Debt Side Story

2012 – A tale of two markets

2012 presented borrowers with a two tier market in terms of accessibility and available options for liquidity. Looking ahead to 2013, there is little to suggest the market will take a different direction….

Bank lending – where next?

EMEA bank lending plummeted by almost 25% in 2012[1] driven by a number of factors… to name just a few:

- Borrowers diversifying away from reliance on banks
- Banks rigorously considering the value to them of corporate lending relationships and retreating where the returns don't work for them
- Continued retrenchment of banks to home markets
- Developing impact of regulatory requirements and restitution for previous issues eg PPI
- Ongoing macroeconomic challenges including mounting fears of a triple dip UK recession and Eurozone concerns

Notwithstanding the above, the bank markets remained open for strong credits and will continue to play a crucial role in supporting UK plc. However, we expect the borrowers diversifying trend to continue.

[1] Source: Dialogic
[2] Source: Private Placement Letter

The view from the top

Large borrowers with strong credit metrics and sufficient scale of borrowing requirements have been able to access liquidity via the debt capital markets, with bond issuance outpacing syndicated bank loan issues. Long term funding is being locked in at historically low all-in rates, as investor appetite both in domestic and overseas markets and the various government interventions drove borrowing costs down.

Strong mid-sized corporates also contributed to record issuance in the USPP market with approximately 50% of issuance by non-US borrowers[2].

However, borrowers should remember that timing is all in the debt capital markets to ensure best execution. As for any refinancing, timing and execution, particularly for new issuers, must be carefully planned with plenty of time ahead of any debt maturity deadlines to retain flexibility.

Stuck in the middle?

Mid market corporates no longer need to be wholly reliant on the traditional bank market to meet their funding requirements. We are helping some of our clients access a number of alternative markets, including the bilateral private placement market, the retail bond market and asset-based lending solutions.

In an unpredictable environment, maximising optionality is important to reduce the risk of surprises and ensure that sub-optimal decisions driven by lack of choice are avoided.

However, for some borrowers there may not be alternatives to the bank market as poor trading, sector issues or structural complexities can position them in the "too difficult" box. Now more than ever it is important to consider how best to position the credit story to lenders and demonstrate credit enhancing actions to maximise deliverability. With uncertain bank liquidity and appetite, having a "Plan B" is good practice.

2013 - Markets to watch out for…

A positive outlook for the retail bond market

In the June 2011 edition of Debt Side Story we wrote about the then-nascent UK retail bond market, which had seen the launch of several bonds specifically targeting retail investors. Continued issuance has supported the development of this market, and it is becoming an increasingly credible alternative to the traditional institutional bond and bank markets.

Since the formal launch of the retail bond market more than £2.6 billion[3] has been raised, with several issuers successfully returning for repeat issues. The marketplace was particularly busy in the second half of 2012, with several issuers often simultaneously competing for retail investors' funds, yet nearly all closed at or above the targeted fundraising amount[3], demonstrating the increasing ability to absorb multiple deals at any one time.

However, relevance to individual borrowers is likely to vary depending on objectives and circumstances. Access to the retail bond market was once considered to be restricted to borrowers with a recognised name, material assets, robust performance or large and loyal customer bases. Whilst name recognition and brand awareness still remain important factors, the range of borrowers accessing retail funding has widened materially. This diversification of issuer profile has been reflected in a growing range of bond terms and structures, including both fixed-rate and index-linked coupons, issuance from unrated and rated borrowers, covenanted and unconvenanted bonds and the market's first secured retail bond. An important factor in determining liquidity and successful execution will therefore be building borrowers' understanding of the market's key features – and working out whether a retail bond is right for their business.

A shiny new market?

As borrowers search for liquidity, the German Schuldschein market has sparked interest amongst some European corporates, capturing the attention of the Loan Market Association which is considering how it can facilitate 'internationalising' a historically nationally focussed market. Advocates have pointed enthusiastically to Sainsbury's €220 million multi-currency issue in February 2012, the first FTSE 100 company to tap this market. Issuers from France and Belgium have also sourced liquidity in this market.

In the current environment of constrained bank lending, corporates could view the Schuldschein market as a potential alternative financing source. Deal size for non-German borrowers will be smaller and tenors shorter than the much larger and more developed USPP market. No formal ratings are required (albeit many issuers are already rated) and this, together with the private nature of these deals, can offer issuers clear benefits for those wary of the transparency of public bond markets.

Recent issuance suggests the need for any issuers to have either a sizeable German operation, or significant name recognition (e.g. Sainsbury's), or both. However the market remains an interesting alternative funding source which more non-German corporates could exploit in the future.

A government wrap up

- Corporates with overseas sales or operations are unlocking capacity from the expanding remit of government-backed UK Export Finance (formerly ECGD)
- Support takes the form of a triple-A guarantee for UK businesses selling goods or services overseas
- UKEF can underwrite the risk associated with contingent lines e.g. performance bonds / advance payment guarantees
- Take up is still relatively low, but we believe more corporates will look to the UKEF to unlock funding capacity in 2013

[3] Source: Corporate press releases

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