

Business Finance Opportunities

Alternative Fixed Income Opportunities

Prestige Funds - OpenTalks SME Lending in a post Coronavirus World

Interview with Craig Reeves - Founder, Prestige Fund Management

Joseph Ingrassia - Co-Founder,
Capstone Capital Asset Management, Inc.

What is Prestige Funds - OpenTalks?

Prestige Funds - OpenTalks is a periodic publication by Prestige Capital Services, in which we interview key members of the Prestige Funds investment management team and dedicated, specialist Finance Arrangers which provide vital funding to Small and Medium Size Enterprises (SMEs).

We hope this provides a useful and somewhat unique insight into how specific areas of the economy and Prestige operate. The idea is to share with existing and future clients the challenges and opportunities that members of our team see in their field and beyond.

The Topic

The growth of SME sectors and the Coronavirus challenge

How important is the SME sector to the overall economy, including as a source of employment and an engine of productivity? What is going to happen to this sector during the year of the Coronavirus? How do lending firms manage their risk in such a vast and diverse environment?



Introduction

The Dodd-Frank Act was introduced in the US to protect the banking system from the sort of systemic threats it faced during the Great Financial Crisis in 2008. It has also created a situation where many SMEs are finding it harder to secure much-needed cash flow finance in order to survive and to grow.

With the onset of the COVID-19 epidemic the need for cash flow facilities like factoring has increased. SMEs are turning to non-bank finance providers to help them to unlock much needed cash to enable them to remain competitive such as in the construction sector.

The SME market in the US remains large and economically important and is a major source of jobs growth. As the country moves out of the worst period of the coronavirus lockdown and the economy stabilises, alternative sources of finance will become even more important.

Macro Environment

Dodd-Frank and the changing face of US SME financing

The introduction of the Dodd-Frank Act, which became law in the United States in 2010, has radically transformed the US lending market. This has included new regulations covering banks and is designed to make sure that banks don't become 'too big to fail'. The legislation brought with it strict capital requirements and enhanced the scrutiny placed on any credit decisions.

One outcome of the Act has been that SMEs in the US are faced with tougher credit requirements by the banks. According to the OECD, SME lending in the US declined steadily from Q2 2008 to Q3 2013, but then saw a modest recovery. Small business loans at the end of 2017 were still 6% lower than before the financial crisis. Data from the Federal Reserve in 2018 showed that only 47% of employer firms that applied received all the credit they required¹.

- Banks now tend to focus their lending activities on the bigger, higher rated corporate borrowers.
- Many community banks, traditional providers of SME finance, have been forced to merge with larger financial institutions to cope with the Dodd-Frank legislation.
- Larger banks are less inclined to make smaller business loans unless the business hands over most or all of its banking business.
- Some companies are finding that they are having difficulties when they go back to their bank for refinancing or a credit line increase.
- Small business loans are taking longer to process (from 10 days up to 12 months) and typically will require the submission of at least three years of audited financial statements.

Some sectors have been more heavily impacted than others. Companies with sales in the area of USD 2 million to USD 20 million are finding it much harder to locate working capital through existing routes².

Sources:

¹ 'Financing SMEs and Entrepreneurs: An OECD Scoreboard' OECD, 2019, and Federal Reserve Small Business Credit Survey 2019

² Capstone

Prestige & Capstone

**“OVER A CENTURY
OF EXPERIENCE IN
THE AREAS OF
FACTORING AND
TRADE FINANCING”**

Prestige is a specialist lending fund manager, with expertise in both the UK and US markets. The collective in-house expertise of both the Prestige Funds core team and our dedicated Finance Arrangers represent a nexus of expertise in SME financing. We work closely with our Finance Arrangers to allocate capital across the important SME market in both countries.

Capstone is a Finance Arranger headquartered in New York City which focuses on helping SMEs to accelerate their cash flow through a range of client specific solutions, mainly Single Invoice Factoring (“Spot Factoring”) and a number of other financing services. Its in-house team has over a century of experience in the areas of factoring and trade financing.

Capstone offers US SMEs a range of financing products, including:

- Invoice factoring
- Purchase order factoring
- Trade and import funding
- Construction funding
- Minority owned funding
- Staffing and temp agency funding
- Supplier and distribution funding
- Contract manufacturer funding
- Music royalty factoring

Commercial lending in the US requires a great deal of knowledge of the local SME market and the many regulations that pertain to it.



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Q. What does the SME sector look like in the US?

In 2016 there were over 5.6 million employer firms in the United States³; of these, firms with fewer than 500 workers accounted for 99.7% of those businesses. Small businesses remain the powerhouse of net new job creation in the country. Firms with fewer than 20 employees account for over a million net new jobs in the US every year.⁴

But US small businesses play a more important strategic role than this. They are more likely to develop emerging technologies than larger firms - they account for 24% of the patents in the top 100 emerging technology clusters.⁵ In international trade, companies employing less than 500 workers account for 97.6% of all identified US exporters. Small and medium-sized US companies regularly account for around 20% of total US exports.⁶

Small businesses account for a significant amount of small business borrowing: loans going to small businesses are split between banks and financing companies, roughly 50/50 depending on the year. Total loans guaranteed by the US Small Business Administration in the financial year 2019 totalled USD 28 billion.

