect client)



Audits and Appraisals

- Field exams & inventory appraisals performed quarterly or semi annually
- Examiner updates initial review to determine:
 - Changes in dilution of accounts receivable
 - Change in inventory mix or cost systems
- Examiner validates information given on an ongoing basis to ABL lender (borrowing base)
- Corroborated by books & records of borrower



Audits and Appraisals

- Increased dilution = lower lending advance rates on A/R
- Invoice reviews to rule out pre-billing situations
- Lower NOLV = reduction of inventory advance rates



Reporting Requirements in ABL

- Ongoing monitoring process by Lender
- Borrowing Base certificate
- A/R & A/P Ledger
- Inventory Reports
- GL trial balance
- Bank statements



Reporting Requirements in ABL

- Monthly certificates
- Additional documentation (specific to deal)
- Verification process with account debtors
- Field examinations and inventory appraisals
- Audited & interim financial statements
- Business plan & projections



Financial covenants in ABL

- ABL deals have limited to no financial covenants
- Covenants established based on projected performance
- Springing covenant structures becoming common
- Typical covenants include:
 - Minimum margin surplus
 - Debt service if term debt part of capital structure
 - Positive EBITDA



Negative covenants

- Acquisitions
- Debt
- Dividends
- Investments
- Share repurchase
- Restricted payments
- Change locations



Cash Management

- Cash Dominion
 - Blocked accounts or lock-box
 - Springing dominion
 - Daily sweeps to lender's collection account
 - Tri-partite agreement with borrower's bank
 - Operating banks' expectations
 - Indemnity, chargebacks, set-off



Legal Due Diligence

- Constating documents
- Corporate structure & shareholdings
- Permitted debt & lien documents
- Contingent liability documents
- Material contracts (offset rights, restrictions on assignability)
- Licence & franchise agreements



Legal Due Diligence

- Permits, consents & authorisations required to conduct business
- Leases
- Insurance policies
- Environmental audits
- Taxes
- Searches (liens, bankruptcy, litigation, intellectual property)



Legal Documentation

- Offer letter / Commitment letter
- Loan agreement
- Security documents (hypothec, GSA, 427, pledges, guaranties)
- Intercreditor / priority agreements
- Third-party agreements and waivers
- Cash dominion agreements
- Estoppel certificates
- Assignment of insurance
- Local search reports & opinions



Third Party Documents & Waivers

- Intercreditor / priority agreements
- Subordination / postponement agreements
- Standstill agreements
- Third-party waivers:
 - Landlord
 - Mortgagee
 - Processor
 - Warehouseman / bailee
 - Licensor



Intercreditor / Third-party Expectations of the ABL Lender

- First priority lien on all assets
- Standstill on accounts receivable & inventory
- Subordination & postponement of junior debt
- Right of use of necessary software & intellectual property
- Right of use of leased M&E (completion of WIP)
- Right of occupation in operating premises
- No account-debtor notification by subordinated creditor



Portfolio Management

- Relationship manager oversees and communicates:
 - Borrowing base reporting requirements
 - Drawdown request procedures
 - Payment application process
 - Verification process and results
 - Weekly / Monthly reporting requirements



Portfolio Management

- Ongoing requests / changes in the facility:
 - Increases, over-advances
 - Changes in A/R advance rates in line with dilution
 - Decrease inventory advance rates not supported by NOLV
 - Change in reserves



Exit Strategies in ABL

- Many tools in ABL transaction allowing lender to mitigate risks.
- Ongoing reviews identify problems and allow lender to react accordingly, such as:
 - Reduction of advance rates based on NOLV of inventory
 - Decrease in accounts receivable advance rates based on dilution
 - Increase volume of verifications or frequency as well as monitoring
 - Increase ineligibility of certain accounts or inventory categories



Exit Strategies in ABL

- Progressive reduction of advance rates
- Increase in field exams / inventory appraisals
- Non-tolerance and/or demand letters
- Enforcement / realization process
- Appointment of monitor / interim receiver, etc.



Cross-border Issues

- Multi-jurisdictional searches / filings
- Withholding tax
- Fraudulent conveyance
- Deemed dividends
- Syndication



Recent Trends

Typical Deal

2001/2003

2006/2007

Interest Rates

Prime + ½ – 1.25%

Prime + 0 – ¾% (Prime minus)

BA's / Libor + 2.75 – 3.75

BA's / Libor + 1.75 – 2.25

A/R Advance rates

85% subject to dilution 3-5%

85%

Finished Goods

60-70% subject to appraisal

100% NOLV

Raw materials

35-50% subject to appraisal

85% NOLV

WIP Advances

Low adv. Rates, small sub-limit

25-50%

M& E Advances

80% OLV

80-90% NOLV / 100% Forced

Trademark Advances

None

25-40% Appraised

Real Estate Advances

50-60% FMV

65-75% FMV

Syndication

Prospect bears syndication risk

Easy Sell

Collateral Monitoring

Full, detailed, Qtly F/X & IA

Limited, springing, reduced F/X & IA

Covenants

Average 4 covenants

Springing (Covenant-lite / free)

Flex

Routinely flex up > 50bps

No flex > 50bps

Q102 42% Flexed up 16

Q107 36% FL institutional flexed down



Outlook for ABL

- Credit Crunch will lead to increased use of ABL Facilities
- Cash Flow lenders already beginning to tighten up, reduced hold limits, de-market industry sectors no longer in favour
- Advance rates returning to 2001/2003 levels
- Risk based pricing returning to market (P+ 1/2% - P+2%)
- Market Flex (upwards) in both price and structure evident in recent deals



Outlook for ABL

- Private Equity Groups still active as financial buyers
- Strategic buyers beginning to see value at reduced multiples
- Turnarounds and distressed opportunities heating up
- Debtor-in-Possession (DIP) loans making come-back
- Healthy companies looking at ABL facilities before refinance needs evident





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