Those market mood swings

AFTER THE RELATIVELY BENIGN ENVIRONMENT OF THE FIRST HALF OF THIS YEAR, MARKETS HAVE REACTED SHARPLY TO LOOMING UNCERTAINTIES. BUT **SIMON ALLOCCA** INSISTS HE IS NO PESSIMIST.

For most of the first half of this year, loan markets were experiencing reasonable levels of liquidity, with banks looking to support their clients in a fairly benign market environment. During that period, we saw pricing reduce and borrowers much more readily able to dictate documentation and structure, while banks were both able and determined to maintain their supportive client relationships.

It is true that there was very little H1 debt-funded acquisition activity but, for most of that period, the bond markets – both investment grade and high yield – were very much open for business and performing in an orderly manner. Bond investors and loan investors alike succeeded in taking the sovereign debt challenges emerging in southern Europe in their stride and didn't necessarily interpret those difficulties as a reason to stop doing business for their corporate clients. The leverage business also remained extremely buoyant, driven by high levels of CLO (collateralised loan obligation) investor liquidity.

DEALS EXEMPLIFY THE MOOD In that environment, banks were able to structure loans and bonds knowing that there were appropriate numbers of investors to buy those assets. And, in the last year or so, several transactions have exemplified this mood.

During what most would regard as one of the most volatile periods for the construction industry, for example, leading housebuilder Barratt Developments successfully secured debt refinancing to provide the group with around £1.1bn of committed facilities to May 2015, with some extending to 2021.

Barratt was strongly supported by a core group of UK banks, led by Lloyds Bank, but, encouragingly, new money was attracted from overseas.

The depth and scale of banking support for a relatively new enterprise is illustrated by Towergate Partnership's ability to

THE MARKETS, IN THE BROADEST POSSIBLE SENSE, HAVE STARTED REACTING TO THE SOVEREIGN DEBT CRISES IN SOUTHERN EUROPE, AS WELL AS TO THE CONTINUING INSTABILITIES IN NORTH AFRICA AND THE MIDDLE EAST.

secure £200m of equity investment from global equity firm Advent International, plus £930m of new debt facilities.

That refinancing, which reduced Towergate's total borrowings by more than £100m, comprised a £520m corporate bond issue led by JP Morgan and Credit Suisse, and £410m of new bank debt facilities agreed with a consortium of banks led by Lloyds Bank Corporate Markets and Goldman Sachs, of which £90m was ring-fenced for acquisitions.

On the back of strong investor liquidity, deals such as the €395m senior debt facilities for Bain Capital's acquisition of IMCD from AAC Capital were successfully syndicated. Lloyds Bank, UBS and ING underwrote the €395m, with KKR underwriting the €105m mezzanine facility.

SHARP FOCUS ON SOVEREIGN DEBT What we have seen over the last three months or so, however, is an increased focus on and elevation of the wider macro issues: the markets, in the broadest possible sense, have started reacting to the sovereign debt crises in southern Europe, as well as to the continuing instabilities in North Africa and the Middle East. They have been heavily influenced by the growing perception that there seems to be no clear or obvious route to a resolution of these instabilities.

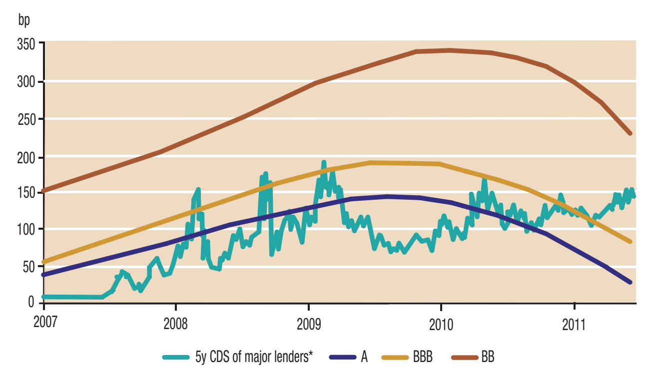
That is the over-arching factor now affecting market sentiment. It has become increasingly apparent that there is no single answer to the problems flowing from the sovereign debt crises, that the measures put in place in the last two years have been simply a stop-gap and that more remedial work is required within those sovereign entities and through external interventions.

But it is the lack of clarity about the action agenda that is now driving markets most. It is clear that neither the problems nor the solutions can be confined to individual countries or even groups of countries. It needs to be resolved globally and not locally. Trying to deal with the sovereign issues piecemeal is not going to provide the solutions the markets need.

BOND MARKETS ARE HIGHLY VOLATILE In this more febrile environment, the products impacted first are those that are most sensitive to these macro market uncertainties. All bond markets – the high yield, the unrated and indeed pretty much the investment-grade bond market too – can often close quickly and remain volatile.

