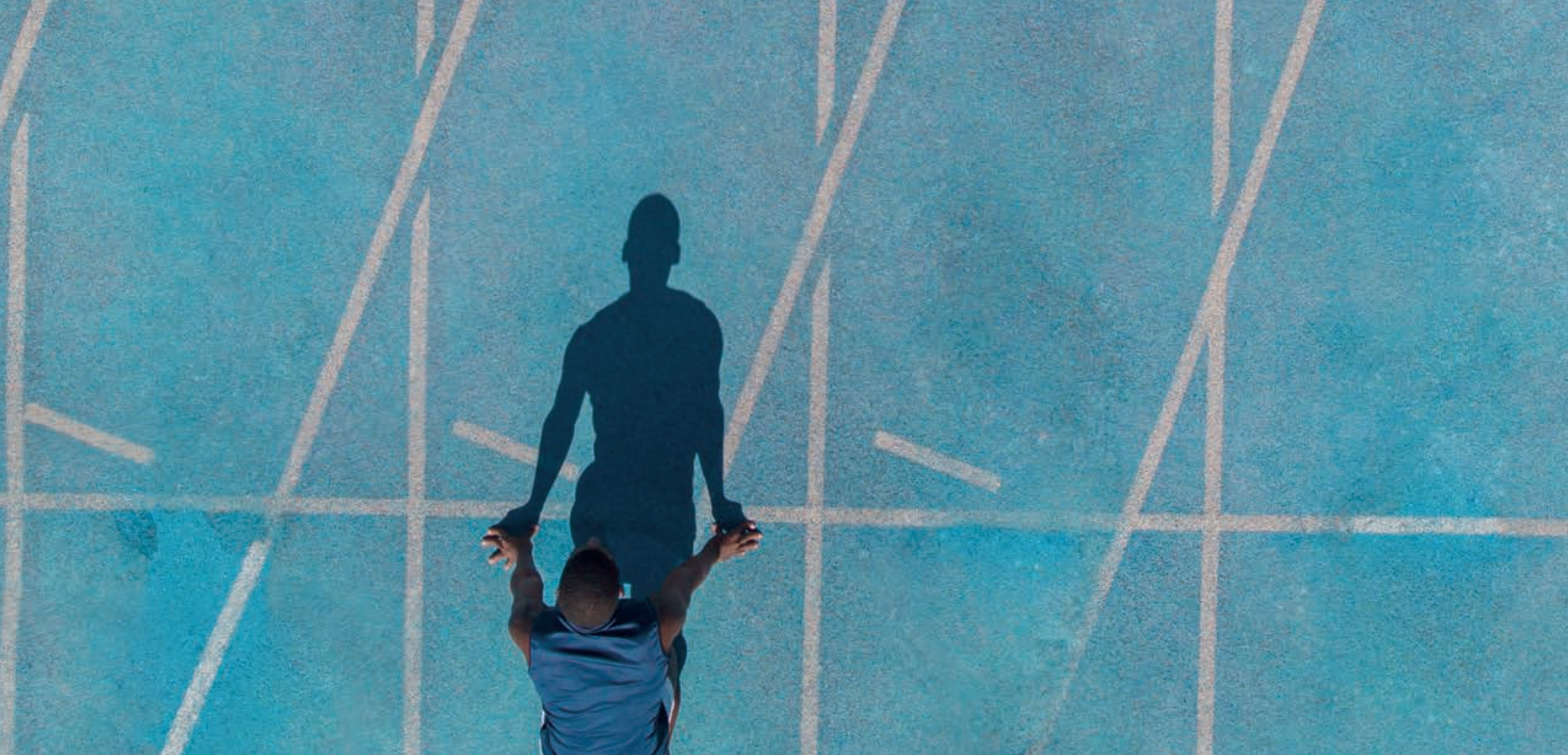
FEATURE STORY

Nonbank Regional Asset-Based Lenders Provide an Overview of their Market

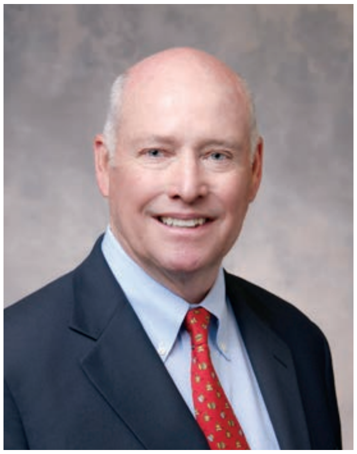
BY MICHELE OCEJO

TSL's editor-in-chief gathered the heads of several nonbank regional asset-based lenders to discuss the industry from their point of view, including the challenges and opportunities, effects of COVID and their predictions for the upcoming year.



The executives interviewed are Tom Cleveland, managing partner, Access Business Finance; Michael Fussell, president, Aegis Business Credit; J. Brad Leach, president & CEO, Lighthouse Financial Corp.; Rhett Rowe, CEO, Great Lakes Business Credit; and Patrick Trammell, founding member and president, Southeastern Commercial Finance.

Thank you to Rhett Rowe and Charlie Perer, guest editors of this issue of *TSL*, for their assistance.



TOM CLEVELAND
Access Business Finance

MICHAEL FUSSELL
Aegis Business Credit

Please provide readers a little background on your companies and yourselves.

ROWE: At present, Great Lakes Business Credit is in its 20th year of business. We're a privately held, non-bank focused in the Eastern and Central US time zones, offering up to $6 million credit commitments to impaired operating companies which have quality accounts receivable. We additionally accommodate advances on inventory, machinery & equipment as well as owner-occupied commercial real estate.