Sources:

³ United States Census Bureau: Annual Survey of Entrepreneurs

⁴ Small Business and Entrepreneurship Council - Office of Advocacy Report

⁵ Anthony Breitzman / Diana Hicks - 'An Analysis of Small Business Patents by Industry and Firm Size' (SBEC)

⁶ US Census Bureau data



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**“THERE HAS BEEN
A SUBSTANTIAL
CHANGE IN THE WAY
US BANKS HAVE
MANAGED LENDING”**

Q. How has Dodd-Frank changed the way credit facilities are managed in the US?

There has been a substantial change in the way that US banks have managed lending since the introduction of Dodd-Frank. Credit requirements have become progressively tighter, with bank lending focused heavily on those companies which can demonstrate the best balance sheets and consistent profit growth. Community banks still consider small business lending their main focus, but their rates are typically higher and their lending thresholds lower. Many community banks have been forced to merge with larger financial institutions to cope with the Dodd-Frank legislation. This process is eliminating many important sources of capital for small business.

Larger banks are less inclined to make small loans unless the business hands over most or all of its banking business. Even those SMEs which have an existing banking relationship can have difficulty when it comes to a refinancing or credit increase request.

Exactly how this will change in the wake of COVID-19 remains to be seen, as SMEs will remain under pressure around the world in the near term. But access to flexible and specialist finance will probably be even more of a priority going forward.

Q. How is factoring used and how does Capstone assist US SMEs?

Factoring is a cash management strategy which can be very effective for companies that want to bridge significant working capital gaps. This is in more demand from some sectors, like construction. Factoring lets companies sustain themselves and take on higher volume contracts.

Most construction firms finance projects on their own but also need to use significant working capital lines of credit if they are to maintain their existing customer base.

Among the services we provide is single invoice factoring, a business funding option in which individual invoices are purchased from an SME client rather than using a typical factoring arrangement which might require a two or three year contract. We don't require SMEs to sell us all their invoices. Companies can therefore factor accounts receivable on an as-needed basis.

The benefits of single invoice factoring are numerous, but among them are:

- Meet payroll obligations
- Pay suppliers and creditors in a timely fashion
- Confidence to bid for additional work
- Generally quicker and easier to obtain (initial transaction takes between 48 hours to seven business days)
- Straightforward terms - financing is 'non-recourse' (fully payment is achieved by receivable collections)

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Q. Do you specialise in any specific sectors?

We don't specialise in any sectors, although there are some we typically screen out because they represent risk or ethical issues. We do a lot of lending in the construction and electrical services area. These are areas where we find SMEs having to turn down work from even existing clients because of cash flow issues. Contractors regularly face cash flow issues that are caused by issues out of their control. Many have been increasing competition in the bidding process - e.g. for municipal contracts. They need to meet payroll obligations and pay suppliers. But they also have to manage loan covenants and manage debt hangovers. It can pose a complex challenge before you even introduce the change to the national lending landscape caused by Dodd-Frank.



That said, we also work with many other sectors. For example, we have lent to companies in the mobile games development industry, where firms are operating on work for hire contracts that require software development and operational milestones to be met. Master factoring facilities can help games companies to migrate from self-publishing to the more lucrative work hire opportunities in this fast growing market.

Q. Do you make use of any other funding sources, other than from Prestige?

We are the Finance Arranger for the Cayman Islands exempt limited partnership with Prestige that has various investors as limited partners. In addition, we have three managed accounts and a USD 50 million credit facility.



Q. Do you have a specific level of lending capacity, and how much have you lent historically?

The maximum amount varies based on the credit history of the parties we are extending credit to. In some cases, we have a high exposure of USD 17 million to a public traded company that we have four years' experience with or USD 25 million to a government agency, and by comparison as little as USD 10k to a small general contractor. Historically we have loaned over USD 6.5 billion.

Q. How many people do you have working at Capstone?

We have 20 full time employees.

Q. How do you source your lending customers?

We have a network of 280 referral agents across the US who source deals for us from their local areas. We pay them a commission based on the deals we fund after we have collected our principal and interest.

We also occasionally source loans from banks. We convert borrowers to our format of factoring and Purchase Order financing, or any combination of the two forms of financing we offer companies.

Q. How do you select the firms you lend to?

We have a standard due diligence process that we use to vet the client's customers to make sure they are creditworthy. This includes a detailed analysis of our lending client, their contracts and their current legal status

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Q. What do you anticipate the impact of the COVID-19 outbreak to be on Capstone and its customers?

Invoice factoring is going to play an important role in helping US SMEs stay afloat during this crisis and in the aftermath. We have already emphasised how important SMEs are to the US economy. Now these companies are seeing cash flow shortfalls, not just because of the virus but also because they operate in an increasingly competitive area.

Good cash flow management is becoming more essential but there is a risk that stretching inadequate cash flow will impact a firm's bidding capacity for projects. We expect that invoice factoring and spot factoring are going to play a critical role in helping these companies - many of them with very large clients - navigate the current circumstances. Factoring will help to provide the sector with the staying power it needs to survive until cash flow catches up with expenses.

