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JULY 21, 2014

Asset-Backed Lending: Short Loans, Steady Profits

Savile's funds have an unbroken record of winning performance, even through the financial crisis



CEO Pablo Mariño of Savile Finance Group.

In the current investment environment, where fixed income has become a source of principal risk with negligible returns, wealth managers are ever on the lookout for a solution for their affluent clientele.

[Savile Finance Group](#) offers an investment product that addresses the lack of return on fixed income with a direct lending asset-backed strategy designed to generate low volatility, noncorrelated, absolute returns over fluctuating market cycles.

Savile's domestic Opportunity Fund, which launched in October 2006, makes senior secured loans to small and midsize companies in the U.S. and select Latin American and Caribbean markets, mainly in the business services, consumer products, food and beverage, health care, manufacturing and telecommunications sectors.

Savile deployed the same strategy in the Bermuda-domiciled Savile Opportunity Fund International, rolled out in 2007.

The loans to companies are short term — typically less than a year — and asset based, backed primarily by account receivables and inventory that can be liquidated within one year. These companies tend to be off most banks' radar screens.

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Investors in the domestic fund and its offshore counterpart are high-net-worth individuals and foundations based in the U.S. and Europe, according to Pablo Mariño, Savile's chief executive and chief investment officer.

Profitable, Low-Risk Investment

Private investment funds have been making asset-based loans to companies for some time, according to Inez Markovich, shareholder and chair of [Anderson Kill](#)'s banking and lending practice.

"At present, there is a strong, growing demand for asset-based lending which is not being met by banks, presenting a real opportunity for investment funds," Markovich wrote in an email message.

Asset-based lending is attractive to investors and fund managers, she said, because it is "an area of investment where funds can and do charge higher returns than banks, realizing significant returns on their investments.

"If properly structured and monitored, asset-based loans can be profitable, fully collateralized and, in fact, low-risk investments."

But risks do exist, Markovich said. "A typical ABL borrower is not as financially strong as most commercial borrowers eligible for traditional bank financing."

Absent proper credit analysis and collateral monitoring, she said, the lender could be susceptible to borrower fraud.

"Investment in infrastructure and hiring experienced ABL professionals skilled in collateral monitoring, rigorous underwriting and due diligence, and portfolio management are critical to assuring the success of this strategy."

Credit Oriented

"The most important thing about our strategy is that it's heavily credit oriented," Mariño said in a recent interview.

Savile, which is headquartered in New York, is a relatively small organization, with 11 members. Of these, five or six are directly involved in credit and three are involved in operations, Mariño said.

“Those tend to be the most important areas of ongoing credit work and ongoing credit analysis and making sure we’re able to get our work done.”

Savile has developed a proprietary credit model that generates a rating for each facility, similar to models used by banks and rating agencies, but adapted for application to small-business lending.

Mariño said that with Savile’s assets under management at about \$50 million, the typical loan size is between \$1 million and \$1.5 million, and can rise to \$3 million.

Savile has even managed to make larger loans—in the \$5 million to \$7 million range—by working either with other firms similar to Savile or individuals who want to invest alongside it.

Savile Opportunity Fund has been profitable every year since its inception, with an average net annual return of 10% — including 2008, when it finished up 7%. Year to date through May, it is up 2.8%.

Eugene Braigen, who manages Savile’s business development and investor relations, attributed this success to Savile’s choice of self-liquidating collateralized transactions. This means transactions move toward cash as part of their natural cycle, so the fund is not reliant on a functioning secondary market to get cash out of the position.

In addition, Braigen said in the interview, “we are not primarily in the business of lending money; we are primarily in the business of getting it back.” This approach informs Savile’s analysis, structure and methodologies, he said.

“Our product on an unlevered basis yields — purely on the interest rate — between 7% and 9%,” he said.

“On occasion, we’ll get involved in a deal and take an equity kicker, which in the past has lifted the returns up to 14%.”

He stressed that Savile is not an equity player. The investment decision is based on the credit metrics. “Our ability to get equity is a function of negotiation, not a function of perceived risk.”

How It Works

As an illustration of Savile’s lending process, Mariño said the fund has provided financing to tobacco in Brazil, a space generally ignored by the banking sector.

He described the tobacco industry in Brazil as essentially a cooperative business, whereby thousands of individuals on farms, some as small as an acre, grow tobacco and sell it to processors.

The processors, for their part, may need to borrow working capital to buy from the individual producers. One such processor to which Savile has made loans for a long time is an independent company called [Marasca](#).

Mariño said the proceeds of Savile's loans to processors to purchase tobacco go specifically to cooperative owners. Marasca and other processors then sell their inventory to global tobacco companies, and Savile gets its money back with interest.

The loans to the processors such as Marasca are secured by the physical tobacco held by warehousing companies on their grounds that issue warehouse receipts.

"We don't lend any money until we get issued a warehouse receipt, and then the custody of that tobacco is managed by Savile's warehousing agent," Mariño said.

He acknowledged that many people are opposed to financing tobacco, but said Savile found "some real societal benefits" for working with the Brazilian processors.

"People are going to smoke," he said.

"Our money is being used to buy tobacco from small individual families and helping to create employment in the region. There's clearly a societal benefit for the people in Brazil who are doing it."

Risk-Control Platform

Savile sources lending opportunities from relationships it has in North and South America with warehousing operations, as well as from law and accounting firms and existing customers.

"Having done this for many years, origination is not really a problem," Braigen said. "The organization is really a risk-control platform, and that's done analyzing deals and operations, making sure that post-funding the loan works."

He freely admitted that Savile's strategy is not totally risk free. "Like all lenders, we have losses — about 2% of the portfolio on an annual basis."

Braigen said Savile has increasingly gotten inquiries from larger potential investors who are looking for a fixed income solution. The firm has recently been asked to submit a proposal for a structured product by a large group, he said.

He laid out the theme of the request in this way:

- We’re looking for yield; you seem able to produce yield
- Your loss ratio of between 1% and 2% a year is very consistent with the banking loss ratio
- You lend into the short-term balance sheet, so you can charge higher rates because that money is turning faster

It seems likely that Savile’s existing — and presumably satisfied — investors would agree with this assessment.

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