

Finding the Gold

Smaller ABLs Sift Through Bountiful Opportunities as Uncertainty Takes Its Toll

With the Fed chairman recently using the dreaded “R” word for the first time, the asset-based lending industry is bracing for an uncertain future. However, for many of the small- to mid-market lenders, a silver lining of opportunity is present in the turmoil of the recent and soon-to-come economic landscape. ABF Journal sat down with four industry professionals to discuss what’s in store in the asset-based financial arena.

By Darryl Seland

While testifying before the congressional Joint Economic Committee on April 2, Fed chairman Ben Bernanke voiced the concern that has been on many minds since the economy began to slow down bringing with it the prospect of a recession. But, facing a potential crisis can present opportunities for the ABL industry.

“[At the recent CFA conference,] every single speaker was talking doom and gloom,” says Deborah J. Monosson, president and CEO of Boston Financial & Equity Corporation in Boston. “The economy is not doing well, we all know that, but for most of us, there are still industrial and manufacturing companies that are plugging along and if the banks are not going to provide for them, then there is a whole industry out there that will. I think for independent lenders, we look at that as an opportunity.”

After reading about one of the larger financial institutions having liquidity problems, Monosson contemplated the boon for asset-based lending and independents. “With all of these banks having liquidity problems in the past couple of years we have all been saying we’re waiting for a down time to get business,” she says. “I think this is the year.”

Richard E. Mount, president of MidCap Business Credit, LLC, in West Hartford, CT, agrees. “Borrowers are being asked to leave traditional banking sources and are turning to asset-based lenders such as us,” he says.

“I actual just got a couple on my desk in the last two days. Those were cases where the banks didn’t want them anymore,” says Monosson. “These weren’t even large banks, they were small banks.”

According to Tom Matthesen, CEO of Presidential Financial Corporation, there is no question more borrowers are seeking out asset-based lenders, although the first wave has mainly benefited the larger players, who compete at the deal size level of the larger commercial banks.

“We are just beginning to see movement in the small- to mid-sized marketplace,” he says. “As commercial banks continue to address their real estate challenges, there is no doubt they will raise the credit standards significantly for their current and future [capital and investment] loans. We believe the implications of that will be favorable for Presidential.”

Mark Sunshine, president of First Capital and a frequent guest commentator on Fox News, notes that his company has seen a large inflow of new clients. “We’ve received, from a funding perspective, a lot of inquiries and quite a number of new credit facilities,” he says.

According to Sunshine, First Capital is sitting on a great deal of liquidity and access to an abundance of high-quality borrowers. He credits the company’s credit-first culture for its current situation. “It has been a wonderful environment for us and we haven’t seen any deterioration in our credit book,” Sunshine explains. “And as a result, we haven’t had to tighten and have actually improved credit quality in our portfolio within the past year.”

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— Deborah J. Monosson, *President & CEO*, Boston Financial & Equity Corporation

And such apparent imperviousness to the current economic climate is not uncommon. “The ‘economic turmoil’ has had very little impact on Presidential thus far,” says Matthesen, who, overall, believes the shift in the capital markets will be beneficial to his business later in the year. “We’ll have our eye on the credit quality of our borrowers, of course, but given our lack of exposure in real estate, we are not concerned,” he says. “Also, with a stronger pipeline of new opportunities, we can limit the number of stretch deals that we might otherwise consider in different market cycles.”

The current struggles in the capital markets haven't directly hit Presidential's business, and the Fed's lowering of interest rates has actually benefited the company, making its pricing look more competitive to clients and prospects.

"While we still face a fair amount of competition in our non-healthcare business, we are extremely bullish on our healthcare business," says Matthesen. "The capital market turmoil has little impact on this segment."

Monosson, whose company does not only asset-based lending, but also equipment financing, looks at it two ways. "Obviously the health of the economy is a two-edged sword, because, while [a credit crunch] is going to give you more business, you are also going to have a concern about whether companies are going to be investing in new capital equipment," she says. "Also, a lot of my financing is for startup companies and there is still a lot of venture money out there, but recently I am seeing more investors losing patience — if you don't ramp up in time, you don't get the money."

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According to Mount, a larger concern than banks turning borrowers away is when conventional bank lenders don't identify problem loans promptly. "Often, they keep a borrower on their books well beyond the time when an asset-based lender can be effective," he says. "Lower prime rates affect the gross yield on our loans — but in the longer term — benefit our clients. Taking that longer view, we prefer to have clients with the opportunity to enhance their earnings whenever it is possible. Our goal is to return a stronger company to the banking system."

It is these concerns that highlight the fact that, while asset-based lenders are looking at potential opportunities and growth in a downturning economy, it is no cake walk. They still have to keep their eye on the ball.

"We face [economic] issues every day," says Sunshine. "We make decisions based on the best information that we have." He relates a story from back in 2005, when the company had about 20% of its portfolio indirectly exposed to the U.S. housing market.

"We were financing manufacturers, things like plumbing supplies, electrical fixtures, tile, and all sorts of things that were used in the construction of homes. We looked at the economic data and what we thought was going to be an explosion in the subprime mortgage market and concluded that housing prices were probably too high. We didn't think it was going to be exactly what it is now, but we concluded that if housing prices were too high there would be a fall off in home building. And suppliers, etc., won't do so well," he says.

