FINTECH ONE-ON-ONE PODCAST 376-MEREDITH CARTER

Welcome to the Fintech One-on-One Podcast, Episode No. 376. This is your host, Peter Renton, Chairman and Co-Founder of Fintech Nexus.

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Peter Renton: Today on the show, I'm delighted to welcome Meredith Carter, she is the CEO of Context Business Lending. Now, they are an asset-based lender focusing on what we call the middle market, those are not small businesses, not large corporations. I've never had anyone in this market on the show before so really wanted to sort of delve into the market a little bit, talk about who are the borrowers, how they underwrite because this is not a high-volume business where you're doing hundreds of loans a week, you're talking $25 sometimes even $50 Million at a time.

So, this is a much different underwriting process, we talk about that, we talk about how Context is adding technology into the mix here, what type of collateral they require. Obviously, we talk about the terms of the loans and that sort of thing, talk about their loan performance during the pandemic and how everything fared out there, we talk a little bit about what it's like on the capital market side. When you've got a single-family office, you don't really need a massive capital markets operation and the advantages of that and much more. It was a fascinating interview, hope you enjoy the show.

Welcome to the podcast, Meredith!

Meredith Carter: Hi, thanks for having me, Peter.

Peter: My pleasure. So, let's get started by giving the listeners a little bit of background about yourself. Why don't you talk about what you did before you got to Context Business Lending?

Meredith: I don't know if anyone has a traditional path to asset-based lending, mine might be a little bit less traditional than others. I started my career as a practicing lawyer in Delaware, started off doing corporate litigation and then corporate transactional law. Litigation ended up giving me good practice figuring out everything I possibly could as quickly as possible about different businesses and the transactional work inevitably had you introducing your clients to different types of finding.

When I left private practice, I had joined a client back who was launching a litigation funding business focused on patent litigation, another sort of nuanced form of providing capital. I did that for a number of years and we ultimately sold that to a UK-based funder looking to come to the US and one of the funders of the litigation funding company is also behind Context Business Lending. So, upon that sale they invited me to take a look at what was going on in Context Business Lending.

Peter: When did Context, when did it start because you weren't there at the very beginning.

Meredith: No.

Peter: Can you tell us a little bit about sort of how it got started.

Meredith: It was a bit opportunistic, there were two gentlemen that identified ABL as our great opportunity who were also running overall seed investment for the family office so they were spending a small portion of their time on ABL and a lot of their time in the real estate investment and there was a core team of really two or three dedicated people at a given time for the first four or five years of the original Context Business Lending which at one point was called Adam's Business Credit. When I joined in 2017, it was about as traditionally old school ABL as you can get, you know, people were printing calculator tape and stapling them, walking them down the hall (both laugh) so it kind of really hit restart now not as anything bad, but as a dedicated effort in 2017.

Peter: Right, right, okay. So, maybe we could just take a step back for a second. Tell us a little bit about the asset-based lending market, particularly the segment that you guys serve which is I guess what's called the middle market, tell us a little bit about what the state of that market is today.

Meredith: I would say that it still remains pretty traditional, most of the asset-based lending industry is run by former bankers that have a little bit more flexibility being at a non-bank, but are pretty hamstrung either by traditions and the ways things have always been done or secondary constraints by their leverage providers. So, we really saw a couple of distinctions that we could bring to the market, one being our source of capital.

We're funded by a family office, very large single family office in addition to having a bank line which is a little less restrictive that's led by CIBC with Texas Capital as a co-arranger and through having that sort of capital structure we can go as far as our imagination takes us. The other thing is finding a new way of looking at things and through automations which we will cover and get into a little bit to a very archaic business. So, we're trying to rapidly swim against the tide, go against the grain and do things in a new way.

Peter: I mentioned, like a lot of these things are still getting done with relationships, right, where people go out on the golf course, you know, sign a deal based on personal relationships, am I wrong there or is that kind of how it's done?

Meredith: You're not. (laughs) No, it's still which is amazing especially in this sort of post-COVID environment where many things have become more streamlined and digitized, people are going right back to opportunistic meetings as their source of finding new business which is amazing to me. One of the things I really liked about the industry and thinking it's ripe for disruption, one of the things that we're doing is experimenting with different tools and data sets to find potential borrowers directly and get to those potential borrowers via others, get to them directly and also expand the addressable market beyond people who are already looking for ABL to maybe others who didn't know what ABL was.

Peter: Right, right, okay. What are the typical industries you serve, it sounds like you're pretty broad, but do you have any kind of focus by industry?

