



Five key trends in asset-based lending

As the credit cycle matures, several trends worth noting emerge

Ed Gately, Managing Director

Asset-based lending (ABL) is a method of providing companies with working capital and term loans that are secured by various forms of collateral such as real estate, inventory, machinery and equipment, and accounts receivable.

The following trends are becoming increasingly apparent at what is now—10 years after the economic downturn of 2008–2009—a mature stage of the credit cycle:

1. Structures and advance rates

Structures continue to loosen and advance rates are becoming more aggressive as we near the peak of the credit cycle.

2. Commoditization

Certain loan structures are becoming commoditized in usage. This commoditization is notable among large corporate transactions led by private-equity sponsors, who are replicating structures they've already deemed successful in previous transactions with similar companies.

3. More FILOs

Over the past few years, there has been a rise in the use of first-in, last-out (FILO) loans, which contain an advance against the most aggressive form of collateral. Common advance rates in asset-based lending are estimated at approximately 85%, whereas the advance rates of FILOs can reach 90% or even 95%. Moreover, higher advanced rates are increasingly being used for all different types of collateral that present greater risks.

4. Looser covenants

It is increasingly common to find more relaxed contractual covenants—even to the point where companies can be on the verge of bankruptcy before they ever default on an asset-based loan.

5. Aggressive lending in the middle market

Asset-based lending is becoming more aggressive among middle-market companies, many of which don't have the depth of capital and resources to withstand an economic downturn as strongly as their larger counterparts. Although not all types of collateral will necessarily perform in a similar fashion when the economy softens, we advocate for a more careful distinction between middle-market borrowers and large borrowers.

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Recently we have seen a number of lenders seek to expand their business by employing aggressive strategies. However, with lending standards loosening, these plans are often too risky and don't take longer-term consequences into consideration. That's why it is critical for lenders to maintain rigorous credit and underwriting guidelines as they pursue growth opportunities.

ABL is no longer considered an option of last resort for corporate borrowers. It's become a more acceptable consideration—even by investment-grade companies—because of its accommodative structures that require little or no covenants.

We believe these trends will continue to shape ABL in the years to come.

**Ed Gately, Managing Director,
Asset-based Lending**

MUFG took a significant step in enhancing its asset-based finance business when Mr. Gately joined the bank in 2017. With 35 years of experience in asset-based lending, he has overseen a number of enhancements to the group, which now has underwriting portfolio management and loan-origination support on both U.S. coasts, embedded in MUFG's regional and wholesale banking businesses.