So the UK Government has triggered Article 50 of the Treaty on European Union and Brexit is now a reality. Lots of questions still remain to be answered, and in truth many questions still remain unasked or unconsidered.

Time for Action
When it comes to advising clients on Brexit planning, Deloitte is taking a sector approach. Deloitte is recommending its clients to activate a ‘Brexit Taskforce’, which is a dedicated team with responsibility for:
- identifying specific areas which may be materially affected and require further investigations;
- communicating the action plan to stakeholders;
- preparing and taking action where risks need mitigation or opportunities arise;
- planning and monitoring for triggers as the Brexit negotiations develop.

Financing is an area which will require significant attention by CFOs and Treasurers, as Brexit will have implications for all companies in the sector in Ireland. Consequently prudent companies are taking steps now to:
- plan for potential downside financial risks; and
- be proactive and ready from a funding perspective to avail of investment opportunities when they arise.

Deloitte can work with companies to assist in this scenario planning, and to plan for maximum change.

### Threats

<table>
<thead>
<tr>
<th>Threats</th>
<th>Opportunities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increased cost of accessing UK markets arising from</td>
<td>Seek out new markets – e.g. continental Europe, US, Africa, Asia</td>
</tr>
<tr>
<td>• Trade tariffs</td>
<td></td>
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<tr>
<td>• customs &amp; duties</td>
<td></td>
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<tr>
<td>• new costs/inefficiencies arising from changes to supply chains</td>
<td></td>
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<tr>
<td>• impact of different regulations and food standards</td>
<td></td>
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<tr>
<td>Loss of competitiveness of Irish food exports to UK</td>
<td>M&amp;A opportunities in the UK due to weaker GBP rate</td>
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<tr>
<td>FX price volatility &amp; increased cost of FX hedging</td>
<td>Consolidation in the Irish market</td>
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<tr>
<td>Reduced profitability of sales into the UK market</td>
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<tr>
<td>Potentially more expensive supplies if importing from the UK</td>
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<tr>
<td>Reduced shareholders returns</td>
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<tr>
<td>Implications for debt covenants (e.g. Net Debt/EBITDA, DCSR, ICR) arising from reduced profitability</td>
<td></td>
</tr>
</tbody>
</table>
Positioning for Opportunities

Growth Capital

Those companies which predominantly trade in the domestic Irish market are less likely to be directly impacted by the effects of Brexit. The market uncertainty created for other participants in the wider industry may create an investment opportunity for companies looking to expand – either organically or through acquisition.

There is a growing universe of debt and equity providers in the Irish market which are funded and actively backing food, beverage and agribusinesses with strong management teams, attractive product/service offerings, and clear business plans.

The senior debt market for food and agri companies in Ireland is dominated by Allied Irish Banks, Bank of Ireland and Ulster Bank, each of which have specialist teams servicing Small & Medium Sized Enterprise (SME) and Large Corporates in the sector. These are further augmented by Rabobank (a food and agriculture focused bank), Barclays and HSBC who tend to focus on the larger corporates. These relationship lenders typically provide senior debt financing up to circa 2x EBITDA with relatively flexible covenants.

For those companies seeking to pursue accelerated growth strategies, there is an active community of alternative lenders now operating in the Irish market. For many businesses these lenders provide an attractive alternative to raising new equity, in that they can provide flexible debt financing of up to 5 times EBITDA by way of unitranche, and/or a mix of senior and mezzanine debt. Such lenders in the market include BlueBay and BMS Finance, which are part funded by the Ireland Strategic Investment Fund, as well as the likes of Broadhaven Capital and Cardinal Mezzanine Fund.

These leveraged debt products clearly come with higher credit margin costs, given the higher risk from a lenders’ perspective. However from a growing company’s perspective the benefits of such financing include:

• low levels of principal amortisation during the term of the loan (allowing for cashflows generated to be used in the business for capex, growth etc);
• potentially more flexible covenants versus stretched senior debt from banks;
• cheaper and faster to raise than new equity; and
• support company growth without diluting shareholder ownership or control.

Alternative lenders, which include asset based lenders, are also good financing options for some companies seeking to avail of strong credit markets to extract value from a company by dividend recapitalisations, share buy-backs, and management buy-outs.

The FB&A sector in Ireland includes many co-operatively owned companies. A co-operative’s ability to finance growth, or effect transformational acquisitions, can be constrained by its inability to raise third party equity. Raising equity from the co-op members can also be challenging at times of low commodity prices (e.g. dairy between 2015-2016). Mezzanine debt and/or hybrid equity financing from alternative debt providers and investors can therefore be an attractive option for co-operatives when considering acquisition financing.
## What Debt Structures are available in the Market?

### Structures

#### EV/EBITDA

<table>
<thead>
<tr>
<th>0x</th>
<th>1x</th>
<th>2x</th>
<th>3x</th>
<th>4x</th>
<th>5x</th>
<th>6x</th>
<th>7x</th>
<th>8x</th>
<th>9x</th>
<th>10x</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unlevered</td>
<td>Leveraged</td>
<td>Unitranche</td>
<td>Senior/Mezz</td>
<td>Unitranche &amp; Holdco PIK</td>
<td></td>
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</tr>
<tr>
<td>Up to 2x Senior debt (E + 50 - 350bps)</td>
<td>3x-4x Senior debt (E + 300-450bps)</td>
<td>4x-5x Unitranche (E + 650-900bps)</td>
<td>1x - 1.5x Mezz (E + 1200bps)</td>
<td>2x Holdco PIK (1200bps)</td>
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</tr>
</tbody>
</table>

