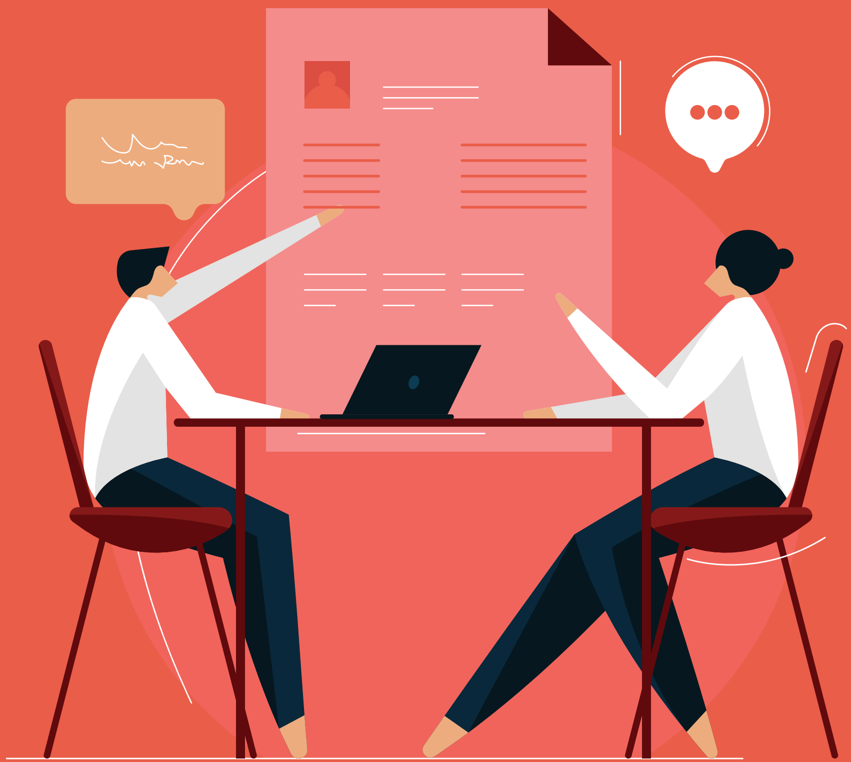
TSL
INTERVIEW

Interview with Michael Scolaro, BMO Commercial Bank ABL

BY CHARLIE PERER

As part of our series of executive interviews, Charlie Perer sits with Michael Scolaro, managing director and asset based group head for BMO Commercial Bank ABL,to hear his perspective on the state of the ABL market, bank vs. non-bank competition, the future of ABL, executive development and competition, among other things.



Thank you for your time, Mike. To begin, can you please talk briefly about your background?

Charlie, I grew up in suburban Chicago before attending the University of Notre Dame. My father owned a small fruit and vegetable wholesaler, where my brother and I worked over the summers. The job started at 4:00 am and ended when the last case was delivered. He taught me the importance of customer relationships, the value of exceptional service and the necessity of making the workplace an enjoyable place.

What are the challenges and opportunities facing ABL leadership groups right now given all signs point to a recession?

The obvious challenge is going to be talent, retention, recruitment, and development. In terms of retention and recruitment, BMO has committed to paying competitive compensation, we have designed a workplace which fosters collaboration, we recognize the value of a diverse workforce, we foster continuous learning and we offer a hybrid office solution. Further, it is fun to be on a winning team.

In the face of a recession, we will all be faced with heightened standards and increased reporting, especially as the financial outlook deteriorates. Risk ratings may deteriorate, liquidity might tighten, lenders may become reluctant. However, the bold will understand their customers' needs and create logical, timely solutions, thereby securing long-term clients.

How will this next economic cycle test the relationship between commercial banks and their ABL groups?

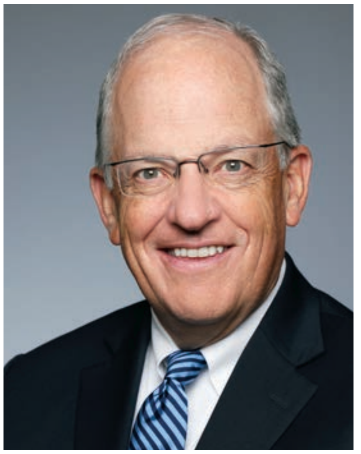
I can't speak for other banks, but at BMO, the relationship between our commercial banking teams and the ABL group has never been stronger. Our operating model very clearly codifies the roles and responsibilities of both groups, which include both ongoing relationship management and portfolio management. As approximately two thirds of our business is originated by our commercial banking partners, we stress the importance of our internal relationships. The most important thing for both groups to remember is to overcommunicate with your partner.

