

# The Secured Lender



*2012: Working Harder  
and Smarter in the  
“New Normal”*

## **WHAT'S IN/ WHAT'S OUT**

### **IN THIS ISSUE:**

**2011: The Year that Was... P26**

**The Post-Crisis Landscape P30**

**Understanding Insolvency P34**

**Finding the Right Mix P40**

**The TSL Interview:** Pete Connolly  
and Jim Hudak **P44**

### **DEPARTMENTS:**

**Collateral P12 / Profile P43**

**Policy Watch P 46 / Brief P48**

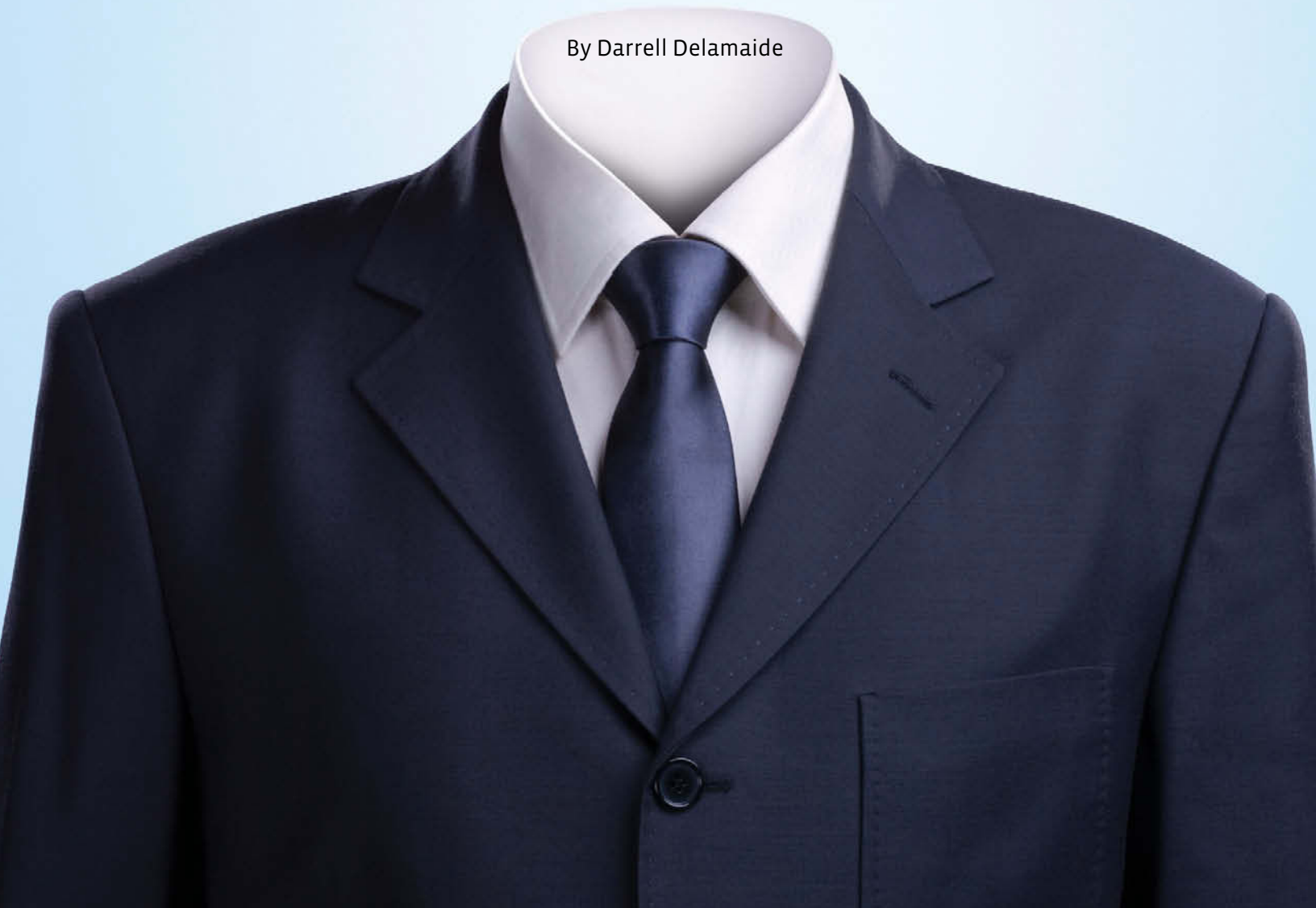
**Legal P62 / Revolver P64**





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By Darrell Delamaide





Although a good deal of uncertainty clouds the horizon, most secured lenders are cautiously optimistic that the favorable trends of the second half of 2011 will continue into 2012 and make it a good year for their business.

