Ready to refinance

THE ACT, IN CONJUNCTION WITH FTI CORPORATE FINANCE, HAS RECENTLY CONCLUDED A SURVEY THAT PROVIDES A DETAILED, HIGH-QUALITY INSIGHT INTO ACTIVITIES AND TRENDS IN CORPORATE REFINANCING.

The refinancing survey benefitted from a very high response rate, reflecting the significant interest this topic is getting from the treasurer community. Key market participants were also canvassed, including bankers, lawyers, high-yield issuers and private equity sponsors, to take their qualitative views on how the refinancing landscape will develop over the next 18 to 24 months.

Several themes were consistent across the treasury community and market participants. In combination these send a clear message to all corporates with a maturity date in the next 24 months and are looking to complete their refinancing successfully: go early where possible, be prepared, and understand your lenders.

European banks are open again for business, and for selected corporates it has never been easier (and in many cases cheaper) to put in place a renewal of existing facilities or arrange a completely new set of facilities. This window of opportunity is expected to be short-lived, though, as corporates rush to beat the mountain of refinancing that is due to take place between 2012 and 2014.

The demand for renewals in that period, driven by the boom in lending between 2005 and 2007, is expected to exceed significantly the supply of liquidity. Those corporates that fail to prepare, do not understand their lenders' criteria or cannot clearly articulate their credit story will find themselves in a very difficult predicament and what should be a reasonably straightforward refinancing may turn into a costly and time-consuming exercise for the whole management team.

The ease of completing a refinancing will largely depend on the quality of the underlying business and the size of the overall ask. For the FTSE 100 and larger-performing leveraged buy-outs (LBOs), the option to use the bond/high-yield market will provide the access to capital to fill any gap left by the shortage of senior bank debt. However, those in the mid-market that are too small to tap the debt capital markets (i.e. they require less than €300m) are expected to find it more difficult.

GO EARLY 60% of respondents suggested that, where sensible, refinancing should be executed as soon as possible to take advantage of the current liquidity supply, and beat the rush in 12 to 18 months' time. Only 47% of respondents agreed that there would be sufficient liquidity available regardless of price in the future.

Shaun O'Callaghan, a senior managing director in FTI Corporate Finance in London, says: "Even though funding is generally cheap, you may have to pay a premium over your current pricing to refinance early, but that may be a price you are willing to pay to secure future financing and take away the uncertainty in 12 to 18 months' time."

This is particularly the case for investment-grade or "cross-over" credits where a business has a solid track record of deleveraging and can demonstrate a strong credit story. There is currently a strong appetite from many active lenders to put their money to work in new deals, often on improved terms depending on the quality of the existing facilities.

BE PREPARED Three areas were identified as the most important for corporates in terms of preparing for conversations with prospective lenders:

- the information memorandum;
- a detailed financial model; and
- the involvement of senior management.

The involvement of the chief executive officer (CEO) and chief financial officer (CFO) has also been significant in recent deals. Mark Dewar, also a senior managing director in FTI Corporate Finance in London, says: "No longer is refinancing something that the treasurer is solely responsible for. It has become as important as an M&A transaction and needs the full support and interaction of the CEO and CFO."

Being prepared extends to ensuring a business goes through as much self-help as possible before looking for external funding. 73% of respondents said that they would be looking for the same or less debt than their current facilities allowed, and over 80% said the difference would come from their own initiatives. Managing cash and working capital more effectively, disposing of redundant assets and reducing operating costs are listed as the main areas for reducing reliance on debt funding from future refinancings.

UNDERSTAND YOUR LENDERS The majority of corporate investment-grade respondents expect to reduce the level of security, undergo reduced due diligence and obtain improved operational flexibility in their next refinancing. This is consistent with recent deals that FTI has advised on where the corporate has done its homework and tailored its request to the lender group.

O'Callaghan says: "You need to know your prospective lenders and tailor your request accordingly. Knowing which lenders are looking to advance funds in your sector or geography and supplying them with all the material to ensure a smooth credit process can go a long way to ensuring a successful refinancing."

Providing the lenders with a source of additional income can also help to sway their decision-making in other key areas of negotiation. Dewar says: "Understanding the cost of capital to the banks and enhancing their return over and above the yield on your borrowing through providing swap facilities, cash management support or advisory mandates can be hugely beneficial to selling the credit story internally. So a good understanding of which banks would prefer each ancillary income stream can help the borrower pitch the request in the right way."

MOST RESPONDENTS EXPECTED THE EUROPEAN ECONOMY TO CONTINUE TO STUTTER, WITH 60% FORECASTING NO GROWTH IN 2011, AND 80% BUILDING IN A RISE IN INTEREST RATES.

According to one of the most active UK lenders, the terms of new facilities seem to be reverting to longer durations, but this was not reflected by the survey responses. The contraction of new deals from historic levels of five to seven years down to three-year deals in 2008-2010 has meant many corporates are facing another refinancing much earlier than they would ordinarily have had to deal with.

O'Callaghan says: "The majority of the respondents felt the three-year deal was the norm and here to stay, but from our experience in recent deals and from observing other deals in the marketplace, five-year terms are definitely available and some corporates are pushing for seven years. Knowing who is willing to push the term out beyond three years will also strengthen the chances of success in putting a bank group together."

PRICING AND COVENANTS Other significant findings from the research included views on pricing and covenant expectations from ACT members.

- **Pricing** While there is a more stable outlook for bank debt margins in the next two years, with only 20% of respondents expecting an increase, the expectation for margins on bonds and leveraged loans is less clear. With the demand for these debt instruments expected to rise significantly as corporates switch to bonds/high-yield and many of the leverage loans from 2006-2008 mature, most respondents expected a hike in both margins on debt and up-front fees.

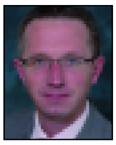
Dewar says: "From our perspective, pricing is pretty closely correlated with leverage and 3.5 times seems to be the key hurdle. Beyond that level, pricing is currently on the rise as lenders seek to match the risk/reward dynamic to avoid getting stuck with low returns on poor-performing credits, and would rather place their funds with low-leverage 'safe' businesses."

- **Covenants** Covenant lite deals have already started to re-emerge in the US and some commentators believe it won't be long until we see them back in many deals in Europe. "This seems to contradict the notion that refinancing will be more difficult in the next 18 months," says a senior banking lawyer in London. "However, it is simply reflecting the current supply/demand imbalance of liquidity where certain lenders are committed to hitting their lending targets and are willing to write business with little protection."

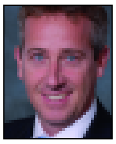
Perhaps the most resounding finding from the research was that most respondents expected the European economy to continue to stutter, with 60% forecasting no growth in 2011, and 80% building in a rise in interest rates in 2011. This suggests that while lenders may seem openly keen to lend now, there are further difficult times ahead for businesses, which may mean further deterioration in earnings and borrowing power. This reinforces the message for CEOs, CFOs and the treasury community: if you want certainty and flexibility around your funding position, act quickly to build the relationships with the right lenders and lock in your support for the next five years.

See A Supporting Role, page 37

FTI will be presenting the survey findings at ACTAC Workshop 3 (Is Refinancing the New M&A?) at 14.15 on Tuesday 10 May and a PDF of the survey will be available on the ACT website after the conference.



Shaun O'Callaghan is a senior managing director at FTI Corporate Finance.
shaun.ocallaghan@fticonsulting.com



Mark Dewar is a senior managing director at FTI Corporate Finance.
mark.dewar@fticonsulting.com

www.fticonsulting.com