

RESTRICTED ACCESS

Banks are lending again, but new banking regulations, loan structures and products, coupled with more conservative bankers, make for tough going.

The world economic crisis demonstrated just how devastating the lack of capital can be. Without reliable lending from a smoothly functioning financial system, companies can't operate (let alone expand), stock markets plunge, unemployment soars, and recession takes hold. The global recovery couldn't begin until credit markets started to thaw. Now, with fears of a double-dip recession fading, banks have begun lending again to creditworthy corporations. Yet today's environment is hardly a return to precrisis days. CEOs and CFOs, facing an altered lending landscape, are finding that it takes more effort to persuade bankers to provide infusions of cash.

"Now, as companies start to refinance the five-year loans they took on in 2006 and 2007," says Shaun O'Callaghan, senior managing director, Corporate Finance/Restructuring, in the London office of FTI Consulting, "nothing looks the same as it did during the days before the crisis.

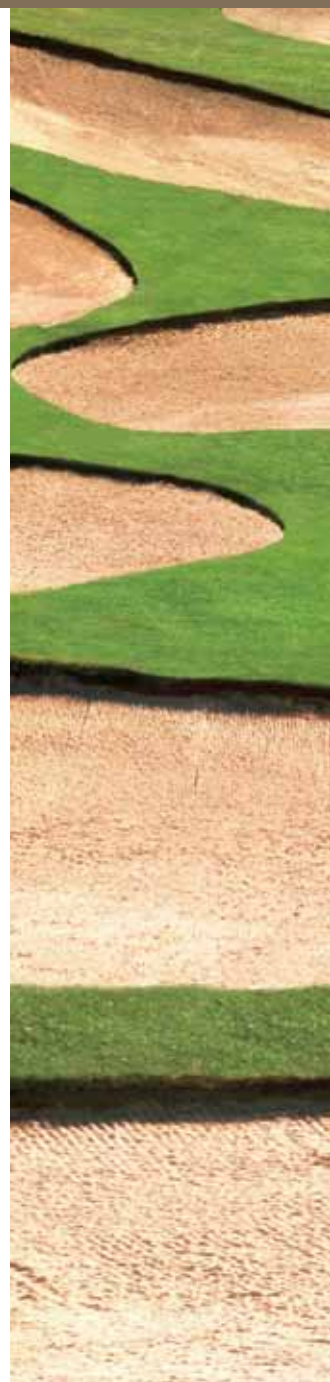
Then, European corporations sent their treasurers from bank to bank shopping for the best deal, and capital was there for the asking." Today, however, there are new banking regulations, loan structures and products, and the bankers themselves have changed.

