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Refinancing And Liquidity Risks Remain, But Australia's Rated Corporates Are Set To Clear The Debt Logjam

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Some signs of confidence are returning to the world's battered credit markets, but that doesn't necessarily mean Australia's corporate treasurers are breathing any easier. Indeed, corporate Australia still faces a significant debt-refinancing task in 2008. Of the A$130 billion of debt outstanding for rated corporates across Australia and New Zealand, about A$24 billion or 18% of outstanding debt is scheduled to mature over the remainder of this year.

Nevertheless, we're confident that the region's largest rated corporates have their 2008 refinancing task well in hand. The companies with the most maturing debt in 2008 include some of Australia and New Zealand's biggest companies: Wesfarmers Ltd., Telstra Corp. Ltd., Fonterra Co-operative Group Ltd., BHP Billiton Ltd., Westfield Group, and Orica Ltd. Several unrated corporates also have significant rollover funding requirements in 2008. While much of the A$24 billion in funding will be met from cash reserves and existing undrawn bank lines, we estimate that a significant portion will need to be met from new or rolled-over borrowings, or—as Wesfarmers are doing—through an issue of equity.

Ominously, this sizable refinancing task comes at a time when global credit markets are in the most difficult shape for many years. The pessimistic view is that the changed lending environment may thwart issuers seeking to refinance debt maturities. Of course, the cost of replacing maturing debt will be significantly higher and lending conditions tightened. However, we expect Australia's investment-grade companies to meet the debt-funding challenge in 2008, even if credit markets remain skittish. For these corporates, we expect to see a planned and logical approach to meet upcoming debt maturities. Liquidity and liability management, which are key components of our rating methodology, are therefore particularly important.

Borrowing Task Becomes Tougher As The Lending Landscape Shifts

Thanks to the upheaval in global credit markets, today's lending landscape is very different to the one that we've become used to over the past few years. In short, the days of easy money—which helped fuel the boom in leveraged buyouts and complex funding structures—have virtually disappeared. The ripple effects of the lingering U.S. subprime lending situation have led to a substantial contraction in liquidity, much higher borrowing costs, and tighter lending terms and conditions. And until very recently, corporate bond markets have been virtually closed to Australian issuers.

Fortunately for local issuers, banks haven't totally lost their appetite for lending, reinforcing the bank sector's long-held position as the most common funding source for Australian corporates. Nevertheless, the lending environment has changed. Banks are now facing much higher funding costs in wholesale credit markets and are, therefore, borrowing and lending less themselves. The upshot: higher borrowing costs are being passed onto corporates, and banks are becoming more discerning about who they lend to. Single-customer-exposure limitations at individual banks are adding to the woes, restricting the extent to which banks pick up the funding gap historically filled by debt-capital markets.

We believe that investment-grade companies (those rated in the 'BBB' category or higher) should be able to meet their refinancing tasks in 2008. However, there is likely to be some pain: the cost of replacing that debt will be materially higher, companies may not get the tenor they are used to, and they may have to strengthen the covenant protection offered to investors. Among the hardest hit by ongoing credit market volatility will be speculative-grade companies (those rated in the 'BB' category or lower); these companies are more exposed to refinancing risks and will find liquidity harder to come by in the current credit environment, particularly those with complex structures or businesses. Those that do manage to refinance their debt obligations will do so at a much higher cost and with tighter covenants, as lenders demand a greater risk premium.

Following this week's announcement of Wesfarmers' new equity and debt raisings, Australia's investment-grade companies with the largest debt refinancing all now have their 2008 refinancing task in hand. Wesfarmers, which owns retail and energy assets, shored up its significant refinancing task through a A$2.5 billion underwritten equity issue, the rollover of bank facilities, a US$650 million private placement, and the 100% underwritten reinvestment of its interim dividend payment. The large 2008 refinancing was necessary to meet the upcoming maturity of the bridging finance raised to purchase Coles Group in 2007. Elsewhere, BHP Billiton's refinancing task (A$1.8 billion) is small relative to the size of the company, and even smaller relative to the committed US$55 billion bank facility it has arranged to support its bid for rival miner Rio Tinto PLC.

