

## SPECIAL SERIES: PRIVATE EQUITY

# Seeding & Harvesting 'Greener' Lending Pastures... An Idea Whose Time Has Come

BY THOMAS BONNEY

In the current 'Green' culture, it's becoming even more important for asset-based lenders to keep pace with the commercial market's stand to reap substantial benefits. However to do so, might mean making increased eco-friendly innovations of your own. Thomas Bonney explains.



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The eco-friendly product frenzy may seem to have materialized overnight, but the heightened activity and interest around "going Green" has actually been a long time coming. This product segment has just now achieved its tipping point, or mainstream demand, after years of innovation and brand seeding, and is coupled with recent shifts in the general economy and competitive landscape (namely, gas prices more than \$4.00 per gallon) as well as consumer behavior (such as the increasing use of public transportation) that have propelled growth.

Asset-based lenders that keep pace with the Green commercial market's new momentum stand to reap substantial benefits, but capitalizing on this trend may require lenders to pursue eco-friendly innovations of their own — specifically, making changes in brand identity, communication with individual markets and management of related covenant/compliance issues.

### The Private Equity Tip-Off

In the private equity industry, a number of firms have recently touted renewed commitments to investing in companies involved in sustainable, Green product offerings. For example in late May, Craton Equity Partners of Los Angeles announced a debut Clean Tech fund of nearly \$200 million. These timely commitments are powerfully resonant marketing and investing platforms, and asset-based lenders have a similar opportunity to demonstrate environment-focused thought leadership that helps attract new customers. Lenders might consider promoting the creation of a specific group knowledgeable in sustainability, not only to build dialogue with and capture a larger share of Green business, but also to ensure underwriters are fully informed on lending risks and opportunities presented in this growing, but complex subsector of the economy.

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The following are issues the asset based lending community might consider before dedicating resources to the Green marketplace:

- Should lenders establish specific groups that speak Green and market them as understanding this new market dynamic better than traditional asset-based lenders?
- Should lenders incorporate an overall sustainability or Green component to initial due diligence and ongoing covenant disciplines: for example, percent of total product cost made from recycled goods? Use of scrap goods in production? Power use and generation?
- Should lenders revisit assets definitions and alter the nuances of Green terms such as scrap raw material, which may no longer be deemed as scrap?
- Should lenders invest in continuing education on being Green for lenders and underwriters alike?

In addition to investing in Green, on the operations side funds are taking proactive steps to enhance sustainability as a concept for existing investments in manufacturing/distribution operations. One example is Kohlberg Kravis Roberts & Company, which recently partnered with the Environmental Defense Fund to help improve the environmental performance of its portfolio companies.

It appears likely other funds will follow suit with branded initiatives to ensure Green, sustainable portfolio operations, and that ultimately this practice will become a standard element of management regardless of the industry or a fund's focus. For lenders, environmentally sound operations initiatives could also conceivably become standard elements of the loan package, perhaps as part of the due diligence process or conditions within the covenant provisions.

Private equity investors such as HSBC Capital are increasingly looking at the Green components within manufacturing and distribution businesses they look at. "Given two equal transactions, the one having operations more integrated with sustainability goals will get a better look by our investment committee," says Andrew Trigg, director, HSBC Capital (USA) Inc.

Like these forward-thinking funds, asset-based lenders that move quickly to organize, innovate and market around the Green trend can gain a "first mover" advantage that forges a valuable early foothold.

### Capitalizing on Lending to Key Green Segments

On the Green scene, new asset-based lending opportunities can lie with long-time players, crossover firms and new entrants, but a tailored approach to marketing and prospect evaluation is required for each group.

The long-time players — innovative, tenacious, eco-minded entrepreneurs such as ECore, a manufacturer of recycled rubber and other products — has long endured curtailed visibility and demand driven by economic, regulatory and political forces more favorable to traditional, commodity-consuming companies, but now the times are changing.

