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## Asset-based lending could see a boom in economic hard times

Feb 17, 2016 | by Julius Melnitzer | Lexpert, online exclusive 

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Timothy Baron

The very economic conditions that do not bode well for large sectors of the Canadian economy could prove to be a catalyst for asset-based lending (ABL).

“ABL is very important in this climate because a lot the banks’ A-list clients are having difficulty with ratio formulas and balance sheet equations,” says Wayne Ehgoetz, Managing Director of Waygar Capital Inc. in Toronto. “But many of these companies still have collateral, even in bad times.”

As [Timothy Baron](#) of [Davies Ward Phillips & Vineberg LLP](#) in Toronto points out, business doesn’t come to a full stop just because things are rough.

“In a downturn, people are still creating accounts and inventory they need to move,” he says. “So to the extent they

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can't borrow on cash flow, there may be

an uptick in ABL."

There's an argument, though, that the ABL market doesn't change much in the current type of economy.

"I don't see ABL as better suited to good or bad economies," says [Diane Brooks](#) of [Blaney McMurtry LLP](#) in Toronto. "It's about smart money management and using ABL as a flexible financing tool."

Indeed, ABL proponents insist that the notion that ABL is a product of last resort meant primarily for distressed businesses is a misconception.

"ABL lenders look at things like seasonal businesses and companies that are having issues but need hard assets to move forward," Brooks says.

It's not, after all, as if ABL is the panacea for the hardest-hit sectors, like commodities.

"I don't think any asset-based lender would say they're not doing business in Alberta, but we'll certainly think very carefully about clients whose survival is dependent on the price of oil," says Adam Flomen, VP, Business Development at Bibby Financial Services Inc. "On a case-by-case basis, we can get our heads around a lack of profitability and we will definitely look at the turnaround trend and the costs of getting a company back in the black — but the truth is that if the price of oil doesn't come back, many of them won't survive."

As well, even ABL lenders are wary of lending against equipment.

"We'll lend on receivables and inventory, which are much more liquid," Flomen says. "Anecdotally, we're hearing about auctions for equipment that are drawing no bids at all."

To be sure, ABL has matured to the point where all of the Big 5 banks have an ABL group. Their focus, however, is quite narrow.

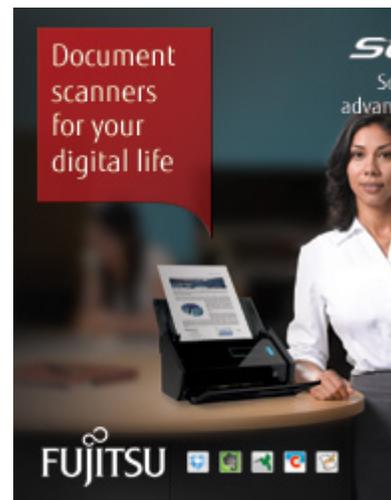
"Banks don't see ABL so much as a growth product but more as a vehicle to avoid losing their existing clients to asset-based lenders," says Nick Dounas, Director at TD Asset Finance.

What has evolved, then, is an alternative ABL lending sector composed largely of non-deposit taking, unregulated entities.

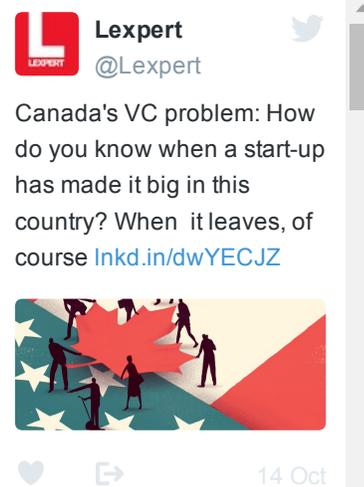
"It's a tale of two markets," Flomen says. "A larger company that needs \$10 million or more will get a pretty good deal from the banks' ABL groups. If they don't meet the banks' ABL criteria, or if they're looking for less than \$10 million, they'll seek out alternative asset-based lenders like ourselves."

To some, the alternative end of the ABL market represents a vibrant and wide-ranging group of companies. Nonetheless, the stigma of "last resort lender" remains a challenge for this sector.

"Some people see alternative ABL lending as the Wild West," Flomen says. "The stigma might come from the fact that some lenders are charging rates into the high teens and low



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twenties.”

Still, however one regards the alternative ABL market, its future is very much in the hands of the banks.

“Alternative ABL lenders like us are a fraction of the overall credit market, so our activity is driven by what Canadian banks will and won’t do,” Flomen says. “Right now Canadian banks are very solvent, their capital ratios are strong, and banks’ losses are still quite low.”

Despite all the negative headwinds, then, the banks haven’t started pulling credit.

“When they do, that’s when we get their crumbs,” Flomen says.

The difficulty is that the crumbs aren’t dropping as easily as they have in the past.

“We’re in a mend and extend environment,” Flomen says. “Even if there’s a problem and loans are under water, banks have come to the conclusion that it’s in their interest to rehabilitate and support clients through the down periods because they know that the outcomes will either be an industry consolidation or a rebound.”

The upshot is that the greater the downturn in the economy, the greater the likelihood the alternative portion of the ABL market will flourish.

“The bottom line is that ABL lenders will continue to come in where the banks will not go,” Brooks says.

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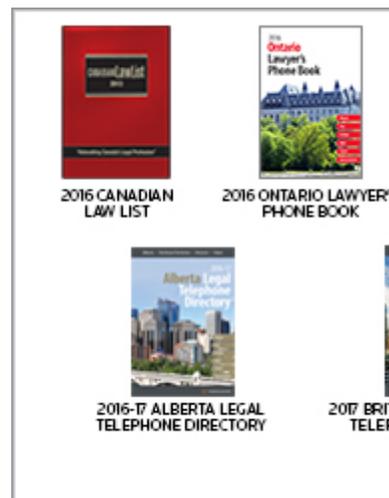
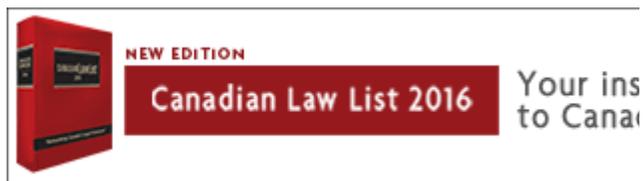
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