ADDLESHAW GODDARD

January 2018

CORPORATE BORROWER UPDATE

INTRODUCTION

Welcome to the January 2018 edition of the Addleshaw Goddard Corporate Borrower Update.

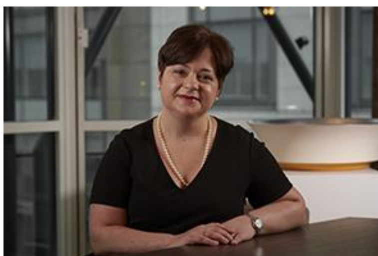
Q4 proved to be a characteristically busy period for our corporate banking team, with high levels of activity in the corporate and leveraged markets, continuing the theme following a busy summer.

The team saw a particular rise in in the combination of asset based lending (**ABL**) facilities with traditional term loans and/or revolving credit facilities. We closed a number of hybrid corporate and ABL deals in Q4, including one of the first ABL unitranche deals in the market, and saw an overall rise of ABL across the piste. Whilst this form of lending was traditionally reserved for the manufacturing sector, a much wider range of borrowers are now using ABL facilities as part of their suite of financing options. From page 1 onwards we discuss the merits of ABL and how it can be easily combined with other products. Emily Makinson, Head of ABL (South & Midlands) at RBSIF also provides her view from a lender's perspective.

If a corporate takeover is one of your new year's resolutions, we take a look at the key considerations when acquiring a public company on page 3. Simon Wood, a corporate partner based in our London office, has recently returned from a two year secondment as Secretary to the Takeover Panel. Simon shares a number of key insights when raising finance for a public takeover.

Finally, from page 5 we take a look at one of 2017's biggest buzzwords – blockchain – and consider its role in finance transactions. Many readers will be aware of blockchain and bitcoin, the most prominent example of a cryptocurrency, and we provide a simple overview of what blockchain is and where borrowers may encounter it in the ordinary course of finance transactions.

We do hope these articles are of interest – do not hesitate to contact any of the team if you would like to discuss (see page 7 onwards) or if there are particular topics which you would like us to tackle in future editions.



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THE RESURGANCE OF ABL – AN OPTION FOR YOUR BUSINESS?

Asset based lending (**ABL**) as a debt structure has become increasingly common over recent years as an alternative, or in addition to, revolving credit facility (**RCF**) and term loan facility structures.

ABL is a secured form of lending where the amount of credit available is based directly on the value of the assets (including typically the trade receivables, stock, plant and machinery and/or real estate) of the borrower. This differs from RCF and corporate style term loan facilities where a lender will typically look at the EBITDA/cash-flow generation of a business in order to establish the level of debt it is willing to provide. The ABL lender can also be flexible with the security requirements, ranging from taking an all asset debenture to fixed charges over the assets it finances and a floating charge.

ABL can be used as an alternative to conventional cash-flow based revolving credit or term loan facilities in a variety of transactions, including acquisition finance deals, working capital financing and, on occasion, restructures. Recently, we are also seeing ABL facilities being combined with revolving credit and/or term loan facilities, and AG closed one of the first ABL unitranche deals in the market pre-Christmas.

THE BENEFITS OF ABL

- COST EFFECTIVE: As an ABL facility calculates funding availability directly against the assets of the business it can provide a greater level of flexibility for the borrower. This is typically reflected in reduced cost of funds. Facilities are primarily focused on funding trade receivables and inventory on a revolving basis, with plant and machinery and property also funded as part of the same facility on a term loan basis.

- SEASONAL: ABL provides flexibility for businesses which experience cashflow peaks and troughs through seasonal or market trends as availability of funding moves in line with the value of the assets funded.

- COV LOOSE: ABL provides simplicity on the basis it is documented as a single facility, often with one financial covenant structure and sometime with no financial covenants required.

- ABILITY TO COMBINE: Facilities can be provided to companies with both private (including private equity) or public ownership and work alongside other financial institutional lenders on either a bilateral or syndicated basis.

- PURPOSE: The purpose of ABL facilities can be less restrictive than the purpose prescribed to an RCF. For example, ABL lenders may allow drawings on the revolving facility lines for the purposes of funding acquisitions or capital expenditure, which are often restricted uses under an RCF.

- GROWTH OF DEBT SIZE: as the value of the loan is directly linked to the value of the assets funded, an ABL facility is able to grow flexibly as the business grows.