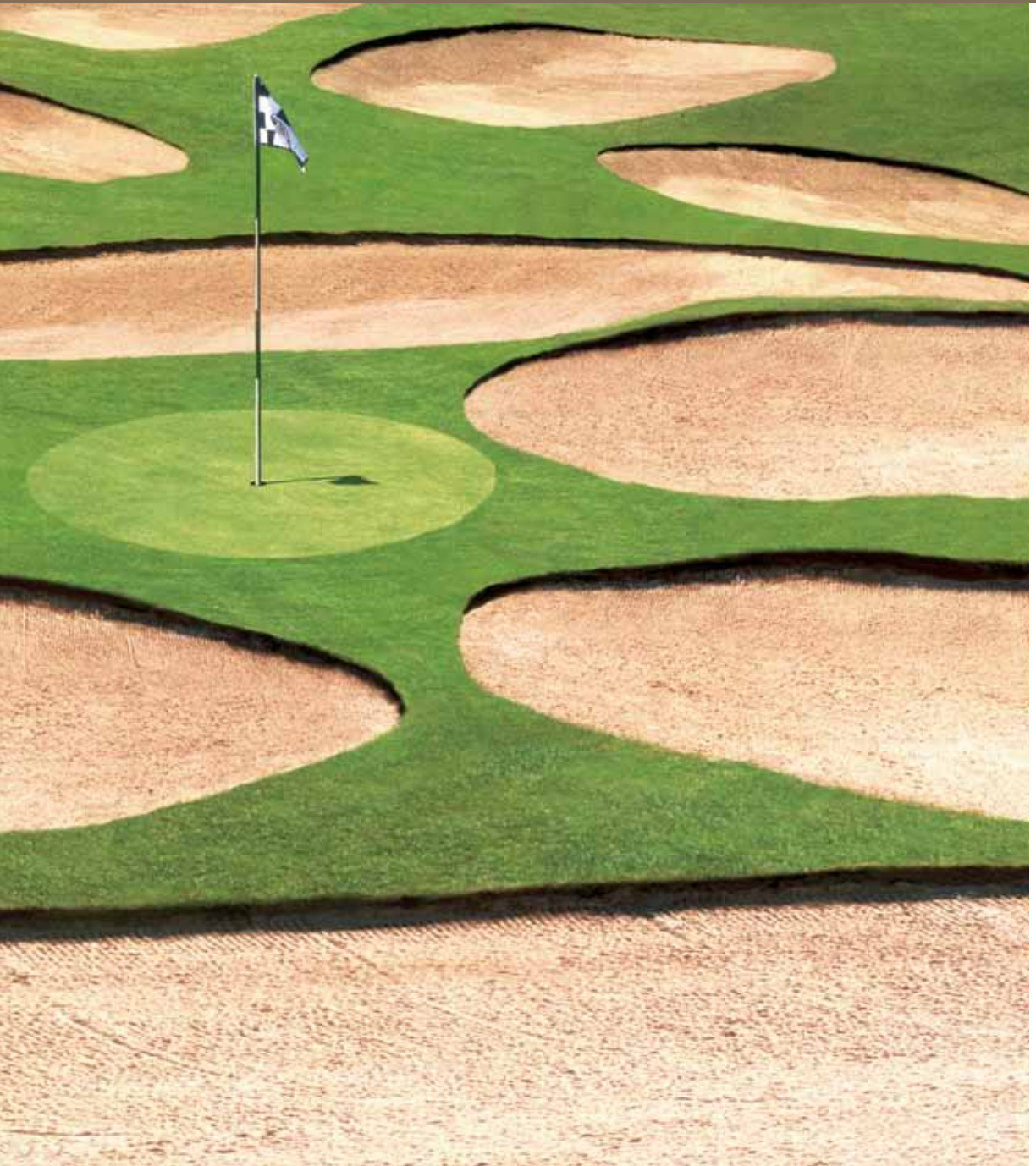
"It might take 10 calls within a bank to find the right person for a CFO to speak with, and then she still might hear 'No' several times before she hears 'Maybe,'" says O'Callaghan. That, he notes, is especially true in Europe, where "a mountain of corporate refinancing" is chasing a competitive, finite pool of capital. "C-suite executives who never viewed refinancing as a priority will be getting a rude awakening during the next 18 months," he predicts.

A REVITALIZED U.S. LOAN MARKET

In the United States, where acquiring capital through the high-yield bond market is a much more accepted and developed business practice than it is in Europe, most companies find that

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Amount in billions of dollars of new high-yield-bond issues in 2010

route open again after steep declines in 2009. The high-yield bond market had one of its best years on record in 2010 in terms of volume, with \$259 billion of new issues. Merger and acquisition activity was also strong, with \$43 billion in leveraged buyouts and \$37 billion in dividend recapitalizations. By the fourth quarter of 2010, U.S. lending was up 100% from the previous year. “The increased inflows to the bond market and the leveraged market meant there was more capital available to lend,” says Kris Coghlan, senior managing director, Corporate Finance/Restructuring, in the Philadelphia office of FTI Consulting.

From the perspective of U.S. bankers, “the loan market is the healthiest it has been recently, certainly since the fall of Lehman Brothers and

corporate-bond default rates — from more than 10% of all bonds in 2008 to less than 2% recently — also reassured banks that companies again had become reasonable credit risks.