**“INVOICE FACTORING
WILL HELP U.S. SMEs
STAY AFLOAT”**





Joseph Ingrassia

Joseph is a co-founder of the original Fund (Capstone Cayman Current Liquidity Fund LP, incorporated 8 January 2009) and is an officer and director of the General Partner of the Business Finance Opportunities Fund L.P.. He is also a Managing Member of New York City based, Capstone Capital Credit Group, LLC, and Capstone Credit, LLC, the financing platforms for the Capstone Current Liquidity funds, and oversees international marketing of the Capstone programs and services to investors, joint venture partners and various parties who originate business opportunities for Capstone. He is also responsible for capital formation for the Capstone group of funds.

Since the early 1990s, he has been a principal of the various companies comprising the Capstone group of companies engaged in accounts receivable factoring, accounts receivable financing and asset based lending. He was awarded a Bachelor of Science degree in Psychology in 1980 from Siena College, Loudonville, NY, and an MBA from Golden Gate University, San Francisco, CA, in 1984.



Craig Reeves

Craig is a Director and Founder of Prestige Capital Management Limited, Prestige Fund Management Limited, Prestige Asset Distribution Limited and Prestige International Marketing Services Limited and is a Board Director of various international Prestige Funds. He is also a Director of Nucleus Holdings Limited and is a co-founder and nonexecutive director of OpenFunds Investment Services AG. Formerly Managing Director and co-founder of Platinum Capital Management Limited (an international asset management group). Formerly Head of Portfolio Management and Asset Allocation at Titan Capital Management Limited (an international asset management group). Prior experience as a Proprietary Trader at Gaiacorp Trading Limited (an international asset management group), Proprietary Trader at London Currency Exchange Limited (a private client / proprietary trading house) and an internship at Bank of America (London). He has also previously provided retained consultancy services to a large London-based international family office, a large London-based international stock broker, a London-based pension consulting group and a London-based international real estate investment group.

He has over 25 years' experience in financial services as a professional investment manager, trader and investor of alternative investments, hedge funds, capital markets and real estate and has written several articles for various financial publications journals including the AIMA Journal. He has served as a Board Director on over 20 international Funds. He graduated with a BA (Hons) in Business Administration from Huddersfield University and a Higher National Diploma in Business and Finance from University of Greenwich (London). He also attended the New York Institute of Finance (NYIF) where he studied various financial markets and derivative trading courses and is also a member of the Chartered Institute for Securities and Investment (CISI).

Approved in Malta by the Malta Financial Services Authority (MFSA), approved in Switzerland by the Swiss Financial Market Supervisory Authority (FINMA), approved in Luxembourg by the Commission de Surveillance du Secteur Financier (CSSF), a certified individual for UK Financial Conduct Authority (FCA) purposes and registered with the Cayman Islands Monetary Authority (CIMA).

About Prestige

Founded in 2007, Prestige consists of several companies under common ownership and control focusing on investment management / operation / administration / marketing and direct lending businesses with offices in UK, Malta, Luxembourg and Cayman.

Prestige specialises in direct lending to small businesses primarily in the United Kingdom and the United States. It owns equity stakes in several dedicated, specialist "Finance Arrangers", amongst these Capstone Capital Asset Management, Inc., which has existed since 1990, and has lent approximately USD 6.5 billion representing thousands of transactions.

Financing areas include asset finance, project finance, invoice finance and specialist commercial finance. Prestige currently manages approximately USD 1 billion of assets for approximately 300 international financial advisory and institutional investor groups.



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The investment objective of the Business Finance Opportunities Fund L.P. ("BFO") is to generate stable returns and achieve competitive investment performance while preserving capital by means of active management of private debt markets investments. The Sub Fund's aim is to achieve this objective by taking direct or indirect exposure to loan/debt investments in small and medium sized enterprises (SMEs) in the United States. Based on the Fund's investment objective, the AIFM has decided that sustainability risks are not relevant for the purpose of the assessment required under article 6(1) of the SFDR considering that the Fund's investment objectives do not pursue ESG goals.

The Representative of the Fund/s in Switzerland is OpenFunds Investment Services AG, with its registered office at Seefeldstrasse 35, CH-8008, Zurich, T: +41 44 500 31 08, www.open-funds.ch. The Paying Agent in Switzerland is Società Bancaria Ticinese SA, Piazza Collegiata 3, CH-6501, Bellinzona, T: +41 91 821 51 21, F: +41 91 825 66 18, www.bancaria.ch. The distribution of Shares in the Fund in Switzerland must be made exclusively to Qualified Investors. The place of performance and jurisdiction for the Shares in the Fund distributed in Switzerland is at the registered office of the Representative. Publications in respect of the Shares are effected on the electronic platform www.fundinfo.com. The disclaimer on OpenFunds acting as Swiss legal representative has been drawn up in the English language. In case of any discrepancy between the English text version and any translation thereof, the English version shall prevail and be regarded as binding.

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