Moody's ANALYTICS

Cheeseburger in Paradis

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As the Moody's Analytics Structured Issuer Solutions team continues to interact with borrowers and lenders through this time of COVID-19 and low term securitization volumes, it is important to understand ramifications within the broader asset-based lending markets. We continue to review where, how borrowers can source liquidity and how lenders are evolving practices to meet the market's needs.

This month's Cheeseburger in Paradis takes a closer look at the potential fallout for the asset-based lending sector. We highlight those who rely on the sector for liquidity, ways Moody's Analytics Structured Issuer Solutions team is working to assist in isolating anomalies, optimizing borrowers' needs within this market, and available utilities to assist in streamlining the submission and reconciliation of the borrower/lender relationship.

The start of any new month is a critical indicator for the financial positioning of every business, but none more so than those at risk of financial and cashflow stress. In a normal month, especially in recent years of general economic growth, research demonstrates that around 85% of invoices/current receivables are settled within the first 10 business days. The third quarter will be an interesting barometer in understanding the working capital implications for businesses, especially, again, those that initiated broad payment deferral programs. If, as anticipated, payments continue to slow down materially, and additional government-based stimulus does not quickly make it into the markets, we are likely to see a large number of businesses breach their debt service compliance covenants. These businesses will be forced to borrow at unfavorable rates. Although many borrowers may have taken advantage of re-financing opportunities when the pandemic hit, it is still likely that existing and new originations will impact cost of funding and liquidity.

How should lenders respond?

Lenders will need to consider their response and associated ramifications carefully as lending portfolios are almost certain to come under credit stress. Opportunities for new lending are scarce as there is attrition in the borrower market. Further, an influx of non-bank lenders look to gain market share from the global banks. New funding opportunities continue to be discussed virtually, which is not ideal and thus it is more likely in the short-term that credit analysis and risk functions will be focused on managing existing borrower client' challenges instead of writing new deals. This is especially true if there is no current business relationship. That being said, we have heard from lenders that there should be a significant uplift in deals once businesses can physically start returning to work. This will call upon ABL related funding to help businesses recover and grow, albeit with heightened scrutiny and potentially tightened underwriting standards.

What does it mean to the traditional originator/borrower trying to free up cash within a credit sensitive market dealing with this pandemic?

As we have seen, many have reacted to the stress of reduced liquidity by monitoring and/or delaying their debt. This course of action is undertaken so that unpaid invoices don't go beyond the recourse period, thus increasing reported delinquencies and/or write-offs. It was conceivable that this type of activity wouldn't become visible in the data for two to three months – giving some businesses an extended stay. However, the third quarter timeframe will likely bring any credit issues to light. Additionally, the current economic climate could lead to a potential increase in the level of pre-invoicing. As business owners look to maintain working capital to keep their business afloat, many are leveraging borrower prepayments in an effort to fund day-to-day operations in the near term, thus potentially postponing risk to later periods when economic stability returns.

What can we do to gain financial stability?

It's clear that for our market, and society as a whole, to return to a thriving financial stalwart, we must all be in it together. Businesses and lenders need to keep the lines of communication open. Lenders are expecting a continued, although hopefully muted, shortfall in payments during the crisis and are identifying the sectors and sub-sectors likely to be most impacted. Lenders will naturally want to understand how they can help businesses survive the coming months. In times such as these, it is imperative to have a clear understanding of how best to monetize and reconcile assets, provide clear and transparent communication between the borrower/lender, and deploy sophisticated automated processes to ensure optimization to the funding process.

How can Moody's Analytics help?

Moody's Analytics is in a unique position to assist both borrowers/lenders within the structured finance markets to adopt procedures that will advance the funding process and streamline interactions. Our solutions enable those in capital markets/treasury roles to seamlessly interact with pledged and unencumbered assets, assist in ensuring compliance with structure specific criteria, and perform advanced analytics ensuring borrowers can maximize funding requirements.

Conversely, Moody's Analytics' lender-based modules assist in streamlining the ingestion, normalization and analysis of diverse data across a multitude of asset types, borrowers and formats. This improves monitoring process and risk assessment function, along with ensuring that historical trend analysis by facility or across a portfolio can be performed. Additionally, an ability to fully reconcile or validate compliance and other reported results is available.

It is certain that the remainder of 2020 will be trying for borrowers and lenders alike. However, we continue to develop products to meet the changing demands of our clients, whether in asset class expansion, credit monitoring requirements, or, dealing with the evolving financial implications of an ongoing global pandemic.

If interested in learning more about Moody's Analytics products and services for the ABL markets, please visit our microsite: https://issuersolutions.moodys.io/.

For more information, please visit moodys.com or alternatively call:

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