Corporate Treasurers Face Some Difficult Decisions

The recent refinancing difficulties and near collapse of some high-profile Australian companies, including the unrated Centro Properties Group, have sharpened the financial market's focus on companies with near-term debt maturities. It's also enticed some corporates to quickly get their refinancing plans in order. Some of the more sage advice recently given to a corporate treasurer by his Board was to get the company's refinancing done without trying to finesse the financing and pricing too much. Just get it done was the instruction.

Amid the heightened volatility in global credit markets, corporate treasurers with pending debt maturities or new debt funding in 2008 might be asking themselves questions such as:

- Do I refinance now or wait for conditions to improve?
- Do I rely on the good relationship I have with my lead banks?
- Do I borrow on a shorter term so as not to lock-in what I believe to be temporarily higher credit spreads?
- Do I take a position on the Australian dollar and go unhedged when accessing lower offshore interest rates?

There are no easy answers. What's known, however, is that debt markets are open—albeit more expensive—and will be harder work in 2008. The pricing will certainly be wider than last year, but most markets are still there, including the bilateral and syndicated bank market, the U.S. 144A private placement market, the commercial paper market for solid credits, and the Euro and Samurai markets. However, it would be a brave corporate treasurer who waits until the last minute to refinance. What's more, waiting for the pricing to come in, or for conditions to improve could be a dangerous folly.

The collapse of markets for mortgage-backed securities and capital-market bonds has forced many borrowers to turn to the banks for credit. In these times, therefore, bank relationships are very important for corporates, particularly as banks are finding themselves capital-constrained. For some borrowers without strong banking relationships, that will mean much higher pricing and shorter tenors, while for other borrowers it may mean there is no bank-lending capacity at all. Banks are taking advantage of their stronger negotiating position by raising lending rates and by insisting on stronger covenants than in the past, particularly change-of-control protection.

Refinancing And Debt-Raising Task Is Widespread Across The Rated Universe

Corporates across a range of sectors in Australia and New Zealand have had significant debt maturities to manage in the past six months. In the main, most have managed to refinance successfully. Perhaps the sector to suffer most from negative sentiment in Australian capital markets has been the Australian real estate investment trust (AREIT) sector. This stemmed from the refinancing difficulties of Centro Property Group and possibly from the rising interest rate environment. For instance, while the Australian iTraxx generic five-year credit default swap index has widened by a factor of about five times over the past year, CDS spreads for the AREITs have widened by a factor of about nine times. Nevertheless, the large rated AREITs have shown an astute sense of timing by shoring up their liquidity before the credit crisis really took hold. In October 2007, GPT Group shored up its liquidity position and debt-maturity profile with a EUR2 billion syndicated bank facility. The facility has three tranches, with maturities between one and three years; the one-year tranche can be extended to three years at GPT's discretion. Meanwhile, Westfield raised about A$7.4 billion through asset sales and equity issuance, and had A$7 billion in undrawn facilities at Dec. 31, 2007. As part of this, Westfield also modestly increased its main syndicated bank facility in June 2007 to US$4.7 billion. Elsewhere in the property sector, Goodman Group was very active in shoring up its debt funding. In January this year, Goodman entered into a four-year A$800 million unsecured banking facility maturing in 2012, which replaced a facility maturing in May 2008. In 2007, Goodman also extended a €525 million revolving bank facility to 2012, established a A$2.1 billion syndicated multicurrency bank facility also due in 2012, and issued A$327 million of step-up, perpetual preference units (known as Goodman PLUS, with the first remarketing date in 2013). In addition, all material refinancing requirements for the Goodman-managed funds have been completed.

