

INVENTORY FINANCING: INNOVATION AT THE HEART OF EUROPEAN AGRIBUSINESSES

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Since the Global Financial Crisis, there has been a quiet revolution in Europe. Banks are no longer the sole suppliers of finance to companies – asset managers now regularly help firms to fund expansion and acquisition through private debt.

This trend has been shaped by strong policy initiatives, at both a European level and within individual countries, to disintermediate banking finance.

The introduction of Basel III has made it harder for banks to finance corporates. Individual countries have also introduced new legislation making it easier for asset managers to grant loans to companies, such as France's *fonds de prêts à l'économie*.

PRIVATE MARKETS OFFER MANY ADVANTAGES TO INVESTORS

Enabling companies to access alternative sources of finance is, however, only one side of the equation – if investors did not want to invest in these assets, there would not be a market. The low-yield environment, however, has created considerable appetite for higher returns offered by private debt.

Investors tend to prefer the loans to high-yield bonds, even though the volume of these illiquid assets is limited. In the past, investors were concerned about the illiquidity of loans but now recognize that curbs on bond market-making capabilities have made high-yield bonds difficult to sell.

In addition, loans are usually more senior in a company's debt structure, so offer investors better security. This is especially true for loans to mid-sized companies.

Investing in private debt also allows institutions access to smaller companies that they cannot find in the public bond market and to capture an illiquidity premium.

These assets are especially appealing to insurance companies, which have to abide by Solvency II regulations. Under these rules, private debt has a favourable solvency capital ratio, as it is close to a BBB rating for the same duration.

DESPITE EASIER ACCESS TO BANK LENDING, COMPANIES STILL STRUGGLE TO SOURCE FINANCING

The market dynamics have shifted, however, over the past year. The high volume of the Long-Term Financing Operation promoted by the European Central Bank has encouraged more banks to lend to corporates.

Deal terms have been relaxed – banks have reduced their covenant requirements, increased the maturity of their deals and even introduced bullet loans.

Despite the easier access to banking finance, many companies choose to opt for alternative sources of financing. While some banks will now offer bullet loans, most of these only have a five-year term and many do not offer bullet loans at all.

The bullet loans offered by alternative financiers are particularly attractive for financing acquisition or capital expenditure because they typically do not need to be repaid for six or seven years. This allows the management to focus on business development and diversify sources of financing.

Not every business can find a bank willing to lend to them. Banks are happy to lend to mid-sized companies with strong balance sheets and good growth prospects, but they are much less willing to lend to smaller companies, even if their business is in good shape.

There is an opportunity for investors to provide financing to small, strong businesses that find it difficult to access banking finance. As these firms have

limited financing options, they are often more willing to offer investors better returns than they would receive from larger companies.

ITALY'S BANKING CRISIS PROVIDES A UNIQUE OPPORTUNITY FOR INVESTORS

The lack of bank financing is particularly acute in Italy. The country's banking crisis makes it even harder for companies to access financing. There are around €300m non-performing loans on banks' balance sheets, which prevent banks from offering new loans.

The conservative business culture is an additional challenge – few companies are aware of the benefits of alternative financing models and educating companies about these benefits takes time.

That is not the only difficulty facing asset managers. It is also hard to find those small Italian companies with a strong balance sheet and good growth prospects.

It would not be cost effective for an asset management or private debt firm to build the deep networks needed to find these companies. The only cost-effective way to access these companies is to work in partnership with a bank.

That is exactly what Amundi has done throughout Europe – it has formed partnerships with 14 different institutions that allow it to benefit from their deep networks.

AMUNDI NOW PROVIDES FINANCING TO PARMIGIANO AND PROSCIUTTO PRODUCERS

While there is growing international demand for parmesan and prosciutto, the companies that produce them face a particular challenge which makes expansion difficult – all these goods must be aged for between 12 to 36 months.

Managing the cash flow of a business with a high inventory is challenging. For example, the inventory of a parmesan producer can be equal or even higher to its net debt position. The average net debt to earnings before interest, tax, depreciation and amortization is around eight times. This debt ratio makes banks very reluctant to provide additional funding.

Financing is even trickier for a parmesan cheese producer looking to expand into international markets, where there is buoyant demand, or consolidate the Italian market.

Even if these companies could find a bank to lend them a significant sum to fund expansion, it is likely that repaying the interest and the principal on a standard loan would jeopardize their business before they can sell their goods abroad.

BULLET LOANS PROVIDE THE RIGHT STRUCTURE FOR THESE AGRIBUSINESSES

For these agri-businesses, six-year bullet loans are a much more attractive structure. Under these structures, the companies only pay the interest until the end of the loan term, when repayment of a principle is due. This gives the firm the additional funding it needs to fund expansion but does not cripple the business before it can sell its aged goods.

When lending money to these companies, Amundi uses fixed interest rates which allow a company to plan its precise interest-rate expenses, enabling it to fine-tune its business plan. Banks typically use floating rates for their loans, which could have a negative impact on the business in the future, if they were to increase.

At the end of 2016, Amundi launched its first prosciutto bond, which provided this type of financing to regional ham producers. Not only did this bond ensure the companies had access to the type of financing they required, but it also provided attractive terms for investors. The loan is secured with the company's assets, its hams.

Prosciutto and parmesan are surprisingly good loan collateral. Their value increases as they age. In the worst-case scenario, this collateral can be sold easily as demand is strong and the availability of the product is limited.

Amundi aims to build a fund with at least 10-20 different companies all of which have inventory which needs to be aged. Grouping these different producers together will help mitigate the risk through diversification.

AMUNDI

Publicly traded since November 2015, Amundi is the largest European Asset Manager in terms of AUM, with over €1,000bn worldwide(*). Headquartered in Paris, France, Amundi has six investment hubs located in the world's key financial centres, and offers a combination of research depth and market experience that has earned the confidence of its clients. Amundi is the trusted partner of 100 million retail clients, 1,000 institutional clients and 1,000 distributors in more than 30 countries, and designs innovative, high-performing products and services for these types of clients tailored specifically to their needs and risk profile.

End of September 2016 Amundi has created a dedicated platform for real and alternative assets. Real estate, private debt, private equity, infrastructure and alternative multi-management are now all part of a single integrated business line, bringing together some 200 experts in origination, structuring and management of these asset classes worth more than €36bn in assets under management (**). Through this new platform, Amundi offers institutional or individual investors the opportunity to directly invest in the full range of real assets through dedicated or commingled vehicles (funds, co-investment, multi-management or advisory mandates).

PIERRE-HENRI CARLES

Pierre-Henri Carles joined Amundi in January 2015 to manage the real and alternative assets business line in Italy: Pierre-Henri oversees the Private Debt, Private Equity and Infrastructure investments. He was previously working in Contrarian Capital, a US hedge Fund investing in different asset class such as credit across Europe. Pierre-Henri was responsible for southern Europe. Pierre-Henri worked in investment banking mostly for Lazard Frères in Milan, New York, Paris and Sydney. Pierre-Henri was notably involved in mergers and acquisitions and restructuring departments. Pierre-Henri graduated from Dauphine University (Corporate Finance degree).

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