

## CEO TOPIC: FINANCING IN CHALLENGING TIMES



For those companies with a December year end, it is probably around now that the planning team is breathing a sigh of relief and looking forward to a break over the holiday period. The 2012 budget will have been locked down and approved. No more reconciling version y to version x for another year.

The formal budget process may be an annual event, but in the current economic environment, it is worth considering a more dynamic approach to the coming year. Companies have their own approach to updating the budget as the year progresses (“revised budget,” “latest estimate,” “6+6,” etc). This may historically have been relatively informal. Right now, a more rigorous approach is justified and will have been worth the extra effort if the unexpected happens.

The macro-economic environment is very uncertain and management should “expect the unexpected.” Companies may be hit by one or more of the following risks:

- Challenging banking conditions
- Government austerity measures
- The Euro crisis
- Emerging market competition

The severity and timing of the impact of such issues is hard (impossible?) to predict with any certainty. But that does not mean that management should not plan for the uncertainties (“those who fail to plan, plan to fail”). We have recently met with companies which don’t just have a single “downside scenario” but have multiple downside scenarios of varying severity, each with an agreed action plan. The companies which emerge most successfully from a crisis are typically those which have taken early and decisive action to address the issues.

Scenario planning and stress testing should include detailed cash planning and the consequent financing requirements. Banking relationships cannot be taken for granted any more. In particular, management should be focused on any upcoming refinancing requirements as a matter of priority because capital constraints and extreme volatility will make this process significantly more testing than in the past.

There is stress on bank balance sheets from various sources:

- Pressure for banking reform in a number of key countries
- Exposure to peripheral European sovereign debt
- Stress in the interbank lending market
- Unsyndicated loans from pre-crisis times
- Basel III, driving increased capital requirements

The above factors are driving significant deleveraging and a flight to quality. But many banks remain under considerable stress.

From the corporate point of view, significant cash deposits and investments should be held with a variety of financial institutions as a matter of good corporate governance. More broadly, companies should be reviewing their recurring banking relationships and assessing the impact of a single bank failure.

Examples of bank facilities which may historically have been taken for granted include:

- Trade finance insurance
- Letters of credit
- Foreign exchange facilities
- Undrawn working capital facilities
- Factoring agreements
- Recurring leasing arrangements

In the current environment, management should, for mission-critical facilities, consider ensuring that they have access to alternative providers which can step in at short notice to replace unexpected loss of existing facilities. It is hard to know exactly how things will play out across geographies and sectors but it may not be appropriate, for example, to assume that the working capital facility which is drawn down to fund additional inventory at peak times will always be there. The leveraged loan market is particularly difficult. The glut of deals completed in 2006/07 with five year senior debt financing is coming up for refinancing. This will be the focus of many banks for the foreseeable future, rather than providing new leveraged loans. Corporate lending is showing some signs of a flight to quality with the spread between AAA and BBB widening in the past few months.

Companies with loan facilities (leveraged or otherwise) which are due for renewal in the coming year should engage with their bank(s) as early as possible to discuss options. All aspects of the existing facilities may be subject to change: interest rate, term, security, covenants etc. Lenders dislike surprises and therefore regular clear communication is vital to smooth the path to successful renewal of existing facilities on acceptable terms.

If the renewal of existing loan facilities is likely to be challenging in the current environment then it is far better for management to identify this in good time. They will then have time to explore alternative strategies, for example:

- Non-core disposals
- New equity capital
- Asset leasing
- Debt factoring

In the current environment, I can only end by suggesting:

*“If you don’t plan for yourself, you’ll be part of someone else’s.”*

For more information on financing in challenging times, please contact your GA team.

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