



Chicago/Midwest

New Views in a Post- Recession World

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Credit availability expands in post-recession market



Availability of commercial and asset-based credit has improved over the last year, experts say, but the size, sector and history of a company affects its individual attractiveness to lenders.

“There are more active lenders in the market, and there is still a limited amount of new loan demand. These two factors have caused rates to drop and loan terms to be more favorable to the prospective borrower,” explains John Stewart, executive vice president and regional manager of the Business Credit Division of Wells Fargo Capital Finance.

While credit markets have opened up relative to 2009

levels, a company’s ability to obtain credit depends on having a strong track record of performance, says Michael Buenzow, a senior managing director at FTI Consulting and Midwest region leader for FTI Corporate Finance. Companies without that track record need to have the ability to sell their story through a sound third-party-validated business plan to attract new capital.

“Due to losses incurred during the recession, lenders are now much more critical of marginal businesses, furthering the need for a credible business plan that the lenders are confident that the management team can execute,” Buenzow says.

Characteristics considered

Large cap companies (greater than \$1 billion in sales and globally diversified) have broader credit options, including access to the high-yield market and, in some cases, the equity market. “In terms of short-term financing, larger businesses tend to have much more ready access to commercial paper,” Buenzow says.

Buenzow says he sees credit availability for large, well-diversified companies remaining strong if the economy continues to improve. However, a significant shock to the global economy—inflation in BRIC countries, increased government regulation or further unrest in the Middle

East—could offset the credit expansion begun in 2010.

Smaller companies typically are limited to asset-based financings and/or rescue-type capital infusions from the existing equity sponsor. If they are an out-of-favor industry, smaller companies’ access to capital is limited even further, Buenzow explains.

Stewart says that in just about every middle and lower middle market loan size, credit availability has increased on terms more favorable to borrowers. “That said,” he notes, “businesses looking for asset-based facilities under \$5 million will still encounter relatively fewer options and higher interest rates.

“Lenders remain cautious about lending disproportionately on fixed assets, including equipment and real estate,” Stewart says.

Companies in favor with creditors include those with good product breadth and geographic diversity, which offers lenders a natural hedge against local economic effects. Companies that own or have strategic access to raw materials also should fare better. In addition, Buenzow says, “industries that are heavy consumers of commodities, such as steel and corn, will be challenged to maintain profit margins because of the upward pressure on commodities from demand growth in BRIC and emerging markets coupled with existing supply constraints and the amount of time required to bring significant incremental

capacity on line.”

Businesses in agricultural, food and durable goods manufacturing and distribution markets, which have shown the most consistent performance turnarounds, will find more favorable credit pricing and terms, Stewart says. “Businesses in or related to the housing and construction industries are continuing to struggle, and the availability of credit to companies in these industries continues to be limited.”

Diversified v. standalone

AccuVal Associates, which performs industrial appraisals for large banks, private equity firms and hedge funds, among others, can see the changing factors in the credit market, says Rick Schmitt, executive vice president and COO.

“We see what banks are willing to lend and talk to lenders about what they’re advancing,” he says. “There is an amazing amount of dynamics going on in the marketplace. There are big differences between what large private equity funds can get as compared to what middle market companies can get.”

Schmitt says banks are eager to lend to large private equity funds because they command significant dollar investments and represent 50 different companies. To some degree, the bank isn’t as quick to say the debtor’s proposed financing is overaggressive because they are worried about



Be attractive to ABLs

To be attractive in the asset-based lending market, companies need to articulate a clear business plan based on reasonable/third-party-tested assumptions for the next three to five years, says Michael Buenzow of FTI Consulting.

Wells Fargo's John Stewart concurs, noting that prudent lenders always have and will continue to look for a solid management team first. They also look for a sound business plan, projections based on reasonable assumptions and acceptable liquidity levels and debt to EBITDA multiples.

Buenzow says a business plan should address:

- How the company plans to profitably grow continuing operations,
- How it will minimize cash burn in non-core operations and
- How it will maintain a competitive cost structure.

"Lenders typically want to see a management team that has thought through the issues and conditions, and can articulate the issues and conditions," Buenzow says. "Lenders also find further credibility if a reputable financial adviser was involved with management in developing the business plan."

not getting the next deal versus a standalone business that may be struggling a bit but not necessarily distressed, he says.

"Most of the major lenders are focused on the revolver piece of a loan ... banks are much more interested in loaning against receivables and inventory," Schmitt says, because receivables turn into cash in a 30-, 60- or 90-day cycle. "If the company gets into trouble, the bank is not far away from receiving loan payments."

Mezzanine, securities return

Schmitt says another player in the lending market has returned to the forefront. "Mezzanine debt lenders have always been out there but are becoming popular again because their purpose is to provide a layer of debt a company needs in order to operate its business but cannot be satisfied by senior secured lenders.

"As far as credit availability, the key is to have some mezzanine lenders out there who are willing to take on that piece of the pie to allow companies the flexibility to move from one bank to the next," Schmitt says. "In the past, the company and bank had to stay as a team. They couldn't get rid of each other because no one else wanted the company."

In addition, high-yield securities that dried up in the recession are reappearing as underwriters are willing to step in and underwrite some

companies. "Now we're seeing companies take out what were large loans previously done asset-based and going back to the high-yield market, which don't have a lot of restrictions on how you can run the business," Schmitt says.

Financial diversification too

Melody Stallings, senior vice president and division manager of the Receivables Funding Group at Wells Fargo Capital Finance, says executives should consider diversifying their debt and credit base to meet their needs both now and in the future.

Diversity of credit, Stallings explains, could include using products offered by diverse financial institutions and trade creditors, as well as capital providers such as angel investors and private equity groups.

"Banks and other financial institutions are beginning to offer or are enhancing their special offerings in order to diversify risk while improving

the company's buying experience," she says.

Lessons learned

On the positive side, Buenzow says, today's companies were forced to become much smarter in managing their cost structure. "Businesses took out significant costs—both product and overhead—in the last recession and have maintained their operations at these levels to provide additional earnings leverage as the economy improves," he says.

Stewart agrees. "More and more companies that survived the recession are now showing a clear and sustainable turnaround in performance," he says. "This is a distinct improvement from the depths of the recession when revenues and profitability had declined dramatically and turnarounds were often unpredictable and often unsustainable."

Going forward, Stewart expects economic growth will continue in the range of 2 to 3 percent in the next

year or two, allowing credit availability on relatively favorable terms to continue. He continues, "Looking out five years, the availability of credit will depend on the health of the overall economy and corresponding trends in non-performing loans and charge-offs within lenders' portfolios."

Businesses also need to recognize the limited credit options and plan strategically. Buenzow says businesses should strive to generate an internally funded business plan so that any funding is obtained ultimately from growth capital. Management should assess regularly all angles, including working capital, employee benefits, corporate overhead, non-core asset sales, to identify sources of liquidity.

"It's important for the lenders or any potential source of credit to see that the company has kicked the tires hard to identify internal initiatives to reduce the lenders' overall exposure," Buenzow says. ♦