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Time to Refinance?

Many companies are looking towards a refinancing in the near future, whether because their current facilities are maturing shortly, they are reaching the thicker end of their amortisation profile or perhaps because more fundamental balance sheet surgery is required. In the context of the current liquidity squeeze, it will be more important than ever for companies to plan for a refinancing in good time. This note discusses some important factors for a borrower to consider in order to mitigate refinancing risk and achieve a satisfactory refinancing.

When do the facilities mature?

Companies would be well advised to start any refinancing process well before the date their facilities mature given the "refinancing wall" of debt which is repayable in the next few years. In addition, a company's auditors may find it difficult to sign off its accounts on a going concern basis in the last 18 months of a facility without a clear route to a refinancing. An early refinancing may also be desirable to avoid the impact of provisions included in a facilities agreement to incentivise repayment towards the end of the facilities' term. These could include an increase in the proportion of excess cashflow that has to be applied in the cash sweep or an increase in the rate of interest payable.

An extension to facilities may be required up to 18 months before their maturity date

If a simple extension to the facilities is all that is required and the existing lender is supportive, a facility extension or "forward start" arrangement (whereby the lender agrees in advance to extend the facilities) can be agreed. However, the borrower and/or the lenders may require additional changes to be made to the facilities, which will require careful consideration.

Is a deleveraging required or desirable as part of a refinancing?

Before the credit crunch, a number of companies took advantage of abundant liquidity to borrow debt on the back of favourable macroeconomic conditions and EBITDA forecasts which subsequent events have made difficult to achieve. Lenders are rarely willing to make new loans at leverage ratios which were available pre-credit crunch so there may be a funding gap to be bridged upon a refinancing.

A refinancing may be desirable, not because of an imminent maturity date, but to avoid the consequences of breaching financial covenants agreed in a more favourable economic climate. Whilst a financial covenant re-set may be appropriate where a covenant breach has occurred or is imminent (click here to access our note on financial covenant re-sets), it can be expensive in terms of fees required by lenders and destabilising to have a series of waivers and re-sets without a resolution of the underlying problem.

In addition to financial covenant pressures, there may also be pressure from a company's lenders to achieve a refinancing to improve the lenders' own liquidity. This may manifest itself in an unwillingness to waive "technical" defaults (click here to access our note on potentially toxic clauses to be found in facilities agreements).

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Refinancing considerations:

1. Will the existing lender be prepared to extend its facilities and, if it is, will it be prepared to extend the full amount of the facilities? If not, which other banks or investors will step in to bridge the gap? Could the required liquidity be provided by other types of investors, such as mezzanine funds?

2. Can more competitive terms be obtained from other lenders, rather than necessarily only negotiating with the incumbent lender?

3. What market terms are being offered by lenders? Whilst margins and fees are higher than before the credit crunch, these should be considered in the context of current low LIBOR levels. What other terms will lenders require in the current environment? Will lenders require security for the refinancing from members of a borrower's group which were not required to give security for the original facilities? If so, this can significantly increase costs, particularly where the security is required from companies incorporated in jurisdictions outside the UK.

4. It will always be preferable for the borrower to retain control of the refinancing process and to make plans in good time. It goes without saying that the borrower's position will be better if it can avoid being in default at the relevant time.

5. Will a refinancing require changes to any existing hedging arrangements? With current low LIBOR rates, many borrowers remain stuck with relatively expensive hedging and a refinancing may provide an opportunity to remedy this. Conversely, a refinancing could trigger a forced close-out of an out of the money swap, triggering an unwelcome liability.

6. What is the timetable for refinancing? Borrowers should note that many lenders are taking longer to approve financings because of greater credit committee scrutiny and more thorough due diligence requirements. Appropriate planning could mitigate these potential delays.

7. Will a refinancing trigger a prepayment fee in respect of the existing facilities?

8. For sponsor backed companies, a refinancing is likely to require investor consent under the equity documents, meaning that it is important for sponsors to be actively involved in the refinancing process.

A series of financial covenant re-sets and waivers can be expensive and destabilising without a resolution of the underlying position

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