In search of new answers

DAN ROBERTS TELLS PETER WILLIAMS HOW PREVIOUS REFINANCING ANSWERS MAY NOT WORK IN A NEW ERA OF BANK LENDING.

Much has changed in the bank lending market. Even experienced treasurers who have seen many different economic and credit conditions should not assume that the old answers will necessarily be the right ones this time around. Amid the volatility and uncertainty of the last three years, keeping funding under review has been key to the survival of many businesses. With the European-wide peak in refinancing anticipated in 2011-12, and tighter regulations on capital and liquidity being introduced, treasurers need to continue to focus on their funding requirements. Now is the time for businesses to open up the discussion and investigate the options available to them.

Market commentary has recently focused on refinancing in general and, more specifically, the implications of regulatory changes on refinancing. A substantial level of refinancing activity in 2007 and the first half of 2009 has created a maturity 'spike' around mid 2012 for UK and European borrowers, as the three-year and five-year deals signed reach maturity.

Alongside this known increase in demand, regulatory change is on the horizon. The impact that these new regulations will have on banks and their supply of capital is unknown so businesses need to think carefully around whether their current banks will be able to support financing in the future.

Dan Roberts has been in conversation with a number of businesses on the topic of accessing finance. He said: "These businesses have been talking to us seriously because they share our concerns and belief that now is a good time to refinance. In contrast, the prognosis 12 months out is uncertain. The uncertain nature of future availability of finance means clients should engage with us earlier and start planning ahead."

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The increase in companies bringing forward such refinancing discussions has been accompanied by a rise in mergers and acquisitions (M&A) activity which sparks an event-driven desire for companies to discuss the need for finance with their banking group. It is hard to tell whether this renewed interest in M&A is an emerging trend but Barclays Corporate certainly welcomes the discussion. Roberts said: "It is an indication that companies are starting to get back onto the front foot, and that they are coming back to the banking market to help them find ways to fund their investment ambitions." (see box)

WHY REFINANCE EARLY? Treasurers have two broad options against the backdrop of future uncertainty – they can either absorb the risk and delay discussions around refinancing options, or they can initiate those discussions now.

There is a misconception that bank lending is expensive, following the widening of spreads over base rate and LIBOR. This may be encouraging businesses to delay their refinancing options in the hope of getting a better deal. However, this is not an accurate portrayal. Banks may have increased the margins they charge for loans (as a result of volatile money markets and increased lending risk) but the widening of margins has been more than outweighed by the decline in interest rates. This means that bank debt is still substantially cheaper in absolute terms than in 2007 and 2008.

Roberts said: "Finance teams are looking at their liquidity management and treasury risk and planning around that. People coming to talk to us are taking the view that it is better to be safe than sorry."

Roberts has been talking to a retailer that has funding from Barclays Corporate and two other banks. The business is not required to access finance now, however it understands that it might find it difficult to access finance from new banks if existing banks are not in the position to re-finance further down the line. It therefore wishes to manage the risk head on rather than take the risk that one of the banks will be unable to fund it in the future.

Roberts said: "The retailer doesn't have to do anything for about 18 months. We are talking to them now because we think it is in everyone's interests to plan a way forward which provides the company with certainty of liquidity over the medium term."

GIVEN THE REFINANCING CHALLENGE MANY GROUPS WILL FACE IN 2011 AND 2012, TREASURERS MAY DECIDE TO REVISIT CASH MANAGEMENT ARRANGEMENTS.

Another company Roberts has been engaged in conversation with is a Western European business services provider who took out a syndicated loan in 2007. Within the banking group are a number of European banks that have neither the risk appetite, nor the balance sheet to roll over the re-financing commitment. As a result, the company is looking at a £100m liquidity shortfall in its refunding.

Barclays Corporate is talking to this business about all its potential solutions: including assessing whether its capital structure is right and alternative solutions such as accessing debt and equity capital markets. Roberts said: "We are working with our colleagues in Barclays Capital to review the full range of available options in an attempt to find the best solution. One of the advantages of Barclays is that we can liaise with our counterparts in Barclays Capital to explore alternative options alongside offering our clients the opportunity to access traditional forms of finance."

While neither of these companies has to do anything for well over a year, Barclays Corporate agrees with both that it is smart to deal with the big issues now. Dan Roberts asserts that opening dialogue with your banks early is the key to developing a successful relationship and ensuring there are no surprises: "Smart treasurers are very clear on who is providing balance sheet and who is providing other services and they are really very thoughtful about how they manage those two elements." Good treasury practice has always emphasised the need for treasurers to have a handle on all the expenditure that the group, and all its subsidiaries, have with financial services providers. The need to follow that good practice has never been greater.

THE FUNDING MIX Companies need to look at all potential sources of funding. This starts with the efficient management of cash within treasury. Barclays Corporate is always looking to engage with treasurers and finance departments about the sort of help it can provide in terms of cash management solutions. Many treasurers may believe that they are already effectively managing the cash that the group does have at its disposal and have driven out any possible inefficiencies in the current funding arrangement. But given the refinancing challenge that many groups will face in 2011 and 2012, treasurers may decide to revisit the task, in particular looking at cash management arrangements that potentially create capacity.

