# Asset-Based Lending

Asset-Based Lending involves senior loans that are secured by hard (e.g., equipment, inventory) and/or financial assets (e.g., accounts receivable, royalties) across a variety of industries. In contrast to asset-backed lending, asset-based lending does not involve the use of securitizations. As a rule of thumb, asset-based borrowers are typically corporations and asset-backed borrowers are typically lenders. Borrowers seek asset-based loans for a variety of purposes, including for financing growth, acquisitions, refinancings / recapitalizations, bridge financings, and special situations. During difficult economic periods, stressed or distressed companies that are cash flow constrained often turn to asset-based loans – in lieu of cash flow based loans – for rescue financing. Or, in the worst case, debtor-in-possession ("DIP") / exit financing. Unlike corporate direct lending where borrowing capacity (i.e., loan-to-value ("LTV")), is measured against enterprise value, the LTV of asset-based loans is measured against the liquidation value of specific assets. As a result, the recovery of asset-based loans is dependent on the value of borrowers' assets and not on their financial performance (i.e., EBITDA). Asset-based lenders generally take measures to mitigate downside risk by legally protecting their rights, such as entering into security agreements and filing Uniform Commercial Code ("UCC") financing statements on the assets. Lenders often seek to maintain a diverse asset pool in the form of correlated and/or non-correlated assets to protect their principal. In certain circumstances, asset-based lenders will obtain warrants in the borrower as an additional form of compensation.

## Why invest in Asset-Based Lending

- Large, Diverse Opportunity Set: Large addressable asset class that reaches across many different segments of the economy.
- Downside Protection: Collateral that serves to protect principal risk and potentially appreciate with inflation.
- Attractive Income Solution: Underlying assets produce recurring, often contractual, cash flows
- High Barriers to Entry: Less competition as a scaled multi-sector approach requires a high level of resources
- Portfolio Diversification: Exposure to diversified sectors, idiosyncratic borrower events, and low correlation to general corporate credit.
- Flexibility in Deal Structures: ABL transactions can be structured in various ways to meet the needs of both the borrower and the investor. This flexibility allows investors to tailor their involvement based on risk preferences, return expectations, and the specific financial situation of the borrowing company and charge a premium for these customized capital solutions.

## What are the main risks of Asset-Based Lending

- Credit
- Origination volume

## What characterizes Asset-Based Lending?

- Industry/Sector: Typically, generalists across all industries and sectors, though some managers have an industry/sector focus, e.g., Real Estate.
- Instruments: First Lien, secured by hard assets that generate recurring or consistent cash flows.
- Maturity Profile: Typically, medium term (1-5Y), but it depends on the situation.
- Credit Quality: Moderate/Higher. Typically, the emphasis is on secured lending backed by high-quality collateral over unsecured credit.
- Interest Rate risk: None (floating rates) / Moderate (floating/fixed rates). Typically, interest rates for these loans are priced as a spread above a floating reference rate.
- Borrower Size: Small / Mid / Large. It can cover everything from single-family homes to large portfolios of assets, depending on strategy.
- Return Profile: Derived from contractual yield, OID and occasionally equity warrants. Unlevered target net return would typically be 10 – 15 %.
- ESG: Impact / Positive Screening / Negative Screening. Depending on the strategy.

# Manager Q&A

## *“What is driving the evolution of the opportunity set in Asset-Based Lending?”*

**KKR**

Private Asset-Based Finance (ABF) has gained prominence amid the retreat of banks from lending post the 2008 Global Financial Crisis. This $5.2 trillion global private ABF market is expected to grow by almost 50% to reach $7.7 trillion in the next five years. Factors such as inflation, rising interest rates, and banking system volatility contribute to the increased demand for private ABF. By strategically pursing new, underserved, and/or mispriced lending opportunities, ABF investors aim to deliver attractive returns, offering diversification to institutional private credit portfolios. In navigating financial landscape changes, private ABF remains resilient, addressing evolving investor and borrower needs. Our firm strategically positions itself to capitalize on these opportunities in the ABF space.

## *“What specific factors do you prioritize when evaluating the quality and valuation of assets proposed as collateral?”*

**KKR**

KKR’s approach to collateral differs by investment type, however all methods involve granular analysis. For Portfolio Acquisitions, KKR reviews individual loan attributes and analyzes factors such as historical delinquency roll rates, loss to liquidation, and borrower characteristics. Ongoing dialogue with banks shapes leverage assumptions, impacting projected returns. For Platform Investments and Associated Asset Flows, the team assesses historical default rates, loss, recovery, prepayment, and other inherent risks. For asset originators or aggregators, considerations include the cost to originate/aggregate, overhead, alignment of principals, compensation, and the deployment timeframe to reach scale. For Structured Investments, KKR stresses the structure with various deterioration scenarios and ensures a margin of safety by referencing historical distress periods

## *“What underlying sub-asset classes does the Asset Based-Lending investable universe consist of, in your view?”*

### KKR

KKR categorizes the ABF opportunity set into four sectors: Consumer / Mortgage Finance (e.g., auto lending, residential loans, and other secured lending segments), Commercial Finance (e.g., SME business loans and receivables financing), Hard Assets (e.g., aircraft leasing and green energy), and Contractual Cash Flows (e.g., intellectual property and royalties). While many ABF investors may focus on a single segment or geographic region, we think this approach sacrifices some of the most important diversification benefits of a global, multi-asset approach. It’s essential to note, however, that these four segments do not represent the entirety of the ABF market (although a substantial majority), and certain areas of asset-based lending are not within the focus scope for KKR ABF (e.g., payday lending).