Uncharted: the road to recovery

Episode six: Returning to growth

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Rebecca Burn-Callander: This week we are reviewing the lending landscape. The pandemic has created a shift, whether it's government-backed loans and grants, or the response from the alternative finance industry. How will business leaders with ambitions to scale finance growth over the coming months? How will their relationship with lenders change, and how can organisations adapt to ensure they can access and make the most of the available funding?

So first, let's talk about growth. Is growth still on the agenda for businesses? The entrepreneurs and business owners that you're meeting, David, are you seeing that they are still full of vim and vigour and want to take advantage of new opportunities despite the crisis?

Dave Atkinson: Yeah, without a doubt, there is a real mixed bag of opportunity that the crisis has brought about for industry. I don't think it's a one size fits all approach. There's a mix of businesses that have been forced to innovate which have created growth opportunities. And equally, there have been businesses that have had to respond to the demands of the crisis to support the likes of the ventilator challenge and the Nightingale Hospital. There is definitely some growth opportunity out there. We've seen and been able to support a number of businesses with ambitious goals throughout the first few months of this crisis.

Rebecca Burn-Callander: Great. And Tom, what kind of growth is being financed? Are businesses growing substantially on last year, or have they had a setback and are looking to recover? What have you seen?

Tom Cox: Well, I think it's very mixed. I think in the main, COVID's had a big impact on a lot of businesses, unsurprisingly. I think we've seen something in the order of 40% to 100% fall in revenues in some businesses during Q2. But it's very, very sector dependent. There are clearly, very resilient sectors – e-commerce, healthcare, pharma, and tech-based businesses – that have grown considerably from where they started. Equally, a number of businesses have stepped back and are really just looking to build a platform now, to target returning to where they were before the crisis. It's really a very mixed perspective at the moment, I think.

Rebecca Burn-Callander: Yeah, absolutely. And Parminder, with your perspective, you've got a couple of great businesses in your portfolio. How are they performing? What sectors are they from? Have there been any interesting consequences for those founders?

Parminder Basran: Yeah, it's been interesting for us. Our two main businesses in our current fund which we started investing last year, one is an eCommerce retailer for training apparel, specifically in the CrossFit space, but also across wider functional fitness. People are still working out at home. They're still going for runs. That business is up over a 100% on last year for this last three-month period.

We also have a business that sells luxury sneakers. That business is also over 100% up on the previous year. The average order values in that business are quite high. It's £300 average order values. So that consumer who's spending that amount of money on footwear is still spending. And they're actually not spending in other areas such as restaurants, bars, hotels, holidays. But they are still spending their money at home online. We've actually seen a positive effect across the majority of our portfolio.

Dave Atkinson: Just to come back in there, that consumer behaviour has also created opportunity for lots of businesses. We've recently supported an oriental spice company in Shropshire, where people have been honing their home cooking while they've been in lockdown. I guess partly for something to do, partly for entertainment, partly because they've had the opportunity. But of course, that does then create opportunity for businesses. The government backed CBILS loan has been a great source of financial support to that business where they'd been able to ramp up production to meet new demand. And I'm sure there's lots of other examples around the country that have been supported in a similar way.

Rebecca Burn-Callander: And I'm conscious there, David, that when we talk about innovation and businesses pivoting, we're often talking about businesses at the smaller end of the market. Nick, I know that you speak to a lot of business owners in the kind of mid-market and above enterprise sized businesses. So, are you seeing a similar level of innovation, of companies pivoting to focus on higher margin activities? And are those businesses looking for finance right now, or is it a different picture?

Nick Grainger: I think, as you might expect, there's been winners and losers throughout depending on the sectors. Tom just mentioned that healthcare and IT had been quite resilient, e-commerce as well and the hygiene sector together with home delivery and logistics. But I think you could probably split them into three different segments. There's those that have needed government support through bounce back loans and CBILS to survive in the face of reduced revenue and earnings.

You've then got those that have been able to manage without government support. But a lot of those now have depleted cash flows and less cash at bank. And then you've got those that have been more resilient. And they're pretty well placed to grow and recover the lost ground and to improve their sales moving forward. So, whether it's a business which is in the 'S' of SME, say sub-£25million revenue; or perhaps more of the 'M' of SME, where they're slightly larger – the businesses that Tom and I deal with routinely. I think the trends actually are relatively consistent across the piece where good businesses sometimes in poor sectors can survive and can prosper.