Table 1

Average Debt-Maturity Profile Of Rated Corporate Australia

At April 2008

Year	Proportion of debt maturing (%)
2008	18
2009	10
2010	16
2011	13
2012+	43

For the rated companies in Australia and New Zealand, an average of 18% of total debt is scheduled to mature in 2008 (see table 1). Over the remainder of 2008, the companies with the most significant debt maturities include Wesfarmers (bridging finance due early October), BHP Billiton (MTNs due August), Telstra (CP rolling regularly, and various MTN tranches), Fonterra (bank loans maturing), Westfield (secured debt due through 2008), and Orica (large bank revolvers due in December). There are various other maturities this year; however, they are of less significant amounts (see table 2).

Of course, maturing debt can be managed in various ways, and not necessarily via a direct replacement with new debt. Because of the credit environment in Australia, some companies are choosing to utilize equity issues (including dividend reinvestment plans) to reduce the refinancing task. Others are running down cash balances or liquidating other investments, while some are undertaking asset sales. Most maturing debt, however, needs to be met by replacement debt. This is being made difficult by the credit market conditions and the associated effective closure of the domestic bond market, the shrinking of the CP market, and through the reduced lending capacity of local banks. Where debt is available, it is more expensive and probably of a shorter tenor.

In addition to the companies who need to finance upcoming maturities, various other companies will soon need to raise debt to meet capital-expenditure needs. Santos Ltd. has a potentially large funding need for its Gladstone LNG developments, which are expected to cost A$5 billion–A$7 billion. Woodside Petroleum Ltd. has committed to the development of the A$12 billion Pluto liquefied natural gas project. Its capital expenditure in 2008 is forecast to be about A$5 billion, of which A$3.3 billion will be spent on Pluto. Elsewhere, Alumina Ltd.'s AWAC venture with Alcoa Inc. has committed to invest about US$1.6 billion in 2008 to complete the Alumar refinery expansion and the development of Juruti mine in Brazil; these projects will require considerable funding.

Table 2

Debt-Maturity Profile Of Selected Australian And New Zealand Corporates

(Bil. A$ at April 2008*)

Company	Debt-maturity profile	Comment/analysis
Wesfarmers Ltd. (BBB+/Negative/A-2)	2008: 5.8 2009: 1.2 2010: 5.0 2011: 0.0 2012+: 0.4	Wesfarmers has successfully eliminated its near-term refinancing risk. On April 21, 2008, the company announced an underwritten equity issue of A$2.5 billion and commitments from banks for the remainder of the bank debt maturing this year, including a A$1 billion working-capital facility. Wesfarmers has had the largest refinancing task of all Australian corporates, with more than half of its on-balance-sheet debt maturing before the end of 2008. This large 2008 refinancing task has arisen mainly as a result of the acquisition of Coles Group in November 2007. The 364-day A$4 billion tranche of the bridge facility used for the Coles acquisition matures in October 2008, as does the A$1 billion working-capital facility. Various other bilateral bank debt and a A$250 million MTN tranche also matures this year. As well as the newly announced equity issue and extended bank debt, the company has more than A$1 billion in cash and undrawn committed bank facilities. Earlier in April, Wesfarmers put the first dent in the refinancing task with a five-year US$650 million private placement issue in the U.S.
BHP Billiton Ltd. (A+/Negative/A-1)	2008: 1.8 2009: 1.0 2010: 0.7 2011: 3.2 2012+: 6.5	While large in absolute terms, BHP Billiton's 2008 refinancing task is very manageable by virtue of the company's strong cash generation, and very strong cash position. The 2008 maturing amounts represent less than 15% of total debt, and represent two tranches out of BHP Billiton Finance Ltd.'s MTN program, which come due in August 2008. BHP Billiton has very strong global market access, and their debt consists of a combination of bank loans, commercial paper, MTNs, and capital-market issuance in Australia, Europe, and the U.S.
Telstra Corp. Ltd. (A/Negative/A-1)	2008: 3.7 2009: 0.0 2010: 1.3 2011: 2.6 2012+: 7.1	Telstra has the largest debt load of the Australian corporates, and a quarter of that debt matures this year. The company's liquidity is considered adequate to weak. At Dec. 31, 2007, Telstra had about A$3.7 billion of short-term maturing debt, about A$2 billion of which related to the group's CP programs. The average debt duration at Dec. 31, 2007 was 4.5 years, which is within their preferred range. Cash on balance sheet was about A$900 million, and Telstra maintains A$750 million of CP back-up facilities, which is sufficient to cover about 30 days of maturing CP. Recent debt raisings have reduced non-CP short-term debt maturities to less than A$900 million, and the group is well-progressed in the refinancing the remaining near-term maturities. Furthermore, Telstra is considered well-positioned to refinance these maturities on acceptable terms given its modest leverage, strong underlying cash flow generation, and discretion over the timing of its capital expenditure. As a large, well-rated, and regular borrower Telstra has been able to raise finance virtually covenant-free.
Fonterra Co-operative Group Ltd.* (A+/Stable/A-1)	2008: 2.4 2009: 0.6 2010: 1.4 2011: 0.2 2012+: 1.4	Fonterra is the largest New Zealand-based corporate borrower and currently has NZ$6 billion of debt outstanding, of which NZ$2.4 billion or 40% comes due this year. The maturing debt is mainly syndicated multi-lateral bank debt (NZ$1.2 billion) and New Zealand CP, but also some small Euro MTN tranches. Fonterra is well-placed to meet this refinancing task due to its very strong liquidity; the combination of its undrawn committee bank facilities and cash balance exceeds the maturing amounts, so there is no necessity to tap the capital markets if it chooses not to.