So, the company decided to lighten up on home building and indirect real estate exposure and has minimal portfolio exposure to the residential or commercial real estate market. "Every day we make those calls as to what we are going to do and not going to do, based upon what we think is common sense," Sunshine says.

He admits, though, that hindsight is 20/20. "I couldn't tell you now what the most significant things we are doing are, or what's going to yield the best results in 2008, 2009, 2010," Sunshine says. "But, we are making daily decisions based on where we see the economy — we are a little like a super tanker."

He elaborated on his analogy by saying, "It's not like we make a grand decision and suddenly turn that super tanker around and send it in another direction. It's more like a lot of little decisions. Sticking to that discipline and day to day, common sense and logical work, and its those thousands of little decisions that create a mosaic, but who's to say which one of those little decisions that we are making now are the real good ones. We could be making some catastrophic ones right now and not know it and we get a mosaic that looks like a bad Jackson Pollock painting. Everyday you have to move it a little bit in one direction — with a lot of mid-course corrections."

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Maintaining Growth

To keep their businesses growing, these executives are keeping an eye on a number of concerns, including infrastructure, staff, credit quality and continuing to do the little things right.

"The restraint for our company has always been making sure we have the infrastructure and delivery platform to be the market leader in service levels and have the gold standard from a credit perspective," says Sunshine.

"Frankly, we have had access to great additional staff — really super people with tons of experience and a wonderful track record of success. I think the thing that distinguishes us from a lot of our competitors was we always ran a low-leverage model for our company and we were always a credit-first culture," he adds.

With growth comes a concern over managing all of this new business. "Any time we are faced with significant growth, as we anticipate this year, there is a concern about credit quality and the ability to manage existing credits," says Matthesen. "The challenge is maintaining a team of sophisticated underwriters and portfolio managers during the growth curve. My other concern is execution risk in a market of overwhelming opportunities. We want to be focused on the right deals where we can execute quickly and efficiently while delivering excellent customer service."

The flip side of growth during a stagnant economy is that the economy is not growing and the borrower is not growing either. "We're going to have to keep bringing on deals," says Monosson. "So, if we are going to build the portfolio up it's going to be more about putting on a larger number of deals, not portfolio growth from good economic activity."

Sunshine's biggest challenges going forward remain the same as in the past, in particular, doing the little things consistently and correctly — of course, without forgetting the bigger things that relate to the company's interaction with its peers, clients, vendors and financing sources. "The little things are technical and operational things that we have to do every day," he says. "We have to do them in a deliberate and disciplined way."

The company also runs a verification program on accounts receivable that, at a minimum, verifies 20% of all the accounts receivable and all the assets that are pledged to the company.

"It's easy to do the verifications; it's harder to do the follow up. There are always discrepancies, but they get to be hundreds and hundreds of follow-up items that need to be done," says Sunshine.

Outlook for the Rest of 2008

Although we can see what's in store in the present due to the increasing conversations and panels both at the Fed and through other industry areas, the future isn't always so clear to predict. However, *ABF Journal's* roundtable participants still see smooth waters ahead as they prepare to finish the year busier than ever.

According to Mount, "We expect it to be very busy this year and next providing secured credit facilities to borrowers with sales volumes of from \$7 million to \$100 million."

“We need to have a banking system that is more selective in the type and amount of credits it extends. Banks move from new business officers to workout officers and then return to new business officers when the cycle changes. They need to learn to have an even balance between the two disciplines.”

— Richard E. Mount, *President*, MidCap Business Credit

Matthesen sees much of the same with opportunities continuing. "Presidential's outlook on the rest of year is very positive. Given our long-standing relationships with commercial banks and other larger asset-based lenders, we are poised to benefit from the overall shift in the markets. As seen in other times of turmoil, commercial banks will run for cover, and larger asset-based lenders will raise the average size of their deals. That will create a larger pool of opportunities in the small- to mid-size marketplace."

Sunshine agrees saying that based on what the company is seeing right now the outlook for the rest of the year seems bright. "We continue to have great access to capital and bank lines and all the other things that apparently other people are having trouble getting and continue to have a very large pipeline. We are sort of the antithesis of the company and management team that follows the current trends. It's the tortoise versus hare analogy. Since we grow more than 50% a year, we have been a really fast-moving tortoise. We don't follow the trends. We compete on our service levels and we are an attractive place to work because we are both stable and we have an environment that's very employee friendly. We're getting the cream of the crop from a liquidity and capital standpoint, the cream of the crop from the credit perspective."

Although these companies and their executives enjoy a positive outlook moving forward, some aspects of the economy and financial future in the U.S. are less optimistic.

"We need to have a banking system that is more selective in the type and amount of credits it extends," says Mount. "Banks move from new business officers to workout officers and then return to new business officers when the cycle changes. They need to learn to have an even balance between the two disciplines."

Sunshine concludes, "By the time this issue comes out, our industry is going to have been turned on its head." [abf](#)

Darryl Seland has worked as an editor and writer for a number of trade publications and industries, including software, heavy equipment, home building, insurance and the automotive aftermarket. Previously, he was an associate editor at *Construction Equipment Guide*. He also is currently earning his M.B.A. in Finance. Seland can be contacted via e-mail at darrylseland@yahoo.com.

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