“For quite some time, Bank of America and other institutions have had many billions of dollars of available credit that went unused because companies reacted rationally to the severe economic downturn and weren’t borrowing to build plants, invest in inventory or start hiring,” says Powers. This situation is beginning to change, though, as companies become increasingly bullish on the recovering economy. “Our outstanding loans are still down from where they were before the crisis, but we are prepared to lend aggressively, and that’s true for most banks,” says Powers.

As lenders compete to get loans on their books, companies are being offered interest rates 50 to 100 basis points lower than what they could have gotten a year earlier, along with more favorable covenant structures.

arguably since the summer of 2007,” says Joseph P. Powers, senior vice president and marketing manager for Bank of America Business Capital. “Once banks built fences to contain their problems and began to get their own capital ratios in order, they started seriously looking for opportunities to lend.” A dramatic improvement in

GOOD CREDIT, BAD CREDIT

As lenders compete to get loans on their books, companies with high-quality credit profiles are being offered interest rates 50 to 100 basis points lower than what they could have gotten a year earlier, along with more favorable covenant structures. Dividend recapitalizations are also being considered, Powers says. Large deals of more than \$100 million might command rates of London Interbank Offered Rate plus 250 to 300 basis points, while interest rates may be even more competitive for middle-market companies seeking smaller loans.

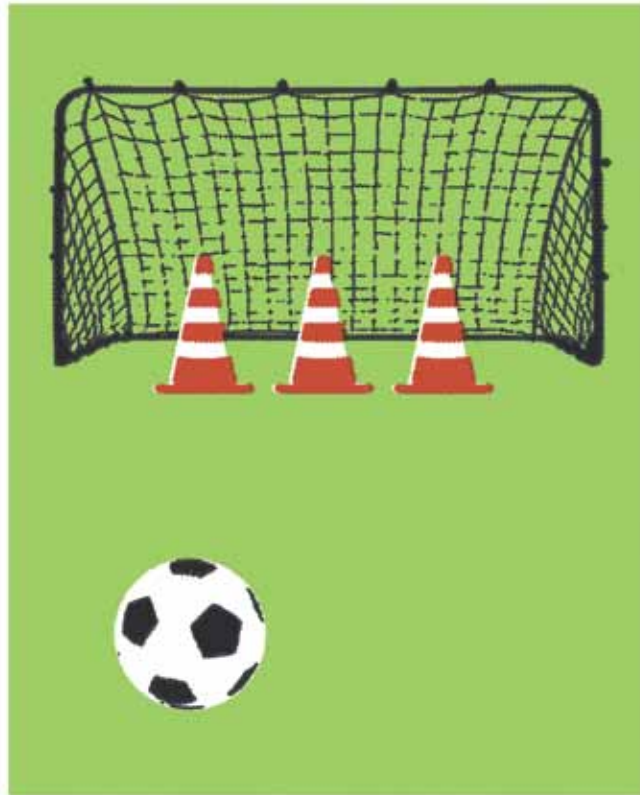
“There is less discipline for banks doing local lending on smaller deals



than there is in the broader syndicated market,” says Powers. “Middle-market companies, even those with somewhat marginal credit, may be able to get great deals from local lenders, especially if there are a number of banks vying for that business.”

Companies with a more challenging credit story face an evolving plateau. “Companies that have had some trouble can still get loans, but they are not priced anywhere near as favorably as they were before the crisis,” says Carlin Adrianopoli, senior managing director, Corporate Finance/Restructuring, in the Chicago office of FTI Consulting. “Nor are banks lending as much to these companies.” Each situation is unique, but in general, says Adrianopoli, a bank will lend a troubled company as much as 3½ times EBITDA, while, for those with good credit, it’s 4½ times EBITDA. “And whereas before the downturn, there could be a spread of 100 to 150 basis points between the two types of loans, now you’re looking at a spread of 200 to 300 basis points,” he says.