One of our competitive advantages is that we are nimble. We field of team of in-house field examiners, generally closing/funding within 21 to 30 days of proposal acceptance. Secondarily, we have zero termination (prepayment penalty) structures. We offer every credit facility on a discretionary demand-note basis with one-year maturities. Our historical average tenor is 22 months and we extend beyond the initial 12 months routinely. Our pure mission is to bridge the gap of our clients to their next lower-cost solution, oftentimes a conventional bank.

We follow our bank group's prohibited and restricted industry type list. At times we are asked if we dabble in cannabis or other industry types which banks will not finance. We pass on non-bankable transactions as we look to banks, in general, to be our takeout source.

FUSSELL: Aegis Business Credit is a commercial finance company based in Tampa, Florida. We are celebrating our 15-year anniversary this month. Aegis provides factoring, asset-based loans, inventory and purchase order financing to lower middle market companies across the United States with a focus on the Southeast. We also have two sister companies, Aegis Real Estate Capital, which provides real estate bridge loans, and Aegis Venture Fund, which can provide more flexible capital structures for early-stage companies, oftentimes in the software and technology space.

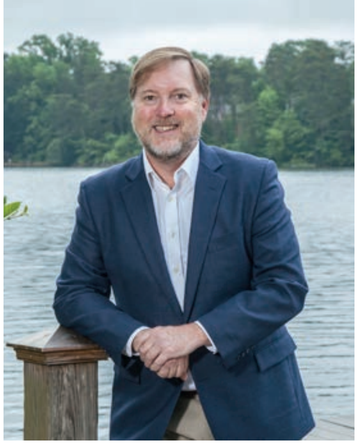
TRAMMELL: Southeastern was founded in 1996 in Birmingham, Alabama. We are a very traditional non-bank ABL lender. Over the past 25 years we've evolved a bit into more of an asset-based lender for banks without asset-based departments. We do transactions from $2 to $40 million, often we will lead and a bank who brings it to us will participate. We will manage the credit and share the risk. And that's been a very good business model for us.