These relationships will be put to test when a recession occurs in each of three scenarios: 1) for existing ABL clients covered jointly by the commercial bank and ABL 2) for existing commercial bank clients contemplating a move to ABL and 3) for prospects of both the commercial bank and ABL. Again, an operating model fostering collaboration amongst the groups will be paramount to success.

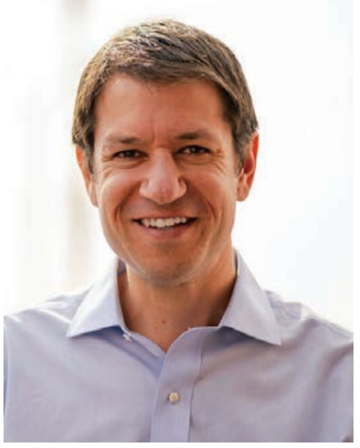
How would you characterize the current state of the ABL market?

It is a fascinating time to be in the ABL market. Pricing has moved to ultra-competitive rates; portfolios have their best weighted-average risk rating since the creation of the ratings systems; utilization has soared in the past year, all while fears of a deepening recession are growing. In summary, it is the potential perfect storm for continued ABL growth.

What will be even more interesting will be the response of the lenders. The bold will dedicate resources to ABL.



MICHAEL SCOLARO
BMO Commercial Bank ABL



CHARLIE PERER
SG Credit Partners

What are your predictions for the future of ABL over the next 5 to 10 years?

I have a number of predictions I am very confident in:

1. Bank consolidation will continue, leading to larger ABL teams at the acquiring banks
2. Banks love low LGD businesses such as ABL (and rightly so) and they will continue to provide resources to the teams. When coupled with increased customer demand for covenant lite debt, ABL will be in demand.
3. Every major bank ABL team will have at least four industry verticals.
4. The pace of international ABL will continue to accelerate.
5. Investment in technology, making due diligence and ongoing reporting both easier and more accurate for both the client and the bank, will further establish ABL as a preferred method of financing.

How has bank-ABL evolved to keep with the proliferation and innovation in middle-market, non-bank ABL?

The bank ABL players have and will continue to play to our strengths – size, cost and availability of funds, technology, training and scope.

However, a recessionary environment could test these natural, inherent advantages. Without the ability and desire to finance collateral sound, cash burn loans in a competitive fashion, the bank ABLs face losing at least some ground to the non-banks.

Does the competition from non-banks force bank-ABLs to take more risk or is it the other way where the non-banks are forced into a higher risk-premium curve for their return?

The punitive nature of capital allocation based upon risk rating forces banks to cede much of what was considered “core ABL” 20 years ago to the non-regulated lenders. However, this will likely remain a small percentage of the overall ABL industry.

Do you think the sheer number of large non-bank entrants is going to lead to consolidation similar to what we have seen in the traditional bank-ABL market?

It always has.

What I foresee is the non-bank lenders continuing to consolidate, with the larger lenders picking off smaller finance companies. As we head out of the next recession, the larger non-bank lenders, fresh off of a series of acquisitions, riding impressive, cyclical loan growth and possibly at the end of their owners' investment cycle will seek to monetize their positions. The number of well-capitalized buyers seeking such an acquisition would be impressive.

Is the trend of ABL vertical specialization, i.e. retail, healthcare, etc., just getting started?

Customers have always welcomed the opportunity to work with lenders who understand their industry. At BMO ABL, we currently have verticals in metals, retail, healthcare and tansportation. These teams compete on a national basis, working with their local counterparts to create a tremendous advantage of both local coverage and industry expertise.

In addition, we are in process of considering verticals in food & consumer, technology, staffing & business services, chemicals, building supplies, automotive and others. This trend will only continue to accelerate over the next five years as lenders try to become even more entangled with their clients.

