

Corporate Financing: Safety First

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Since 2009, ensuring the availability of financing has increasingly become a top priority of companies' boards. This article summarises the measures a company can take to increase the availability and continuity of financing. The data of large Dutch firms shows that most companies have taken these measures since 2009. The data also shows that most companies have used the liquidity in the bank debt market in the first half of 2011 to further secure availability of financing.

The main purpose of a firm's financing policy is to support the execution of its strategic goals. The objectives that are derived from this purpose are:

- To secure the availability of funds to prevent the firm from running into liquidity problems and to enable the execution of the strategic goals.
- To maintain a certain flexibility to be able to react to unexpected circumstances, to facilitate changes in the firm's strategy and to seize new opportunities.
- To realise competitive financing costs by maintaining competition between suppliers of finance and by optimising the capital structure.

Since the end of 2008, the emphasis in finance has shifted from a focus on optimising costs to a focus on securing availability. In the years thereafter, this focus on availability has become even stronger. In this process, the awareness for the importance of financing is no longer restricted to the chief financial officer (CFO), but is high on the agenda of the board as well. The board wants to be aware of the status of financing and the measure taken to secure funding of the business.

Measures to Increase Availability of Finance: Part One

The first decision the board of a company can take to increase the availability of financing is to adopt a more conservative financing policy. A more conservative financing policy is reflected in one or more of the following measures:

1. *Strengthen the balance sheet:* less of the free cash flow should be dedicated to cash dividend and/or share buy backs. Debt financing of large investment projects or acquisitions should be limited to conservative leverage ratios. Dilution of profit per share should not hinder equity issues to finance net present value positive investments.
2. *Strengthen the liquidity position:* increase the cushion between cash and headroom under committed credit facilities versus forecasted cash positions and short-term repayment obligations. If liquidity is scarce, the company should place extra emphasis on cash management, ensuring visibility and control over cash and an up-to-date and reliable cash and liquidity forecast.
3. *Extend the maturity profile of debt:* debt capital markets provide longer tenors, but are expensive as their flexibility is very limited compared to bank debt. In the trade off between cost of funding and tenor, more emphasis should be put on tenors.
4. *Reduce dependency on bank debt:* apart from longer tenors, debt capital markets can reduce dependency on bank debt. In the current turbulent financial markets, the funding problems of banks are such that many banks are not in the best position to provide long-term funding. Even if market circumstances improve, the implementation of the liquidity coverage ratio and the net stable funding ratio of the Basel III package will limit the possibilities and willingness of banks to provide long term finance.

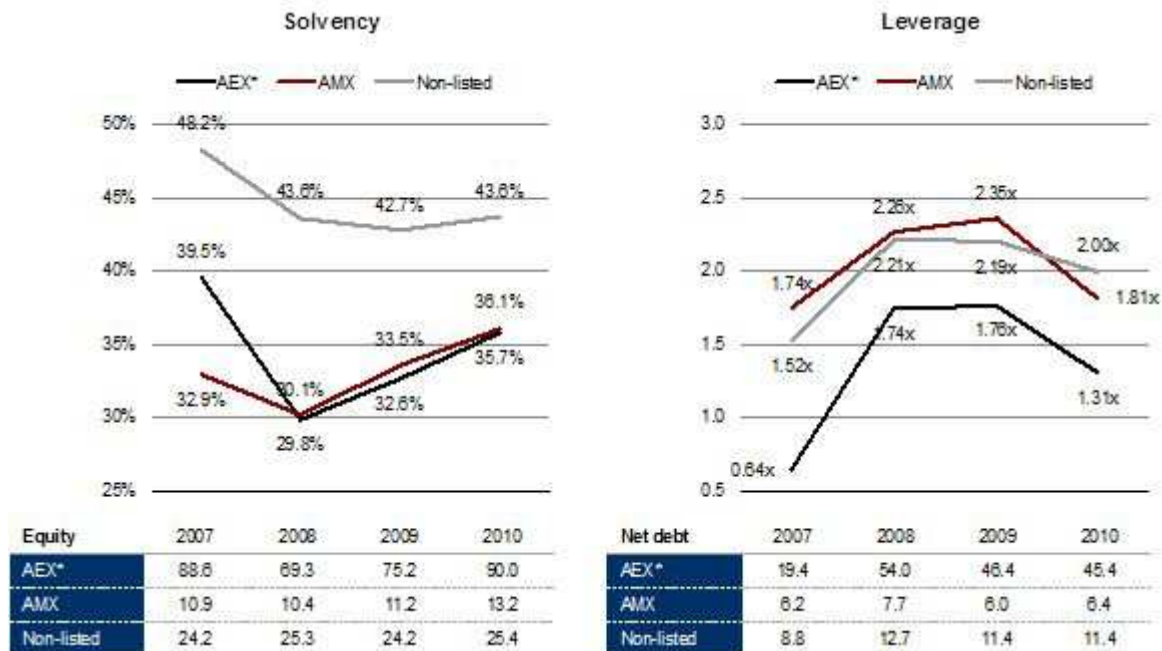
Financing Policy in Practice: Large Dutch Corporates

