FAIRVUE PARTNERS

ASSESSING CAPITAL MARKETS COMMUNICATION CHALLENGES FOR LEVERAGED ISSUERS THROUGH THE PANDEMIC

As companies continue to navigate their way through the pandemic, they have adapted their communications and engagement approach with their various stakeholders. In this paper we assess the implications for debt issuers, in particular those below investment grade and under private ownership, that are seeking additional liquidity, refinancing options or facing restructurings in an uncertain environment and with increasing complexity around their investment narrative.

Whilst the level of complexity will vary significantly across sectors and be heavily influenced by debt and ownership structures, there are nonetheless overriding themes that issuers will have to be cognisant of in order to succeed in their quest to navigate the fallout from the pandemic successfully.

01

TIMING CONSTRAINTS

in tapping the public and private debt markets for extra liquidity, refinancing or restructuring purposes

02

REPOSITIONING

the investment thesis on the back of the pandemic impact and as distressed sales and restructurings become more prevalent

03

MANAGING DIFFERENT EXPECTATIONS

from a more diverse and demanding investor audience if the credit risk profile has worsened

1 Timing constraints

The "whatever-it-takes" approach adopted by the Federal Reserve and the ECB has created short-term opportunities for credit investors across developed markets. As a result, greater demand for debt investments – both on the primary and secondary markets – represents what for some issuers will inevitably be a limited window of opportunity to raise capital.

In the US, the Fed's decision to extend its bond-buying programme to "fallen angels" - i.e. investment-grade issuers downgraded to high-yield – as well as junk bond ETFs, has led to a substantial increase in fund inflows into high yield bonds through April 2020, as well as a notable volume of new bond issuances after a market shutdown the weeks before. It now appears likely that this trend will soon be replicated in Europe, where the ECB recently loosened its collateral rule to accept these fallen angels.

These measures increase the likelihood of tighter spreads in the future, whilst current yields offered by certain bonds are clearly very attractive. This explains why a number of institutional investors are going overweight in debt versus equity, along with the anticipation that equity valuations have yet to bottom out, with more earnings downgrades expected through upcoming reporting seasons.

In this context, we expect a number of leveraged corporates to tap the debt markets as they face severe liquidity bottlenecks, rating downgrades and, in many cases, the necessity to access new funding to support a change in strategy. Instruments such as bonds and leveraged loans are likely to be used to refinance existing debt and/or raise new capital. This applies particularly to fallen angels, who will naturally have to refinance part of their debt due to the deterioration in their rating. Additionally, for certain companies, tapping into the public markets might not suffice, and corporates will also rely heavily on private debt from, amongst others, private equity firms.

2 Repositioning the investment thesis

Investment stories will at least need to be updated to factor in the short-, medium- and possibly long-term implications arising from the pandemic. Simultaneously, many debt issuers' credit risk is likely to worsen, placing greater onus on them to address heightened concerns within their investor base which, in the case of fallen angels, will now include new and more demanding high yield investors.

In the past, it might have been enough to provide an overview of financial KPIs on a regular basis to address bondholders' main ongoing queries. In the current environment, it will be paramount to outline the external factors influencing the business as well as a broader set of operational KPIs. In outlining downside risks and upside opportunities to the cash flow generation of a given business, any modelling guidance will be considered a strong plus, similar to a description of the company's approach to mitigating new risk factors.

Against this backdrop, as the corporate and sponsors focus shifts from maintaining adequate liquidity buffers to ensuring solvency, it is likely that, for a number of leveraged entities, this will result in the need to either restructure operations, corporate organisations or capital structures altogether. In particular, the assets sales, carve-outs or business restructurings will impact the underlying business model and de facto investment stories.

These considerations go beyond traditional debt financing, as private equity investors and specialist distressed asset investors, amongst others, are screening the market for undervalued assets and potential bargain investments. However, from a communication and engagement standpoint, the challenge will be to explain the benefits of and rationale for such transactions. Critically, the objective is to explain how the remaining entity still offers an attractive investment opportunity. Finally, it will be key to understand and address investor concerns around execution risks and the related mitigants that are in place.

3 Managing expectations of a more diverse and demanding audience

Another crucial level of complexity will arise for those issuers used to dealing with a specific audience which might become more diverse, depending on the recent evolution of their debt structure and/or credit profile.

Fallen angels will attract a different class of investors and lenders and the onus will be on the issuer to understand their motivations, areas of interest and investment strategies, in order to articulate the appropriate investment story. This is also the case for longstanding high yield issuers whose bonds are trading at a significant discount and who are therefore engaging for the first time with distressed investors.

Additionally, in the case of a restructuring process, issuers are likely to see bondholders combining efforts and forming groups of interest, depending on their respective risk appetite. Understanding bondholders' motivations ahead of any transaction will therefore be paramount.

Equally, private equity firms are likely to have broader investment strategies, including the capacity to take up private debt, and their focus will definitively encompass a broader scope than that of the "traditional" lenders.

As new classes of investors come on board and inject new funds, it will also influence the debt structure of the issuer. Understanding the resulting seniority structure will also be critical, in particular for restructuring scenarios.

Lastly, depending on the sector and profile of the issuer, it is likely that management will have to engage with other stakeholders, such as rating agencies, credit analysts and the media, as well as the core investor audience, whilst maintaining consistency in its messaging. And, more than ever, striking the right balance between addressing the different needs of a diverse audience and delivering a consistent message to the investment community is a critical challenge.