So, recruitment is not a great sector through COVID, although healthcare recruitment is, and perhaps IT recruitment is. I think you need to be quite clear that labelling a sector or labelling a size or shape of business is not necessarily the thing to do.

Rebecca Burn-Callander: Absolutely. It's tough to generalise when the fates of so many different sectors are so, so different. And I suppose that that might actually be the answer to my next question, which is about whether the kind of flavour of growth funding is changing at all? Whether business owners are looking more at private equity, more at debt, more at alternative forms of finance. Tom, I'd love to bring you in here. Are you noticing any trends or is it a completely mixed bag as with so many other things in this topic?

Tom Cox: As ever, I think you see quite polarised approaches. I mean, the private equity sponsors that we speak to continue to tell us the level of dry powder they have to deploy. I think the challenge for private businesses taking on that investment continues to be the issue around dilution of control. And whether now is the right time to do that. And some businesses may be forced into that. But I think ultimately equity funding and preferred equity funding is more likely to be a bigger part of the solution to this crisis than frankly debt, because clearly there are a lot of heavily levered businesses in the market generally already. And taking on additional credit is not necessarily the answer frankly right now. Now, there are alternative private credit providers that offer on the one hand less cashflow demanding products, and the move towards the institutional credit market may continue as it has done over the last 10 years.

But I think the solution will come from many sources, both debt and equity over the course of the next two to three years. I think equity will drive a big part of that.

Rebecca Burn-Callander: That's fascinating. And I suppose the point about the kind of skew towards equity, I mean, the government has already made so much money available through the various forms of intervention. David, I'd love to hear from you sort of how popular have those levers been, how many businesses have come through Lloyd's alone?

Dave Atkinson: Yeah, absolutely, and without doubt, the government intervention has been critical to a number of businesses. The CBILS loans that we agree through our relationship managers team, where we have a one to one relationship and are able to understand that business's history, as well as its current challenges and the future opportunities. We have agreed somewhere in the region of 8,000 of those CBILS, about £1.5 billion worth of funding were the latest reported sort of numbers.

I think the other key thing to remember here is support through the furlough scheme to allow businesses to go through this period of uncertainty where, let's face it, we're in unchartered territory here at the moment, and lots of businesses have never faced into these kinds of challenging times. And for most of us, this particular challenge really is unprecedented.

So we'll see what the true impact is, I think, when that furlough scheme starts to unwind. I think lots of businesses have now already started to contribute to retain staff as the scheme starts to widen. I think the true impact will come when we see how businesses have started to return to trade.

There's going to be a tough balance as well for some businesses, particularly in sectors like manufacturing, where do they make that tough decision of trying to find a way to retain staff, knowing that skills is a huge problem for the sector, that they may need in six to nine months' time? But of course, how do they continue to fund that when business hasn't returned to pre-COVID levels. There's going to be a considerable number of challenges that these businesses are going to need support on over the next six to nine months.

Rebecca Burn-Callander: Nick, are you seeing that a lot of the companies taking up these loans, these bounce back loans, CBILS loans, I mean, are they using them? Are they banking them? Are they keeping hold of the cash in case there's a second wave? This growth finance, are they actually using it to grow? Or are they using it to kind of batten down the hatches?

Nick Grainger: Yeah, to the end of July, the government has supported £50 billion worth of intervention measures through bounce back loans and CBILS and CLBILS, and that's to 1.2 million SMEs. And the vast majority of those are small businesses with a limited number of employees where they qualify for a bounce back loan of on average £30,000. So in many circumstances those loans have been used to either survive or to provide dry powder to help them in the coming months.

When you look slightly up the curve in terms of the slightly bigger businesses, I think growth is there. And as Tom alluded to earlier on, there is a wall of capital, whether that's equity from private equity, some kind of recapitalisation from the government or debt from the high street banks, asset-based lenders or alternative finance providers. I mean, there's lots of capital around. But they just need to back the right business at the right time in the right sector.

Rebecca Burn-Callander: No, that makes sense. I suppose are we worried when we look to the future that when all these emergency loans mature, we're kind of heading into some kind of crisis. I mean, David, you must think about this quite a lot. Are we walking into a bit of a nightmare in a year's time?