ABL IN ACTION

Our Scottish team have seen ABL being implemented widely in relation to one particular asset class – whisky stock. The team have undertaken the refinancing of 3 high profile whisky distillery businesses in the last twelve months. The combination of the whisky stock being held in bonded warehouses, offering a great deal of practical control of the assets without placing an additional administrative burden on the borrower, allied to the active whisky stock trading market make it an asset ideal for ABL. The additional benefit is the fact that whisky stock's value increases with age which will typically be verified under the ABL facility by an annual independent valuation of the stock.

The independent whisky distillers in particular have taken advantage of lender's appetite for ABL to obtain sizeable facilities at very reasonable pricing. This gives these companies access to funding for expansion and the development of new production facilities. Unlike other asset classes our experience is that it is not uncommon for ABL lenders to be comfortable to provide a facility based entirely on the whisky stock. If leverage needs to be stretched for an acquisition a combined ABL facility against stock and debtors can provide additional headroom, or the product can be combined with term debt or a revolving credit facility to provide a full finance package.

ABL & UNITRANCHE

ABL provides innovative facilities that can work alongside other debt structures including cash-flow led term debt and unitranche facilities. To date, the combination of ABL alongside unitranche has been relatively uncommon in the market – with the majority of super senior working capital facilities being provided as a RCF. However we are seeing increased appetite for this product combination for businesses particularly suited to ABL.

ABL lenders are able to be more flexible on the intercreditor principles than a typical RCF lender – either slotting into the usual super senior position on the intercreditor where they retain the true super senior ranking position on realisations of all assets, or giving the unitranche lender prior ranking security on those asset classes that the ABL lender does not fund in return for greater involvement in an enforcement. We expect this to be a growth area in the ABL market – watch this space!

CONCLUSION

With the clear ability of ABL to work alongside other debt structures as well as its flexibility, simplicity and efficiency providing dynamic funding solutions for businesses in different situations and stages in their lifecycle, finance directors should consider ABL, either in addition, or as an alternative to their existing debt when they are entering a refinance or capital raising process.

We hope that this article has provided useful examples and highlighted ways in which ABL can be used by borrowers with liquid asset classes and in combination with other products. Please do not hesitate to contact our team with any queries you may have.

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PUBLIC TAKEOVER – CONSIDERATIONS FOR BORROWERS

Addleshaw Goddard's public M&A team are pleased to announce the return of Simon Wood, a corporate partner based in London, from a two year secondment as Secretary to the Takeover Panel, giving the team and clients unrivalled expertise in M&A transactions. During his time at the Takeover Panel Simon was responsible for regulating the most significant recent M&A transactions, such as AB InBev's £79bn offer for SAB Miller, SoftBank's £24.3bn acquisition of ARM Holdings and Kraft Heinz's abortive approach for Unilever. He was also involved in all the major decisions and policies made during that time. This unrivalled depth of experience gives our clients the benefit of cutting edge know-how on M&A transactions and in this article we will discuss key considerations when financing a public takeover.

DEVELOPMENTS IN PUBLIC M&A

The frequency of debt financing in public M&A in 2017 has dropped from the previous year as 2017 marked an increase in all share or cash and share bids - the key advantage of these deals for target company shareholders is the value which can be created through synergies, rather than a knockout bid premium. There has been some appetite for public M&A from private equity with 30% of all bids in 2017 backed by private-equity groups and the targets were mostly smaller listed companies admitted to trading on AIM rather than the Main Market.

Against the backdrop of these activities, the market has also seen a continuation of a recent trend where debt-funded bidders took out short term bid finance with the intention of refinancing with longer term syndicated facilities or a bond issue prior to closing of the deal or shortly after. Given that the duration of public bids is generally becoming longer due to the proliferation of antitrust and other regulations to be complied with, this seems set to become an established feature of the M&A landscape.

KEY ISSUES FOR DEBT-FUNDED OFFERORS

The Takeover Code regulates the conduct of parties to an offer for a UK listed public company – the key issues for debt-funded offerors are as follows:

- Absolute secrecy before announcement of an offer or possible offer is of vital importance, and an offeror must take all steps to maintain the bid's confidentiality.
- An offeror may approach lending banks in confidence – the Panel allows up to six parties outside the offeror's deal team to be approached in this way (eg shareholders, equity/debt providers or significant customers).
- If a lending bank declines the opportunity to participate in the funding, the Panel may allow that bank to be substituted by another without counting towards the limit of six.
- Any funds lent to fund a bid must be on a certain funds basis. Notably, this will not permit any drawstops for material adverse change for the duration of the bid. This is to enable the financial adviser to the offeror to confirm publicly that the cash consideration will be available at completion – known as the "cash confirmation statement".
- Any facilities agreement entered into to fund an offer is required to be put on display by way of website disclosure for the duration of the bid.

