

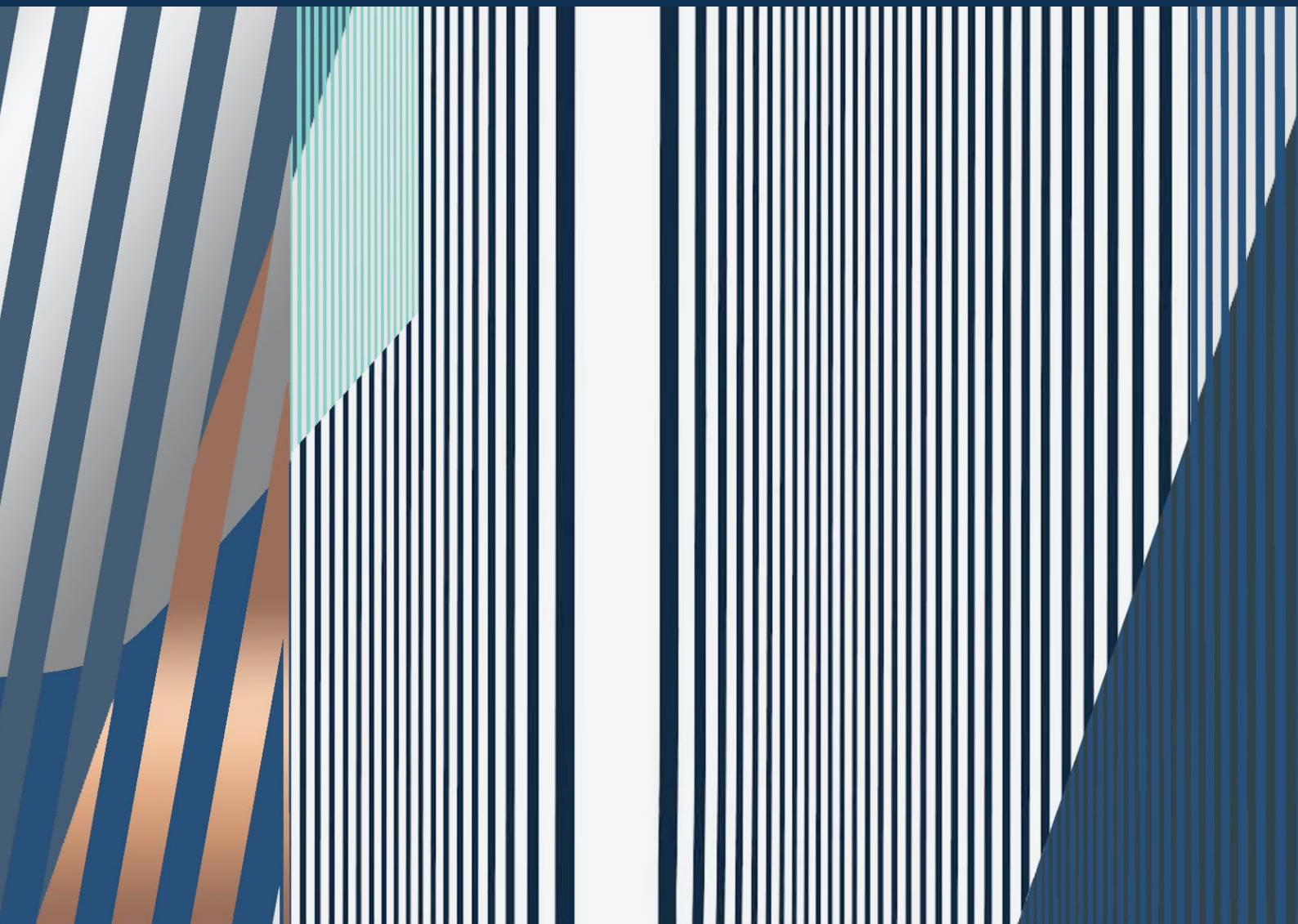
# DRIVING CERTAINTY IN UNCERTAIN TIMES

MEETING THE CHALLENGE: THE ABL ADVANTAGE

A WHITE PAPER BY BZ

Specialists in structured asset-based lending facilities.

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## DRIVING CERTAINTY IN UNCERTAIN TIMES

**While technically not in recession, the UK economy is facing strong headwinds that are expected to persist for several years.**

A host of factors, including soaring inflation, rising interest rates, the energy crisis, labour shortages and supply chain disruption, have collectively thrust the nation into a period of economic uncertainty.

As a result, traditional lenders are becoming increasingly more selective in terms of where they deploy capital, culminating in a flight to quality. The decline in risk appetite amongst these lenders, including independent cash flow and leverage finance providers, has resulted in reduced leverage, more rigid structures, and stricter covenants and controls. This, in turn, has led to businesses increasingly exploring balance sheet-led funding options to unlock value and secure funding to meet these demands.