Table 2

Debt-Maturity Profile Of Selected Australian And New Zealand Corporates (cont.)		
GPT Group (BBB+/Negative/A-2)	2008: 0.7 2009: 0.8 2010: 1.1 2011: 0.0 2012+: 1.9	GPT Group has a relatively short debt-maturity profile at 3.2 years, although only A$700 million of debt matures in 2008. The maturing debt consists of a A$300 million bridge loan and A$400 million of MTNs. GPT's debt finance is weighed toward syndicated bank loans and fixed-rate MTNs. In October 2007, the group shored up their liquidity position and debt-maturity profile with a EUR2 billion syndicated bank facility. The facility has three tranches, with maturities between one and three years, and the one-year tranche can be extended to three years at the GPT's discretion.
Westfield Group (A-/Stable/A-2)	2008: 1.5 2009: 1.3 2010: 1.9 2011: 1.8 2012+: 8.0	Although Westfield has A$1.5 billion of debt maturing in 2008, and is one of the biggest borrowers in the Australian corporate sector, the group holds ample liquidity to meet this refinancing requirement. Westfield routinely holds sufficient liquidity to cover all short-term refinancing requirements and near-term capital-expenditure commitments. Furthermore, in 2007 the group added to its solid liquidity profile by raising about A$7.4 billion in equity capital via asset sales and new equity issuance. As a result, total undrawn bank facilities at Dec. 31, 2007 stood at about A$7 billion. Westfield's short-term maturing debt consists of secured debt (bank and CMBS) and Australian dollar MTN tranches. Westfield has a well-spread debt-maturity profile and regularly accesses both domestic and offshore capital markets.
Orica Ltd.(BBB+/Stable/A-2)	2008: 1.1 2009: 0.1 2010: 0.6 2011: 0.0 2012+: 1.0	Orica's liquidity position is very strong, which positions it well to meet its 2008 debt maturities. Orica termed out its bank facilities in December 2007, so its earliest maturities are December 2008, when about A$1 billion of 364-day revolvers mature. The company has also continued to access the Australian 'A-2' CP market, and have full CP back-up in accordance with our CP back-up policy for an 'A-2' rated issuer. Orica also has term bank debt out until 2012 and Australian MTNs, U.S. private placements, and a step-up preference security with no legal maturity (but a pricing review in 2011). Orica's debt-maturity profile is managed prudently, and cash and committed bank facilities can adequately meet upcoming maturities in the event that capital or syndicated markets are unavailable or too expensive.
AWB Ltd. (BBB-/Negative/--)	2008: 0.5 2009: 0.0 2010: 0.0 2011: 0.0 2012+: 0.0	AWB has all of its debt maturing in 2008 and is therefore exposed to refinancing risk. About A$377 million of this debt are unsecured interest bearing deposit notes issued by Landmark Operations Ltd. (rated BBB-/A-3), which are guaranteed by AWB. These interest-bearing deposits are owed to customers of Landmark's rural business; as such, its maturity profile is short term and assists Landmark in funding its working capital. The other maturing debt is a short-term tranche of AWB's syndicated loan facility that matures in October this year, and there is another undrawn loan tranche that matures a year later. The size of the maturing debt suggests AWB's refinancing task is manageable.
AWB Harvest Finance (--/--/A-1+)	2008: 0.4 2009: 0.0 2010: 0.0 2011: 0.0 2012+: 0.0	AWB Harvest Finance (AWBHF) funds the single-desk wheat marketing and pooling operations, which are "ring-fenced" from AWB Ltd.'s commercial operations. AWBHF funds the payments to wheat growers from each pool through accessing the CP market or via other external funding sources. At the end of March 2008, there was about A$356 million debt outstanding. By its nature, AWBHF's debt is always short-term and refinancing risk doesn't really exist because the debt is self liquidating and is paid down as the wheat is sold. Uncertainty around who will manage future wheat export pools means that this debt may not be replaced by AWBHF in the future.