Dave Atkinson: I think it's unfair to make predictions of what the future holds at the moment. I mean, if I play back to the start of the crisis where there wasn't, surprisingly, the biggest peak of demand for the government funding schemes. But part way through there are still a number of businesses that once they got the funding haven't used it to the extent that they originally planned for. Because they've been very agile and been able to find new ways of trading. And of course, they've also used other support mechanisms available.

I think whilst we've definitely got one eye on the future, we will definitely get a truer picture of what we face into when we head towards quarter four later this year. The end of the furlough scheme, assuming things continue as they expect to at the moment with that finishing in quarter four, will be a real turning point in terms of us understanding what we face into. The biggest thing is making sure we're prepared to continue to find ways to pragmatically support, help and guide those businesses.

We know that some will undoubtedly face difficulties, and those challenging times is what we're preparing for now, to empathetically and sympathetically do everything we possibly can to deal with that.

Rebecca Burn-Callander: Absolutely. And I totally hear where you're coming from about the uncertainty and the fact that we just don't know. Tom, can you talk to me about businesses that have taken some time out of the business, many have had a little bit of downtime, or at least they've regained some of their working day because they're not commuting, whether they're maybe being a bit more strategic. So a lot of them, are they looking to refinance, are they restructuring their debt, are they kind of taking that kind of more strategic view with their finance? What have you noticed?

Tom Cox: It's a good question. I think what this crisis has demonstrated is, some management teams have really taken the opportunity to step back and throw their operating models up in the air, as a result of necessity frankly. And to a certain degree, having the benefit of time and the ability to step back and think about how you do business has been actually helpful for some. And so, whether that's restructuring your supply chain, changing your production model, maybe moving towards dark kitchens into home delivery for dining. It's accelerated a lot of that growth.

In terms of people looking to refinance the loans, I think it comes back to the point Dave made. It's a bit early to tell. I think most clients are already thinking about repaying that additional debt as soon as they can. Some of them are sitting on cash reserves and will just, assuming that we don't have a second wave and we don't have another lockdown, they will repay it as fast as possible because they don't want that excess leverage. And/or they're looking at the structure of those facilities. Clearly a number of them will have amortising elements albeit structured to their revised business plans and saying, well, that may well ultimately impede growth over the course of the next two or three years, so we may well need to find a way of refinancing it with a better perhaps non-amortising structure.

Dave Atkinson: Yeah, Tom, I agree with you, in terms of businesses reflecting on what they've got. But equally it's not all doom and gloom because some businesses have maybe taken a bounce back loan as a knee jerk reaction. It's available, maybe I need something. When you actually get under the muck and bullets of what's going on in their business. Actually, if they had taken or had the guidance to take a little bit more time to assess what they actually needed, we are starting to very carefully refinance some of those bounce back loans into CBILS where a business maybe hadn't considered the true impact. Particularly where we start to think about what that platform is for growth, I guess is another question.

But where we see businesses coming out of a recessionary period, we know that lots of businesses will face cashflow difficulties at a greater level coming out with growth than what they do going into a recessionary period or a downturn. So making sure they've got sufficient and structured in the right way to support growth opportunities is equally as important. And some of that refinancing may well support that.

R Howard is a great example over in the East of England, where they've taken around £300,000 worth of government support and exactly what you said, they've used the opportunity for the downturn, one, to keep the business trading, because some of it was business critical. But equally to invest time to accelerate the growth of eco-friendly products, which they had planned to do, but just never got the time to do. So, this will actually pivot them and give them a platform to accelerate growth when we do come out of this.

Rebecca Burn-Callander: And we talked a lot about the innovation that we're seeing among businesses, and that this is a time to kind of go for growth if you have a model that works and that you're resilient. But I'd like to look at how lenders themselves may need to change.

I've been reading a lot about agile lenders, the rise of the agile lender post-COVID, I mean, is that a real phenomenon? Are traditional lenders like banks, as well as alternative finance houses, are they changing dramatically as a result of the pandemic? Or is that kind of just an illusion?

Nick Grainger: Yeah, I'll take that, Rebecca. Our business spans across all manner of debt providers from asset-based lenders, to cashflow and leverage finance providers, to special situations businesses, to debt funds and credit funds. And I think a big part of the growth, which this podcast is all about really, is focused on ABL to a degree. Because as businesses start to trade more, to sell more, they'll have more receivables. So therefore, an invoice discounting or factoring facility is going to become more beneficial to them to fund that working capital requirement.