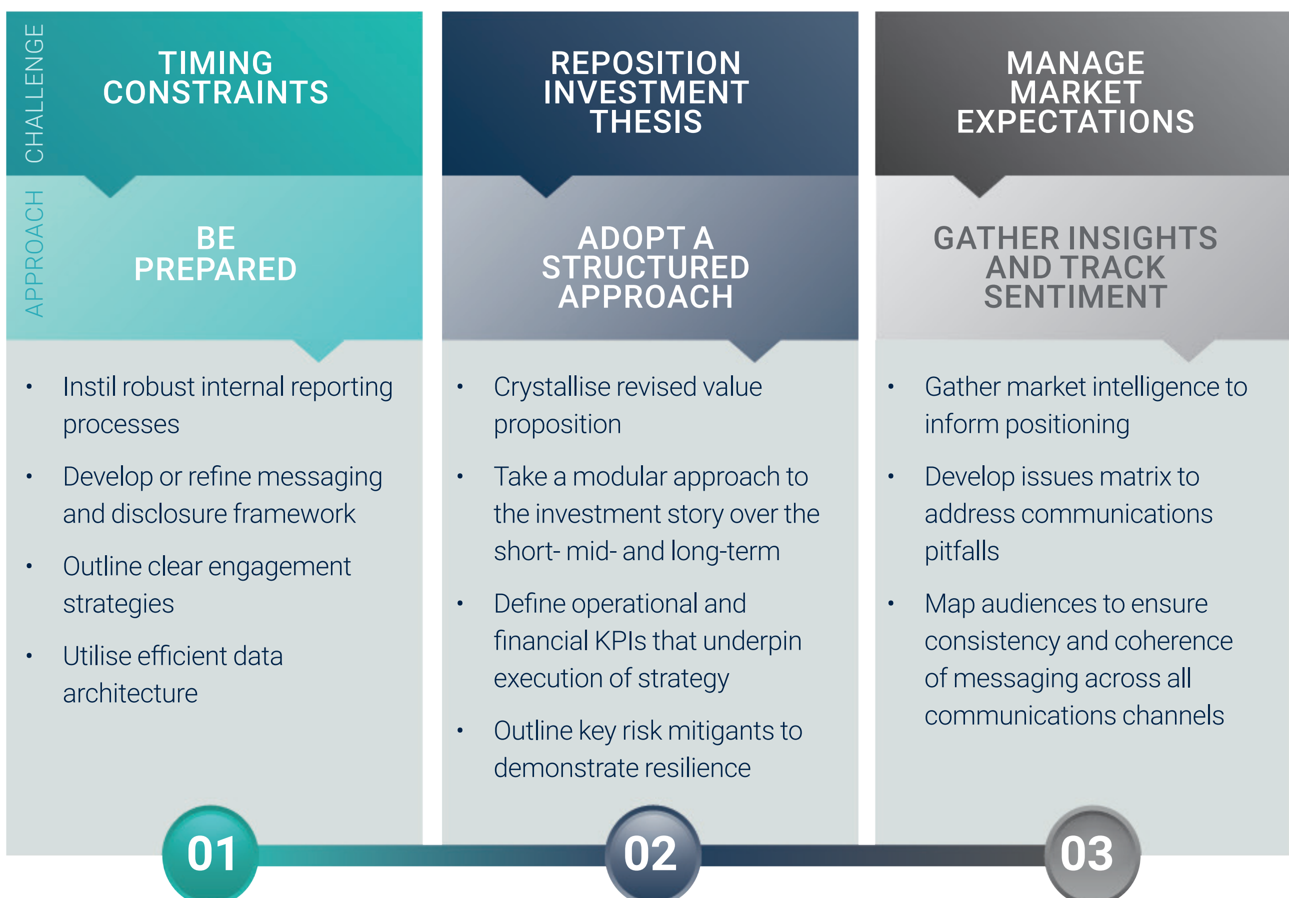
Communication Priorities

Given these challenges, preparation, transparency and consistency in messaging will become genuine strategic advantages, particularly in volatile markets where adequate pricing can make a material difference for highly leveraged entities.

Whilst corporate issuers will receive expert support from their sponsors, bankers and legal advisors in order to prepare and execute the deal, we believe that there are specific building blocks that the finance, treasury and IR teams can work on to support the successful execution of the transaction and ensure a smooth transition post issuance. Beyond that, this process can help bring consistency to the investment story on an ongoing basis.

To this effect, adopting a modular approach to articulating the investment story (see our previous publication "Adopting a modular approach to your Investment Story" **here**) and focusing on understanding where market scrutiny will develop over time will be crucial to gain and maintain support from various investor audiences. Equally, a robust financial communications infrastructure is fundamental for any successful engagement with the capital markets, as it enables greater focus on value-accretive activities and provides a clear understanding of market sentiment and expectations.

Those IR imperatives have never been more important than today.



ABOUT US

Author of this publication

Severine Camp
Partner

T: +44(0) 203 771 4200
M: +49 (0) 173 85 11 241
E: SCamp@fairvuepartners.com

Fairvue is a strategic financial communications and investor relations advisory firm. It supports debt and equity issuers to devise and implement effective communications and engagement strategies to support their capital market goals. We adopt an analytical approach to get to the heart of our clients' ambitions and challenges and deliver meaningful and measurable results.

Fairvue has a diverse client base who shares our ambition to use capital markets communications as a strategic competitive advantage. We seek to enhance the understanding of the business in the investment community while addressing concerns, building confidence and, ultimately, devising the best investment proposition.

To learn more about Fairvue Partners and our Debt IR practice please contact **DebtIR@FairvuePartners.com**