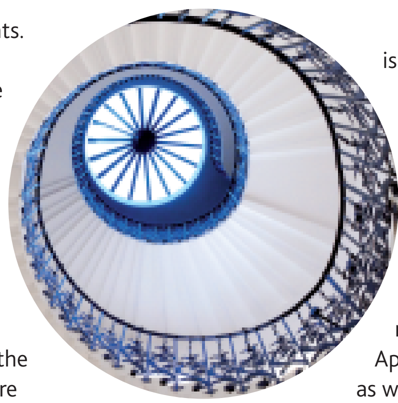
When every possible cash avenue has been explored and the company still has a funding requirement, the next question is where to go to find the required funding.

Roberts said: “Given all the regulatory changes that have happened and will continue to happen we perceive that debt capital markets will play a bigger role for more companies than has traditionally been the case.

“Although this won’t apply to all companies, larger corporates are finding that capital markets can provide solutions to their funding requirements. That is why Barclays Corporate is configured in the way it is and, where appropriate, we introduce companies to the expertise of colleagues within Barclays Capital.”

Products such as bonds and private placements will become increasingly relevant for a greater range of companies. Roberts agrees: “It is the pure substitution effect. As the bank lending market has become more regulated, so the bank loan input costs have increased. So while three years ago it may not have made sense for a company to issue a high yield bond, now it may well do.”

“WE WOULD PREFER TO WORK WITH THE TREASURY DEPARTMENTS AND DISCUSS THE RANGE OF OPTIONS TO GET THE BEST SOLUTION.”



OVERALL COST OF FUNDING Overall funding rates at the moment are at record lows because interest rates are so low, but the cost of different components of the available mix of funding is changing. Loan margins, for example, are back to where they were in the 1990s.

The conclusion, according to Roberts, is that treasurers and finance directors need to be “risk alert”. Thinking about their funding risk is now different. He said: “Good treasurers are entering into financing dialogue with their banks right now. Even if they don’t have to do anything now it is just good risk management.”

It could be argued that if companies can’t refinance then logically they would have to dramatically restructure or even go out of business. For companies with sound underlying business models, most banks would be willing to roll over a loan unless it was simply unable to extend credit. But even so, serious re-thinking may have to be done.

Roberts said: “We would prefer to work with the treasury departments and discuss the range of options to get the best solution, rather than just saying the right answer is the straight replacement of what the company has.” There is increasing recognition by treasurers and others that solutions such as invoice financing are a good and viable alternative source of finance. Roberts said: “In the world of scarce bank capital, these types of finance are a much more efficient use of a bank’s capital than a straight loan. Invoice finance is a much more controlled method of providing working capital finance so the capital we mark against it is much lower than a general overdraft.” And in today’s environment that advantage matters a great deal.

AVAILABILITY OF CREDIT Despite worries over refinancing, the statistics suggest credit is still being made available. A look at approval rates would counter the suggestion that banks are risk averse. It is true to say that Barclays Corporate’s risk policy remains broadly unchanged in the last 10 years. Approval rates have remained relatively constant over this period as well, even throughout the recession. This is not to say conditions haven’t changed, which affects both the business seeking to borrow and the bank’s ability to lend. If the value of collateral offered has decreased in value due to prevailing economic conditions (for instance a freehold commercial building where values may have fallen by up to 40%), then the amount of money based on the accepted loan to value criteria will be adversely affected. So some companies have not been as able to borrow as much credit as they would have wished, and in poor trading conditions where cash flows have come under pressure, this has also affected the amount of free cash that companies have had to service loans.

Clarity has yet to return to the bank lending market. It will do so when the full impact of banking regulation is known and when the benefits of the recovery are starting to flow though. At that point bank lending will be able to respond fully to the needs of business investment. Roberts said: “There is no doubt that balance sheets will look different: more reliance on bonds and private placement and less emphasis on leverage.”

With uncertainty over future refinancing apparent for many businesses it is key that corporates should engage early with their financial partners so they can understand the full range of solutions available. With a corporate arm and an investment bank arm, Barclays sees itself as one of the few UK players that has got strength and span to encompass all the ways to finance an acquisition from cash management and commercial banking to investment banking.

M&A back on the agenda, as are financing questions

Much M&A is opportunistic with companies perceiving values on deals. Generally they are looking for underwritten offers. Roberts added: “It is very early days but the concept of underwrite seems to be back.” When such situations arise, Barclays will work with companies by undertaking full credit discussions, looking at business strategy and financial performance and working with management to understand issues such as the strategic fit of the proposed acquisition. How the acquisition is funded is key and the company needs to discuss the options available with its financial partner – be it bank market solutions or capital markets, or both.

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To see how treasurers are looking at funding, see page 30

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