And equally if a business holds stock and inventory of finished goods, or is a manufacturer, some kind of asset-based lending facility to leverage against that asset class is equally going to be good as well. So I think advisors generally, FRP specifically, are pretty well placed to help the medium sized enterprises to navigate their way through the challenges that are going to be there from increased working capital demand, as businesses start to grow and get back to where they were.

Parminder Basran: I think I'd just add to that. Clearly the UK clearing banks are always going to have their place to play in the market. But over the course of the last 10 years, we have seen a huge growth in the alternative private credit world. And I think as a result of the pressure that will have been created on the balance sheets of those banks as a result of the issuance of a lot of the government support, even if it is guaranteed, will mean that we will see a continuing growth in the alternative market. Because it does have a different credit appetite to the clearing market.

Dave Atkinson: I think it's important that businesses out there get the right advice. Because we all have our place to play in the market. Different financiers and different structures of lending, whether it be venture capital, whether it be growth capital, whether it be start up seed corn funding, traditional high street bank, we all have our place to play. And understanding the role of those different institutions for a business is a stage in its life cycle. I think is really important.

From a Lloyd's perspective, we have always, or certainly for the last nine or 10 years, we've adopted a very simple UK-focused, low risk approach with relationship managers there supporting clients through the cycle, so we've been very consistent. And I don't see any change or desire or need to change that strategy. I think the key important message behind all of this is helping clients understand where each one of those different types of financiers fit into their life cycle, and whether they're talking to the right one at the right time.

Rebecca Burn-Callander: But it's interesting, isn't it, because all these alternative forms of finance have been around for a while, but is it the case that maybe business owners have more appetite to try something new now or that the pandemic has changed their attitude to kind of embracing the new? Tom, what do you think?

Tom Cox: Well, I think it's by necessity, a number of borrowers or private shareholders have had to broaden their horizons. Now that alternative market has expanded exponentially in the last 10 years. But today's point, there's a different risk tolerance for different institutions. And it's about us as advisors directing them to the right place that has the right risk tolerance frankly. And so, unfortunately for some clients that will mean it isn't the traditional senior bank pricing or solution that is going to be the one that lifts them out of the crisis. It could be something unfortunately considerably more expensive, but that may be the price of liquidity.

Rebecca Burn-Callander: And Parminder, can I bring you in, have you seen changes to risk tolerance? Do you agree with, Tom?

Parminder Basran: There’s been an uptick in the number of investment opportunities that we've been looking at and we see that as going to continue through the rest of the year and into next year. I think the entrepreneurs that we're speaking to are realising that one, they may want to de-risk themselves from their businesses a little bit. So some of them may want to take a bit of cash off the table and just secure their future. We're also seeing some entrepreneurs, a lot of them are realising that above just money, firms like ourselves can help them navigate difficult periods, help them grow their businesses, help them build new or existing revenue streams and bring a bit more discipline and structure to how they operate.

And that is becoming more and more important to a lot of these founders. So, we've certainly seen an uptick in interest in entrepreneurs wanting to find out more about what a partnership with a firm like us can bring them and their business.

Rebecca Burn-Callander: And I'd love to do a bit of kind of crystal ball gazing, because the way that we're talking about access to capital now, it feels like there's a lot of money out there. Good businesses won't struggle. But what about in a year, two years, three years’ time, are we imagining that this environment will persist or are we likely to see big changes? Nick, I might try and pick your brains on this one.

Nick Grainger: Yeah, it's nice to gaze into the crystal ball, but I'm not sure any of us actually know what the future holds. I think the lockdown and the scale of the government intervention has represented a historic experiment in many ways. It's been like a hundred-year storm. The government's put out the sandbags, the water level rose, and we're not sure what's going to happen next. And a lot of things will depend on whether there's a second spike and whether there's a V shape recovery or W shape recovery or whatever.

But irrespective of all of that economic, social background, I can absolutely guarantee there will be a lot of capital still to deploy for the right businesses. So whether that's equity through firms such as VGC Partners or whether that's debt through Lloyd's Bank or others, and whether people access that through FRP, who knows. But there will always be a lot of capital to support good management teams running good businesses.