The data on large Dutch corporates¹ shows that most of these companies have taken some or all of the above mentioned measures to implement a more conservative financing policy.

In 2009 most companies took swift measures to cut costs (by introducing cost reduction programmes) and to free cash by rationalising investments in fixed assets and working capital. Furthermore, share repurchases came to a standstill and cash dividend was decreased in order to use the free cash to repay

back bank debt. These measures were very effective and enabled companies to manage their financial ratios. On average, the net debt to EBITDA ratio hardly increased and the solvency ratio improved in 2009 (Figure 1).

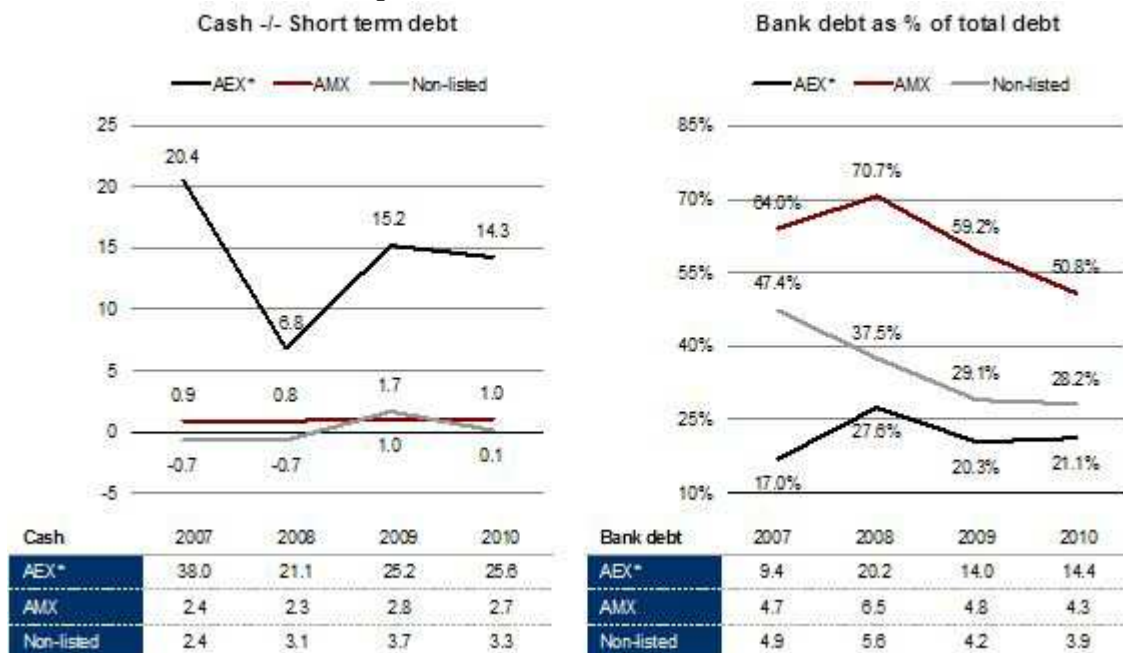
Figure 1: Financial Ratios For Large Dutch Corporates



Source: Orchard Financial

In addition, companies still tapped debt capital markets despite high credit margins, to secure long-term debt and to extend the maturity profile of their debt funding. These actions had two consequences, which are illustrated in Figure 2. The first effect is that it further improved the liquidity position, where on average the cash position by far exceeded short-term debt. This implicated that these firms had financed their invested capital (including net working capital) completely with long-term capital (long-term debt, provisions and equity). The second effect was that the bank debt showed a declining trend since 2008 both in absolute numbers (total bank debt for all indices €32.3bn in 2008 versus €22.6bn in 2010) and in relative numbers.

