

# Critical Asset Financing

Why Critical Asset Financing May be a  
Viable Option in Volatile Markets



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*By Jeff Lupoff, Senior Managing Director, Structured Finance Group, GE Capital*

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With many banks now allocating capital selectively during these volatile times, what alternatives exist for companies seeking longer term, fixed-rate financing? Options will vary on a case-by-case basis, but there is one avenue that should not be overlooked-- Critical Asset Financing or CAF.

Financing secured by the critical assets of a business represents an alternative source of capital to traditional asset-based revolvers and cash flow term loans. CAF may be structured as a lease, on or off balance sheet, or as a secured term loan.

## **CAF Characteristics**

Critical assets are usually defined as manufacturing or production facilities that are of the utmost importance to the enterprise and the industry at large. Critical assets could also be intangible such as key patents or distribution rights. In either case, such assets would likely continue to operate or be of interest to third parties in the event the company became insolvent. Lessors and lenders look to critical assets as a source of liquidity for lessees and borrowers and a means to recover their investment whether by sale or by lease of the critical assets on a going concern basis to a successor operator.

CAF lessors and lenders typically look for the following characteristics in critical assets:

Current, but proven manufacturing production process and technology; efficient, low-cost producers relative to competitors; and, significant market share in growing or stable sectors (a sole source supplier of a product or component could represent an even stronger candidate for CAF).

## **Borrowers and Lenders Benefit**

Critical assets are often subject to a lien by an existing bank group. Potential CAF lessees or borrowers should review their bank credit agreements to determine if they have a provision for sale/leasebacks and how proceeds would be applied. In today's environment, many banks might release the lien in return for some or all of the proceeds from the financing. CAF may allow existing lenders to reduce their exposure and may free-up scarce capital, while providing an alternative source of financing for lessees or leveraged borrowers.

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### Good Candidates

Good candidates for CAF may be borrowers who are having a hard time generating sufficient cash flow to comply with existing credit agreement covenants and/or to meet scheduled amortization payments. The proceeds from a sale/leaseback of CAF could be paid directly to the existing bank group avoiding a default and providing the portfolio account with longer term, fixed rate capital. CAF is also a good option for the capital-intensive company that is not having cash flow, covenant or other credit facility issues, but is still seeking additional financing to expand. In this instance, CAF can provide longer-term capital, leaving revolving lines of credit undrawn but available.

### CAF at Work

CAF was used recently for a sale/leaseback for a non-investment grade company in the building materials sector with significant U.S. market share. The plant was highly efficient using current and proven production technology.

The leased assets included property, plant and equipment--essentially everything necessary to operate the facility. The base lease term was 7+ years. The proceeds from this CAF sale/leaseback provided additional, long-term, fixed rate liquidity to the levered lessee in a tightening capital markets environment. What's more, an Early Buyout Option (EBO) provided the lessee with the opportunity to regain ownership of this critical asset when the time was right.

### Considering CAF

While CAF financing may be more expensive than typical senior secured bank term loans, such financing is certainly cheaper than injecting additional equity--if it is even available or can even be raised. For non-investment grade companies with little access to the capital markets, Critical Asset Financing may be an attractive alternative source of funds at a critical time.



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*Jeff Lupoff (jeffrey.lupoff@ge.com) leads GE Capital's Structured Finance Group that focuses on meeting the specialty finance needs of mid-size and large U.S. companies. [www.gelending.com](http://www.gelending.com)*



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