

Syndicated loansmeeting today's needs

The rapidly changing corporate world means syndicated loans are now used by banks to provide ever greater liquidity to companies. Richard Cartledge of HSBC investigates.

Ver recent years, the industry has witnessed a gradual change in the landscape of the syndicated loan market. The traditional lending model, targeted at relationship banks, has been replaced by a product which has taken on many of the characteristics of the public capital markets. The market has shown the capacity to raise significant amounts of debt finance, and is one that corporate treasurers and finance directors cannot afford to ignore in either the short or medium term.

The varied changes in the loan market have been driven by:

- the M&A boom in the US and UK, and now spreading across Europe, as companies are required to enhance shareholder returns through consolidation within their particular industry and resultant cost cutting;
- the unattractiveness of raising new equity at a time when share values of many companies in traditional industries have fallen significantly. As a result companies are prepared to operate with increased debt leverage and correspondingly lower credit ratings; and
- the desire of banks to increase their return on equity by managing their balance sheets more actively and achieving better returns from their lending activity.

This M&A boom is placing greater emphasis on the ability to raise debt finance, often in large amounts and at short notice. The syndicated loan market has proved in recent years that it can provide such finance by:

 harnessing vast liquidity from the banking market. More than 60 The syndicated loan is capable not only of meeting the day-to-day working capital needs of companies, but also of facilitating major M&A activity which is reshaping the corporate landscape

banks worldwide have shown an ability and willingness to underwrite \$1bn or more in various acquisition financings. The \$8.5bn financing for ICI in 1997 broke new ground, and both Olivetti and Vodafone have now shown that fulfilling needs of up to €30bn is possible. The chart in Figure 1 provides details of Euromarket volumes;

- providing this liquidity with speed, certainty and confidentially by way of underwriting;
- providing 'bespoke' financing structures to suit specific situations; and
- incorporating flexible bridge options allowing borrowers the breathing space to undertake either a disposal programme or to refinance in the long term capital markets to improve their capital structures.

All of this begs the question of how a company can go about getting the 'best' transaction so far as pricing, flexibility, execution and distribution are concerned. Besides choosing arrangers with market presence and experience, treasurers must be aware of current pricing, market conditions and the factors that drive banks' lending appetite.

Pricing/current market conditions

Loan market pricing is determined by a combination of factors. Whilst perception of underlying credit will always be important, it is the balance of supply and demand between borrowers and bank lenders which is the principal determinant of loan pricing. Interest margins and fees have increased over the last two years as a result of increasing demand from borrowers and a reduction in supply caused by consolidation in the banking industry (as rapid amongst banks as with their clients). However, as detailed earlier, there is still a healthy appetite when loans are pitched at the right price.

Lending appetite

While appropriate pricing is the key factor to unlocking lending appetite, there are other important factors such as:

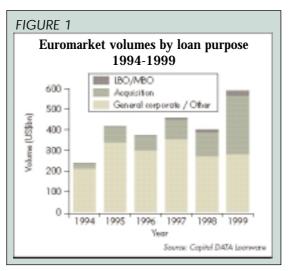
- the value and extent of ancillary business to relationship banks. Borrowers with significant ancillary business are better placed to achieve the finest pricing, provided that the financing can be accommodated within that relationship group. It is important for borrowers to manage their relationships carefully to ensure that sufficient banks are in place at any one time without diluting ancillary business benefits too far;
- the quality of financial and other information which a borrower is able to share with its lenders. The provision of detailed financial

projections is now normal market practice for large scale acquisition finance, even for highly-rated corporates;

the extent and strength of appropriate financial covenants. Cash-flow-driven covenants have now largely replaced balance sheet tests, other than for asset intensive businesses, such as property companies. Interest cover and limits on debt as a multiple of EBITDA are now the normal basic tests, supplemented by others as necessary. Multiples of 3x for interest cover and 3/3.5x for debt/EBITDA would be considered normal cor-

porate tests, and the further a borrower moves beyond these boundaries, the greater the impact on liquidity and pricing levels;

for larger financings the inclusion of a 364 day tranche will help to sustain appetite. A 364 day tranche of between 25% and 50% of facility size is common in acquisition financing, (provided take out



options are realistic), which helps to maximise lender appetite and keep pricing in check; and

• the ability to freely transfer loan assets in the secondary market will have a positive impact on lender appetite. Corporate facilities will normally include language which allows banks to transfer, subject to borrower consent not to be unreasonably withheld. However, larger acquisition facilities will normally permit transfer without any form of consent. This allows banks to manage their balance sheet assets more effectively, and banks will be encouraged to commit higher amounts.

Overall the basic merits and advantages of the syndicated loan have remained unchanged and it is simply the environment in which the product is used that has moved on apace. The syndicated loan has proved itself capable not only of meeting the day-to-day working capital needs of companies, but

also of facilitating the major M&A activity which is reshaping the corporate landscape. Volumes raised are testament to the role that banks can play in providing liquidity to meet the aspirations of their clients worldwide.

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