Even companies that haven’t had past credit problems may face skepticism about overly bullish business projections. “Banks these days are much less forgiving of a hockey-stick business plan for which a bridge to an acceptable EBITDA or an acceptable level of earnings is built into the forecast but hasn’t yet been achieved,” Adrianopoli says. “You will have a much tougher time commanding competitive pricing with a business plan that has an unproven level of growth than you

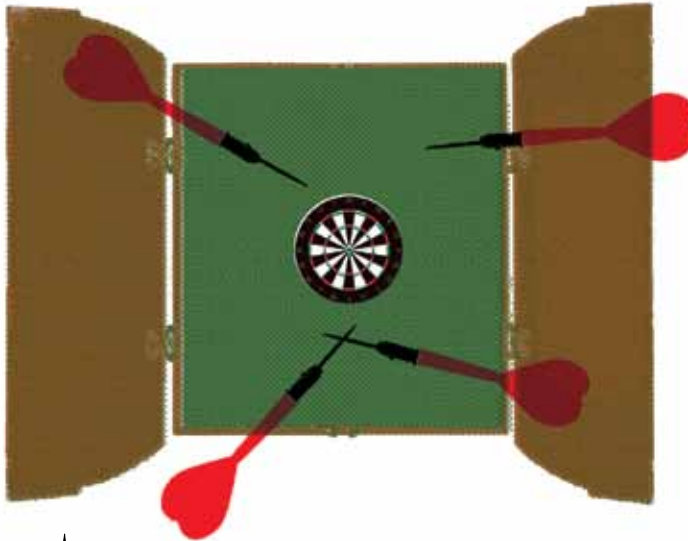


will with one that demonstrates a track record of earnings.”

Companies turned down by their banks have other options, including mezzanine lenders — hedge funds that will take a second lien or a junior position behind a bank on lending in exchange for a higher return on an investment. “Hedge fund lenders are out raising capital again and have resolved many of their portfolio-management issues,” says Coghlan. “They’re optimistic that they’ll get back into the lending market, which will create available funds for underperforming or distressed companies.” And while



Some banks challenge loan requests from companies in certain industries.



With so many mid-market companies aiming for good rates and desirable terms, some are bound to fall short.

a traditional lender won't lend these companies more than 3 to 3½ times EBITDA, a mezzanine provider may be willing to go as high as five to six times EBITDA, says Powers. Private equity investors are another option. "Companies without good credit that are looking for capital don't have to restrict themselves to a traditional bank lender," Powers notes.

A MORE STRINGENT EUROPE

In Europe, however, to be considered for a loan, companies may have to measure up against a much longer list of criteria. Some banks will lend only to corporations with headquarters in their local jurisdiction, for example. Others routinely turn down loan requests from companies in certain industries, including construction and real estate, or they may court only those in sectors in which the banks have had successful

deals in the past. "If you understand a bank's sweet spot and can tailor your request, asking for financing becomes an easier conversation," says Mark Dewar, senior managing director, Corporate Finance/Restructuring, in the London office of FTI Consulting.

Banks can afford to be highly selective because there are far fewer traditional institutions willing to take a pure lending position on deals in Europe today. "In the past a number of banks would have been quite happy putting £30 million to £40 million to work at LIBOR plus 250," says Dewar. "Now banks have to pay an internal capital charge against that money, and the economics don't work out unless the bank can, for example, also underwrite a bond issuance for the company or generate additional income through ancillary business such as hedging or cash-management services."

That's not a concern for very large corporations or very small ones. "If you are on the top of the pile, you'll always get your financing, no problem," says O'Callaghan. "And there are political pressures on banks to keep lending to small companies so they'll also get the financing they need. It's the mid-market corporates wanting to borrow \$50 million to \$200 million that can end up in a difficult place because they're not big enough to go to the debt capital markets — you need a minimum of \$200 million to \$300 million for that — and they don't generate enough ancillary fees to support a large syndicate of banks. Many of these mid-market



companies have loans that are maturing, and it's unclear where they'll get the money to pay off those obligations."

