MAKING HAY WHILE THE SUN SHINES

The outlook for corporate fundraising is bright thanks to greater liquidity within the banking sector, momentum in the bond market and IPOs coming back into vogue. Philip Smith reports

Over the summer, expectations were high that a policy shift at the US Federal Reserve could stem investors' appetites for corporate debt. It was widely believed that the Fed would begin to withdraw from its asset purchase programme – a move that would usher in the end of record-low corporate borrowing rates.

But the predicted slow death of quantitative easing (QE) appeared premature, and when the Fed announced it would maintain its current activity in the market – making monthly asset purchases of $85bn a month – corporates began to line up to take advantage of the still-open window of opportunity, both in the US and in Europe.

The spate of issuances began even before mid-September when Fed chairman Ben Bernanke backed away from his 'guidance' given three months previously. Early in September, international food group Nestlé launched two bond issuances on consecutive days – a $500m six-year issue followed by a €500m eight-year issue.

Dealogic, the corporate finance research provider, anticipated that September's bond issue total was likely to hit $140bn. This figure was, of course, bolstered by Verizon's record $49bn bond issue, to help finance its acquisition of UK telecommunications operator Vodafone's stake in its wireless business, dwarfing the previous $17bn record sale of Apple bonds made in April.

But this window of opportunity may only stay open for a few more months as QE inevitably draws to a close. "The Fed's decision to continue with QE [in September] heralded general excitement and means that the taps are still on in the bond market," says Luke Reeve, a debt advisory partner at professional services firm EY. "But QE is unsustainable, and given recent news on the US's debt ceiling, I cannot see it lasting more than a few months."

The combination of ultra-low interest rates, supported by the interventionist action of central banks such as the Fed, Bank of England and European Central Bank, means that investors are constantly looking for better yields, which is having a significant impact on how corporates can raise funds. "In the US, there is a large amount of liquidity trying to find a home, and companies are taking advantage of this," explains Fenton Burgin, debt advisory partner at consultancy Deloitte. "In the UK and Europe, companies have been used to using primary bank debt, but we have seen a shift over the past 18 months towards the US model."

"Corporates continue to diversify their sources of funding, buoyed by significant liquidity both in Europe and the US," comments Nick Atkinson, a debt and capital advisory partner at PwC, the professional services firm. According to the firm, conditions in the corporate debt markets have improved in 2013, continuing last year's strong performance. But it also notes that banks are once again liquid and open for business. This has resulted in loan volume growth outpacing the bond

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"The general story is around bonds," says John Grout, policy and technical director at the ACT. "Larger companies, but also some mid-sized companies, are tending to use bonds rather than banks because banks haven't felt well for a while. But companies should not overlook banks; this is partly because banks are able to sell loans on to funds that are looking for higher-yielding instruments."

Government policies are also having an impact. As Reeve says: "The initiative that has had the most impact on the loan market [in the UK] has been Funding for Lending, which anecdotally has driven down pricing for an average investment-grade corporate by between 75 basis points and 1% since this time last year. And because Funding for Lending has targets attached to it, as we get towards the end of the calendar year, any banks that are under-invested could become increasingly aggressive on pricing and terms."

But Grout says that the rule followed by companies of "funding long and funding early" means that companies are continuing to take advantage of favourable conditions in the bond markets. "This is partly reflected in the large cash holdings that these companies are now sitting on," he says, "both for small- and medium-sized companies as well as larger ones."

$49bn

VERIZON DIALS UP BIG NUMBERS

- Investors were quick to snap up the $49bn bond issue from Verizon, the US telecommunications company, when it was launched in September. Proceeds from the bond were to be used as part of the company's $130bn acquisition of Vodafone's 45% stake in Verizon Wireless that it did not own.
- The deal dwarfed the $17bn bond issued by computer giant Apple in April, which at the time was the largest such issue. But the terms of the Verizon bond were regarded as more generous than those offered by the iPhone manufacturer, as it sought to lock in a low interest rate before any QE tapering comes into effect.

