Gaining momentum

AFTER A SLOW START, THE M&G UK COMPANIES FINANCING FUND IS PROVING AN INCREASINGLY ATTRACTIVE ALTERNATIVE TO THE BANKS AS A SOURCE OF FINANCE. **GRAHAM BUCK** INVESTIGATES.

In the depths of the financial crisis in late 2008, there was much despair at the sudden disappearance of liquidity. Amid the gloom, some hope was offered by reports that fund manager M&G Investments was developing an innovative fund to provide financing for UK companies.

By July 2009 M&G, which is part of Prudential, was ready to revive the UK private placement market for corporate debt, with a £1.5bn fund backed by pension funds. The ambition was for it to emulate the thriving private placement market in the US, where long-term loans are readily available to businesses from insurance companies.

Almost a year elapsed before the M&G UK Companies Financing Fund was able to report its first loan. In May 2010 it announced a £100m loan with a 10-year tenor to freight and logistics group Stobart to finance its planned redevelopment of Southend Airport.

A second loan followed in November, again for £100m, to housebuilder Taylor Wimpey. Momentum has slowly but steadily built since, with four more loans announced over the early months of 2011, as shown in the table opposite. An additional unpublicised loan for £30m takes the total to seven, and M&G reports that a further three or four potential deals are in the pipeline.

TIME LAG There were several reasons for the time lag between the fund's launch and its first loan, says M&G's head of alternative credit Mark Hutchinson. "Credit spreads were still moving around quite sharply in early 2009, some companies didn't want to be seen as the first to borrow from the fund, and the lending targets set by the government enabled others to secure increased funding from their banks," he explains. "At the same time quantitative easing was injecting more liquidity into the market, while US insurers were aggressively re-entering the private placement market for UK issuers."

Diversifying at least some capital funding away from the banks is now becoming an increasingly attractive move for many businesses.

As the number of lending banks shrinks, so the ability to access other funding options makes increasingly good business sense.

"In addition to the fund's obvious benefits, M&G is a relationship lender but not a bank-type lender," says Calum Macphail, head of corporate private placements at M&G. "We're not knocking on our customers' doors every few months looking for ancillary business." He adds that the "share of wallet" issue was very much to the fore in discussions at this year's ACT conference.

Another attraction is the average life of the loans completed by the fund to date, of seven to eight years. "Although our early deals might give the impression that we favour the construction and property sectors, we're looking to diversify across various businesses," says Hutchinson. "Basically we're interested in all mid-sized companies with solid metrics that are seeking long-term funding. So we're looking to develop a UK private placement market that lends in sterling and, over time, is as credible as its US equivalent."

He points out that M&G can claim a lengthy track record, with its first private placements completed back in 1997. The early deals were UK-only and in sterling but as it became evident that the main providers were US insurance companies, later investments were a sterling or euro tranche alongside the larger US tranches. The UK Companies Financing Fund is a continuation of that activity.

CASE STUDY: BARRATT DEVELOPMENTS When Barratt Developments updated the City in May on how its sector had fared in the early months of 2011 it also announced that it had completed a comprehensive debt refinancing package. The news was well received by the markets. The refinancing reduces the group's effective cost of borrowing through a more favourable balance of the facilities between term debt and that allocated for its working capital requirements and an improved maturity profile. The group also cancelled around £290m out of a total £480m of interest rate swaps in return for a £30m cash payment.

Chief executive Mark Clare said that the new package would enable Barratt to "eliminate the inefficiency of having a fully drawn loan" and support the ongoing reduction in debt going forward.

Under the refinancing, the group has secured £770m in committed bank facilities, reducing to £680m in October 2013 to reflect its reduced borrowing requirements, and maturing in May 2015. Its existing private placement notes, totalling £162m, remain invested until their original maturity dates between 2013 and 2020, while it has added a new US private placement note equivalent to a £48m fixed-rate loan and due in August 2017.

Topping up the refinancing to provide a total of around £1bn in committed facilities was a new £100m term loan from the M&G UK Companies Financing Fund of rather longer tenor – the first repayment, of 25%, does not fall due until 2019, followed by a further 25% due in 2020 and the remainder in 2021.

Barratt is still one of the first borrowers to draw on its new M&G facility. "We'd approached the fund at the time of the Stobart issuance to find out how it worked," says Bob Williams, head of treasury and corporate finance for Barratt. "So when we began thinking about the refinancing at the end of 2010, we knew about all of the various options available.

"Our banking facilities were due to mature in April 2012 and, in line with accounting practice, our auditors expected 12-month committed facilities to be available in order to sign off on the accounts. So we completed the exercise just under a year ahead of the maturity date, on 10 May."

Among the main aims of the refinancing were obtaining liquidity and increasing the maturity profile. Both have been achieved, with the banks signing up to a four-year facility, as opposed to three years previously, and other debt facilities offering up to 10 years.

Barratt was aware that banks have been seeking to reduce their overall exposure to the construction sector, even though the problems experienced in 2008 and 2009 are swiftly receding. At the same time, most are keen to maintain their key relationships with the bigger players, which was reflected in the longer maturity period secured by the group.

"Obviously we considered various options when we undertook our refinancing exercise, but we were keen that the new structure would retain our private placement holders and also bring the M&G fund on board," adds Williams. Among the alternatives that were ultimately rejected was following the lead of rival Taylor Wimpey in issuing high-yield corporate bonds.

"Our balance sheet structure now provides term facilities beyond four years through a combination of the private placements and the fund, which support core working capital, while the banks support our seasonal working requirements."

EXTRA LEVELS OF APPROVAL Barratt's refinancing took less than five months to complete, but the group found that extra levels of approval were required by banks before the new facilities were approved.

"In the past it was quite common to turn everything around in six weeks to two months," says Williams. "This time the period was at least twice as long, which I believe is now pretty much standard. M&G moved quickly, which was helped by our long-term relationship with them. The fund was able to understand how our credit facility was arranged and the timeline we were working to, enabling us to announce the refinancing package to the market on 11 May when we issued the interim management statement. It was still a complicated transaction as the bank facility, private placement facilities and the fund all had to be linked together in a consistent covenant package that supported the group going forward."

Not surprisingly, Williams is an enthusiastic supporter of the fund. "It's a creative way of providing alternative sources of financing to help UK corporates," he says. "Post-credit crunch, there was an obvious need to address the capital constraints on the banking sector, and to support UK corporations with a facility that was longer term. The only surprising thing is that, to the best of my knowledge, no-one has followed M&G's lead by establishing a similar fund."

M&G UK Companies Financing Fund loans

Date	Company	Amount
May 2010	Stobart	£100m
November 2010	Taylor Wimpey	£100m
January 2011	Provident Financial	£100m
February 2011	Grainger	£100m
April 2011	Northgate	£100m
May 2011	Barratt Developments	£100m

Graham Buck is a reporter on The Treasurer.
editor@treasurers.org