# TOP TAKEAWAYS

## What the Board Needs to Know About the Capital and Financing Markets

This paper states the top takeaways from a roundtable discussion of "What the Board Needs to Know About the Capital and Financing Markets" facilitated by Foley & Lardner partners Patrick Daugherty and Carrie Long on November 10, 2016 in Chicago as part of Foley's National Directors Institute "Executive Exchange."

Featured speakers in the roundtable were Brett Paschke, Managing Director and Head of Equity Capital Markets, William Blair & Company, Chicago; Kelly Martin, Managing Director, Head of Leveraged Finance Group, also at William Blair & Company; and Dee O'Dell, Senior Vice President and Group Head, National Corporate Banking, U.S. Bank, Charlotte.

1. Election Reaction

   After some volatility in the immediate aftermath of the presidential election, equity markets are showing a strongly positive trend based on expectation of a shift from exclusive reliance on central bank monetary policy (low interest rates and quantitative easing) to pro-growth fiscal policy (lower taxes and infrastructure spending. Unified Republican government at the federal level seems to be viewed as pro-business by investors.

2. Higher Price/Earnings Multiples and Expected Higher Earnings  Good for M&A

   A shift in focus to fiscal policy is expected to be accretive to company earnings, which have been a source of uncertainty for investors as stock prices continue to rise in the face of declining earnings. While higher price/earnings multiples have been good at driving up M&A deal value in the short-term, they have been a source of concern for long-term investors given the possibility that high multiples will lead to a market correction. Expected earnings increases are positive for M&A activity early in 2017, but eventually the market will decline.

3. Public Equity Market Activity Down in 2016

   2016 was a down year for public equity offerings, with only 79 IPOs, a reduction in follow-on offerings, and more private companies electing to use M&A as an exit strategy instead of going public. In addition, the market saw an increase in "fully bought" follow-on offerings, with underwriters purchasing all the securities to be sold (usually at a larger discount) before the launch of an offering.

4. Shift from Active to Passive Funds

   The equity capital markets have seen a shift from actively managed funds to passively managed (index) funds, with $124 billion in capital pulled out of actively managed funds in 2016 and an influx of approximately $500 billion into passive funds in the past three years.

5. Changing Players in the Leveraged Finance Market

   Since the financial crisis, there has been a shift in the leveraged finance market, with debt credit funds emerging as significant players that are capable of providing a variety of loan structures that most commercial banks cannot furnish due to heightened regulatory burdens.

6. Attractive Financing Options are Available for Small to Midsize Companies

   Never has there been available a broader range of financing options for small to midsize companies, with the attractiveness of the high-yield debt market, the emergence of debt credit funds in institutional lending and an availability of capital that has exceeded demand for credit for deals in the market.

7. Increasing Interest in High-Yield Debt Offerings

   There has been an increasing appetite in high-yield debt offerings by smaller companies (EBITDA of $20 million or more). The companies issue five- to seven-year notes in these SEC Rule 144A transactions. Flexibility for the borrower is excellent.

8. The Clock is Ticking on the Current Low-Rate Environment

   The bank finance market continues to be characterized by low rates in the face of increasing regulatory costs. Currently, the increased costs are not being passed on to borrowers due to bank preference for more deals and deposits, which have become a barometer for bank health. It is believed that the current environment cannot last much longer, with Dodd-Frank and Basel III set to drive up capital requirements. As a result, the market may soon see a tipping point as banks will be forced to push costs to borrowers and re-evaluate their existing client-base in light of the banks' own financial goals and objectives.

9. Deciding Between Issuing Bonds or a Bank Loan

   Companies considering financing options should weigh the advantages and disadvantages of issuing bonds versus incurring commercial debt. While bonds can allow a company greater leverage than a bank can offer, bond issuance will typically result in higher transaction costs to the company. But bond issuance can be beneficial due to the lack of financial covenants or amortization requirements associated with bank financing. Companies should also consider the outlook for economic growth when selecting financing options, as fixed rate borrowing will be advantageous to a borrower (versus floating rate debt) during a period of high growth.

10. Strong Market for Asset-Based Lending

    Banks are showing an increasing desire to do asset-backed loans, due to their lower capital requirements and increased profitability. Borrowers should be mindful that asset-backed loans are not exclusively for distressed companies (depending on the industry and peer use within the industry) and can be structured to avoid strict covenants so long as there is a certain amount of availability remaining in the credit arrangement.

For more information on What the Board Needs to Know About the Capital and Financing Markets, please feel free to contact the moderators directly:

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