The loan market remains open but clearly that too becomes more difficult if banks don't want to absorb new money with no expectation of being repaid through bond markets that are closed.

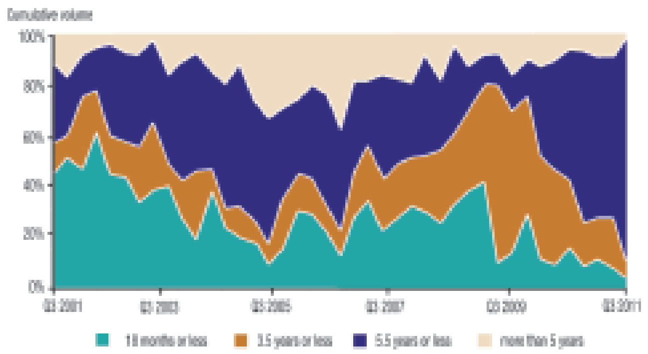
Figure 1: European corporate pricing



*Major lenders: Lloyds, Barclays, HSBC, RBS, JP Morgan, BNP Paribas

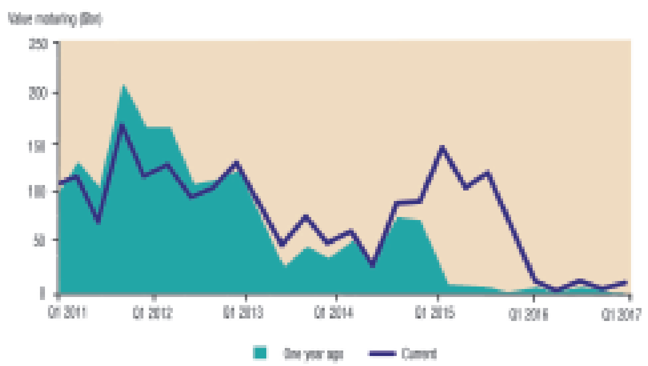
Source: Dealogic/Bloomberg

Figure 2: European corporate loan tenors



Source: Dealogic

Figure 3: European corporate maturity profile



Source: Dealogic

The big issue for the banks going forward is not if, but when, all these bond markets – high yield and investment grade – will re-open. Until they do, it is bound to inhibit any transaction underwriting, M&A activity or other investments that companies may want to fund through debt.

IMPACT ON LOAN PRICES AND TENORS These evolving uncertainties have affected both the pricing and tenor of loans. Over the last 12 months, there was significant downward pressure on loan pricing, with the result that we've seen a reduction in margins on every rating class of borrower.

That has now stabilised and has been replaced by some pressure for pricing to move upwards. The significant issue here is the effect this has on driving up the internal funding costs of lenders themselves. As lenders' costs rise, that is going to be quite a big determinant of the pricing of loan products banks provide to their customers.

Loan tenors have also altered, as you would expect. Following the 2008 financial crisis, tenors had come in but they have now gone back to where they originally were, which effectively is five years for strong corporate borrowers. We have not witnessed any movement on that in the current market and, indeed, we don't expect to see any.

REGULATION DRIVES UP LENDERS' COSTS Over the coming months and years banks' operational relationships with corporate clients are likely to be affected by growing regulatory pressures. As banks come to terms with these, it is imperative that borrowers fully understand the implications, as more onerous rules governing the capital adequacy and liquidity of banks all imply additional costs.

Liquidity rules will require banks to hold enough liquid assets to withstand a 30-day period of stress. Committed but undrawn facilities are included in the calculations. These inevitably feed through to pricing, which impacts any bank's ability to provide support and finance for its clients.

"WALL OF REFINANCING" NOT AS BIG On the other hand, I do sense a diminishing concern about the sheer volume of imminently maturing loans. People have talked about a "wall of refinancing". My own view is that many of those situations have already been refinanced or rolled off. Certainly, there are certain asset classes – infrastructure and leverage, for example – where it is still an issue, but I think the so-called wall of refinancing is not as big an issue as some thought it might prove to be.

On the contrary, there appears to be a genuine desire by banks to lend and to support their customers. Liquidity remains good and if there is an appropriate opportunity to lend, then in my view, banks will.

REASONS FOR REALISM – AND OPTIMISM What is so important right now is that all parties remain realistic about what can be achieved in today's difficult and volatile environment. We're on this financing journey together. The purpose of the partnership is simply to ensure that corporates feel they're getting the support they need from their banks, and that the banks themselves grasp the convincing growth opportunities being offered by the corporate community.

Personally, I'm far from being pessimistic about what lies ahead. On the contrary, I'm upbeat about the endurance and resilience of the lending markets: even in the darkest days of 2008, lending activity persisted. Our market has never closed en masse, and I don't see that changing. That is our business.

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