Treasury Trends

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2021 — year of the refinancing?

As businesses reacted, at short notice, to the first round of lockdowns which were almost a year ago, the relationship between corporate and banker became ever more important. In the main, banks responded positively to customers' needs and we saw many smart solutions being offered in the areas of funding, liquidity and transactional banking.

From a funding perspective, much of the refinancing scheduled for 2020 was 'simply' rolled for 12-18 months. This served to alleviate the then immediate issues, and afforded many to focus on running their businesses in recognition of the unknown business and economic outlooks. Waivers and covenant holidays, as well as other flexibilities around shorter term liquidity facilities, were all seen as pragmatic and working solutions for all parties in an uncertain environment. This short term flexibility typically went hand-in-hand with simpler, and perhaps more regular, reporting requirements.

Conversely, some businesses were faced with more difficult circumstances whereby the incumbent banks were not comfortable to offer more flexibility and other sources of funding and/or banking solutions had to be found. As all good funding risk policies would encourage, it is best not to need 'new' funding solutions when your incumbents have said 'no' — but in extreme times, choices and flexibility are compromised. We saw a number of innovative solutions identified, at short notice, and whilst not necessarily on 'ideal' terms were able to serve their purpose and keep businesses operating.

Key Points

- **With many funding lines simply rolled 12-18 months in 2020, this year's refinancing activities are likely to be busier than usual.**
- **Allocate sufficient time for a more strategic approach to the funding plan and its implementation.**
- **Early evidence points to a tightening in bank margins, although appetite remains fickle.**

Strategic thinking critical

The focus for 2021 has to be for a more strategic approach being taken towards funding and other banking requirements. It is too early to suggest the full impacts of COVID-19 are known, but time has passed to allow some re-setting of businesses, reworkings of forecasts, the assessment of various scenarios and so on. To that end, logical business cases backed by a greater sense of reality can be presented to potential lenders with the opportunity to explore options on more permanent arrangements.

As ever, from a borrower's perspective, time is your friend. The more time that can be allocated to the thinking, testing of ideas, exploring of options, etc, i.e. determining a clear funding plan, the better. Those that provide some broad numbers and expect banks to respond favourably within two weeks will likely continue to be disappointed. If you want a good outcome, consider the other parties' inputs too — they also need time.

What we have all learned through the pandemic is that travel restrictions and lockdowns have made it more difficult to interact, and that alternative approaches to exchange information, get to understand a business, complete Q&A, etc., have to be found. As surveys find that a third of all M&A transactions 'struggle' to complete with the new environment obstacles, so parallels with the efficiency of a 'standard' bank/funding tender can be drawn. There will likely never be a substitute for the rapport built through meeting management teams face to face, affording better opportunity to 'read the room' and body language of those in attendance, but transactions still need to occur in the virtual world and, in the future, a hybrid model of remote and face to face will have to become the norm.

(Continued on page 2)

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As a pricing margin matrix may have been inserted into a facility last year to address increases in risk if ratios 'failed', so such steps can benefit the borrower on the way back to an improved performance. A borrower will want to understand the risks of any business, the risk mitigation strategies in play, sector analytics and dynamics, and so on — it should not be a surprise if a lender declines to respond in the absence of what is core information. Imagine trying to borrow on a home loan without providing evidence of your income, or details of the property you want to purchase.

Banking appetite key

Back to the current time, in basic terms, a vast majority of all the refinancings due for 2020 and 2021 (together with last year's waivers and amendments) will now fall in the next 6-12 months. Banks' appetites have changed and, notwithstanding the support shown in recent times, there will be greater stringency as to which customers (and respective returns) meet with internal targets from here on.

Policy measures undertaken by the central bank in 2020 — including the reduction in the cash rate and the introduction of the term funding facility — have lowered bank funding costs and supported the availability of credit. With plentiful liquidity available, banks have responded by reducing deposit rates further, with rates for new wholesale deposits easing by another 10 basis points over the past few months.

Many businesses have repaid lines of credit that were initially drawn down in the early stages of the pandemic, meaning credit growth has declined. Although demand for new corporate borrowing remains subdued given the uncertain business outlook, we expect to see increasing evidence of the lower bank funding costs being passed on to corporates as the pricing benefits of cheaper bank funding sources flow though. And with banks having further capacity to draw down cheap funding via the term funding facility, those corporates with the right story to tell could benefit from a drop in bank funding margins versus margins available last year.

While banks continue to be cautious about lending to some sectors and to customers that are new to the bank, our early 2021 corporate refinancing activities point to a material tightening in bank pricing versus last year, in cases where a competitive process has been run. It won't always be about price — some sectors will fit with wider bank strategy, some won't. It is ever more important for each customer to work out its value to a bank, e.g. what ancillary business can be offered, or is willing to be offered.

There is great focus on ESG lending currently. This won't suit everyone but will be an agenda item for many.

The corporate bond market is also gearing up for another busy year of issuance, with corporate bond spreads back to pre-COVID-19 levels and investors still chasing yield.

Banks and other funders will want to know any process is genuine and therefore need to understand the timelines involved from start to finish. If there isn't sufficient time built in for, for example, full presentation of information (via IM and/or RFP) or clarity around the evaluation process and short-listing opportunities, there is an increased likelihood that a bank(s) will choose not to respond positively. And we would argue, justifiably.

At its core, a funding plan should consider the target funding option(s), and the ideal position and structure (one, two or multiple banks/lenders, bilateral/club/syndicate, secured/unsecured etc.) Key elements set out in a terms sheet would be expected to include:

- Facility type, amount, tranches and tenor including currency, pricing basis and base rates
- Security structure, obligors and guarantors
- Covenants, events of default and review
- Any business specific carve outs in respect to Reps, Warranties and Undertakings or facility mechanics (availability, utilisation, prepayment and cancellation)

If you want to discuss a funding plan or strategy for your business, please speak with your advisor.

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