PUBLIC M&A: KEY ISSUES FOR DEBT SYNDICATION

On larger public M&A offers which are funded by debt, the offeror's lenders will often syndicate the debt. This syndication will require the lead arrangers to produce and distribute marketing information in relation to both the debt facilities required and the offeror and the offeree company.

The Takeover Code imposed restrictions on the dissemination of information, and the rules in this area were amended relatively recently in 2016. Lead arrangers will need to take care to ensure that any syndication process is carried out in accordance with the Takeover Code. In particular, the Panel will be keen to establish that any potential syndicatees who hold, or may in the future acquire, shares in the offeree company do not receive inside information relating to the bid solely through participating in the syndication.

The Panel will be keen to establish that a shareholder-lender does not receive beneficial treatment in the syndicate as an inducement for them to accept the bid. This concern can be addressed by confirming to the Panel that any participation in the syndication is carried out on market terms.

Any facilities agreement entered into to fund an offer is required to be put on display by way of website disclosure from the date of the firm offer announcement. In a syndication, the market flex provisions, which allow adjustments to pricing in order to facilitate a syndication, may be redacted between the date of the firm offer announcement and publication of the offer document. If the syndication has not been completed by the date of posting, the unredacted facilities agreement, showing details of market flex, must be publicly disclosed.

CONCLUSION

As appetite increases for debt financing in public M&A, corporates and lenders will have to be wary about certain considerations under the Takeover Code and their ramifications. Given Simon Wood's experience with the Takeover Panel, AG has a unique insight into the way in which the Takeover Code is applied by the Takeover Panel on a daily basis. We hope that this article has provided useful examples and highlighted issues to consider in the public M&A market. Please do not hesitate to contact us with any queries you may have.

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DEVELOPMENT OF THE BLOCKCHAIN

It seems to be the topic on everyone's lips. We have seen cryptocurrencies boom and bust and blockchain has been tipped to revolutionise financial services - Australia's main stock exchange has said it will become the first global market to use the technology to clear trades. But what is blockchain and what does it mean for borrowers?

Blockchain is the cryptographically secure method of recording and validating information and transactions – from obscure ideas to mainstream technology and specifically the implementation of the blockchain in the context of cryptocurrency. One particularly interesting feature for corporate borrowers is the issuance of cryptocurrency through Initial Coin Offerings (**ICOs**) as a method of raising finance.

What is Blockchain?

The blockchain enables the creation of highly secure transaction records (blocks) which are recorded on an electronic distributed ledger. The nature of the blockchain is that crytography renders it an immutable object and therefore a high degree of trust can be placed in a transaction recorded on a block.

Creating blocks of value in ideas and concepts has become possible and one of the most innovative implementations of blockchain has been the token sale or ICO (Initial Coin Offering) using cryptocurrency.

What is cryptocurrency?

Cryptocurrency is an expression of digital money that is trusted and secured by reference to complex cryptography in the blockchain which protects transactions from alteration and fraud by the public and third parties. Once created Cryptocurrency, often shortened to "**Crypto**", has the following characteristics:

► Irreversible: After a confirmation of a transaction the block is written and is an immutable object (i.e. it cannot generally be reversed or changed).

► Quasi Anonymous: Transactions and accounts are not able to be connected to real world identities.

► Distributed Ledger: The fundamental component and concept of Crypto is the decentralised nature of the ledge. There is no central repository of transactions or records, rendering it theoretically immune to government interference or manipulation.

The first cryptocurrency was Bitcoin, born in 2009 following the issues by Satoshi Nakatomi of the first bitcoin software. There are now over 900 crypto currencies available on the internet.

What is an Initial Coin Offering / Token Sale?

Innovative and speculative start-up tech enterprises require funding but conventional channels are frequently limited, highly regulated and governance orientated. An ICO enables these businesses to create a currency, coin or token representing their idea and ask people to buy into this idea by acquiring the token. Blockchain technology enables that token to be bought or sold with the consideration being calculated by reference to people's perception of the value of the underlying idea – provided of course someone else is willing to be the transactional counterparty i.e. if two people want to trade then there is a market in the Crypto and therefore a value.