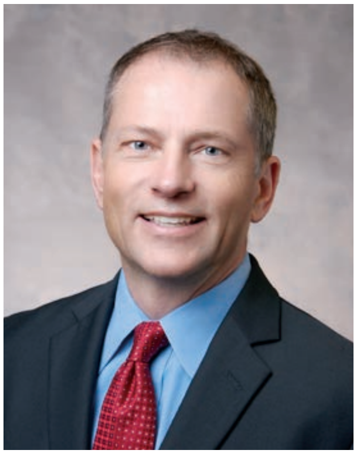
Our footprint is south of the Ohio River, east of the Mississippi and Tampa, Florida. We were recently acquired in March of 2022 by one of our partner banks, Renaissance Bank, which is a $17-million commercial bank with offices in six southern states headquartered in Tupelo, Mississippi. We continue to operate as Southeastern Commercial along the same business model.

CLEVELAND: Access Business Finance was co-founded in 1996 by Doug McDonald and me. We are celebrating our 26th year in business. We are a senior secured asset-based lender. The majority of our balance sheet is made up of lines of credit secured by accounts receivable and inventory. We also are very active in interest-only bridge real estate lending and often combine our real estate lending capabilities to provide additional borrowing under operating lines of credit. As well, we do equipment lending where we have lines of credit exposure. Our loan amounts range up to $20,000,000 to as low as $300,000 and our footprint in national. Before we fund any deal either Doug McDonald or I will visit the borrower at their location; this really helps the process for us and our clients.

LEACH: Founded in 1987, Lighthouse passed the 35-year mark in May. We are very proud of this accomplishment and owe our longevity to terrific business and referral partners, the quality of our team, and the service we provide. Lighthouse is a traditional asset-based lender providing working capital lines of credit and term loans against machinery and equipment in the $1,000,000 to $5,000,000 range and occasionally larger with participants.

Based in Greensboro, North Carolina, our geographic footprint covers the Eastern and Central time zones, or the eastern half of the country. Lighthouse provides loans for growth and expansion, refinancing and financial restructuring, business turnarounds, mergers, acquisitions, partner/shareholder buyouts, and debtor-in-possession financing. Lighthouse is widely recognized for its creative loan structuring, rapid credit evaluation and approvals, expedited loan





BRAD LEACH
Lighthouse Financial Corp.

DOUG MCDONALD
Access Capital

closing schedules, and superior service.

What are the unique challenges and opportunities in your sector right now?

ROWE: The challenges that we face are two-fold: One, the scalability of our business model, considering the size of the credits that we're limiting ourselves to, we're generally up to $6 million, but our comfort zone is $2 to $4 million. As a result, in terms of growing and scaling, that's adding significant numbers of clients to grow to a couple hundred-million-dollar portfolio.

Second, we will not pretend to match pricing which bank ABL platforms offer on larger credits, so we view our niche to be just that, a niche that we favor in that there's many more companies needing less than $5 million than there are needing $10 million or more. We have less competition in our space, but it's hard to scale considering it is a referral-based business model. We do partner (similar to Pat had mentioned) with a significant number of banks that are looking for an exit, oftentimes without their own ABL unit, so that's kind of a nice basket for us.

As for opportunities, I mentioned in our business model we're very nimble, so we can generally beat any bank-owned platform to the table in terms of not only proposal stage but closing timeline as well. So, generally, most of our prospective customers are very high sense of urgency, they need the money or help yesterday, so that's really what we pride ourselves in: delivering a very nimble product and reliable product at that.

TRAMMELL: It's interesting to follow up on what Rhett said. In '96, when we formed Southeastern, one of the things that we did not have to contend with from a competition standpoint was that most of the non-bank ABL lenders were owned by the principal and several outside investors, which I would call "friends and family money."

Today, the majority of the independent ABL lenders are owned by private equity, or funds or family offices. So, you know, the competition amongst ourselves is a lot larger. So that's how the industry has evolved.

