Learning to REFI

Considerations in credit agreement refinancings

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KEY TAKEAWAYS:

- Credit outlook, pending business acquisitions, board dividend policy and expected funding needs are the primary drivers for refinancings.
- When selecting an administrative agent, the goal should be to develop a long-term relationship so that there is good institutional knowledge of your business and needs.
- Be inclusive in the refinancing process; first ensure senior management's buy in, but then involve internal functional groups early.

A number of factors drive a company's decision to discuss refinancing its credit facility, including pending maturity dates and changes in interest rates. With interest rates on the rise, what other considerations are important to CFOs, treasurers and cash management professionals and how do they manage the refinancing process as it unfolds?

Lawyers, especially outside counsel, are not often privy to early conversations about refinancings. So I recently sat down with Frasier Brickhouse, II, treasurer of Tredegar Corporation; Jeff Fender, treasurer of Performance Food Group, Inc.; Candace Formacek, treasurer of Universal Corporation; Pete Graham and Neal Petrovich, CFO and Senior Vice President of Finance of PRA Group; Jonathan Leon, treasurer of Owens & Minor, Inc.; and Cameron Warner, treasurer of NewMarket Corporation; for an insider's view on how companies approach the refinancing process and the insights a trusted banking partner should provide. Because the roundtable participants are speaking based on their own experiences, both with their current companies and with prior employers, I have not attributed any answer to an individual.

1 An upcoming maturity date is undoubtedly a big factor that drives refinancings. What would you say is the next most important consideration?

Other than M&A or other strategic drivers, I would say potential for change in credit conditions or credit outlook—either for the banking market or the company itself. If the company is approaching a strategic cycle that requires more certainty of lending, then it can be helpful to get in front of that. Similar drivers may lead to an "amend and extend" approach—often to simply push out the window of liquidity access certainty—sort of a hedge against unforeseen circumstances.

A refinancing may also be driven by upcoming changes in the regulatory environment that could change a bank's lending strategy. Another primary consideration is timing needed to maximize achievement of an optimal capital structure, especially for infrequent issuers looking to combine or change levels or form of debt/equity that may require different issuance size.

2 How much of a move in interest rates piques your interest and leads you to begin thinking about weighing the costs and benefits of refinancing?

While it is difficult to pin it on an absolute number, it is easy to keep a calculation of "breakeven" for rates, fees and other hard costs. But there is always an element of uncertainty when launching a refinancing that requires judgment based on the likelihood of success and access to the current market, which ebbs and flows. Of course, for frequent or strong credit issuers, this may be much easier to estimate. There is also the matter of timing—specifically, whether the refinancing fits with other maturities, payoffs and issuances planned in the capital structure.

We look at the overall trend in interest rates and the global factors related to those movements. In the current interest rate environment, I would say that an actual or expected change of 50 basis points over our planning horizon would pique my interest.

For those of us that have consistently used bank financing for working capital purposes, there may be a need to occasionally "term out" bank debt, especially if a meaningful increase in the size of the revolving bank facility is not available or desired (or I have simply targeted how much bank debt I'm willing to have before terming out).

3 In your experience, what other events or business drivers have spurred refinancing conversations?

Pending business acquisitions, board dividend policy and expected funding needs are the primary drivers for refinancings. Improved credit quality permits improved terms, such as covenant, capital expenditure and acquisition flexibility, and may also spur refinancing talks. And certainty of longer facility maturity dates is key, should there be concerns of a bank market dislocation.

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4 Do you typically approach your current administrative agent and key relationship banks with a refinancing wish list or proposed business term sheet?

Normally, I will have tested the current markets with a few key banks so that I have some idea of what to expect, and can then start a specific conversation with the banks to vet my expectations on desired terms and pricing.

I keep a file of key aspects of deals of peers of similar credit quality that are of interest and make sure that, if there are terms in a peer's deal that are attractive, I include it in early conversations with the arrangers. Also, we research potentially contentious points in an effort to find precedents where the agent or a large portion of the bank group have given such issues to others. This can be a lot of work, but has proven very effective.