Most secured lenders expect the U.S. economy at best to remain flat, while the ongoing crisis in Europe and the presidential elections in this country will continue to inject uncertainty into the picture.

But business owners are getting used to this situation, and learning to live with it.

**“Three years into this economy, companies have been forced to accept this as the new normal,” said Thomas Geisel, chief executive of Sun National Bank. “They don’t complain about it, they don’t hide from it. Conversely, they have learned to live with it and not be afraid to seize the opportunities that arise from it.”**

While companies, by and large, have made adjustments and are ready to move ahead again at a lower level, banks are not ready to move with them, creating openings for asset-based lenders.

“Banks are slow to adjust,” said Einat Steklov, president of Coral Capital Solutions. “After the credit crisis and in such heavy regulation and supervision environment, banks are more conservative and cautious when considering extending credit. Businesses had to adjust quickly in order to survive and stay competitive. The banks, on the other hand, are taking their time before approving new credit lines or increasing existing ones. There is a growing gap between the capital-raising capabilities of large, public companies and small and midsized private business. The latter ones have little power in finding new sources for working capital. They are moving more and more toward the non-traditional/alternative financiers such as ABL and factoring.”

The federal bailout in the wake of the 2008 financial crisis provided the banks with an extension that they were happy to seize upon, and now they face contagion from a potential sovereign default in Europe as well as the uncertain impact of new regulations from the Dodd-Frank financial reform act.

“When the banking systems are lagging behind and slow in making credit decisions, alternative financiers, such as ABLs and factoring firms, see higher flow of financing opportunities,” said Steklov.

Colin Cross, senior managing director at Crystal Financial, is bullish about 2012. “It’s going to be a good year for us – our pipeline of deals is better than it’s ever been,” he said. “Whenever traditional lenders run into trouble, it’s good for the asset-based lending sector.”

Cole Taylor Business Capital group senior vice president-region manager and Commercial Finance Association president Bruce Sprenger agreed. “The stage has been set in 2011,” he said. “Unless there is some significant disruption, 2012 should be better.”

He, too, sees American companies as having made good progress with the necessary restructuring and ready to move ahead in spite of continuing stagnation in the economy. “American business has gotten keener in what they do to survive – it has learned to be resilient,” Sprenger said. “Their attitude now is that things are not going to get much better and I’m not getting any younger.”

“Manufacturing, distribution, chemicals, metals, and other commodity-driven sectors have certainly seen improvement in the last two years”, said Jeff McLane, president of Bank of America Business Capital, “and that has led to a steady and consistent improvement in the credit quality of our asset-based loan portfolio.”

“The surge in lending started already in the second half of 2011,” said Coral Capital’s Steklov. “Many of these companies are in various stages of turnaround,” she said. “Small businesses are adjusting to a new reality and see the economy improving.” Traditional lenders find it harder to offer financing to small businesses, many of them are not audited, suffered losses in the last few years and still defining their own business model. These small and mid-sized businesses are turning

to the ABL/factoring sector.”

“And despite the pressure to reduce the federal deficit, and unemployment, the lending community doesn’t expect either party to do anything that would risk tipping the economy into a new recession”. Steklov said, “The economy is recovering: It is a slow process, but I’m pretty sure that we won’t see another significant drop before the upcoming election.”

The third and fourth quarters of 2011 were so strong, concurs Allen Frederic, chief executive officer of Republic Business Credit, that the trend is bound to continue through the first quarter of 2012 and perhaps longer. “The surge in business is not due to an improving economy, rather, it’s due to pent-up demand,” Frederic said. “At the same time, banks are starting to push deals out,” he said, as they trim their loan books.

Frederic, for one, is not willing to predict much beyond the first quarter because of the uncertainties about the situation in Europe, as well the political situation in the United States. “The economy in Europe is going to worsen,” Frederic said, “and here we have a continuing political logjam.”

Asset-based lenders don’t expect any improvement in the political situation before the election in November. “The parties don’t really want to legislate,” said Crystal Financial’s Cross, “they just want to talk.”