One of the challenges for us as an independent was getting a bank line of credit to work with and there's an old adage that says why would we lend to somebody that lends to somebody that we wouldn't lend to and it's very difficult as a startup. I went through this, and I'm sure everyone else has, too, to access capital to grow with.

I think the opportunities are staring us in the face once again. I was going back through our history and I think this is our third full-blown recession and it's not true that we double our business in a recession, but it is true that we see more opportunities. It has always been an opportunity for us to use our expertise to work with our referral partners, which for us has generally been commercial banks.

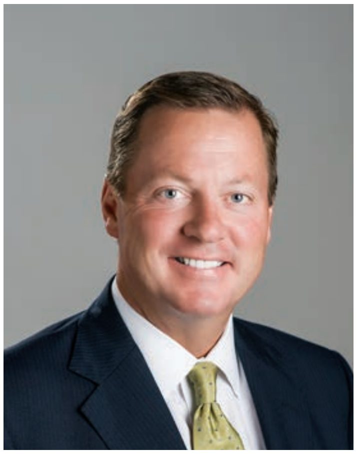
FUSSELL: I spent the first 15 years of my career in traditional commercial banking, both in sales, credit and then special assets. So, for me, given that perspective, now being a nonbank finance company, I think one of the key differences is that we are more forward looking. Since we are not regulated by the FDIC or other federal regulators, we do not have to restrict our clients to specific historical financial covenants and ratios.

Risk management and underwriting is very important to us, however, we have more flexibility in the criteria we look at and take a more common-sense approach to credit risk. We are more understanding of clients with historical financial performance issues than banks, however they must have clearly defined turnaround and growth plans and have a management team capable of executing on those plans.

We've had several clients during the COVID era over the past two years or so that were seeking lower-cost bank financing and spent upwards of six months trying to obtain loans from a bank and were ultimately unsuccessful and, as a result, they missed key opportunities in their industry and lost significant revenue due to the lack of working capital financing. Those companies ultimately came back to Aegis and we were able to structure credit facilities around their specific needs. So, for us, the speed to close and the certainty to close is key compared to some of our bank-owned competitors.

LEACH: Competition is prevalent in any industry, but ours seems to shift as players come and go. Other than the U.S. government, community banks have been one of our biggest competitors over the last couple of years. However, as in the past, we expect this competition to decrease during economic downturns. Also, there are typically a few new ABL players that enter the space annually. Over our 35 years, we have withstood new entrants competing on price or overly aggressive structure by remaining steadfast and providing a creative, competitively priced product backed by quality service from experienced account managers.

I would say the biggest opportunity of non-bank status is the ability to prosper and grow during and immediately after an economic downturn. Asset-based lending is well suited for this environment due to our reliance on the conversion of working capital collateral to



■ **RHETT ROWE**
Great Lakes Business Credit

■ **PATRICK TRAMMELL**
Southeastern
Commercial Finance

cash as our primary source of repayment. Conversely, banks usually tighten credit standards or seek to exit lending relationships where the borrower has suffered balance sheet deterioration as a result of losses incurred during a downturn. As a non-bank lender, Lighthouse can provide financial support to companies that may have more balance sheet leverage, whether from growth or distress, than a bank can accept.

CLEVELAND: I don't think our challenges ae much different from regulated lenders; we are all impacted by the same economic forces. Currently, we are in a recession/stagflation situation and it will be hard to predict the length or severity of this situation. Leveraged loans from non-bank lenders and banks as well are all under pressure. That pressure is twofold: Slowing revenues and increasing interest rates and other costs as well. That all impacts cash flow, earnings and the ability to meet debt obligations. Clearly, banks are restricting credit generally and, in some cases, those restrictions are pointed at certain industries. Banks are less patient with tough credits and are moving those credits out of their portfolios quickly. Over the past few months, we have noticed a pickup in referrals within our network. Additionally, we are receiving increased activity and inquiries from private equity sponsors, which provided good activity for Access over the past several years in markets throughout all sectors of the U.S. I think for us, since we are comfortable with $10mm credit facilities or more and we also do Real Estate Bridge Loans, we have enough financial capacity and product diversity to compete with any other ABL lender and even sometimes banks.