ECore International CEO Arthur Dodge notes, "Long before Green products were fashionable, we were developing energy-efficient, lower-cost manufacturing systems to produce environmentally sustainable products for a number of markets."

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Dodge and other long-time eco-entrepreneurs' efforts were rewarded over the past six months in particular as a fast-moving blaze of socio-economic change effectively cleared away many growth-stunting forces, including easy credit, limited government regulation, and low oil and commodity prices.

When marketing to the long-time players, it may benefit asset-based lenders to promote experience and speed in making lending decisions in similar rapid growth industries, as well as an established presence in the environmentally sustainable product marketplace. Lenders may also gain a competitive advantage by positioning themselves as a partner and resource for these entrepreneurs as they navigate a potentially overwhelming wave of growth. Effective management over the variety of changes in physical plants, business processes, information systems and personnel is the difference between winners and losers in today's rapidly changing world.

The foundation for a partnership with Green's long-timers can be established during the prospect evaluation process, as the lender moves quickly with underwriting criteria, covenants and lending decisions. At the same time, the lender explores overall preparedness from an infrastructure, inventory and/or personnel standpoint to transition operations to meet significantly increased demand.

While some companies like ECore have been Green for more than a decade, other firms are taking aggressive steps to quickly make the transition. In one example of a crossover strategy, Target recently introduced an eco-friendly line of clothing featuring organic materials. Additionally, OfficeMax recently partnered with TerraCycle to introduce recycled office products that reduce waste. While a crossover strategy typically provides opportunities for early adopters, late adopters could be exposed to significant business risk.

Asset-based lenders having existing loans with more traditional crossover firms should understand where these clients fall within the crossover timeline. With the late adopters to things Green, lenders should be monitoring business very closely for early indicators of trouble such as declining comparative year-over-year monthly sales, weakening gross profit margins, or a degrading A/R or inventory aging situation. These companies could be significantly weaker than 2007 audited results may indicate.

Finally, brand new entrants to the commercial Green scene have also risen from the fertile ashes of our recent macroeconomic slash-and-burn. Recent private equity fund developments in this sphere include Craton's investment in Enlink GeoEnergy Services, a specialized installer of geothermal energy systems for substantially reduced climate control costs for medium- and large-sized commercial buildings. New entrants typically create the opportunity for new relationships; asset-based lenders with technological knowledge and an astute understanding of the overall industry dynamics have an opportunity to capture significant market share.

### Green on a Grander Scale

Sustainability now has mainstream mindshare. While the Internet innovations of the last ten years have significantly altered our virtual world, the coming Green innovations will alter the physical world to a similar degree — probably over a shorter time period. Environmental sustainability is poised to become a theme of all companies that implement the notion of "best practices."

Asset-based lenders that understand this dynamic change, and respond with a focused marketing and underwriting strategy, will capture market share from more traditional, less nimble competitors. Lenders that deliberately seed and harvest opportunities will find the grass is not Greener on the other side of the fence, but Greener where watered. [sbt](#)

**THOMAS BONNEY** is founder and managing director of CMF Associates, a financial and management consulting firm based in Philadelphia, PA. Bonney founded CMF in 2002, and has grown the business from a one-man agency to a successful consulting enterprise serving private equity, middle-market and small-cap public companies. Bonney's strong foundation in client service began with eight years in the Philadelphia and London offices of Deloitte & Touche, where he was a recognized expert on matters concerning European and American business.

Bonney is an adjunct professor at Temple University. He has also designed and teaches a financial management and accountability module to new entrepreneurs at Drexel University's Baiada Center. In 2006, he was selected as the Mid-Atlantic regional winner of the Financial Executive of the Year Award, sponsored by the Institute of Management Accountants (IMA) and Robert Half International. A frequent speaker on various business topics, Bonney has had numerous articles published in local and national magazines on subjects including private equity and middle-market financial and operational management best practices and practical applications of information technology. He is a member of the Pennsylvania Institute of Certified Public Accountants. A University Scholar at Penn State University, he graduated *magna cum laude*.