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ENTERPRISE INNS TOASTS REFINANCING REFILL

- Enterprise Inns, which owns some 6,000 drinking establishments around the UK, recently secured £97m through an unsecured guaranteed convertible bond. With a seven-year maturity, the bonds carried a 3.5% coupon.
- Neil Smith, the group's CEO, said: "Taking advantage of favourable market conditions, we have accessed a new source of low-cost, unsecured financing to strengthen our balance sheet, which allows us to maintain optimum flexibility."
- The group said the issue would allow it to reduce the current level of pub disposals, and instead focus on the disposal of underperforming assets, "maximising returns for shareholders by the reinvestment of disposal proceeds into trade, generating capital expenditure schemes designed to drive like-for-like growth across the business".

Burgin agrees, noting that the percentage of cash held on UK corporate balance sheets is at an all-time high. This, he believes, could herald a period of M&A activity as corporates come under pressure to show a return on their shareholders' money. "During the recession, companies were conservative, paying down debt, with little M&A activity or capital expenditure," Burgin says. "But now there is the view that many corporates will move out of cash. While the eurozone is recovering, organic growth will still be modest, so there will be a big pick-up in M&A in the next 12 months to help drive growth."

Reeve agrees. "Corporates can only do three things with the cash," he says. "Invest, buy things or give it back to their shareholders, and there are reasons to believe that we could be at the beginning of a strong period for M&As." Reeve adds that, generally, corporates are still deleveraging, but when they start to lever up again for investment, capital expenditure or acquisitions, more leverage will come from the bond market, not the bank debt market.

Reeve has also seen continuing strength in the private placement markets, both in the US and UK, which he describes as a 'stepping stone' between bank loans and bonds. In the US market, volumes reached an all-time high in 2012, hitting $55bn, but have since fallen back to $22bn in the first six months of 2013, according to EY figures.

"You can issue very bespoke maturities and amounts," explains Reeve, "and there is not a significant pricing premium over the public markets these days."

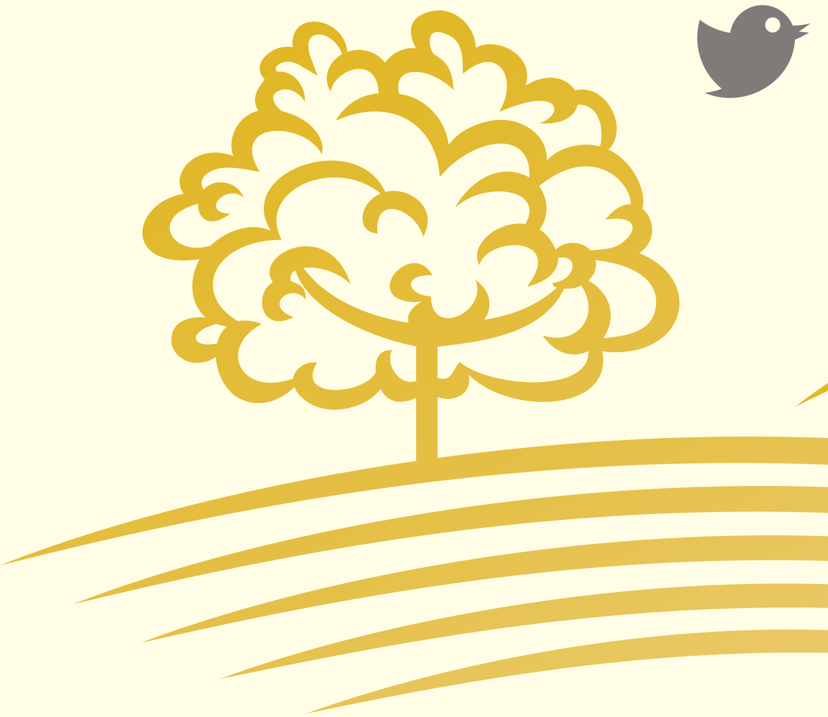
The ACT has also been encouraged by activity in the UK private placement market. A year ago the association reported on the difficulties for mid-sized companies in raising non-bank finance, but it is now seeing signs of improvement. "The ACT was looking at why mid-sized companies did not have much access to the private placement markets," says Martin O'Donovan, deputy policy and technical director at the ACT. "It has been slow to take off, but if you look at France, their equivalent market is quite buoyant."