#### Weighted Average Cost of Debt (WACD)

- **Unlevered**: E + 50-350bps
- **Leveraged**: E + 450bps
- **Unitranche**: E + 750bps
- **Senior/Mezz**: E + 750bps
- **Unitranche & Holdco PIK**: E + 880bps

### Pros and Cons per structure

- **Senior debt (Bank)**
  - Lowest pricing
  - Relationship bank
  - Bullet RCF

- **Unitranche / Mezz (Fund)**
  - Increased leverage
  - Club of relationship banks
  - Stretched leverage
  - Flexible covenants
  - One-stop shop solution
  - Speed of execution
  - Greater role for bank
  - Relationship lender

- **Holdco PIK**
  - Low leverage
  - Shorter tenor (3-5 years)
  - More restrictive terms
  - c. 40% amortising

- **Equity**
  - Higher pricing
  - Higher pricing
  - Intercreditor/AAL
  - No Intercreditor

*Note: the structures and pricing presented are indicative and only for illustrative purposes.*
Working Capital Financing

An often overlooked aspect of growth planning for exporting companies is the amount of working capital financing which is required to support sales growth targets. Irish SMEs setting up operations in new jurisdictions frequently underestimate the amount of working capital financing which is required when entering new markets.

• Suppliers: In preparing business plans there can be an expectation that the credit terms available from suppliers in the new market will be similar to those from suppliers in the domestic Irish market, with whom they have developed long trading relationships. Unfortunately, this often does not turn out to be the case; particularly in the early stages of life in a new market. Where new local suppliers have to be found, the trade credit terms offered can often be limited.

• Customers: From a sales perspective, in order to win new customer contracts in new markets, exporting companies often engage in promotional activity and can be required to offer customers improved, or extended credit terms.

• Inventory: Exporting companies may also be required to hold stocks for longer periods, given the length of time it can take to get the products to the intended customer.

The cumulative effect of some or all of these factors can lead to lengthening working capital cycles, and increased working capital financing requirements for Irish SMEs and large corporates.

Companies seeking to enter new markets as a consequence of Brexit, need to give prudent consideration to anticipated working capital needs. Sufficient headroom and flexibility should be factored into financing facilities to allow for growth and surprises!

The traditional source of working capital financing for many SMEs has been the bank overdraft. Banks are now penalised under Basel III for providing overdraft facilities. Many banks are now looking to restrict the use and availability of overdrafts (by way of reducing credit limits, increasing costs etc) and are looking to move customers onto invoice discounting facilities and revolving credit facilities. These facilities can work well for many customers, but can be inflexible or one-size-fits-all in their approach.

The global food and agriculture sector is characterised by long and oftentimes complex supply chains, which range from small farmers and global commodity trading companies, to value added processors and distributors, to retail multiples, the foodservice industry and the end consumer. This sector has been the focus of significant financial innovation when it comes to working capital financing solutions. Such solutions range from supplier financing solutions for primary producers and farmers, to inventory financing for agri commodities and stocks, to non-recourse trade receivables financing and securitisations for value added processors. These solutions tend to be more structured in nature, as compared to overdrafts and RCF’s, but are generally more tailored to the specific requirements of a company. These solutions can also reduce the weighted average cost of working capital financing to a company over the medium to long term.
Protecting the Downside:
For those companies materially exposed to the UK market, either as sales market, or as a source of key supplies, challenging times lie ahead. Financing and cashflow management is an area exposed to potential downside risks which may need to be mitigated.

Consequently companies need to consider the appropriateness of their existing capital structures (mix of debt and equity funding) to determine the potential risks in the short, medium and long term arising from reduced profitability and cashflows. Particular attention may need to be given to financial and non-financial covenant packages in a company’s debt facilities.

Even those companies relatively less exposed to the direct effects of Brexit (i.e. trade tariffs, FX volatility, customs etc) will not be immune from the trickle-down effect on Irish consumer sentiment and spending patterns.

Running the scenarios
In the context of a company’s capital structure analysis, prudent companies are preparing business plans and cashflow projections which take into account various scenario analyses.

- The introduction of a ‘hard’ Brexit will potentially lead to the introduction of trade tariffs, costs associated with customs, and increased foreign exchange volatility and currency hedging costs. This will be a particularly complex issue for many in the Irish FB&A sector given the potential introduction of a trading border through the middle of what is a highly integrated supply chain between FB&A companies in Northern Ireland and the Republic of Ireland.
- To the extent that Irish FB&A exporters choose to divert products from the UK market to new markets, other costs such as product development, marketing and promotion will need to be factored into plans.
- Companies which source key supplies from the UK may be faced with higher input costs, or in some cases significant loss of access to key business inputs. For example up to 40% of some key fish inputs to the Irish seafood sector are sourced in UK waters.

Factors, such as the above, will apply pressure to trading cashflows, particularly for exporting SMEs, and will bring many loans covenants (including Debt/EBITDA, debt service coverage ratios) into keen focus for borrowers and lenders.

Companies, together with their advisors, can take steps now to mitigate these downside risks. Measures taken can include negotiation of more flexible covenants with existing banks, and/or balance sheet restructuring to introduce more flexible finance with reduced annual debt repayment obligations (e.g. mezzanine debt, hybrid equity and potentially unitranche debt).

Conclusions
While uncertainty is likely to persist for some time yet, as the Brexit negotiations play out, a company’s stakeholders, including its investors, bankers and employees, will be expecting management to be formulating a strategic plan. Accordingly, now is a time for action when it comes to assessing business objectives, projections and associated financing implications.

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