5 How do you size a facility and determine the allocation between committed amount and accordion? Are there factors you would cite as important considerations in addition to the cost of undrawn line fees?

For us, the sizing is mainly about a match with our business strategy. I need enough to fund global operations and potential working capital. That can vary with currency and product pricing, so I am willing to pay for some cushion. Accordions are a good feature to have as they offer flexibility to expand without a full refinancing, but they are not a sure thing. Because we cannot offer a lot of ancillary business for our bank group, undrawn line fees help keep the relationship attractive to our lenders.

6 What factors do you consider and weigh most heavily in selecting an administrative agent/lead lenders for a refinancing?

We like to develop long-term relationships so that there is good institutional knowledge of our business and needs. For example, we have a few atypical definitions in the credit agreement that are understood and supported by the credit side of the lead bank. For us, the top banks need to be international and offer access to strong internal resources with expertise and knowledge in a variety of financial markets. They also should be able to attract other banks to participate in the group.

I like to have enough lead lenders so there is some competition among them, but not so many that ancillary business is spread thin and not interesting to them. The administrative agent needs to have reliable back office support, but generally any of the "majors" can do this. The administrative agent role is mainly earned through a combination of relationship and larger commitment dollars.

7 In addition to guidance on market conditions and terms, what do you expect your administrative agent and lead lenders to bring to the table?

For us, the lead banks should understand our business model and credit drivers and play a key role in helping the rest of the bank group to understand them. They should also bring access to quality teams supporting other ancillary requirements—such as FX and interest rate derivatives and trade finance.

8 Do you expect your key banking relationships to stay current on your competitors' credit facilities or otherwise have a sense of what "market" is in your industry? Is that something you track, to the extent that information is publicly available?

I expect periodic updates of what is market, but it all comes down to conditions at the time of the final negotiation. I try to get market updates from as many sources as possible to form my own view before that time comes, and also to keep executive and board members aware of the direction of the market so there will be no surprises if the refinancing terms look different than what we discussed.

9 Talk to me about putting a bank group together—what considerations are at play in awarding titles, invitation amounts and allocations?

There must be an adequate complement of banks that meet the company's future needs. For example, if there is an upcoming move into a new region of the world, we ensure that the bank group includes providers that give the company options when procuring services and possibly borrowing in that part of the world.

Consistency in a bank's willingness to use its balance sheet is also critical. It becomes quickly known among treasurers if a lender is becoming fickle with its balance sheet and there is evidence of a bank exiting deals. I always have a bench ready to backfill those lenders I am not confident will step up and commit at the invite level.

10 Does your need for treasury management services in foreign countries weigh in the balance of deciding which banks will be invited to participate in a new deal?

Having a limited set of strong global banks to support foreign local accounts or uncommitted lines is one way to support ancillary business needs and to streamline new account KYC, and compliance requirements. We cannot, however, compromise local service requirements by insisting on using only banks in our group because sometimes our needs exceed our bank group's jurisdictional reach and capabilities.

11 When and how do you involve your in-house and outside legal teams in a refinancing?

We generally want to keep counsel apprised of potential transactions within the next six to 12 months, but focused work happens closer to the refinancing kickoff. It is always good to allow enough time to review your current credit agreements with counsel ahead of the bank discussions to get their take on current market conditions and to highlight particular baskets or covenants that may be desirable to renegotiate.

12 What is some advice you would give to a colleague about managing the refinancing process?

Be inclusive in the refinancing process; first ensure senior management's buy in, but then involve internal functional groups early. Engage outside counsel on the front end of the process to share strategies and obtain insights on credit agreement trends. Also, before you execute commitment documents, socialize your "asks" with major lenders in your group to obtain input on what is possible and gauge their level of support.

I always recommend independently watching the market and leafing through specific deals within your credit quality bans, whether you are close to entering the market or not. It is very easy to screen for relevant deals on Bloomberg, watch for activity at selected peers or ask a bank partner for a screening—although the later may bring with it an undesired conversation.

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