

# Banks look to profit from M&A prospects

## News analysis

The volume of loans made to investment-grade companies has risen steadily, says Anousha Sakoui

As hopes rise of a revival in takeovers and mergers, banks have been falling over each other to win lucrative financing business from cash-rich clients. Corporate lending markets, shaken badly by the Lehman Brothers collapse in 2008, are buzzing.

The volume of loans banks are doling out to investment-grade companies has grown steadily during the past year. Global loan issuance rose to \$2,600bn in 2010, a 52 per cent increase from the previous year, according to Thomson Reuters data. At the same time, the cost of loans made to companies has been falling.

"Bankers are making bets that large global investment-grade companies will be doing a lot more M&A and are providing them with capital," says Ashu Khullar, co-head of European loans at Citigroup. "Despite all the issues around Basel III [banking regulations], and funding costs for banks, there is not enough demand from good corporates for money. That is manifesting in strong competition between banks for their business."

However, as regulators impose tougher capital requirements on banks, the question investors are asking is whether the strength in bank lending can continue. One of the problems faced by banks is that their own funding costs often exceed those of the blue chip companies they lend to.

France Telecom is the latest company to receive bankers' attention. It is understood to have raised €6bn from banks for refinancing, at a margin of 40 basis points over Libor, the rate at which banks lend to each other. One large European bank says its own funding costs for such a deal would be about 100bp over Libor. More generally, pricing on loans to single A rated companies fell 33 per cent during 2010 to 53.5bp over Libor, Thomson Reuters data show.

France Telecom declined to comment. But it is not the only company to secure such good terms.

TeliaSonera, the Nordic telecoms company, managed at the end of last year to get a loan of seven years, an unusually long duration and one of the first such deals since 2008.

HeidelbergCement, even though it ran into refinancing trouble in recent years, persuaded its banks to knock 100bp off the cost of its €3bn credit lines in November, without the need to launch a refinancing after having agreed the original terms in April.

While part of the reason

these companies can access such cheap funding is that the agreed loans are rarely drawn, the hope among the

bankers involved is that their clients will turn to them first should they want to raise financing for acquisitions or issue bonds in the capital markets.

In the case of last year's attempted takeover of Potash Corporation by BHP Billiton, the miner needed \$45bn, but could have raised \$50bn, one banker with knowledge of the transaction says. The pricing on such an acquisition loan would have been more lucrative than for refinancings, paying nearly double the interest rate.

Last year, says one banker, M&A financing in Europe represented 15 per cent of loan financing. The hope is that this year that proportion will rise to 30-40 per cent. In 2007, M&A accounted for about half of loan financings, the banker says.

However, as the loans market has revived, bankers have become more careful in their dealings. "Most banks have become significantly more disciplined in terms of how they allocate and evaluate the use of capital against individual transactions and clients," says Kristian Orssten, head of the European loan and high yield syndicate at JPMorgan, who expects leveraged loan activity to continue to grow in 2011.

In the US, the loans market has been boosted by

growing demand from institutional funds to invest in debt. Last year investors poured record amounts of cash into funds that invest in loans, according to Lipper, the fund tracker.

One repercussion of this easier lending is a dearth of investment-grade corporate bond issuance in Europe. For example, France Telecom's credit default swaps, a type of insurance against the risk of the company defaulting, indicate it would have to pay interest of more than 60bp over a benchmark rate for a bond. Issuing the bond would probably be more expensive than borrowing from banks.

Some bankers say such beneficial rates will not be available for much longer, not least because it is questionable that banks will earn sufficient ancillary business to compensate for the differential. That could lead to a correction.


There are also concerns that a two-tiered lending market could develop, with bigger companies sitting on large cash piles able to access financing more easily than smaller businesses.

"The market is much more polarised than it ever was before," says **Rodolfo De Benedetti**, chief executive of **ENR**, one of Italy's biggest companies. "You really have two markets: one where there is a lot of liquidity for large companies, and the other for smaller businesses, where it is very difficult to get credit." *Additional reporting by Daniel Schafer and Richard Milne*



**france**

France Telecom  
 Five year CDS\* 66



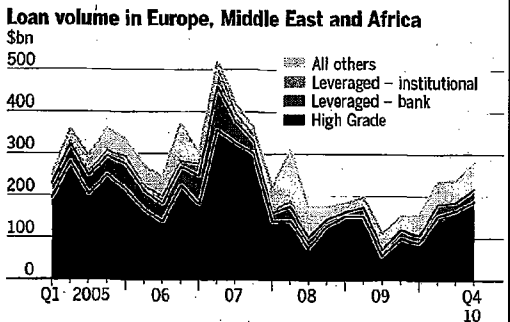
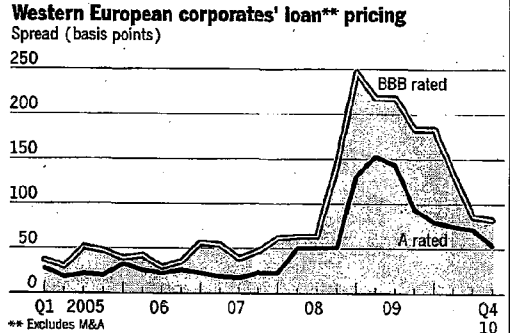
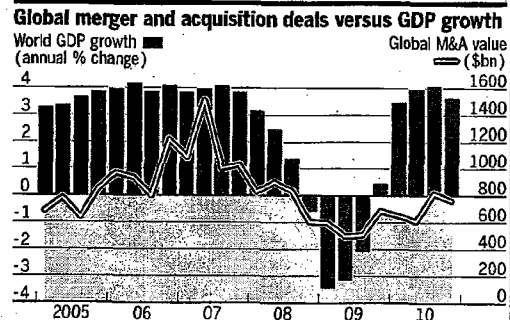
**HEIDELBERG**

Heidelberg  
 Five year CDS\* 256



**TeliaSO**

TeliaSonera  
 Five year CDS\* 56



Sources: Markit; Oxford Economics, Dealogic, Thomson Reuters LPC/DealScan \* Five year cost of insuring against default (basis points)

**Atlantic split**

There is a transatlantic divide in the mood of companies.

US businesses, with record levels of cash, are feeling it burn their pockets, leading to a strong start to the year for M&A.

European groups are more conservative, in part because of the sovereign debt crisis.

Executives say higher cash buffers might be here to stay.

Companies are still pretty cautious (in Europe), says **Rodolfo Benedetto**, chief executive of Italy's **ENI**.

