# Agency Financing - Strengthening Your Balance Sheet Foundations

For Corporate Clients

INDUSTRY INSIGHT

As a result of the global financial crisis and the subsequent events in the Middle East and Europe, the focus on capital has increased. Even as liquidity returns, constraints still exist. Adding agency support across the entire financing landscape can reap huge benefits for CFOs and provide resilience to shocks. Agencies (ECAs, multilaterals and DFIs) are increasingly flexible and pro-active and can truly complement and supplement traditional sources of finance.

One of the key fallouts of the crisis is that CFOs realize the need for as diversified and flexible a range of financing sources as possible. A recent report by Ernst & Young called 'Why Capital Matters' included the inaugural Capital Confidence Barometer. This study surveyed corporate executives from 490 different companies around the globe. The findings suggest: "Boards should challenge their reliance on traditional sources of financing and the barometer shows a clear increase in the breadth of sources being considered." One source growing in utility and usage is agency-supported finance. This source has many benefits, not least that of providing liquidity when private sources of finance dry up. But agencies should not be seen only as a back-stop or financier of last resort. Rather, agency finance can now be used across the entire financing spectrum.

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## A New, Flexible Approach

Because of the crisis, agencies are now more active than before. While global trade finance volumes have shown modest growth in the past few years, the rise in ECA-backed loans has been significant. According to Dealogic, these increased by over 100% in 2009 to US$61.3 billion compared to 2008, and in 2008 by 63% to US$30.6 billion over 2007 (US$18.8 billion).

It is also important to note that ECAs, like other agencies, have become more flexible and proactive in providing financing, and the bureaucracy that agencies were known for has been significantly diminished. Agencies now have more relaxed rules on the eligibility of the companies they support, with some seeking to focus instead on national interest rather than exports. Agencies have also been responding to the demand from the industry by speeding up their processing time while adding new products that did not exist before.

## Financing Considerations

The considerations that CFOs face when meeting their financing objectives are driven by a variety of factors. These can range from the industry they are in and its cyclicality, to more financially-specific concerns over diversification, currency exposure and the economic life of assets they hold. While financing considerations are specific, some of the common parameters include:

- Matching currency between business and debt profile
- Maximizing financing tenor and resulting debt service profiles to business cash flows and economic life of assets
- Minimizing refinancing risk
- Retaining access to financing sources

In addition, CFOs will always have universal considerations of minimizing cost and in more recent times, focus on counterparty risks. A judicious use of agency finance can significantly help address many of these objectives.

## Financing Risks

The crisis highlighted the problems that CFOs can face when a particular financing strategy goes wrong. Sometimes strategies fail not only because of bad or speculative decisions but also due to drastic changes to the environment in which assumptions were made. The yen carry trade was popular in an environment of a stable exchange rate and lower interest rates but not in volatile markets. Bond markets can provide seemingly attractive alternatives, until faced with unforeseen business and market cycles requiring renegotiation. Financing long-term assets, using short term or financing and/or bullet repayments, exposes a company to significant refinancing risks.

Certain sectors also face issues that are peculiar to the financing techniques used in those sectors. Over-reliance of revolving credit by shipping companies, for instance, creates significant refinancing risk. Disproportionately unhedged foreign currency debt for power or telecom businesses, which are predominantly local currency businesses, can create unintended currency volatility exposures.

Therefore it is vital to ensure that optimal weight is assigned to the various financing objectives, industry considerations and market considerations in matching financing sources and structures. Agency supported financing can help stabilize the financial foundations of a company.

## Matching Objectives with Agency Sources

Asian companies have traditionally had access to multiple and diverse sources of financing, depending on the country where they are from. Yet in each case, there is the risk that when the CFO needs it, the market will not be there. Agencies on the other hand are mandated to do exactly the opposite; when traditional sources of liquidity dry up, they step forward.

The global financial crisis has shown that agency finance can now be used as part of a more traditional financing strategy with advantage. In many cases, the use of agency finance can enhance the outcomes and ensure a less risky and more permanent financing strategy.

Moreover, many of the agencies have broader policy goals to support certain sectors, market development or even certain companies. Currently, sectors such as infrastructure and clean energy are highly regarded by the agencies. They are also keen to support transactions that develop local financial markets, especially in local currency. Some agencies, especially those in Asia, also support their national champions in deals that are in certain strategic areas, such as natural resources. If the corporate in question is operating in one of these priority areas, it is a 'sweet spot' and the agencies will be even more flexible.

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## Major Benefits of Agency Financing

Agency support has made long tenors available to Asian deals launched in late 2008-09. Some of these deals have featured tenors longer than 12 years for borrowers in countries including Indonesia and Vietnam, at a time when the cross-border commercial market could only provide a fraction of that tenor. For example, a US$175 million term financing supported under NEXI's untied facility with a tenor of 13 years, was successfully closed in Vietnam at the end of 2008 amidst the global crisis. The deal was primarily driven by agency support, during a time when the traditional bank market for non-sovereigns in Vietnam could only extend tenors of up to five years.

Moreover, agency-supported pricing has only increased slightly (reflecting funding bank liquidity costs) but continues to be very stable and attractive vis-à-vis comparative commercial funding levels. With certain agencies, fixed interest rate programs may be available without additional swap costs or lines. Leading telecom operators in the Philippines, India and Indonesia accessed attractive long tenor fixed-rate financing supported by European agencies in 2009 and 2010.

The structure of agency finance also allows borrowers to optimize leverage ratios for projects, and often interest during construction and agency premia can be financed. Agency support for projects in underdeveloped markets helps mitigate cross-border and political risks. Citi, with the support of IFC, EIB and FMO, closed a US$156 million financing for Digicel Pacific for south Pacific islands denominated in US$, Samoan Tala and Fiji Dollars. Other key benefits include the fact that agency-supported financing is generally withholding tax exempt; some official agencies (particularly DFIs and MLAs) can support financing in local currency; and comprehensive guarantees and insurance by agencies in favor of financial institutions preserves credit capacity for other financial products.

Agencies also have the capacity to facilitate large ticket financings in difficult markets to meet industry specific demands, as has been seen in the aviation industry – Citi alone has either arranged/is arranging over US$4 billion of 12-year financing for airline clients in Asia over the past year. Finally, agency involvement gives greater visibility to deals and improves the profile of the borrower.

## Agencies Respond to Market Demand

Programs that have provided support during times of constrained liquidity and difficult market conditions include:

- A NEXI-supported working capital program for Japanese subsidiaries, which shows how agency financing helped address the need for short-term liquidity in difficult markets in 2008 and 2009.
- The Asian Development Bank's Trade Finance Facilitation Program with banks and IFC's Global Trade Finance Program and Global Trade Liquidity Program, where Citi is an active and significant participant, help provide additional capacity in the trade finance arena.
- With increasing levels of activity in the M&A space and economic stimuli encouraging domestic capacity expansion, a number of agencies, namely, Japanese, Korean and Chinese, are increasingly focusing on import and acquisition support programs for their key clients.

## Conclusion

By adding agency support to overall financing strategy, CFOs can reduce their refinancing and liquidity risks and enhance their likelihood of success to fully achieve such objectives. In these times of challenging credit and volatile markets, agency-supported finance has many potential benefits.

For more information about Citi's Global Transaction Services, please visit **www.transactionservices.citi.com.**

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