A time of fragility

IAN FITZGERALD LOOKS BACK ON WHAT HAPPENED IN THE MARKETS IN 2009 AND HOW CORPORATES RODE THE ROLLERCOASTER.

With most funding options effectively closed for corporates at the beginning of 2009 it was difficult to see how any deals would reach completion, but the acceleration of the European bond markets as an alternative source of funding and the subsequent re-emergence of a syndicated loan market made 2009 one of the most compelling years in memory for deals.

At the beginning of 2009, corporates and banks alike exhibited uncertainty that would not prove easily remedied. Given the damaged balance sheets and soaring funding costs, deleveraging was at the top of both banks' and borrowers' agendas, and many participants in the market were closed for business. Those banks that were open withdrew to domestic markets while others implemented investment strategies that pulled back from non-core lending and shied away from anything but investment-grade corporates. As a result the vast majority of mid-cap and unrated corporates were stranded with few funding options.

Corporates suffering in this liquidity drought needed to refinance existing facilities and so solutions had to be provided. Debt capital markets and the means by which corporates sourced and secured their capital evolved and changed. Government intervention helped to ease the liquidity stalemate that had caused the bank debt market to grind to a halt, but it was the European bond market that many corporates turned to for their funding needs.

BOND MARKET FILLS THE FUNDING GAP The ease and quantum with which some of the top-rated names accessed the bond market was remarkable. Bank debt, forthcoming bond redemptions and commercial paper for strong investment-grade names were all largely refinanced in the bond markets. For instance, Roche (A2/AA-) managed to finance its $45.7bn Genetech acquisition directly off the back of the bond markets without the need to arrange an interim loan. Overall, European corporate bond volumes in 2009 represented 43% of the total global bond market versus only 38% in 2008, clearly outlining a shift in corporate funding strategy.

European corporates in the BBB space were also met with a warm reception and accounted for 21% and 25% of euro and sterling bond issuances respectively. The high-yield market was also reopened in Europe with a flood of unrated corporate issuers accessing the bond market on the seemingly inexhaustible demand from European investors.

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BRIDGE TO BOND LOANS The bank debt market exhibited its flexibility as it supported corporates looking to issue bonds with bridge facilities. The bond and loan markets developed an interdependency with confidence in the bank market underpinned by the assumption that the bond market would continue to be available to fund longer-term corporate liquidity. However, there remained the concern that if the bond market was to fall away, there would be insufficient bank liquidity to bridge the gap.

FORWARD STARTS Innovation played a part in adapting the bank debt market for those corporates that could not access the bond market and were extremely uncertain about not only their own ability to secure liquidity but also of the very survival of the loan market as a debt provider. What emerged was a facility structure known as the forward start. Corporates paid an increase on the margin of their current facility to current market levels to secure and extend liquidity from the existing syndicate. Banks declining to accede to the forward start would remain committed to the existing loan with the original maturity and pricing.

UK brewer Marstons was the first forward start in the market this year, when it announced it had agreed with a syndicate of relationship banks a £295m three-year extension to its existing £400m facility due to mature in August 2010.

As bond deals and refinancings incorporating many forward starts were signed, activity in the loan market showed signs of improvement. Yet transactions by number and value continued to fall, with M&A activity dropping to $1.1bn over the first half of 2009, the lowest semi-annual level since the first half of 2004.

Corporates which continued to focus on deleveraging through disposals proved that the road to recovery was going to be a long and arduous one. Caution was exhibited at both ends of the equation as most of the deals completed were syndicated through a 'best efforts' or 'club' basis with banks unwilling to take on any underwriting risk. With little new money on the table, corporates had to rely more on existing banking syndicates, and those with strong banking relationships found themselves better placed in refinancing.

Glencore International signed a £6.65bn forward start and a £815m revolver in May 2009, extending its existing facility following heavy oversubscription. The deal was supported by a 14-strong group of mandated lead arrangers and a total of 35 banks joined the deal in syndication.

The commodities sector saw a series of refinancings and extensions successfully executed during the year as many commodities brokers benefited from having cross-border operations and significant ancillary business that appealed to a diverse bank group. The UK commodities merchant ED&F Man led the way by signing a $1.25bn refinancing deal in February, closely followed by Trafigura, which in March signed a $520m three-year revolver, and Swiss commodities trader Vitol, signing in August.