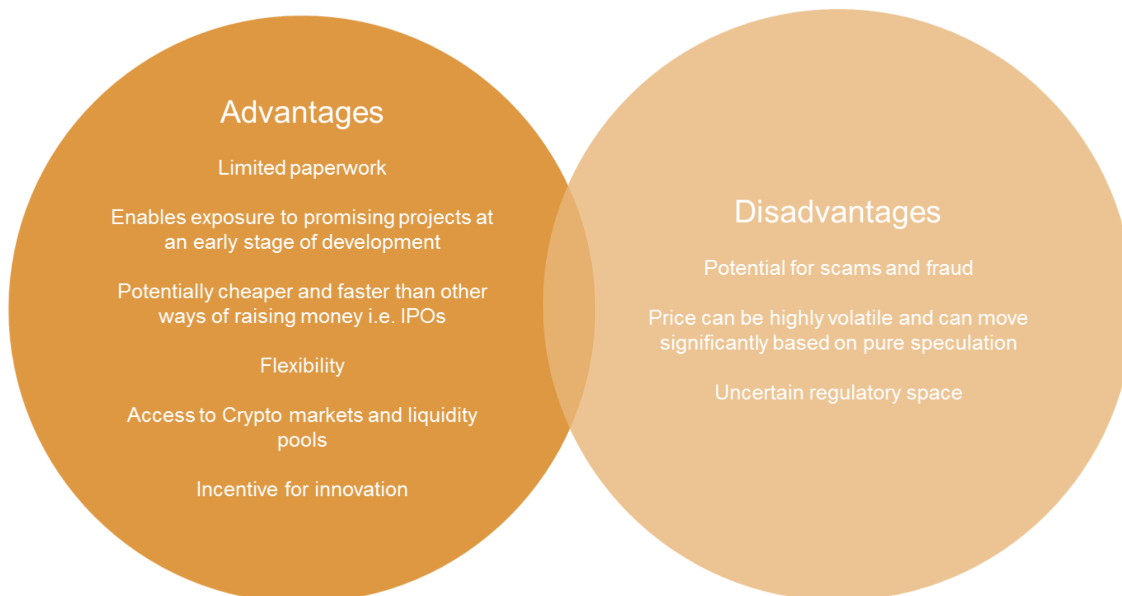
An ICO (or Token Sale) is a process by which funds can be raised for a venture by the sale of tokens representing the idea. Investors in the idea buy the tokens linked to the idea in exchange for fiat currency or other Crypto. Typically an ICO is undertaken by start-ups who want to bypass the rigorous and regulated process required by governments, regulators, venture capitalists, PE houses and banks and rely on the immediacy and 'genius' of the idea behind the venture.

What does the token entitle an investor to?

A token can represent an interest in a wide variety of assets such as properties, shares, intellectual property, new Crypto classes, loyalty programmes or simply rights to use certain software. Issuers may tell investors that the capital raised from the sale of these tokens will be used to fund the development of a digital platform, software, or other projects and that the virtual tokens may be used to access the platform, use the software, or otherwise participate in the project. Some tokens may confer rights on investors to share in the future income or capital generated by the project. The rights in the token are locked into so called smart contracts which then operate independent of the original promoters and deliver underpinning value to the token and the token holder.

By contrast, whether the tokens issued on an ICO can be resold to others in a secondary market on virtual currency exchanges for fiat currency, funds, or other forms of virtual currency, depends on the structure of the ICO, which has usually been explained in a presentation to investors known as a "White Paper".

The White Paper should confirm to investors whether they can resell their token and whether there are any limitations on their ability to do so. Even if they can resell, investors should be mindful that the contents of the White Paper and these virtual currency exchanges are not themselves regulated. Accordingly, investors do not have the same protections that would apply in the case of shares listed on the London Stock Exchange making ICOs potentially a risky investment.



Conclusion

The world of ICOs, Cryptos and Blockchain is very much an unexplored dynamic landscape – subject to change on a daily basis. The decentralised characteristics of the blockchain and their application to Crypto means regulation of these new instruments is uncertain, not only in the UK but globally. The FCA, amongst others, have expressed their views on how best to deal with blockchain, Cryptos and ICOs; however how this will develop is still unknown.

What is known is that many of the advantages that make blockchain and its application so attractive will continue to be attractive. Their compliance with KYC and AML regulations will become more apparent and their perceived appearance as an unknown, unregulated instrument will slowly be removed bringing them into the mainstream. Clearly, using ICO's as a method of fundraising is still limited. That being said it is early days, and as the use of blockchain increases it remains to be seen whether the option will become more attractive.

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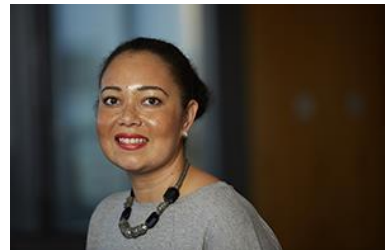

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