# Accessing corporate debt alternatives

## Global uncertainty and regulatory intervention has changed the dynamics of availability of credit for Australian corporate borrowers.

> "There's capital available, but for some it might require some alternative thinking."
>
> **Scott Mesley, Head of Debt Advisory, KPMG**

A recurring issue for Australian corporates is the over-reliance on the Big 4 domestic banks, and the relatively small size of the domestic bond market. At times when global uncertainty gives rise to high volatility and higher prices, it can mean a notable lack of options.

This has never been more apparent than during the first part of 2016, with no corporate issuance in the domestic public bond market for a period of almost 6 months, which is a drought that has not occurred in recent memory. This hiatus was only broken by a AAA-rated government owned corporate issuing to the market in May 2016.

Although volatility has since decreased, the Australian public bond market has re-opened, and corporates of sufficient size and credit rating are able to source through issuance in international markets, the problem won't go away anytime soon, says Mesley. This is of particular concern to the mid-market and mining, oil and gas services sectors, where access to liquidity from traditional sources will remain challenging.

But there are other options. Alternative debt markets, says Mesley, catering to unrated, privately placed bonds, are likely to play a significant role in meeting the funding needs of many of these borrowers into the future.

### Looking for options

Even in less trying times Australian companies are keen to tap the private placement market – most particularly in the United States, but increasingly at home as well. It is with good reason. Not only do such unrated wholesale markets offer attractive pricing, they provide issuers with a welcome diversity of funding and extended tenor typically unavailable from traditional bank financiers. "While it isn't necessarily the cheapest option, it has become a strong market for issuers looking to diversify their sources of funding," notes Mesley.

The well-established US private placement market has seen considerable interest from Australian corporates. In 2015, Australian borrowers became the largest foreign player in the market, even ahead of UK-based borrowers, with more than 16 percent of market share. This market continues to have decent liquidity for investment grade Australian borrowers in the US$120 million to US$500 million range and seeking 7 year plus money. In 2015 and 2016 Australian issuers have borrowed US$7.2 billion and US$945 million via US private placements[1].

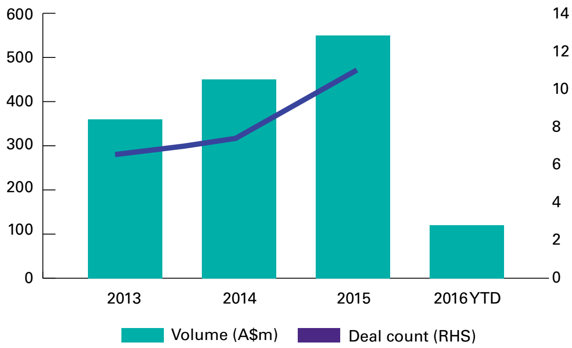
The Australian private placement market, led to date by FIIG Securities and NAB, is also showing increasing signs of activity and appears to be reaching a level of maturity. For the most part these bond-like transactions are being placed with wholesale investors, although 'mum and dad' investors can participate too through self-managed super funds, providing access to a fixed income investment profile that was previously inaccessible. This market is particularly attractive to investors in

1.Private Placement Monitor, KPMG Analysis.

a low interest rate environment where superannuation fund investment needs to move down the risk spectrum, away from the traditional equity investment philosophy of past retirement investment strategy.

The last three years in this market has seen compounding growth rates in both volume and deal count as evidenced by the chart below. Although 2016 has had a slow start to the year, this has been adversely affected by the volatility in the markets generally and is not considered demonstrative of a reduced lack of appeal of this market.

**A$ private bond**




## Volatile times

Yet these unrated markets aren't immune to global pressures either. Certainly the US Private Placement (USPP) market has experienced a jump in pricing across all credit rating ranges over the past six months.

Australian transactions in the USPP market have been muted as a result, with only two priced for a collective issuance volume of US$425 million in 2016's first quarter, and another two in the second quarter with volume of US$845 million (as at 31 May 2016). These included Charter Hall REIT returning to the market for a US$125 million, 10 year note; Healthscope's debut into the USPP market with a US$300 million, 10 year note; Fletcher Building Products US$325 million multi-currency deal over a 10 and 12 year tenor; and SA Power Networks for US$520 million over a 10-15 year period.

It is worth noting, however, that these transactions obtained relatively attractive rates for long-term funding.

## The high price of bank lending

It is not only the bond market that has struggled with a rise in debt financing costs. Bank loans in the Australian market have also seen an increase in margins. This is due to a combination of factors, including:

- increased cost of debt raisings by the banks evidenced by recent capital market issuance,
- requirements from the regulator (APRA) on regulatory capital being retained to cover unforeseen events and credit risk,
- increased loan loss provisions, particularly from exposures in certain industries (such as mining, oil and gas), and
- servicing recent significant equity capital raisings completed to meet regulatory capital requirements.

The ability of the banks to pass on these pricing pressures is dependent on the borrower's credit as well as other relationship factors, notes Mesley. This is best exemplified in recent transactions where both increases and decreases in margins were evident among different borrowers. Woolworths recent 5-year transaction, for instance, was 50bps higher than its October 2014 financing (albeit at a 5.5 year tenor). On the other hand, Asciano's recent 3-year transaction was 10bps lower than its February, 2014 transaction.

As the second quarter continues, volatility has decreased and competition moves back into the market, some of the extreme pricing pressures evident in the first quarter are starting to dissipate.

But for the most part banks are still likely to push through their higher funding costs to borrowers, says Mesley. At the same time, they will continue to pull back from sectors directly or indirectly exposed to the commodity markets. Ultimately, it will not dull their appetite for good quality borrowers.

### Beyond the Big 4 banks

Of course, those corporates keen to borrow are not solely reliant on Australia's largest financial institutions. While a lot of European banks have exited the Australian market, a substantial number of Asian banks are making their presence felt, points out Mesley. "They aren't just supporting their inbound investors. They are participating in corporate syndications and club deals as well."

Such support cannot be taken for granted however. Events may overtake them yet. "In the past six months the amount of liquidity available in the Chinese banking system has taken a bit of a turn so we have seen some pulling back. But as an overall theme there has been a definite shift."

The last 12-18 months have seen a good number of transactions announced and completed with financing provided from non-traditional sources such as institutional money, loan specific funds, niche asset financiers, and export credit agencies, among other options. Many alternative financiers have money available for the right transactions, but are able to be very selective about which deals they seek to pursue and are being quite opportunistic. The success or otherwise of such deals relies on the achievement of the borrower's stated strategies and forecasts, and appropriate debt structuring.

# Contact us

**David Heathcote**
**Head of Deal Advisory**
**Deal Advisory**
**T:** +61 2 9335 7193
**E:** dheathcote@kpmg.com.au

**Scott Mesley**
**Head of Debt Advisory**
**Deal Advisory**
**T:** +61 3 9288 6748
**E:** smesley@kpmg.com.au

**kpmg.com.au**

Download on the App Store



June 2016. QLDN14172ADV.