

Q&A - FINANCING THE DEAL - YEAR END



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ON THE CHALLENGES OF RAISING FUNDS IN THE DOWNTURN, WITH THE DEBT MARKETS SAPPED OF FUNDS AND PRIVATE EQUITY LACKING CASH AND APPETITE FOR INVESTMENT

Q What is the banks' appetite for debt and equity deals?

Measuring the current appetite for these deals is difficult as reports are that the banks are not really seeing the deal flow that they would have in more recent years. Businesses do not seem to view this as a good time to buy or to sell unless they are sitting on large cash reserves or already have committed funds.

It is clear that there is a reduced appetite for cash flow-based lending, with many lenders focusing on supporting existing customers, the thirst for new customers being limited unless the deal involved is considered at "gold star level".

Q How have lending guidelines and processes changed?

The marketplace is telling us that lending is becoming much more challenging as internal processes and policies tighten up. The extent of preparatory work and analysis that goes into a deal is much more in depth and time-consuming, as banks look to cover off an increased number of anticipated risks.

Q Have fees increased?

One of the more noticeable changes in the market has been that the cost of funds for the borrower are rising – this echoes both the fact that

capital is in short supply and the increased underwriting risks that the banks are facing. Leverage in deals is much lower than it was 12 to 18 months ago, and banks are seeking to achieve an increased return on margins and on fees. We are now seeing fees being charged for even basic amendments and relatively high consent fees for amendments to banking covenants.

It is more common for lenders to include non-utilisation fees for undrawn facilities, and they are looking much more carefully at the provision of undrawn funds to their customers to see what is actually necessary for their business requirements.

Q How are financial covenants changing?

Borrowers can no longer expect the sort of flexibility on covenants that they may previously have enjoyed when several banks may have been competing for their business.

Covenant-lite facilities are now a thing of the past, and the trend now is for covenants to be tighter – which is to a degree a natural reversal to a more risk-appropriate lending profile, but also reflective of market cautiousness.

The ability of borrowers to use equity cure provisions to avoid breaching a financial covenant has

been reduced, and it is now typical for banks to impose (among other things) a minimum period between cures, require that cure proceeds are used to prepay the facility or remove equity cures of cash flow entirely.

Q If the large leveraged deals have gone, will there be more money around for smaller players?

While this is in theory a reasonable assumption, it remains to be seen whether this will be the case. In practice most lenders are in a phase of contracting their balance sheets and banks are tending to focus on their existing customers.

The really big deals that we were seeing 12 to 18 months ago were more often funded by lenders who were involved in selling debt down, rather than the high street banks. These large institutions have previously not tended to get involved in smaller deals. However, as the landscape changes, those that have money to invest may well start to look at making their investments in the SME market. And perhaps the lack of leveraged deals will mean that there is more opportunity for banks to support smaller transactions in more specialised industries. We certainly hope so, but only time will tell. ■