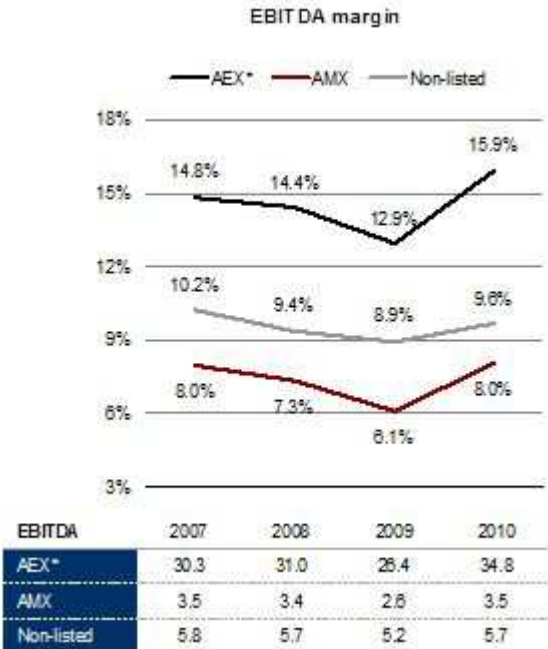
Figure 2: Cash and Bank Debt Positions



Source: Orchard Financial

During 2010 economic recovery drove operating profits, as a result of the cost cutting in 2009, towards record levels (Figure 3). Again profit and cash were used to further strengthen the balance sheet, resulting in record equity levels (Figure 1: total equity for all indices €105.0bn end of 2008 versus €128.6bn end of 2010).

Figure 3: Development of EBITDA Margin²



Source: Orchard Financial

During the course of 2010, liquidity in the bank market returned, with bankers offering lower margins, looser covenants and longer tenors to investment grade companies. This liquidity window enabled companies to increase the size and headroom under credit facilities (Figure 4: total credit facilities of AEX* firms increased from €19.8bn end of 2009 to €25.8bn end of 2010, increasing headroom by €5.4bn to €20.6bn end of 2010).

Figure 4: Size and Headroom of Credit Facilities



Source: Orchard Financial

In 2011, liquidity in the banking market improved even further. These circumstances continued until August 2011, when new concerns about the euro region and the euro itself again put the spotlight on the underlying weaknesses of the banking system. To date we are witnessing decreasing liquidity in the banking markets accompanied with uncertainty whether the bottom has been reached.

From all the financing transactions we have seen in 2011 (Figure 5), it can be concluded that the above signalled measures and trends continued in 2011. Availability of financing was secured as size and headroom under credit facilities further improved compared to 2010. As almost all of the bank debt transactions have a tenor of five years the maturity profile of credit facilities has been extended further. In addition, the number of companies (mainly AMX) active in the debt capital market (mainly US private placements) has increased, thereby extending their debt maturity profile even further and reducing dependency on bank debt.

