'PASSING THE GREAT AFFORDABILITY TEST'

Raising finance is a prevalent issue for companies in these current economic headwinds. **Alex Bell** speaks with experts about the careful considerations business owners must pay sharp attention to when looking to grow via debt reduction

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It was the great American football coach, Vince Lombardi, who said "Winners never quit and quitters never win".

For business owners, to refinance and pay down debts or not is a major juncture in any quest for long-term success.

Do it right and you're the former in Lombardi's quote. Do it wrong and you might just veer towards the latter.

Dave Riley is corporate finance partner in Manchester for audit, tax, advisory and risk firm Crowe UK. He's adamant that affordability comes first when considering refinancing.

"The affordability test is and has to be fundamentally at the forefront," says Riley.

"If you can afford your debt, then your options are far wider than if you can't afford current debt. It'll become obvious if you're a loss-making business and you've borrowed money to cover losses.

"So, unless you fundamentally fix the loss-making problem, moving to another form of debt that may well be more expensive is actually going to put you in a worse position."

The banking and funding environment, Riley is keen to point out, fundamentally changed post-2008 following the collapse of Lehman Brothers. The screw on lending tightened and an influx of funding entrants joined the fray in the form of independent banks and debt funds.

Of course, Covid-19 came along, flooding the market with bounce-back loans.

"Many took on those loans," says Riley, "even if they didn't need them as no one knew what was going to happen.

"Then came the choice of whether they repay those, refinance or look to keep hold of the cash."

Sandra Kylassam-Pillay, debt advisory director at Interpath Advisory, which has a central Manchester office, applies further environmental context.

"With inflation now forecast to hit a 40-year high before the end of the year," she says, "well above the Bank of England's 2 per cent mandate, the current inflationary environment is clearly not a transitory phenomenon.

"The causes are numerous and well-known: rising costs of fuel, energy and food as a result of the ongoing war in Ukraine; unwinding of government support in a post-Covid world; imported inflation due to manufacturing disruptions in locked-down regions; and wage inflation post-Brexit."

> "The current inflationary environment is clearly not a transitory phenomenon."
> **Sandra Kylassam-Pillay**
> Interpath Advisory

The ins and outs

So what should business owners consider, as long-term growth success or financial failure swing from side to side in their minds like a theme park pirate ship?

Riley says: "Fundamentally, if you're looking at a lending proposal and your debt at the moment, the way I would look at it is, what are you wanting to borrow the money for? And what are you wanting to refinance?"

Although refinancing can be relatively simple, depending on your position, it can also create a significant distraction for management, Riley points out.

"While there's still quite a lot of cash flying around, whether it's debt funds, independent banks or mainstream banks, you have to be careful.

"Banks can be 'fair weather friends'," he adds. "When everything's going well, they're really supportive. But when you're in a bit of a tight corner, some banks are more supportive than others and part of that can be down to whether management has been open about the business's future.

"Debt funds, on the other hand, are not banks so there's no protection as such. As a borrower, as a company, you need to be careful as to who you're going to jump into partnership with going forward."

Time is money

David Gorton, head of corporate finance at PM+M in Bury and Blackburn, says borrowing has been a great tool allowing many businesses to reach their current scale.

"But like any tool, what was great for the last job might not be right for the next one," he says. "As a business changes – its operations, its management, its ownership – the current borrowings may become impractical and unsuitable. Like just about every business issue, refinancing is best done with a plan."

Kylassam-Pillay gives an example: "Should a business with a debt maturity in 30 months refinance now to lock in long-term financing, while debt market conditions remain favourable?

"While liquidity in the mid-market from banks and direct lenders remains strong, many lenders are refocusing on defensive sectors such as TMT, healthcare and business services – meaning lender appetite is becoming increasingly fragile. The benefit is in arranging competitive financing arrangements now which provide a stable platform to plan for the future."

The choice between sticking with existing lenders or moving to new sources can have a significant impact on a business's time and money.

"For most businesses, refinancing ends up being surprisingly expensive," adds Gorton.

"There are more interesting and flexible lenders in the market now than I can ever remember. And good businesses have no real problems in getting themselves to a borrowing structure that suits them."

Riley sides with Gorton on one crucial factor for any business owner.

"What people don't take into account generally is the transition from a clearing bank to another clearing bank in terms of how long that can take," says Riley. "There are usually a few hiccups on the way. You've also got to notify your customers that you've now got new banking details.

"If you're borrowing money, you need your bank alongside you as a major stakeholder. And that's all about communication."

Peadar O'Reilly, chief executive officer, Praetura Lending

Is there anything businesses commonly don't know about refinancing that you would like to share?

"My key message would be that I believe asset refinance isn't utilised as much as it should be, or as much as it will need to be as we navigate the current and ongoing economic storm.

"In the months to come, it could become a vital funding tool, particularly for businesses with existing government supported finance, because it is difficult to get new facilities to work alongside CBILS or RLS facilities, due to the complexity of inter-creditors and debenture sharing with banks.

"If you have got a CBILS or RLS loan with, say, three years left to run at a very favourable interest rate, you certainly don't want to refinance that. You're likely to want to keep it in place because that deal was done in a lower interest rate environment.