Meredith: I would describe us as white space lenders so trying to, again, go against the grain. We lend to manufacturing companies, wholesalers, distributors, service companies, but within that we like to look for things where others may not be able to lend to those companies because of their internal constraints, not for credit reasons but for other reasons, so we don't have any ESG caps in the types of loans we can do. We lend into the firearms industry, we lend into oil and gas, coal, anything that's really disfavored (laughs), I would say, are what we're focusing on.

Peter: Hmm, interesting. What are the typical borrowers that comes to you guys, they're not small businesses because their loan sizes are substantial. So, what's the typical size of the company and how much do they borrow?

Meredith: We define lower middle market, as we address them, $5 to 200 Million in revenue is what we're looking at so pretty substantial-sized companies. Our loans are between $2 and 50 Million, it's a pretty substantial-sized loans and the situations they're in, I would say, there's either the temporarily un-bankable group where they've gone through some sort of hiccup in their business and others may not look into the details of their particular business enough to try to find a way through whereas we can be more bespoke in the solutions that we offer or highly seasonal businesses or then those disfavored industries.

Peter: Right, right, okay. Is this all asset-backed lending, like you require collateral to write the loan?

Meredith: Yes. So, for ABL product we look for accounts receivable, inventory, we'll do a 100% inventory, for example, which is a little bit different, machinery and equipment, owner-occupied commercial real estate and in a bucket we like to call an "abundance of imperfect collateral" (laughs), so a bunch of stuff that would have to go wrong at the same time, but may not be your traditional core asset classes.

Peter: Okay, interesting. So then, what is the typical loan duration, what are the typical interest rates, that sort of thing.

Meredith: Loan duration is two to four years being the average, everyone thinks we're going to be (garbled) end up with for one reason or another. A lot of people stay for the flexibility or, you know, it's a hard environment, depending on the type of business you're to get different loans. Interest rate as I would say all-in, including fees, we don't hide our fees, are going to be in your 7 to 11% range and the closer to bankable closer to 7%. We can provide often a lot more flexibility and availability if someone is choosing between us and a bank.

Peter: That's obviously a term loan product. Do you have other products that you provide as well?

Meredith: It's a revolving line of credit wrapped in the term with that revolver. We're looking at other expansion areas, you know, looking at the market and saying, what are other white spaces or really antiquated industries that are not too small, but not too big and don't have a big, you know, a hundred-pound, a thousand-pound gorilla, excuse me, the space where we might be able to find another niche and capitalize on it. One particular area that we're interested in is looking at e-commerce companies, specifically, using data to help inform our lending decisions.

Peter: Okay, like doing a revenue-based financing deal or still doing the same type of thing just using the e-commerce data?

Meredith: Either one, either solely making decisions once we get comfortable with the algorithm based on matrix that they provide and helped us in the past, they have been to meeting their projections and their revenue targets in the types of spaces they're in, maybe also taking an interest in their collateral, depending on the type of company it is and the size of the loan.

Peter: Right, right, got it, okay. I want to dig into underwriting for a little bit because, obviously, these large loans you need to be careful with your underwriting, take us through that process, how do you operate?

Meredith: We have a topnotch underwriting team for sure that one of their prerequisites is, you know, we want really entrepreneurial people that are trying to figure out a way to yes and then we'll pick it out, whether we want to do it. We're in the process of incorporating tools into that that have a little bit more automation involved, thanks to going to LendIt and meeting some vendors there. We are now in the process of introducing loan origination software where we're going to have a portal where prospects can upload information and it will ping people instead of having our BDOs do that, have that information go all the way through the process, with pre-screen involved that doesn't involve humans, pulling out certain information, putting it into data collection forms and having that information available all the way through the life cycle of the deal, including portfolio management, spotting red flags, things like that.

But I think you need about…. in addition to the automations we're working on, our underwriting process is…..we do want to work upfront, we might not be the biggest term sheet out the door, but we like to stand behind what we send out, there's no bait and switch involved at the end of something that we've identified as something that drives people nuts and that's something that we would never do.

Peter: Right. I imagine, you've got to sort of delve into the accounting system, right, is that part of the automations that you're talking about because the accounting data is going to be so critical, right?

Meredith: There's financial spreading software out there that could be very helpful. Depending on the company, there's different comfort levels with whether companies would let you sort of log into their systems directly and pull information. Those are really great tools and ones that we're looking to add and deciding whether it should be a requirement or something that's optional. I think people are less skeptical now of going through third party systems to access their account information with the invention of things like PayPal and go through PayPal or Amazon Pay when you're going through other sites. That's essentially what it's doing when you're accessing your accounting information through the use of third party tools.