This has been helped by Standard & Poor's, the rating agency, which has announced the introduction of a 'mid-market evaluation' (MME). Such an evaluation is designed to assess the creditworthiness of mid-market companies and will, the ACT believes, give added impetus to the market.

"An MME is issued privately, and is tailored for a private placement market," says O'Donovan.

The association is aware of several commercial initiatives from intermediaries that can bring together mid-sized borrowers and new non-bank investors, and provide efficient value-added services to both sides, which will, over time, open up the possibilities for private placement lending for amounts down to around £5m. For the UK market, the Funding for Lending scheme is easing conditions for bank lending to companies, but the ACT's hope is that when this scheme reaches the end of its life in January 2015, a new private placement market will be able to help fill the corporate funding gap.

Burgin has also observed an increase in alternative funding structures, such as unitranche financing, which combines senior and subordinated debt into one instrument. "It's a loan instrument, but looks like a bank loan,"



TWITTER TAKES OFF

◆ The most eagerly awaited IPO of 2013 is set to take place this month when US social media networking website Twitter goes public. Twitter, which hopes to raise around $1bn from the listing, is worth an estimated $12.8bn. Twitter's revenues had grown to $317m by the end of 2012, although it has not yet made a profit since its launch in 2006. It is thought that the company will use the capital it raises from the IPO to improve the content experience that users get and enhance its advertising proposition.

he says. Covenant-lite deals are also on the rise, while smaller companies are now beginning to access the high-yield bond market, once the preserve of companies that could claim profits of more than £50m. "This may be priced at a premium," Burgin says, "but it is very interesting for smaller companies, and is still cheap money."

Of course, one should not forget the level of refinancing activity seen in recent months – there had been fears that a 'wall of debt' would create refinancing difficulties for a number of corporates, especially in the private equity (PE) sector. But such fears have not materialised so far, as companies have been able to lock into improved terms and facilities. In the first nine months of 2013, there was £12.8bn of PE refinancings in the UK, according to the Centre for Management Buyout Research, the same as for the whole of 2012, as PE-backed companies sought to amend and extend their financing.

"The solution has proven to be many different things," says Reeve, "a strong high-yield bond market has taken some – a certain amount of leveraged loans – and some hasn't had to be refinanced at all as companies have generated cash and paid down debt."

Amid the excitement in the bond markets, the initial public offering (IPO) market has also creaked back into life. By the end of the first nine months of 2013, global IPO activity was expected to raise $94.8bn from 566 offerings, according to EY.

"Markets are stable and issuers of equity have a more realistic approach to valuations than they have done in the past," says Reeve. "They can afford to do so with equity markets still fairly high. It is not so easy in unstable markets and if you slap a ridiculous valuation on yourself."

Reeve also says he can see the equity markets playing a role if there is a new wave of M&A activity. "Logically, this activity could come with new equity issuance to maintain balance sheet gearing," he says.

It might not be a return to the halcyon days of the mid 2000s, but if current trends continue, this year could be the second best since 2007, according to Capita, the support services provider. "A healthy IPO market is crucial to the long-term functioning of the economy and the financial system," says Justin Cooper, chief executive of Capita Registrars, who believes this recovery will gain pace into 2014, which it says should see the best deal flow in years, and around 50% higher than 2013.

But there is an elephant in the room – QE – with most eyes looking at what the Fed will do. The situation has been likened to a parent helping a child to ride a bicycle – at what point does the parent lift their hand from the child's shoulder? As economic recovery takes hold, then central banks will begin to let go, but the cyclist may still wobble before getting up to speed.

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