And despite the pressure to reduce the federal deficit, most lenders don’t expect either party to do anything that would risk tipping the economy into a new recession. “Another stiff recession could put a hold on company investment,” Steklov said, “but I’m pretty sure it’s not going to happen before the next election.”

One of the factors fueling a surge in secured lending is increased involvement by private equity firms seeking new asset classes in which to invest their money.

“The balance of private equity activity has increased,” said Cole Taylor’s Sprenger, “as their due diligence

moves along.” Deals get to the finish line a lot more.

He said there are a good three dozen banking and other firms investing heavily in asset-based lending, and more than a dozen new ABL startups were launched in 2011.

“ABL prospects and sponsors like the certainty of close on the deals, and the stability of senior finance,” said Sprenger. “Asset-based lending offers them flexibility and continuity – and they realize it’s a pretty safe way to lend money.”

Another attraction is the long-term nature of the business. “Private equity firms like to build relationships with partners they know and trust,” Sprenger said.

One of the startups is AloStar Bank of Commerce, launched in April with \$160 million in fresh capital from four private equity firms.

Andrew McGhee, one of the founders of AloStar, explained they found the bank platform they were seeking in the failed Nexity Bank of Birmingham, AL, which was in FDIC receivership. Then they tapped the new capital from Fortress Investment Group, Oaktree Capital Management, Stone Point Capital and Pine Brook Road Partners.

“There’s a lot of opportunity in the small end of the market,” said McGhee. “These firms did all their homework.” Smaller banks were focused on real estate and larger players weren’t interested, and that left an opening in the marketplace.

AloStar staffed up with seasoned veterans from the big players in the sector and expects to attain a portfolio of \$400 million in its first full year of operation in 2012, McGhee said. In addition to the start capital, they have ample funding from bank deposits and their private equity partners standing by if the business model fulfills their expectations.

While the entry of well-heeled players into the sector has helped the supply side, there has also been improvement on the demand side.

“There’s a much higher awareness

of what asset-based lenders can offer,” said Wayne Ehgoetz, group head at Roynat Asset Finance in Canada. “They are no longer viewed as the lender of last resort.”

This is a big change for Canada, according to Ehgoetz, where asset-based lending often was not seen as a viable alternative. The impact of the financial crisis on traditional bank lending has helped in “legitimizing asset-based lending for Canadian borrowers.”

Canada has weathered the storm somewhat better than the United States, with Ontario, which accounts for 60% of the national economy, staying flat, while Quebec and western Canada are moving ahead again.

For all the positive feeling, however, no one is forgetting the uncertainties out there. The number one uncertainty in November about 2012 was whether the situation in Europe would worsen to the point of a sovereign default and a new banking crisis.

“There’s still a lot of leverage,” said Crystal Financial’s Cross. “The banking system in Europe could become challenged and that would have an indirect impact on the flow of capital here.”

Cole Taylor’s Sprenger is more optimistic that Europe will work things out. “What we have now is manageable,” he said, as long as there is no significant disruption.

But Republic’s Frederic remained cautious. “We have not yet been assured there won’t be a default, and that affects everybody, every place,” he said.

AloStar’s McGhee sees further uncertainty in the U.S. domestic economy. “The biggest variation in economic forecasts we’re getting is whether the other shoe will drop,” he said. In other words, will the United States experience a double-dip recession?

**That could expose the fragility of the current recovery, according to Sun National Bank’s Geisel. Companies have managed to get back to profitability, even when the top line is not growing, by primarily cutting expenses. “A downturn would hurt business,” he said. “If the top line shrinks anymore, with no**

**room to cut additional expense, some could even have trouble surviving.”**

There’s not even certainty that the election in November will provide any clear political direction, especially if government remains divided, with one party in control of one or both houses of Congress and another party in the White House.

“Will we continue to have a Democratic president who pushes big spending, and a Republican House accused of obstructing legislation?” Frederic asked. Both Keynesian policies and the Adam Smith approach have demonstrated flaws, he said, but it’s an open question whether the election will bring politicians together to find a long-term solution.

Against this backdrop of market volatility and uncertainty, the prize goes to those who dig in and find the opportunities. In this environment, Bank of America’s McLane commented, “We consistently work hard to find opportunities to lend to new clients and grow relationships with existing ones, and have been successful in doing that over the last year and growing our asset-based lending business.”

Frederic agreed. “Some people will do better than others,” he says. “Everyone has to work harder and work smarter.” **TSL**

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