### MEETING THE CHALLENGE: THE ABL ADVANTAGE

To navigate uncertain economic environments, businesses require lenders who can provide both flexibility and speed. Traditional funding sources often fall short in meeting these demands, as their risk appetite diminishes in conjunction with businesses' wavering profitability. While leverage is tied to profitability, asset-based lending (ABL) offers structured facilities that can leverage all balance sheet assets, including accounts receivable, inventory, plant & machinery and real estate. This presents an attractive prospect for asset-rich businesses seeking increased funding, whether that be for a turnaround or to fuel growth, organically or through acquisition. ABL is a solution that works well in all scenarios, particularly during periods of volatility and change where traditional banks may either retreat due to turbulent times to focus on their existing portfolios or fail to step up promptly to support businesses as markets accelerate.

As asset value provides stronger leverage compared to profitability in times of economic uncertainty, credit availability and headroom increase. As external economic factors converge, impacting industries across the board, the additional headroom generated through ABL becomes an increasingly attractive prospect for both clients and lenders. ABL facilities are often committed for an agreed time, unlike overdrafts which can be withdrawn on demand, providing security throughout an extended period when it is predicted the UK economy will face strong headwinds in the coming years.

Asset-based lenders offer a financial covenant suite which is less intrusive, allowing lenders to respond effectively to economic change and meet the specific needs of their clients, facilitating enhanced speed and flexibility. While asset-based lending options are typically covenant-light, they can be more intrusive in terms of operational covenants. This focus often benefits businesses by encouraging them to enhance their discipline in receivables and inventory management as working capital assets fluctuate in response to the wider economy.

## THE ASCENDANCE OF INDEPENDENT ABL IN TIMES OF FINANCIAL CRISIS

During the financial crisis of 2008, the acceptance of ABL as a mainstream source of capital increased, as traditional banks became cautious in offering leverage funding. Debt emerged strongly as a more stable and beneficial line of funding for businesses to utilise. The ensuing financial crash created a gap in the lending market that ABL has now successfully filled, proving itself as a beneficial funding option, not only for turnaround situations but also driving future growth.

Independent asset-based lenders have become widely regarded by private equity houses as key partners due to the flexibility, speed, creativity and focus on relationships that they offer. In contrast, mainstream banks and traditional leverage funds have become more cautious and risk-averse, especially in times of economic downturn where profitability is generally at its lowest across all business sectors.

Asset-based lending has a long-standing presence in the commercial finance industry and has thrived in supporting businesses through successive economic cycles.

*Brent Osborne, BZ's Executive Chairman, reflects on the impact the financial crisis has had on the ABL industry today: "Since 2008, the support provided by ABLs has instilled confidence in the product as a core solution for collateral-intensive businesses that faced severe limitations in demonstrating strong EBITDA multiples required by high street lenders. As the landscape changed, many new players have dipped their toes in the water, from special situation equity houses, hedge funds and even property/pension companies diversifying their risk portfolios. This has allowed significantly larger deals to be considered and has firmly established ABL as a mainstream strategic tool in the armoury of debt advisors."*

## EMPOWERING BUSINESSES WITH CREATIVE ABL SOLUTIONS

According to UK Finance, in 2022 the ABL/IF sector facilitated £314 billion in client sales, demonstrating substantial growth compared to £276 billion in 2021 and surpassing the previous record of £288 billion set in 2018.

Notably, there was an increase of over 7 per cent reported in the number of businesses with a turnover of £10 million or more opting for these products, reaching a total of 5,600 businesses. This upward trend is highly encouraging, particularly as it highlights the growing appeal of the flexibility offered by these solutions among larger businesses. It also signifies a strong expansion of the industry beyond its traditional focus on SMEs, showcasing its ability to cater to mid-market and larger corporates.

ABL has become a valuable alternative to traditional leverage funds as businesses seek additional financial flexibility in the face of external economic conditions. ABL has stepped up to provide stability and additional headroom for growth by unlocking asset value where the risk appetite of leverage funds has declined. Private equity firms are, therefore, actively partnering with ABL lenders to power their portfolio investments. At BZ, we offer creative, fast, and flexible funding solutions that cater to each client's unique needs. We stay updated with market trends and help businesses navigate the current economic environment with heightened certainty.

*“The FRP Debt Advisory team are strong advocates of ABL solutions, having advised on over two hundred transactions over a twenty-year period specialising in the market. FRP has recently advised a well known high street retailer on a debt raising to support a change of ownership, and even though the business has a strongly improving profitability trend, it is still part of a sector unloved by the conventional debt community. Working with lenders like BZ that can offer certainty of funding in this type of transactional situation is a clear positive differentiator in such economically uncertain times.”*

Dave Edwards – Partner

## STRUCTURING FOR SUCCESS

BZ has the capability to offer facilities to any asset-rich business, leveraging all balance sheet assets across multiple jurisdictions. With an asset-agnostic and sector-agnostic approach, BZ funds a variety of situations; supporting the increased utilisation of debt for growth funding, a shift from the recent perception that debt was purely reserved for turnaround purposes.