Peter: Right, right. What is the typical process length, like what's the average amount of time from, you know, the first contact to the borrower getting their money?

Meredith: I think it's about 30 to 60 days on average, it could be closer to 30, part of what we're hoping to accomplish through the automation is getting information quicker from the borrowers. Some tend to be a hurry up situation, like we need to close in 30 days and then we're still missing information 45 days. So, maybe, you know, kind of helping to prioritize and saying it's these many days from this last piece of information to kind of drive home the point that we do need some lead time to do field exams and appraisals and things like that.

Peter: Right, right. So, these companies that are coming to you, I mean, you said often they're not bankable so like, what are their options typically. I mean, I'm trying to sort of think about, I imagine, they're sort of going around and shopping deals, how do you sort of fit in with the competitive process?

Meredith: Over the past year, year and a half, we've been competing a lot with community banks which is not great for us. In those cases, it's going to be a question of what's more important to that company at a given time, whether it be rate or flexibility. We also get a lot of customers that have been kind of burned by banks, pick them out, depending on their stability. It's either community banks, sometimes it's factoring if it's AR only, the rates tend to be much higher there typically, but factoring rates have come down. There's a lot of bank and non-bank competitors in the space that have different things to offer.

Peter: Right, right, okay. So, what about loan performance because you've been going for quite a few years now, you obviously have a sizable business leading into the pandemic so two questions. How did you fare during the pandemic and how have you come out of it?

Meredith: We were very lucky during the pandemic. Some of it was by design, but I would say the majority of it was luck and a little bit of proactivity with our borrowers. We only had one borrower that we lost a very de minimis amount with during the pandemic and that was a CBD cream company that had a lot of concentration with G&C so they didn't see that coming and they really chose not to pivot to an online model early enough. But other than that, Stephen Butler, who is our Chief Credit Officer at that time and now our Chief Operating Officer did a really great job of reaching out to our borrowers early and often and asking what their friends were in the worst-case scenarios and how they could cut back and (garbled) without getting too involved in their business. But, at least, posing those questions so people were thinking about things proactively.

And the makeup of our portfolio too, that's where some of the luck came in. We had a playset manufacturer, obviously did that very well during the pandemic, a lumber company, we had a number of e-commerce companies which is a focus area of ours. One of the e-commerce companies was able to stay open even during the shutdown because they sold Shrek toilet paper that were deemed essential. (Peter laughs)

Peter: Shrek toilet paper is essential, yes.

Meredith: There you go. (both laugh)

Peter: Okay. So then, did you continue to lend, I mean, did you put a pause or how did you operate?

Meredith: No, in fact, we did the opposite. We saw people starting to shut down so we sent out a press release (laughs), that we're still lending. Some of the things early on, we were obviously taking a very close look at our portfolio, but not letting that get in the way of opportunities, but, you know, being careful about the ones we got into. We actually closed a deal on, let's see, March 15th or 17th, March 17 of 2020, pretty quick after the shutdown, this firearms company that, at that point, had a $17 Million back order and now has to think has a $45 Million back order for Glocks, that turned out to be a good one for everybody. We kept hunting through it, I think we caught a nice rising tide there where others didn't get comfortable, we were lending later in the year.

Peter: So, you didn't do anything with PPP, right?

Meredith: We didn't, no. There were a lot of opportunities that came our way, you know, some that purported to have contracts with the City of New York and they were bringing all those PPP stuff over, I know some people really got burned in that. There was one we were looking at closely, but ultimately for credit reasons decided not to move forward with it, a lot of pivoting to that, for sure.

Peter: That's understandable. So, you know, one of the advantages you have obviously is you're backed by a single family, as you said that gives you flexibility, it wasn't a bank deciding that we're closing up shop which, obviously, a lot of the smaller business lenders was PPP or nothing, that was all that was available. A couple of questions, I mean, do you kind of have much in the way of the capital markets operation or are you, because you're just relying on that single source and you said you had a bank line, whatever it meant to you, are you holding all these loans on your balance sheet, are you offloading them? What's your capital markets operation like?

Meredith: Yeah. We are holding them on our balance sheet and it's a combination of funds through the single family office and the bank so we'll try to drive down the cost of capital where we can with loans that are, at least, part of the loan fits inside the bank's box. We'll put as much of it on there as we can, but we have a very flexible arrangement where if an entire loan or a portable loan is ineligible, you know, we're able to fund it out of equity. So, if it's something that we're comfortable with, we don't need to say no to it. Our goal is to grow, it's not to sell off loans or the portfolio.

