HARD CASH

By Andy Smith, Head of Debt Finance Origination, HSBC Bank

The banking crisis has changed the rules of the game for UK mid-market corporates seeking help with their liquidity, but the cash is still there.

Before the start of the credit crisis, bank liquidity seemed close to infinite, with an almost unlimited supply available for any purpose. This resulted in a demand-supply imbalance where the price of credit was so cheap it was reaching unsustainably low margins. Typical FTSE 250 companies were borrowing money at margins between 50 and 100 basis points (bps) and highly rated FTSE 100 companies at less than 20bps. Typical maturity was five years for revolving credit facilities, with no amortisation and lax credit covenants.

Now that supply and liquidity have been dramatically cut, the demand-supply equation has flipped. Companies still need liquidity, but the supply has reduced dramatically. The chief causes of the flip are credit losses, which have reduced liquidity in the system; disfunctionality in the inter-bank wholesale funding market so banks won't lend to each other; a higher level of risk aversion by banks; and increased requirement from regulators for more capital in banks.

Another factor is that fewer banks, of all nationalities, are lending to UK corporates. Two years ago, lenders numbered around 20, but today there are fewer than ten. Large UK banks provide the vast majority of current liquidity, with only a handful of overseas banks operating in the UK, usually to support companies with significant subsidiaries, and therefore ancillary business flows, in their own domestic markets.

Maturing facilities

Most of HSBC's work over the past 18 months has been refinancing maturing existing facilities and identifying customers who might have future funding issues. Those companies with the biggest financing issues in 2009-10 tend to have significant borrowing requirements, with more than ten banks and a high proportion of non-UK banks in their group. As such, with many of the overseas banks taking up the opportunity to withdraw from UK syndicates, there is a requirement for the UK banks to step up their participation levels to take up the slack.

The government's Asset Protection Scheme has helped, allowing RBS and Lloyds Banking Group to commit £30bn of new lending. Where there are still shortfalls, companies have called on shareholders, the equity market, and rights issues to make up the difference. However, the US private placement market, until now often accessed by UK corporates for longer-term debt maturities, has become very risk averse and for new borrowers is only available to those companies that can demonstrate that they have an investment grade credit profile.

My team is still very busy arranging debt facilities for performing businesses, but pricing has had to change. We've moved from the situation where typical maturity was five years and arrangement fees were no more than 50bps, to one where no bank will offer a facility beyond three years and arrangement fees are typically 150 to 200bps. Margins have moved from a typical range of 50 to 100bps to more than two per cent at the bottom of the margin ratchet.

Liquidity fears

Mergers and acquisitions have also been affected. Previously borrowers used one or two banks as underwriters to secure financing at the top level before announcing the transaction. Now, because there's so much fear over the lack of liquidity, banks are not keen to take underwriting risk, uncertain of their ability to sell it down. Companies must, therefore, line up bigger underwriting groups, which inevitably lengthens the process.

When will things return to normal? I don't think we'll ever return to a virually infinite supply of liquidity during my career, but the high pricing environment will ease once foreign banks start lending again to UK corporates. The European and American banking situation needs to improve – lower credit losses in those economies will create spare liquidity to invest outside. But there's still uncertainty about whether these banks have provided sufficiently for their own toxic loans, so until the market and those banks themselves believe they've dealt with the bad debt issues, I don't see any return of sufficient liquidity for the UK market – I think we're in for the long haul.

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