Overcoming Challenges of International Asset Based Financing

As globalization continues to increase, dealmaking becomes more complex for asset-based lenders and borrowers

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With the advent of globalization, the average midsize business has evolved from a regional company to a complex multijurisdictional corporation. Because the benefits of international expansion include competitive tax benefits, more efficiency and market expansion, companies nowadays set up offices in different countries around the world.

For an asset-based lender (ABL) these shifts in business practices add several more layers of complexity to a transaction. The increasing international presence of businesses magnifies the number of typical issues in a given ABL transaction. Complications with local laws, culture, business norms, language, currency and time zone can frustrate and hinder a dealmaker.

To tackle these issues, lenders must modify or adjust their process.

PLANNING

Lead time is key when considering a multijurisdictional transaction. Even with the most efficient and structured planning, multijurisdictional deals will still take longer than their domestic counterparts.

In planning, it is of paramount importance to engage all parties involved in the transaction. The primary relationship may be with the Parent; however, local management of the various subsidiaries must be roped in early in the process. Local management retains control over the flow of information and day-to-day operations. As such, always be mindful in understanding and catering to their needs.

After identifying who the information gatherers are, it is important to appoint individuals on all sides to streamline data collection. Some highly recommended methods of data centralization are data rooms or shared drives, which help avoid time zone issues. For example, use of data centralization means that European auditors don't need to wait five hours for New York underwriters to get into the office and send a critical file.

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VALUATIONS

Once the planning has begun, the lender should determine the proper value of the assets and start structuring a borrowing base. In order to maximize that borrowing base a lender needs to truly understand the local liquidation markets. For instance, selling off inventory in the Netherlands is not as simple as loading it on a truck and delivering it to a customer in Germany. Unlike in the U.S., liquidating collateral and moving it across borders in the EU may be complicated by receivership restrictions or tax laws. Similarly, priority payables, retention of title issues, or employee compensation may place other unsecured creditors ahead of a lender in an exit.

When a lender is analyzing exit strategies internationally, it is important to not get caught up in past experience with other companies or other countries. For example, another lender may have had a problem dealing with a Mexican borrower in the past. Rather than assuming there will be a similar challenge with any Mexican customer, it is important to drill down on the details and examine the circumstances of the previous transaction, such as which state, industry, or court system in Mexico resulted in previous complications. Similarly, evaluating which securities were taken and why problems arose with a U.S.

subsidiary or a standalone entity may lead to insights in avoiding future obstacles.

Many different variables arise when working within different countries; sometimes even the legal systems governing these jurisdictions are still developing and maturing. As such, each transaction needs to be evaluated on its own merits.

COLLECTION AND CASH REMITTANCES

Understanding the company's cash cycle and options to control that cash is as important as valuing the collateral. Note that each country has its own banking laws, systems, and common practices. For example, it is most common to find wire transfers in the UK, direct debit in certain industries in Germany, checks in Canada, and counter deposits in parts of Mexico. Taking the time to analyze how cash is collected will allow the lender to structure for true dominion of cash.

It can be argued that blocking the existing collection bank account through a Blocked Account Agreement is the best structure for the lender, client, and banker; however, not all local and global banks are accustomed to such agreements. Sometimes it is a matter of educating the banker and seeing what resources are available within the bank to achieve a similar structure. In other cases, accounts may need to be set up outside of that local jurisdiction to obtain true dominion of cash.

RESERVE ANALYSIS

Now that the lender has created a plan, assigned value, and set proper controls upfront, it is time to build the borrowing base. The key to setting the borrowing base is in managing the proper reserve. This is true for any ABL deal, although it carries more weight when dealing internationally and within multiple jurisdictions.

The lender needs to engage local counsel to understand the local law and to quantify the liability. Oftentimes, a senior secured position does not guarantee that other creditors will not take priority over the lender's collateral. For instance, in Germany certain suppliers may retain their rights of title over inventory and receivables that may be in the lender's borrowing base.

In other countries throughout Europe employees may have rights ahead of the lenders.

Ben Brachot

Even in areas such as the U.K., where special reserves typically aren't required, unsecured creditors may claim up to £600,000. While difficult to outline all possible issues, it is important that the lender properly engages local professionals to avoid possible liabilities when constructing the borrowing base.

CONCLUSION

A wide variety of obstacles arising in international ABL cases may be daunting to even the most experienced of lenders. That being said, it should not deter lenders from getting their feet wet when handling cases in the international arena. The ability for lenders to offer a true international ABL solution has become a requirement to compete successfully. Although issues arising from cultural and local differences are inevitable, proper planning and structuring will ensure a successful and a timely transaction.

The next time a dealmaker comes across a middle market company with operations in five continents, they need to make sure they have engaged the right group, local auditors, and attorneys. The whole is only as great as the sum of its parts. As such, a team that communicates well and works together every step of the process will reduce misunderstandings. Furthermore, do not let failed transactions in the past deter you from conducting international ABL transactions. Analyzing the root causes of problems in previous ABL cases will better equip you to avoid future mistakes.

However, the most important tip of all is to allocate enough time and resources to deal with potential mishaps. Planning ahead of time will allow you to both recover quickly from errors and remain cognizant of cultural differences in business practices. With a little foresight, creativity, and flexibility, potential obstacles are easily overcome, leading to more successfully closed deals.

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