Note: The debt amounts in this table exclude leases and off-balance-sheet debt. *Fonterra's debt maturities are in N.Z. dollars.

Our Rating Approach To Refinancing And Liquidity

Liquidity and liability management have always been key components of our rating methodology and their importance within credit analysis have been borne out in the current credit market conditions. Prudent liquidity and liability management by corporates means having sufficient cash to cover near-term maturities or a refinancing plan that we view as having little execution risk, such as planned market access with committed credit facilities as a back-up. It also means having a well-spread debt-maturity profile with a number of debt sources and markets, including solid and long-standing banking relationships. Flexibility can be jeopardized when a company is overly reliant on bank borrowings or commercial paper. We view a company's reliance on commercial paper without adequate back-up facilities as a big negative for credit quality (see appendix for our back-up policy).

Our rating approach to refinancing and liquidity risk depends on the market, the company, and market conditions. While it is rare for a rating action to be taken on a company solely based on upcoming refinancing risk, an assessment of liability management and liquidity risk does play an important part of our credit rating assessment, and it does impact ratings and rating outlooks. There is an inherent circularity: if a rating was downgraded because of refinancing risk, the rating action could exacerbate that risk and make it harder for the company to refinance. However, that scenario would not deter us changing a rating if the refinancing risk was material enough. It's not possible to generalize, but if the refinancing of a significant impending debt maturity had not been completed, committed, or underwritten three months prior to the maturity date, then a rating action would be likely. And at some point ahead of that date we would likely reflect the potential upcoming refinancing risk in an outlook change or a CreditWatch placement.

For the Australian investment-grade corporates, we expect to see a measured and logical approach to meet upcoming debt maturities. We would want to see that the company has a credible strategy for repaying or refinancing debt maturing up to 18 months ahead. As maturities move into the forward 12-month time horizon, we will start placing more weight within the short-term rating analysis on the materiality of upcoming maturities and the company's refinancing strategy and execution ability. To avoid negative rating consequences, the ideal progression would be:

- 12-to-18 months ahead of maturity, the company would have a detailed and credible refinancing plan (including a contingency plan);
- No less than six months ahead of the maturity, the company would have documentation substantially in place for the replacement debt issue/s; and
- No less than three months ahead of the maturity, the refinancing would be essentially completed, committed, or underwritten.

APPENDIX: Commercial Paper Back-up Policy

The recent liquidity and credit squeeze has served as a salutary reminder for issuers of commercial paper of the prudence in maintaining adequate and reliable liquidity.