Our group is structured into three primary teams, which together have eight portfolio and underwriting team leaders. The mentor-ship for young talent primarily occurs at the portfolio and underwriting team leader level. Responsibility for developing young talent is also pushed down in the organization, as we want our VPs, AVPs, and associates to have the opportunity to coach in addition to being individual contributors.

Every generation of lenders seems to think they had it the toughest. Can you give us perspective over the past 20 years?

Charlie, you meant 40 years, not 20, right? In the beginning of my career, I witnessed competition over advance rates, pricing, sizes of term loans, tenor. Does this sound at all familiar to today?

The next part of my career saw the most sweeping changes in ABL history as lenders and borrowers alike realized the value of springing covenants and springing dominion based upon excess liquidity. This change happened almost overnight and left the unwilling falling by the wayside.

Today we see competition over all of the above and hold size has also become a bigger determinant than ever before.

In summary, the market has always been competitive, and over the long run more favorable to the borrower.

How is your time spent these days between running your group and mentoring/developing young talent?

Our group is structured into three primary teams, which together have eight portfolio and underwriting team leaders. The mentorship for young talent primarily occurs at the portfolio and underwriting team leader level. Responsibility for developing young talent is also pushed down in the organization, as we want our VPs, AVPs, and associates to have the opportunity to coach in addition to being individual contributors.

With that said, everyone on the team has a voice. At BMO ABL, the question is never “what do you think we should do?” Rather, the question is “I think we should do this, do you agree?”

How do you think about adding value to a new or existing client situation and how do you mentor your team to do this?

We always strive to fulfill an advisory role with our clients. This includes frequent client contact, which has been aided by the advent of video calls that occurred during the pandemic, and a deep understanding of our client's financial needs. Then we search for solutions, whether it is cash management, various hedging products, purchase cards, trade finance, or other financial products. We also look to make introductions between clients that can be mutually beneficial.

Customers also want to hear from and have relationships with decision makers. At BMO, we delegate authority, creating the mutual trust with clients that serves as part of the glue in the relationship.

What are you doing to develop and retain talent in this labor market that you might not have five or ten years ago?

Three areas that come to mind are, first, we have a hybrid work model, which we feel strikes a good balance between the benefits of mentorship and collaboration that we find are best achieved in person and work/life balance. Second, we are focused on using technology to automate low value-added monitoring activities. And third, we are conducting more frequent pay-scale reviews to ensure that pay is competitive with the current market.

We use technology in monitoring and operations, but believe experience continues to be a key factor in evaluating a potential client's creditworthiness or an existing client's credit request. Or, said another way, technology is not significantly changing how we approach lending, but it definitely assists with portfolio decisioning.

Has technology changed the way you approach lending?

We use technology in monitoring and operations, but believe experience continues to be a key factor in evaluating a potential client's creditworthiness or an existing client's credit request. Or, said another way, technology is not significantly changing how we approach lending, but it definitely assists with portfolio decisioning.

Also, the pace of technological change is picking up. One such example is the proliferation to programs to assist with and automate borrowing base creation, which helps to reduce borrower time spent on the task and improves data quality. Step-function change will occur when real-time data extraction allows for the creation of up-to-date borrowing bases (daily?) with minimal effort on the client's behalf due to EDI interfaces. We anticipate this would first be adopted with tougher-to-underwrite credits, where the real-time data is more important from a credit perspective and then gradually make its way to the traditional ABL market

Lastly, tell us something you are worried about that the rest of the market has yet to figure out.

Now why would I tell you that?

Charlie, thank you for the opportunity to discuss ABL. I hope my passion for both BMO ABL and the industry comes through.

Charlie Perer is the co-founder and head of originations of SG Credit Partners, Inc. (SGCP). In 2018, Perer and Marc Cole led the spin out of Super G Capital's cash flow, technology, and special situations division to form SGCP.

Perer joined Super G Capital, LLC (Super G) in 2014 to start the cash flow lending division. While there, he established Super G as a market leader in lower middle-market second lien, built a deal team from ground up with national reach and generated approximately $150 million in originations.

Prior to Super G, he co-founded Intermix Capital Partners, LLC, an investment and advisory firm focused on providing capital to small-to-medium sized businesses. He graduated cum laude from Tulane University. He can be reached at charlie@sgcreditpartners.com.