Peter: Are you looking to add more banks to that operation or are you happy with the relationship you have now?

Meredith: We have six banks in our facility.

Peter: Okay.

Meredith: We've got plenty of room to grow there, we've been very happy with our relationship with CIBC and all of our participant banks. Who knows, maybe someday we'll get to where we need to add more than we have, CIBC as well as some of the other biggest players in the market, like Wells Fargo is a participant in our line as well.

Peter: Do you always co-invest? You said, you sometimes can do the whole thing yourself, I get that, but then assuming a banks wants to do a big chunk of it, do you always co-invest or do you let the whole loan go through your bank?

Meredith: In cases where the amount is somewhere between $25 and 50 Million, we'll typically take on our participant sometimes when it's a little bit north of that, but, we'll find someone to take near $10/15 Million of the loan if we want to diversify a little bit when people want to deploy capital in a passive way. As you probably know, asset-based lending is a very labor-intensive business, it requires a portfolio management department and collateral management department so when people are looking for some pretty good deal without having to create that whole entity themselves and often, you know, counter cyclical to the economy, it's a good investment and sometimes we invest with our competitors. Our family office is one of the founders of SIG, Susquehanna International Group, the world's largest privately owned options trading firm and we have participated with SIG on deals before in the past, that remains an option as well as others.

Peter: Right. Can you maybe just detail, while you mentioned the portfolio management piece, I mean, these are large deals, how do you keep track of your customers' financial health, shall we say.

Meredith: So, we have two teams that really look at it. So, our collateral analysts are looking at the borrowing bases that our borrowers submit where it's kind of like an up-to-date tally of all of their financials as well as their collateral that we're lending against so we can see what availability they have to advance. And then our portfolio management team is also working on the borrowing base, but they are really the face of CBL with the outside world, they have these relationships with our borrowers, they're going out to visit them, see what the operations are like. And then when the inevitable things, the hiccups come in their business, our portfolio managers will try to find a way to work with them. You know, we're not the "got you" group, we're the, you know, you're with us for some flexibility, let's find a way to work together and solve your business problems.

Peter: Right. So, if someone's kind of, you know, inventory gets drawn down more a lot more than you expected, suddenly they're below some thresholds, what do you do then?

Meredith: We'll look at the situation, obviously, in detail and if it's a reasonable situation we've certainly provided over advances in the past, we're comfortable with the borrower and the story, we don't start with no, we start with how.

Peter: Right, okay. So, can you give us a sense of the scale you guys are at, I mean, you're probably not doing thousands of loans, I imagine, annually, but tell us a little bit about where you're at there.

Meredith: We've been pretty close to our projections, so far, and we're projecting to hit half a billion by the end of next year.

Peter: Half a billion total dollars, is that an outstanding or is that just a......

Meredith: Committed.

Peter: Committed, okay, great, okay. So then, as we wrap maybe you could take us sort of through your vision here, I mean, for CBL, where are you taking it, where do you plan to go?

Meredith: We're continuing to look for the white spaces in the market, looking to see where the holes are that others leave behind where companies can't find access to capital not because of credit-related reasons, but maybe they're just disfavored at that time, looking to find edge, looking to find places where we can go that others can't because of our capital structure finding a creative path forward, looking to disrupt the market in terms of the types of technology we're bringing in and continuing to go to LendIt conferences (Peter laughs) to find other providers.

We've had a number of great follow-up meetings from our involvement there that we're incorporating into our process, most of all, it's the type of people and our culture that will help facilitate that. As I mentioned earlier, really entrepreneurial group of people who may have been banging their heads against the wall or financial institutions. We have a really flat, non-hierarchal structure and give them the freedom to finally do what they do best and focus on their strengths and everyone's open about their blind spots and we're close and trying to, you know, continue disrupting the market.

Peter: Okay. Well on that note, we'll have to leave it there, Meredith, it's great chatting with you. Thank you so much for coming on the show today.

Meredith: Thanks so much.

Peter: You know, as Meredith said and what I really appreciate about what they're doing at Context Business Lending is, you know, they're trying to bring a fintech approach to a sector of finance that has really not changed very much in decades where many areas of finance are being completely disrupted by fintech. The middle market lending still has been happening in a way that was fairly much unchanged now for a long time so bringing fintech is only going to make the process quicker and more efficient for the borrowers that takes cost out of the system and it's a better user experience, let's face it. I think as time goes on, these kinds of borrowers are going to expect a similar type of user experience to what you get as a small business or a consumer.

Anyway on that note, I will sign off. I very much appreciate you listening and I'll catch you next time. Bye.

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