"But having that loan will restrict the options you have available to you for new finance. This is where asset refinance as a funding option can help. If you have existing owned equipment or part financed equipment – such as vans, trucks or machinery – a funder such as Praetura Asset Finance can unlock the value held in those assets and release that to drop additional cashflow into your business, without that impacting the existing CBILS (or RLS) provider security. There's the added bonus that if it is equipment that's currently being financed, the asset refinance can extend the terms and reduce monthly payments to provide an additional cashflow boost.

"At the moment, asset refinance is not well enough known as a source of funding to provide working capital. For those considering finding out more about whether asset refinance could work for their business, I would recommend making sure you're dealing with a lender that has a team with specialist knowledge of this funding option."

Is it a good idea for businesses to refinance to pay off debts?

"If you're considering refinancing to pay off debts, that's a bit of a contradiction in

Peadar O'Reilly

"DON'T ASSUME YOUR CURRENT LENDER FULLY UNDERSTANDS YOUR BUSINESS"

Phil Tarimo, founder of DSW Debt Advisory, part of Daresbury Park-headquartered Dow Schofield Watts, gives his five-point plan for companies looking to refinance and grow in the current environment

PREPARATION

- Don't assume your current lender fully understands your business, however straightforward it might be to you. Many refinancing requests fail because the lender doesn't truly comprehend the underlying strengths of a business, and therefore sees risks where in reality there are none. This then either leads to a declined request or a reduced level of funding being approved.
- Make it easy for your relationship manager presenting your case to a credit committee.
- Ensure you have appropriate monthly management accounts and a robust financial forecasting model as it's folly to approach lenders without these in place.

PRAGMATISM

- Don't think "how difficult can it be, I can do it all myself".
- Hiring a good adviser will quickly pay for itself.
- Be realistic in what you're asking for and what you can afford to repay. Ensure you factor in any non-bank, debt-like obligations such as HMRC Time to Pay agreements or landlord payment deferrals, for example, as all need to be fundable from your cashflows.
- Tackle the real risks in the business and be clear about exactly what management actions would be taken should any of them arise.
- Finally, address the impact of the harsh economic environment and how successful your strategies for maintaining revenues and margins have been.

PLANNING

- Have your adviser identify a shortlist, as there are now more than 200 credible funders.
- Don't base your funding request on your management budget – this leaves no room for any downturn in trading. Instead, pare this back to a bank base case set of forecasts against which to assess the debt capacity in the business. The last thing you want is to underperform and make your lender nervous.
- Identify the ideal funding structure for the business's needs, but factor in any credit risks for the lender.
- Maximise the level of funding by highlighting the security available to the lender and factors underpinning a minimum level of profitability and cash flows.

PRESENTATION

- A detailed and focused funder information deck will make for a quicker process and dramatically improve your chances of success.
- Be clear about what the funding is for, why it's needed and the benefits that will flow to the business.
- Don't be shy about shouting out your successes.

PERFORMANCE

- Lenders place a lot of reliance on the credibility of the management team; having everyone fully across the detail within their area of responsibility is key.
- Don't allow the fundraising process to distract from ongoing delivery to budget; many a transaction has fallen away because management time has been diverted and trading falls away before the deal is done.

Phil Tarimo

terms, because you're looking to take on more debt to pay off debts.

"However, if the question is, 'If you've got debts, is it a good idea to consider refinancing them?', then the answer has to be guided by what it will do for your business. It is unlikely in the current climate to reduce your actual interest rate, but if you're looking to get a more appropriate debt structure for your business, then I would say that considering refinancing would categorically be a good idea.

"For example, if you move to more of a revolving finance facility such as invoice finance, you'll be reducing your monthly capital amount to get some headroom in the cashflow of your business. You can extend the terms on your plant and machinery debt by refinancing, too: you may have one year left to go on some finance agreements, and by refinancing those you will be extending the terms over another three to five years, which will reduce the initial monthly outgoings and will allow you to inject additional cash into your business.

"A business is unlikely to reduce the lifetime interest burden on their debts by refinancing, as interest rates have recently increased. But you can ease the cash pressure on a business by refinancing to improve the repayment profile either by moving to invoice finance or refinancing existing equipment (with asset refinance). Refinancing could allow businesses the opportunity to switch to a more favourable interest rate, reduce repayment quantities, and service debt within a company.

"But is it a simple process? The succinct answer is that it is a simple process with the right lender. If you are dealing with a relationship, decision-maker led lender, then it can be a simple process. Particularly in the current volatile environment, you want to avoid a long drawn-out process where you've not got access to the people making the decisions, so you don't find out in a timely manner whether their credit team are comfortable to offer funding and do a deal.

"But refinancing can be an incredibly simple process for the right businesses dealing with the right lender, and crucially dealing with a decision-maker, which is a principle we're proud to have always made a priority at Praetura."

How should a business complete a stress test to assess if it can afford the interest rate increases and headwinds?

"A business needs a reasonable financial model, or the understanding of a set of assumptions of its business, and it should assume elevated levels of interest from where we are now. The way to afford a higher level of interest is to try and extend capital repayment terms or move to more of a revolving facility. So, if you've got more debt revolving, or with balloons on the facilities, you can reduce your monthly capital repayments, which means you can increase the level of headroom in your facilities or cashflow so you can service a higher interest rate. Yes, your lifetime cost of debt is going to be higher. But you can move to a better capital repayment profile on your business debts, which will reduce your monthly capital repayments." ■