Doug McDonald and I started Access Business Finance 26 years ago and have been business partners for over 34 years, all in financial intuitions. We have experienced many economic cycles and this will be another one. But the one thing Doug and I have learned is credit is serious business, regardless of economic conditions and credit losses cannot ever be reclaimed. Many private lenders and banks have come and gone during our careers, the list is very long and the common denominator in that graveyard is credit losses. Credit does not change. It is not technology, it is not space travel. Credit is like gravity: it's laws never change. That's what we focus on: good companies, good management, good partners, good collateral, good cash flow and, most especially, highly qualified and well-trained colleagues who are like minded.

How has COVID affected how you work? Are you remote, hybrid, totally in the office?

ROWE: We were fortunate and fully prepared to operate 100 percent remotely in April of 2020 as lockdowns became prevalent, especially in the state of Michigan. We relied on our disaster protocol recovery plan, and as an essential industry type, we returned to the office more and more, meeting with prospects and conducting field exams.

We have added at least eight (8) staff members over the last two years as our platform is growing and, moreover, we have adopted a hybrid model whereby we're requiring each of our employees at our Troy, Michigan offices to be in office at least twice per week.

Importantly, we also have a mandatory in person staff meeting each month, including a team luncheon. We remain focused on furthering our firm's culture in these respects.

FUSSELL: We've had a similar approach. We tried to be quite flexible our first year of COVID and most of our staff, just as the rest of the country, worked remotely. I think we're finding that the younger generation prefers a very flexible work structure, but we also find that the younger generation has the most to gain from being in the office and learning in a team environment, so we are trying to do our best to come up with a good hybrid structure where there are certain days that everyone is in the office while still providing some remote work flexibility.

LEACH: The pandemic had multiple effects on Lighthouse, including portfolio shrinkage and employee loss. The initial effect of the pandemic was a rapid decline in loan utilization rates within the Lighthouse portfolio. Typical utilization rates (loan outstanding as a percentage of availability) average around 80%; however, this dropped to an average of 65% within one month of the first round of PPP funding in 2020. All but one client of Lighthouse took PPP loans in round one. Utilization rates have still not recovered to pre-Pandemic levels as approximately 45% of Lighthouse borrowers qualified for the 2nd round of PPP, and several took advantage of EIDL loans and ERTCs. The resulting strengthening of borrower balance sheets also led to an above average level of attrition in the portfolio as well.

At the beginning of the Pandemic, we gave team members the option of working from home or continuing to come to the office. We are fortunate to have more space than we need; therefore, social distancing at the office was not an issue. All employees continued to work from the office unless they contracted COVID. We did lose one employee to another industry early in 2022. One of the reasons this employee gave was the desire for a more flexible work schedule and the ability to work from home. Other than regional business development staff, Lighthouse has no direct plans to institute a work from home policy.

TRAMMELL: Like everybody else, we set out when the pandemic "hit," we evaluated where we were. Number one, we put a lot of focus on keeping in very close touch and monitoring a lot of new metrics for our customer base. We decided that we would begin to track sales every day, for example. And I think that made us better lenders on a long-term basis. And we've kept some of that. It did give us an opportunity to look at how we did things in the heat of the battle and I think we're better for that.

From a staffing standpoint, everybody in our office is a 15-to-20-year professional and I certainly have trust in them to do what they need to do. I don't have any issue with working outside the office if nobody is comfortable from a health perspective. But everybody decided in our shop that they would try to keep the routine as much as possible.

I agree it is a concern when you have young people. They need to be in the office if they want to grow with the team. I think we're hiring skillsets as opposed to future leaders. This business is so much about tribal knowledge and hearing the stories of loans from long ago and the success stories.