Rebecca Burn-Callander: David, you were nodding there, do you share Nick's confidence?

Dave Atkinson: What I do share is that we don't know what the future holds. Do we know what the next six months, 12 months will hold? We can model, we can reflect, but we genuinely don't know. But what I do know is that regardless of what economic challenges we face, our intention is to be there and support our clients through this. As it will be for FRP and VGC exactly the same I'm sure. We will react to market conditions at the time and do the very best we can by our clients.

Rebecca Burn-Callander: And I suppose it's worth talking through, given the level of uncertainty and the amount of capital that's available to deploy, and it sounds like will consistently be available, for the foreseeable, notwithstanding any major changes, what should business owners now look for particularly in a lender or investor? Parminder, I mean, obviously you advise the companies in your portfolio, you're also in that network, when you're having conversations with entrepreneurs, whether they're in your portfolio or not, what are you telling them to look out for, to ask for, to be aware of?

Parminder Basran: Yeah. So, from our perspective, I think that we are supporting people who are looking for more than just money. That's quite an interesting point. Because you can easily take one of these debt facilities, burn through the money pretty quickly or waste it. The people that we're meeting, and the people that we're interested in backing, are interested in building great systems in their businesses, great processes. They probably want to grow in several international markets. They probably want to invest in people, they probably want to invest in marketing.

So a lot of what we're doing now is post-investment integration work around the 180 day plans that we do post-investment to support the businesses. And that's become far more of a focus now. I think gone are the days of firms like mine just spraying money around. I think there's a lot more focus on ops. Are businesses focused on ops. We have specific operations teams to support entrepreneurs. That's coming into its own a little bit more now than just the provision of capital.

Dave Atkinson: The point that you said about that your clients are looking for is more than just a lender. And certainly our approach to relationship banking is something that we work very proudly with our clients. And I think what they're tell us is they want consistency. They want a through the cycle approach to supporting their sort of business needs. So they know what they're going to get, regardless of the challenges of the economic cycle that they're in.

But equally, they look for value add. So they want us to be able to signpost them to other support services. Not just within the bank, but within connections within the professional community that can help them with any manner of their challenges that they're facing into. They want that one stop relationship to be able to be signposted to get all of the help and support they need from the bank and also from our connections.

Tom Cox: Yeah, I don't think anything's changed here ultimately in insofar as lender relationships with clients, ultimately relationship is absolutely critical. And what this period has proven is that frankly flexibility and collaboration are the things that are going to allow businesses to get out of this crisis. And if you look at, in the private equity world or the private equity-based businesses, I think lenders have been much more responsive to equity houses that have been collaborative with them in terms of solving the problem. And that's where their relationship has proven its worth. And that, I think it will become a little bit less about lowest common denominator in financing. Whether it's trying to save 25 basis points off the deal or squeeze some additional flexibility out of the documents. Okay, there'll be an area of the market where that always happens. But it will be about how do we together plot our way out or put the financing solution in place that allows the business to grow properly out of the crisis. And when there are bumps in the road, we know exactly how each side's going to behave.

Rebecca Burn-Callander: Nick, I'd like to give you the final word on this. I loved your metaphor about the hundred-year storm. So, I hope you've got another one up your sleeve for this. Do you agree that it's all about value add when it comes to picking an investor, picking a lender? Are there other considerations that you are seeing coming to the fore?

Nick Grainger: Yeah, I think the most important thing is the relationship as Dave alluded to. When you've got good bankers who are proactive in their regions, trying to support the businesses within the confines of their own capital structure, that's where it's at its strongest. But it's not to say that's just the domain of the major banks. I mean, we've got a whole raft of challenger banks as well. You have people like Clydesdale and Shawbrook and OakNorth and Metro to a degree, who are kind of nibbling at the heels of the big four or big five. And they all want to deliver exceptional service. It's down to each of those particular providers to try and differentiate their offerings and to provide that level of customer contact and customer competence that their clients require.

Rebecca Burn-Callander: Thank you, Nick. I think that's a good place to stop. Thank you all so much for your insights. It's been really interesting to just look at how positive the lending landscape is. And you'd imagine it would be a lot murkier a view, but in fact it looks like there's a lot to be cheerful about.