Harness the power

Executive summary

- Available for terms of up to 10 years and attractively priced compared with the rest of the capital funding mix, structured debt facilities offer corporate treasurers a highly valuable diversification tool.

Corporate treasurers are waking up to the fact that the solution to their flexible funding requirements may be closer to home than they realised. For many, harnessing the power of the assets embedded in their own balance sheets could be the answer to their company's financing requirements in this current market.

Changes in the funding landscape mean treasurers are searching for additional prudent funding sources to add to their current funding mix, which by and large had become heavily dominated by revolving credit facilities (RCF) between 2004 and 2007. This is leading to a renewed interest in structured asset-backed financing solutions, designed to give treasurers the opportunity to rebalance and re-engineer their capital structures with well-priced, longer-maturity funding alternatives.

By securing a funding solution on specific assets already owned by the company, or on assets that will be essential to the business, it is possible to rebalance pricing models in a company's favour. This allows treasurers to pick and choose products most suited to their funding needs based on the individual assets they have available.

With deal sizes typically ranging from £25m to £150m, these financing solutions have become a much more attractive option, giving companies the ability to unlock the value of the fixed assets of their business. They can obtain assets for short- or long-term contracts or secure new assets with minimal outlay, thereby preserving cash reserves.

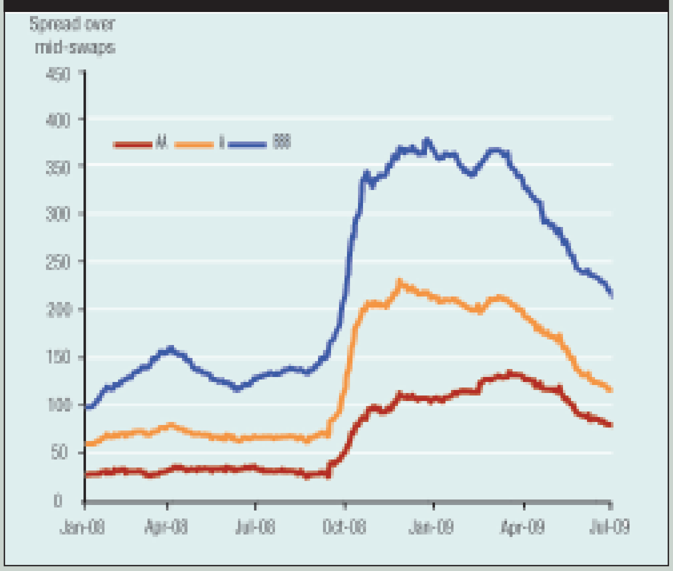
It is also often possible to secure these financing solutions much more quickly than other traditional methods by using the RCF as a framework for the deal documentation. When it comes to explaining the new financing options to the board of a company, these solutions look like an RCF in terms of language and form, but have the added value of price flexibility as a byproduct of being secured. In addition, it is possible to introduce a mix of amortising profiles; most facilities are on longer terms than current RCF profiles and in certain instances they can provide balance sheet benefits.

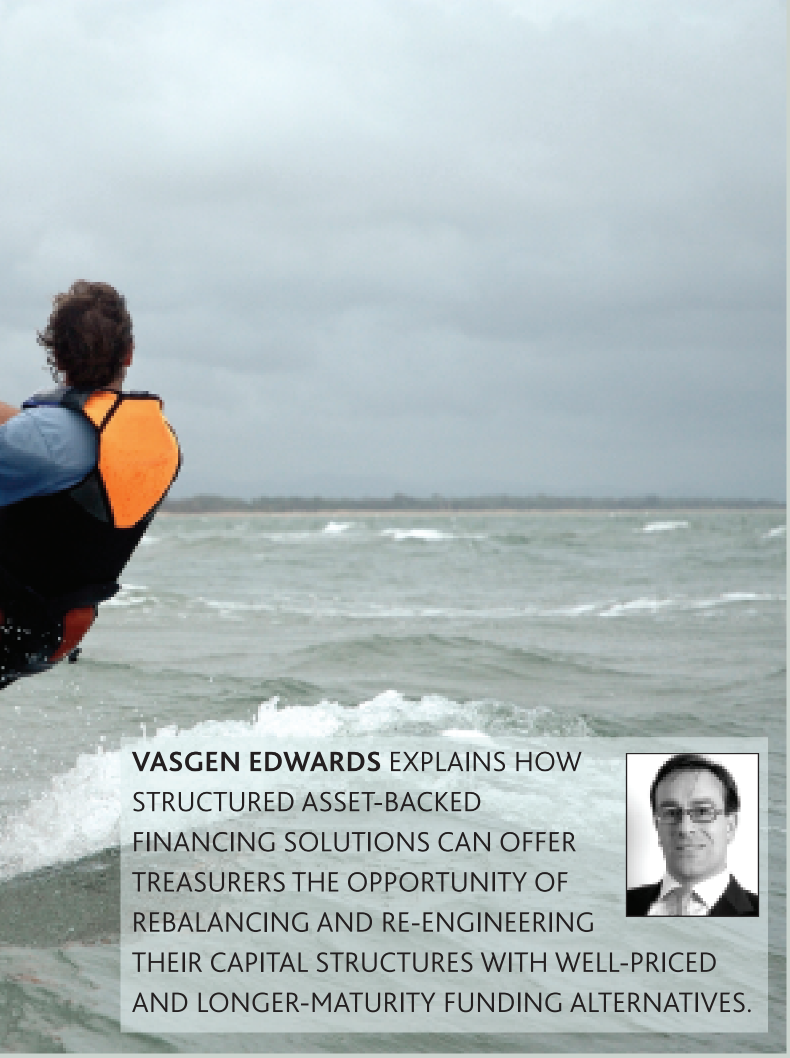
In terms of pricing, asset-backed solutions are attractive, particularly when set against current market alternatives. As the financial outputs are based on the corporate risk, as well as the asset risk, there should be a discernible benefit for the treasurer.