One strategy for dealing with that uncertainty is to refinance existing loans now, even if a loan doesn't mature for another year. "You may pay a premium over today's rates to refinance early, but that may be a price you're willing to pay to secure future financing," says O'Callaghan. And that approach could be preferable to seeing your company's valuation take a hit if investors get worried. "There's a tangible link between securing refinancing and valuation of shares," O'Callaghan says. "If there are concerns about your ability to refinance, then it clearly will affect investor sentiment."

European executives also need to embrace the American model of asset-based lending and bonds as part of a company's financial model, O'Callaghan adds. "As a result of regulatory requirements, traditional European credit lines and products now can carry some of the highest capital charges for the banks, whereas asset-based lending often carries the lowest charge, and bonds are even better for banks because they involve only a fee and not a hold position," he says. "In America asset-based lending is highly sophisticated and accepted, but some European corporations wrongly see it as a last resort. And there is a much longer history of U.S. companies going to the bond market to finance debt than there is in Europe. It's going to be a cultural adjustment for European companies."

LENDERS AS STRATEGIC PARTNERS

On both continents, forging strong relationships with bankers, always important, has become an absolute necessity. "More than ever, CEOs and CFOs need to view their lenders as strategic partners," Adrianopoli says. "The business environment can change quickly, so you need lenders who are willing to stand by you through business cycles and are ready to capitalize on opportunities. You don't want to be the CEO who comes to his bank group only when something is wrong. Lenders hate surprises, and they hate it when you talk with them only when things are bad."

Adrianopoli recommends that companies with a syndicated loan involving several lenders use the lenders for each aspect of their financing

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The minimum, in millions of dollars, required to borrow from debt capital markets, effectively shutting out mid-market corporates

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needs, such as for hedging and cash management. Developing multiple relationships within your banking group may cost you more in banking fees, "but your lenders will be more in tune with your financial needs than if you're viewed as simply another loan," he says.

Often, flexibility is at least as important as pricing. "You want to

make sure that your loan gives you an adequate line of credit for short-term liquidity needs, that it has a flexible capital structure so you can repay your debt early with limited penalties, and that the lenders will be receptive to a business acquisition opportunity or foreign expansion if that's what you need," says Adrianopoli. A lender that markets itself to your industry may be a good fit for your company, but only if the bank has a track record of staying with businesses through good times and bad, he notes. "A bank's expertise in lending to particular sectors shouldn't be the only deciding factor," he cautions.

Also new is the need for the CEO and the CFO to get involved in choosing lenders and "proactively engaging in the lending process," says Dewar. That's a departure from the passive slam-

"You have to be ready to articulate your credit story in a concise and compelling way, and realize that bankers are carefully listening to what your customers, your creditors and the analysts are saying about you."

dunk refinancing that a corporation's treasurer would have handled in years past. Talking with bankers today requires the same careful crafting of mission and message that corporations rely on to prepare for a stock offering or an M&A deal. "You have to be ready to articulate your credit story in a concise and compelling way and realize that

bankers are carefully listening to what your customers, your creditors and the analysts are saying about you," says Dewar. "Demonstrating that you have complete control over your company's finances is key. You can't have overdue receivables, your inventory turns must be in line with industry norms, and you need a clear view of your cash flow requirements for the next 18 months."

PROCEED WITH CAUTION

Though most bankers now appear eager to lend to highly creditworthy companies, any number of economic problems could cause credit markets to seize up again. "Several troubling macro indicators — sovereign foreign debt; U.S. federal, state and local municipality debt; underfunded public pensions and other medical benefits; and long-term unemployment — are present despite a growing bullishness about the economy," says Adrianopoli. "Until we have true fixes to these problems, be prepared for lending choppiness to come back."

Banks seeking new business may later pull back on their lending criteria and pricing. That's why it's crucial to develop a strong relationship with a lending group, says Adrianopoli. "You need to cultivate the relationship so your bank group won't just walk away from you if the lending and business markets become harder. If you have a flexible lending line and strong relationships, you'll have access to capital when you need it, you'll have competitive pricing, and you'll be able to prosper and grow your business in any lending environment." ■