For many years, Standard & Poor's had advocated the need for companies that issue commercial paper to have alternate funding sources in place at the time of issuance. This alternative back-up liquidity protects companies from defaulting if they are unable to roll over their maturing paper because of either disruption in the commercial paper market (which often is global) or there is some cloud over the company that might make commercial paper investors nervous about holding that company's paper.

Full details of Standard & Poor's commercial paper back-up guidelines are outlined in the Corporate Ratings Criteria 2006 pp 54-58.

Back-up liquidity guidelines

For corporate issuers, Standard & Poor's requires full coverage of confidence-sensitive paper for all but the strongest credits. That is, 100% back-up for outstanding paper for companies with a short-term rating of 'A-1' or lower (see table 3). Only companies with a short-term rating of 'A-1+', Standard & Poor's highest short-term rating, need have lesser coverage.

The differentiation in back-up liquidity requirements reflects:

- The lower likelihood of the highly-rated 'A-1+' issuers losing access to funding in commercial paper markets, and
- The timeframe presumed necessary for these issuers to arrange alternative funding should they ever lose access.

Higher-rated entities are less likely to encounter business reverses of significance and, in the event of a general disruption of commercial paper markets, to lose the confidence of investors. Rather, these issuers are likely to benefit from flight to quality.

Table 3

Back-up Guidelines For Corporates*---	
(% of total outstanding confidence-sensitive debt)	
Rating	**%**
A-1+/AAA	50
A-1+/AA	75
A-1	100
A-2	100
A-3	100

*In 1999, Standard & Poor's introduced a more flexible approach regarding the amount of back-up liquidity that needs to be maintained. Essentially, this approach allowed companies to match the amount of back-up available to imminent maturities, while arrangements for longer-dated maturities could be delayed until closer to the maturity date. However, companies in most jurisdictions encountered practical difficulties in implementing this approach. Consequently, Standard & Poor's reverted to is long-standing commercial paper coverage guidelines as outlined in table 1. Some corporates maintain adherence to the more flexible approach.

Back-up liquidity can be provided by excess liquid assets or committed readily-available bank facilities in an amount equal to all confidence-sensitive short-term debt outstanding. In practice, however, the vast majority of commercial paper issuers rely on bank facilities for alternative liquidity.

Importantly, the need for back-up facilities applies to all confidence-sensitive short-term obligations, not just rated commercial paper. Back-up for 100% of rated commercial paper is meaningless if other debt maturities—for which there is no back-up—coincide with those of the commercial paper. Therefore, the scope of the back-up must be extended to all confidence-sensitive short-term debt, including long-term debt maturing in the near term.

Also, although the back-up requirement relates only to outstanding paper and other maturing confidence-sensitive debt—rather than the entire commercial paper program authorization—a company should anticipate prospective needs. For example, the company may have upcoming maturities of long-term debt that it may want to refinance with commercial paper, which would then call for back-up of greater amounts.

All issuers—even if they provide 100% back up—must always ensure that the first few days of upcoming maturities are backed with excess cash or funding facilities that provide for immediate availability. A bank back-up facility that requires two-day notification to draw down will be of no use in repaying paper maturing in the interim. The same would hold true if foreign exchange is needed and the facility requires a few days to provide it.

Importantly, companies issuing commercial paper in various markets need to ensure that appropriate back-up facilities are available in the same currencies and time zones. So-called "swing lines" should be of a sufficient amount of the program size to deal with the maximum amount that will mature in any three- to four-day period.

Standard & Poor's expects all back-up lines to be contractually committed and readily available. Uncommitted lines are insufficient. Even though contractually committed facilities often include "material adverse change" clauses, allowing banks to withdrawing the facility in certain circumstances, Standard & Poor's does not consider it critical or realistic for most borrowers to negotiate the removal of such a clause. Solid bank relationships are the key to whether a bank will stand by a client should it experience difficulties in accessing capital markets.

Equally, banks providing issuers with back up facilities should themselves be sound. Although there is no formal requirement that the bank's credit rating be equal or higher than the issuer's rating, Standard & Poor's would look askance at situations where most of a company's banks were only marginally investment-grade.