At the time of writing, there is a noticeable movement in market pricing for companies in the BBB to AA range. In the case of current BBB-rated 10-year bonds, the pricing level is ranging between 150bp and 250bp compared with secured asset-backed lending facilities, which can deliver a 5-15% all-in cost benefit against these markers (dependent on the nature of assets financed).

For the lender, asset-backed financing can be seen as super-secured. By taking a position on assets that are mission-critical to the business,

Figure 1: Spread over midswaps





VASGEN EDWARDS EXPLAINS HOW STRUCTURED ASSET-BACKED FINANCING SOLUTIONS CAN OFFER TREASURERS THE OPPORTUNITY OF REBALANCING AND RE-ENGINEERING THEIR CAPITAL STRUCTURES WITH WELL-PRICED AND LONGER-MATURITY FUNDING ALTERNATIVES.

Box 1: Benefits

Extending the maturity value At a time when traditional revolving credit facilities have shortened their tenor from five to three years, extending the maturity value of underlying debt is more important than ever. Structured debt facilities can be made available up to 10 years, aligned to the primary useful life of the asset involved. The profiles of these facilities can be regulated to match projected cashflows, including construction periods and working capital increases for new facilities that are coming on stream.

Securing best value Price points are more favourably disposed to these structured debt facilities and it is highly likely that further regulatory requirements will make them even more attractive to lender and client.

Accounting and tax considerations Structured debt providers have a comprehensive understanding of the balance sheet dynamics of these facilities and the corollary of P&L and tax impacts. While very large tax-based leases are no longer as visible in today's market, the knowledge gained from structuring these facilities is highly portable and can be deployed in the analysis of asset refinancing or IAS 17-compliant leases (on or off balance sheet). The Writing Down Allowance regime has been geared to favour borrowers and it is possible to enter into structured debt facilities that will allow a tax-neutral (and balance sheet-neutral) solution.

the lender can engender greater flexibility in the solution. At a time when banks are bound more tightly by regulation, this type of lending fits in well with the Basel II framework, which describes a more comprehensive measure and minimum standard for capital adequacy. By securing a financing solution against a tangible asset, the bank can align the risk profile of the deal with the regulatory capital requirements outlined in Basel II.

In contrast to traditional cashflow-based bank loans, structured asset-backed financing relies both on the borrower's financial and operational performance and on the quality of the underlying collateral. It is designed to address immediate financing needs by allowing companies to monetise their balance sheets and accelerate their access to capital.

DELIVERING THE SOLUTION Larger-ticket structured asset-backed lenders have always engendered a significant degree of creativity in their solutions. This is unsurprising as almost all of the structured debt facilities provided by Lloyds TSB Corporate Markets, for example, are on a bilateral basis, enabling the construction of a precise, yet quickly delivered solution.

Outside the standard credit underwriting process there is also a need to determine how the chosen assets work for the client and how the loan to value can be optimised to suit cashflow forecasts. The asset appraisal process is relatively standardised (and always runs in parallel with the credit diligence), either when considering the refinancing of existing asset pools or raising facilities against planned capital expenditure.

The formula involves an assessment of equipment age, location (these solutions are not limited to the UK), specific operational function and expected lifecycle. Core fixed asset financiers will be able to field in-house expertise to qualify all of the foregoing, thereby shortening any diligence process. In certain instances involving commoditised assets, a desktop review is sufficient for the lender to prepare key credit papers. Very sophisticated structured debt providers will also be able to take residual value risk in a range of asset classes, whether the equipment is new or used. These residual value structured transactions are often highly complementary to the terms and conditions of existing RCFs.

With a clear understanding of the asset piece of the transaction, there is also a need to balance the wider economic considerations of the client. The core tenets here are:

- tenor (and associated cashflow profiles);
- price;
- balance sheet; and
- profit & loss impact.

ALTERNATIVES There are a number of alternatives for treasurers to consider when deciding how to raise capital and structure the most appropriate financing solutions. Structured asset finance/secured financing is designed to complement the core fundamentals of the capital structure (RCFs and bonds).

By using the principles of Basel II it is possible to create very current and flexible funding solutions that are easily absorbed and understood in equal measure. And although they are a useful diversification tool in a firm's capital structure regardless of the economic environment, it is at times like this, when funding sources are limited, that well-priced and quickly delivered solutions can become essential to corporate financing needs.

Vasgen Edwards is managing director of Corporate Asset Finance at Lloyds Banking Group.
Vasgen.edwards@lloydsbanking.com
www.lloydstsbcorporatemarkets.com

Lloyds TSB | Corporate Markets