CLEVELAND: The pandemic has made it difficult for all of our customers due to labor shortages, supply chain disruptions, you name it. Those conditions have not gone away although they seem to be waning. The current inflationary pressure has added to the pandemic effects and we will have to be on guard for changing conditions.

As far as Access Business Finance is concerned our model has not changed, we all work from the office and we did during the heart of the pandemic. We are a very collaborative group and talk about new deals and existing deals constantly. That type of collaboration is a constant training exercise throughout the company (operations, credit, legal and sales) for all of us including, Doug McDonald and me. I simply don't know how a company can get better without constant internal communications and development.

What do you think the outlook is over the next year? What should lenders be concerned about especially with the economic challenges, supply chain issues, etc.?

LEACH: As e-commerce continues to grow with the potential impact of decreased traditional distribution businesses, Lighthouse, like many other commercial finance companies, is now considering financing e-commerce businesses. This financing requires a greater emphasis on inventory financing. Lighthouse has already provided inventory heavy deals to borrowers with e-commerce platforms along with their more traditional distribution channels. We are now in due diligence for a line of credit to a pure e-commerce business. We will still rely on our 35 years of experience in lending against retail inventory within the distribution model, but will need to lean a bit more on our inventory valuation partners for support to determine prudent advance rates and liquidation strategies.

We are hopeful that manufacturing will continue to return to the U.S. and increase deal opportunities for all finance companies and banks.

Fintech and technology enabled finance companies will continue to grow and provide more competition to traditional ABLs and factors; however, this tends to occur at the lower end of the finance spectrum, sub $1MM. Lighthouse will pay attention to whether the new providers start growing the size of transaction they consider.

As has been the case over my 25 years in banking and finance, 21 of those with Lighthouse, ABL remains popular during times of economic downturn or leveraged growth. I do not see this changing and expect to see activity pick up over the coming months as we work through this period of high inflation and rising interest rates.

Remote work appears to be here to stay. We are seeing more and more borrowers and prospective borrowers managed remotely. We can provide examples of instances where it appears to be working and others where it does not. Also, 3rd party providers such as field examiners and appraisers continue to perform a large percentage of their work remotely. We are still on the fence about the effectiveness of this remote work. We remain firm believers that it is better to be face to face with your borrower when discussing financial and collateral matters.

TRAMMELL: Again, this is probably our third recession we've gone through as a company. In 2008, the banks were without capital. As we sit here in 2022, the banks have billions and billions of dollars in excess capital. And I think that's probably going to inform how they work through this recession.

Loan volume is still at a premium in the banks and, as opposed to playing games up a balance sheet, which to the banking industry's credit they were well reserved for, I don't think we're going to see a waterfall of business within the next 6 to 9 months. Now, where the economy goes from there is anybody's guess, but I think from a bank standpoint you'll see a lot of extend and pretend going on and not a lot of banks tightening up to a great degree from a credit standpoint.

CLEVELAND: I think the outlook is good and we will continue to see consolidation within the industry. Operating costs will continue to increase and efficiency will become paramount in maximizing profitability.

FUSSELL: Just as there is general COVID fatigue now throughout the country, I think there is growing COVID fatigue in the bank's credit departments with borrowers that are still having weak financial performance after the pandemic. I think there will certainly be more bank soft exits over the next 12 months, but to Pat's point, I haven't seen the banks taking a very aggressive approach to exiting loans so far. For companies that are still missing key financial covenants I think banks will now begin to act on those defaults whereas they were more lenient over the past 24 months. So, I do think there will be opportunities for us in the nonbank ABL space to take some of those stronger credits off of the banks' balance sheets that haven't quite rebounded to the point where they perfectly meet all of the criteria for a bank.