Figure 5: Financing Transactions in 2011

General		Deal Characteristics		
Company	Index	Type	Size (in EUR mln)	Maturity (year)
Bank				
Air France-KLM	AEX	New	1,060	2016
AkzoNobel	AEX	New	1,800	2016
AMG	AMX	New	202	2016
Arcadis	AMX	New	320	2013-2016
ASM International	AMX	Existing (extension / increase)	150	2014
DSM	AEX	New	500	2016
Eneco	Non-listed	New	1,250	2016
FrieslandCampina	Non-listed	Existing (extension)	1,000	2015
Fugro	AEX	New	725	2016
Heijmans	AMX	Existing (extension)	250	2015
Heineken	AEX	New	2,000	2016
Ordina	AMX	New	55	2014-2016
Philips	AEX	Existing (extension)	1,800	2016
Randstad	AEX	Forward starting	1,050	2016
Schiphol	Non-listed	New	175	2016
TNT	AEX	New	1,140	2016
TomTom	AEX	Forward starting	400	2016
USG people	AMX	New	700	2016
Vopak	AMX	New	1,200	2016
Wavin	AMX	Existing (extension)	220	2015
Wessanen	AMX	Existing (extension)	100	2014
AEX	9		10,475	
AMX	9		3,198	
Non-listed	3		2,425	
Total	21		16,098	
Capital Market				
AkzoNobel	AEX	Bond	800	2021
Arcadis	AMX	Private Placement	76	2021
Fugro	AEX	Private Placement	635	2018-2023
Gasunie	Non-listed	Bond	500	2021
Imtech	AMX	Private Placement	225	2016-2023
KPN	AEX	Euro Bond	500	2021
KPN	AEX	Sterling Bond	469	2026
Logica	AMX	Private Placement	210	2016-2021
Schiphol	Non-listed	Bond	438	2021
Unilever	AEX	Renminbi Bond	33	2014
AEX	5		2,437	
AMX	3		511	
Non-listed	2		938	
Total	8		3,887	

Source: Orchard Financial

Measures to Increase Availability of Finance: Part Two

When reading this article you could come to the conclusion that it is time for the CFO and treasurer to rest on one's laurels. This is however far from the truth - much work is still to be done. Companies should invest in their ability to access different debt markets, thereby diversifying their funding sources while reducing their dependency on any single debt source.

Although we live in a globalised world, there is not just one single debt capital market. Rather, the debt capital market is composed of a number of large public markets and numerous local private markets. These different markets consist of communities of investors that operate within a certain legal and regulatory framework and have comparable investment preferences. Today, and in the foreseeable future, (potential) volatility in markets is high and liquidity in certain markets can disappear overnight. There is no certainty that these different markets will be open for business at the moment a company requires funding. Having access to various (debt) capital markets can prove to be an important lifeline.

Translated into the financing policy of a company, a company should not only invest in access to different debt capital markets, but also in speediness. Time-to-market is crucial as the window of opportunity could be short-lived. When a liquidity window in a certain market appears, the company should be ready to tap this market at short notice. Therefore, smart companies should also invest in the preparation of debt capital market transactions and the availability of staff for a swift execution. One example of such preparation could be acquiring public credit ratings to enable access to the euro bond market.

Outlook

The current economic environment is very uncertain. In this article we have illustrated that, on average, large Dutch corporates have a very solid foundation to meet these circumstances: balance sheets are strong, leverage levels are conservative, liquidity positions are high and the debt portfolios have long maturity profiles. The question for these companies will be: "How can we manage our balance sheets efficiently?" Some companies with growth ambitions will have the financial strength to continue their search for investments and act as a consolidator, whereas companies in more mature markets will be under pressure from their shareholders to distribute more (excess) capital. Examples we have already seen include Ahold, ASML and Wolters Kluwer, who all have announced new share buyback programmes.

Hidden in these averages are also companies with far more vulnerable positions. These are companies in cyclical industries who have seen dramatic decreases in sales and EBITDA in 2008/2009. With the risk of a new recession in the immediate future, these companies are forced again to cut costs and free up cash. An example of a company in a more vulnerable position is Air France-KLM, who recently announced measures to decrease its debt position by €2bn by end of 2014.

¹ The data is derived from the Orchard Finance Monitor, a database with financing details of the large Dutch corporates. The data of this article includes 37 publicly traded non-financial firms of the AEX* (17 firms, excluding ArcelorMittal and Shell) and AMX (20 firms) and the 20 largest non-listed firms (excluding commodity traders and private equity owned firms). All amounts in figures and tables of this article are denominated in €billion, unless expressly stated otherwise.

² The data in the figures and table are either averages (in case of ratios and percentages) or total sums per index (e.g. the sum of the EBITDA of all included AEX firms).