As a leading lender, BZ is finding that more businesses are looking for additional cash flow alongside an asset-based lending facility. This hybrid model plays a crucial role for businesses in uncertain economic environments as it bridges the gap between the asset value that can be leveraged and the necessary funds. The asset backing provides security and serves as collateral for cash flow. This approach is especially useful in a revolving facility for seasonal stock-driven businesses, where assets are impacted by current issues such as escalating energy costs, labour shortages and supply chain disruption. By combining asset-based lending with supplementary cash flow, businesses can better navigate these obstacles and maintain their operations with greater stability.

## MINOVA – THE CASE FOR A HYBRID LENDING MODEL

The acquisition of Minova by pan-European investment group Aurelius was completed in October 2022. The acquisition was multi-jurisdictional with assets held in the UK, USA, Canada, Poland and Australia. Such multi-jurisdictional deals often pose a higher risk, which can deter high street banks and many other leverage and ABL lenders. Traditional leverage funds typically undertake lengthy approval processes and are tentative in completion, which crucially limits their ability to meet expedited timeframes. In the case of Minova, although the transaction was heavily asset-backed, the legalities across jurisdictions meant that these assets could not be unlocked within the compressed timescales needed. Consequently, a flexible approach was required, leading to the granting of an unsecured cash flow loan.

BZ's appetite and ability to provide a hybrid model, including an unsecured cash flow strip in a turbulent economic climate highlights its flexibility and forward-thinking approach to completing complex transactions in collaboration with private equity houses, securing funding for growth.



### MAXIMISING OPPORTUNITIES IN M&A

ABL provides the optimal level of funding for sponsor backed M&A transactions, such as acquisitions, management buyouts and buy-ins. Typically, ABL not only supports the initial purchase consideration but will also generate additional headroom to fund the growth of the business post-acquisition. The potential to fund growth through ABL had historically been overlooked but the private equity market is much more aware of the ABL market today and recognises the significant value it brings to deals.

While ABL was traditionally perceived as a product primarily focused on turnarounds for businesses lacking the earning profile to obtain traditional leverage funds, its scope has expanded significantly. Today, private equity houses now collaborate routinely with asset-based lenders to not only fund turnarounds but also drive growth opportunities.

In recent years, the appetite for debt funds has been high with asset-based lending playing an increasing role in financing acquisitions. The nature of these event-driven transactions demands speed and flexibility as these are inherently risk-averse scenarios. Unlike traditional funding sources, ABL focuses on asset value rather than profitability. The foundational driver of growth for acquisitions is, therefore, not constrained by profitability margins. For many asset-rich businesses, using ABL facilities can often increase the funds available by leveraging asset values, as opposed to volatile profitability rates.

### EVO – SWIFT AND SEAMLESS DEAL DELIVERY

BZ completed a £90 million refinance of EVO business supplies in December 2020, including a £9m structured term loan. EVO is a portfolio company of Endless LLP, a transformational UK private equity investor. This transaction underlined BZ's flexibility, enabling EVO to maximise expansion opportunities within its £19 billion addressable market.

In January 2023, EVO acquired Complete Business Solutions Group (CBS), a leading provider of business supplies and services. CBS is a £100m multi-revenue stream business, and BZ approved an additional funding requirement of £11m within a tight deadline to facilitate the acquisition. The need to transact quickly was critical to EVO in acquiring CBS from administration in a move that was to secure more than 600 jobs across the UK. BZ acted swiftly to complete the transaction during the New Year period, despite the significantly compressed timescale, underlining the commitment and responsiveness of the team and the short lines of communication.



## INNOVATION IS KEY

At BZ, we understand the importance of innovation and set out to structure and deliver large, complex transactions. While we ensure that our pricing point aligns with the nature of the deals we structure, we also strive to collaborate with sponsors and businesses that demonstrate superior quality and possess strong management teams. We want them to choose to work with us just as much as we want to work with them.

We have pioneered a syndicated “First In First Out” (FIFO) structure, in which we bring in a super senior lender as a partner to our debt facility. This innovative approach provides the desired quantum and pricing that businesses and sponsors are seeking.

The key advantage of having a super senior lender as a partner to our facility is the seamless offering it creates. By establishing a pre-agreed set of lending principles with our partner, we eliminate both the execution risk and legal complexity that often arise in other multi-lender transactions.

The ABL landscape has continued to evolve, and BZ now offers full underwrite and hold capabilities for transactions up to £150 million. This represents a significant expansion in the size and scale of ABL transactions, providing businesses with even greater access to substantial funding solutions.



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