The second point regarding the outlook of the ABL industry over the next year has to do with the lingering effects from the supply chain issues. Working capital lenders have been seeing more and more requests to finance larger inventory balances recently for manufacturers and distributors. These companies had real pain points over the past year with shortfalls of inventory and inability to meet demand for product. In addition, most are seeing vendors require longer lead times for inventory orders and are requiring larger order quantities. Now as demand is cooling in some sectors, companies have found themselves overstocked. Lenders will have to tread lightly in these situations to find the right balance between meeting client needs without getting overextended.

ROWE: In our historical upper Midwest territory, we're seeing banks get quite tight – the community and regionals that we work with routinely are pushing to exit credits, at least in our sphere of credit size, prior to year-end. Our counter-cyclical business model is built exactly for this type of environment. With tight credit, inflationary pressure, as well as low consumer confidence, that's a perfect storm for our business model.

What I foresee over the next year is a continuation of consolidation of companies like ours in that our yield is quite attractive to banks as well as equity firms.

Most banks which acquire firms like ours oftentimes make the mistake of holding same within its regulatory frame. Attempting to mirror yields demonstrated by a non-bank whilst attempting to conform with bank policies can be disastrous. We know of two that were in our market (as nonbanks) which are now part of bank platforms. They rue the day because bank application of credit does not win deals in our space. As a former CEO of bank(s), we effectively offer a specified and unique skillset required to do what we do very carefully.

How concerned are you about the various financial disclosure laws popping up around the country? (Editor's Note: SFNet is creating a compliance guide for members focused on the California financial disclosure law, which should be available at the time this is published.)

CLEVELAND: California has implemented its new law and New York just issued its second set of regulations. We suspect other states may follow at some level. California's law is aimed at small transactions. Nevertheless, if one wants to be in this business, the legal requirements will need to be followed.

FUSSELL: I'm in Florida, so I'm curious to see how it plays out and I will be watching it more closely over the next year. I have mixed emotions. I think in some states like California and maybe New York, I'm concerned that they may restrict opportunities for small businesses to obtain financing, which is a negative. But at the same time, I appreciate that certain segments in small business finance area probably do need to have some regulatory oversight and I'm really pointing more towards the MCAs. There have been a multitude of online lenders that have popped up over the past 5 to 7 years and I feel small business owners really don't understand what they're signing up for or know the true cost of capital in most cases. But there is a clear distinction between that type of MCA capital and the factoring and asset-based lending space.

TRAMMELL: I think it's very important, as Mike pointed out, to be very intentional about not having ourselves thrown into a basket with generally predatory consumer lenders. And I think that's the intent of these laws, but some are poorly written.

The SFNet universe is a $4 trillion impact on the economy and helps support multiple billions of jobs. By and large our industry has always been full of good citizens, and I think it's very important as an organization that we tell that story.

ROWE: After a successful banking career, and after my initial stint with Great Lakes Business Credit beginning in 2012, I was lured into the MCA space in mid-2015 for two years. The more I learned about the space, I realized that MCA (and similar offerings) need to be regulated.

The company I led offered only first-position MCAs and maintained a good reputation in the space. However, there was a number of other firms which would offer additional financing (stacking) behind our first position, oftentimes choking business(es) out of existence.

As Great Lakes Business Credit is focused on the eastern US, we generally have no issues with states which (or will) require disclosures.

LEACH: As this issue has yet to directly affect Lighthouse, we have spent little time discussing its repercussions. However, we are not ignoring it and wonder if similar laws will make it to more states where we are active. Lighthouse has always been completely transparent in its pricing to borrowers, so disclosure is not an issue. However, having to institute new policy with regard to regulatory disclosure is, of course, a concern. We do not currently provide financing in California and have no immediate plans to expand our current geographic footprint, which is the eastern half of the U.S. We are discussing whether to institute a deal size floor ($2,500,000) in New York once the law becomes effective. The majority of the transactions we see and close are north of this amount anyway. However, we will make that decision once we have a full understanding of the disclosure requirements. It's hard to say no to a new deal.

Michele Ocejo is editor-in-chief of The Secured Lender and director of communications for SFNet.