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Alternative Assets: Asset-Based Lenders Boom as Traditional Lending Shrinks

By Kyle Stock

-- *Small asset-based lenders are growing.*

-- *Large banks are growing their asset-based lending businesses.*

-- *What it takes to break into the asset-based lending game.*

When the University of Alabama booked its trip to the college football national championship last month, Weezabi LLC went into a hurry-up offense.

The three-employee company -- one of a select few licensed to make "Crimson Tide" merchandise -- needed 60,000 t-shirts. Without the time to huddle investors, Weezabi pledged as collateral part of its future revenue to FTRANS, an Atlanta-based lender and credit analyst, and kept rolling.

"When they went 12-0 last year, we started to think 'This could get pretty crazy,'" said co-founder and CEO Seth Chapman. "If it wasn't for that loan, we would have missed the boat on all of this hot-market stuff."

Asset-based lending, once considered a last-resort finance option, has become a popular choice for companies that don't have the credit ratings, track record or the patience to pursue more traditional capital sources. It is also a providing another critical boost to the finance industry: jobs.

Because asset-based lenders focus on collateral, rather than credit-worthiness, they do deals that more traditional lenders shy away from. Borrowers put up equipment, inventory, accounts-receivable and other liquid assets in exchange for the money.

In 2008, asset-based lending, excluding mortgages, swelled by 8.3% to almost $600 billion, according to the Commercial Finance Association, an industry trade group. Last year, a period when syndicated lending sagged by 39%, according to Dealogic Inc., asset-based lenders were on track to dole out almost $761 billion, or 30% more money than they did in 2008.

"We're no longer viewed as the lender-of-last-resort let's put it that way," said Michael Sharkey, president of Cole Taylor Business Capital, a Chicago-area asset-based lender. "And we should really be viewed as the fireman of this crisis, because we took risks that a lot of companies won't take."

Mainstream on Main Street

The asset-based finance industry is still dominated by Wall Street's biggest firms and almost all of those companies pulled back during the crisis. From 2007 to 2008, almost half of asset-based loan volume from the industry's top 25 firms disappeared.

However, those companies are quickly getting back in the game. They funded 23% more deals in 2009. Wells Fargo, which had acquired Wachovia -- another big asset-based lender -- in 2008, shot to the No. 2 spot on the asset-based lending league table, lending 23% more than both companies combined had doled out in 2008. In December, Wells Fargo had $27 billion in outstanding asset-based loans and about 1,700 workers financing such deals.

What's more, these firms are hiring, adding to the estimated 35,000 people who currently work in the sector.

Bank of America, the industry leader that has a lock on a third of the market, expects "moderate" growth in its asset-based lending staff this year, although the company declined to report its headcount and the number of expected hires.

Meanwhile, JPMorgan Chase, the No.3 asset-based lender in 2009, is expanding its 300-worker asset-based lending unit through the American West, a push that includes opening a new 10-person office in Irvine, Calif.

The initiative is already paying off. In recent weeks, the Wall Street giant injected capital into a California tomato-processor and a Seattle-based coffee-bean roaster. "These are exactly the kinds of businesses that we expected to help," said John Goldthorpe, executive who heads the firm's business credit unit. "We're absolutely committed to the lower end, as well as the higher end."

Small Is Beautiful

Still, as big banks slug it out for market share, a rash of boutiques scooped up a lot of the demand that the bulge bracket deserted during the crisis.

TD Bank, a unit of Canadian-based TD Bank Financial Group, has grown aggressively in recent months and is looking to break into the "top tier" of asset-based lending, according to Barry A. Kastner, who was hired from Wachovia to head TD's asset-based lending practice.

"We think there's room for another significant player in the market," Kastner said. "Typically we see demand in the struggling industries...and pretty much everybody is struggling these days."

Riding momentum from the crisis, TD plans to hire about 20 workers this year in its ABL division. It is also gearing up for an expected wave of mergers and acquisitions, deals that increasingly rely on asset-based loans to round out the financing.

Since it made its first loans in 2007, On Deck Capital Inc., a New York-based asset-based lender, has handed out $50 million to some 2,000 businesses, few of which had revenue of more than $3 million a year.

"The financial system has been focused more or less uniformly on the credit bureau, but had no system to take a broader look at the performance of a Main Street small business," said On Deck founder and CEO Mitch Jacobs. "Now, we're counting on these businesses to push our economy forward and this century-old problem is in the spotlight."

Jacobs is shopping for 20 new employees this year and its bad-credit expenses are "remarkably low".

In 2009, Cole Taylor in Chicago opened six offices across the country to offer asset-based loans; it has plans to open two more this year, including a New York branch. And it has hardly marketed its new offerings; the deals have been dropped on its doorstep by attorneys, investment bankers and consultants.

"Let's face it, every company in the country saw their results fall off a cliff last year; and a lot of banks have their own problems," Sharkey said. "There's just a lot of reasons for companies to be testing the [asset-based] market right now."

What It Takes

Although the borrowers that pledge assets are generally smaller and less-complicated enterprises than those that pursue traditional loans, asset-based lending is, in many ways, a risky proposition. Many clients have spotty or short track records, so due diligence is integral.

Successful asset-based lenders need to understand finance as well as the particular collateral at stake -- be it rolled steel, restaurant revenue or crimson T-shirts. Some folks in the industry are in contact with their clients virtually every day and many of them spend days in the field, checking up on their clients and their collateral.

JPMorgan, for example, is shopping for finance pros in the cities where it hopes to expand, which includes San Francisco and Denver. It wants people who know the lay of the land and the local industries, according to Goldthorpe.

Often, the best asset-based lenders come from within a particular industry or have spent time analyzing a specific industry or line of business.

"It's a very specialized skill set," Kastner said. "You just can't take a banker that has always lent to successful, large businesses and expect them to do well with it."

The one imperative, according to managers in the sector, is being comfortable with distressed companies -- a trait that more and more of us have these days than in the past.

Write to Kyle Stock