IMPROVING SENTIMENT As we headed into the second half of the year, improving sentiment saw market participants diverging. Banks which continued to recapitalise became more willing to lend, albeit only to the stronger credits. As a result, top-rated borrowers with strong credit metrics, extensive local banking relationships, a presence across multiple jurisdictions and significant ancillary business began to see some tightening in pricing. At the lower end of the ratings scale, where doubts concerning credit and liquidity lingered, pricing benefits had yet to be seen.

Volumes in the loan market slowed again as we headed towards the New Year, no longer as a result of poor bank liquidity but rather a combination of the absence of M&A activity, continued deleveraging of corporates, sustained strength of the bond market as a source of funding and increased borrower confidence that market conditions would improve in the coming months.

In October 2009 during challenging market conditions, E2V Technologies successfully secured funding by way of a new three-year facility, contingent on a planned equity raise, alongside a waiver to the existing facility. The cross-over nature of the transaction presented a number of challenges, with the success of the deal reflecting the flexible and innovative thinking applied by all involved and banks' willingness to support tougher credits. Furthermore, the use of a rights issue reflected increasing importance of equity raising as a key component of a balanced capital structure.

OUTLOOK As we look back on another year, the loan market can feel confident that it is better placed now than a year ago, yet unsurprisingly there is still some way to go before the market operates in a more normalised fashion.

The current crisis in Dubai has caused the market to take a step back, underlining the fragility in market sentiment. The contagion seems to have been contained and digested, and it is expected that performing businesses will continue to attract support from local and international banks.

But as some significant difficulties were mastered, were any opportunities won? If we consider what 2010 may have in store, it looks as if the majority of banks face implicit and explicit lending targets and are willing to lend. At the same time, those banks with investment strategies still in place to pull away from non-core lending are less inclined to pull the rug out, and remain supportive in order to preserve value. So where are the opportunities?

Post-IPO funding is anticipated to be a win-win situation for all involved, with sponsors, which were previously unable to sell their portfolio companies through secondary buy-outs, now able to achieve a suitable exit, while corporates benefit from reduced leverage and improved cashflow profiles.

The majority of post-IPO facilities are expected to involve little new money and rely heavily on strong existing syndicates to provide liquidity. Institutional funds, traditionally unsupportive of corporate financings, may stay committed due to the lack of opportunities in the leveraged market, with post-IPO financing encompassing many leveraged facility features. That said, we need to be mindful of the opportunities that primary corporate facilities present opposed to the good value and sound performing secondary assets of a strong leverage facility.

2010 may also see the comeback of the much awaited M&A market, and for the right deals there may be opportunities for underwriting. In addition, if improving sentiment in the market is actually realised, then the forward start facilities seen at the beginning and in the middle of 2009 may be refinanced as borrowers seek to take advantage of recuperating market conditions. Improving sentiment surrounding the pricing environment should encourage new lenders into the market to set the foundation for a year where we can stop manning the barricades and start to rebuild.

Figure 1: Margin analysis of A vs BBB credits

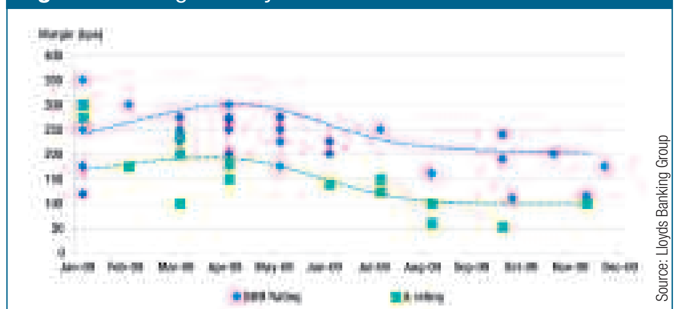

Figure 2: Breakdown of issuance in 2009

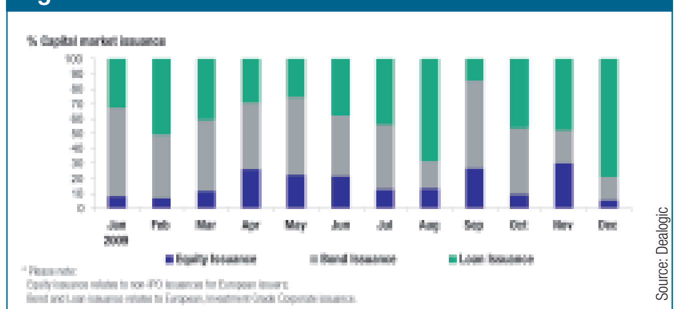

Figure 3: How European corporates used deal proceeds

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