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Dynamics that weigh on
the minds of Boards





Introduction:

Uncover the questions that boards are currently asking, to navigate through the current macro-economic and geo-political influences.

In 2021, equity and debt markets showed a remarkable recovery with local and global stock and bond exchange index's closing at all-time highs. This was in direct contrast to 2020 that had been a year preoccupied with COVID and low vaccination rates causing large volatility in the markets. In 2021, we also saw record IPOs and a boom in M&A and PE activity across key global geographies including Australia. The debt and credit markets were stoked to reach record highs in terms of issuance and a compression in pricing, fuelled by government stimulus, confidence and historically low interest rates.

Looking ahead this year, we expected a meaningful economic and financial transition with a shift back to greater market stability for companies post community lockdowns and border closures

brought on by COVID. However, what now appears to be weighing on the minds of board members and senior management is what will be the medium-term impact from the dark clouds on the horizon in regards to the ongoing macro-economic and geo-political influences, mainly driven from the war in Ukraine.

Year to date 2022, we have seen wild volatile swings in the 'frothy' global financial markets (equity, debt, foreign currencies and commodities) as a result in large part from the grim conflict between Russia and Ukraine. The chart below helps highlight the significant instability that has existed from 1 January 2022- 31 March 2022 in major US Dow Jones Index and our local All Ordinaries.

Dow Jones Industrial Average

[ADD TO WATCHLIST](#)

CLOSED
34,754.93
 ▲ 274.17 0.80%

Last Updated: Mar 18, 2022 5:07 p.m. EDT

PREVIOUS CLOSE

34,480.76



ASX All Ordinaries Index

[ADD TO WATCHLIST](#)

OPEN
7,580.4
 ▲ 9.2 0.12%

Last Updated: Mar 21, 2022 3:32 p.m. AEDT
 - Delayed quote

PREVIOUS CLOSE

7,571.2



Source: Market Watch Data



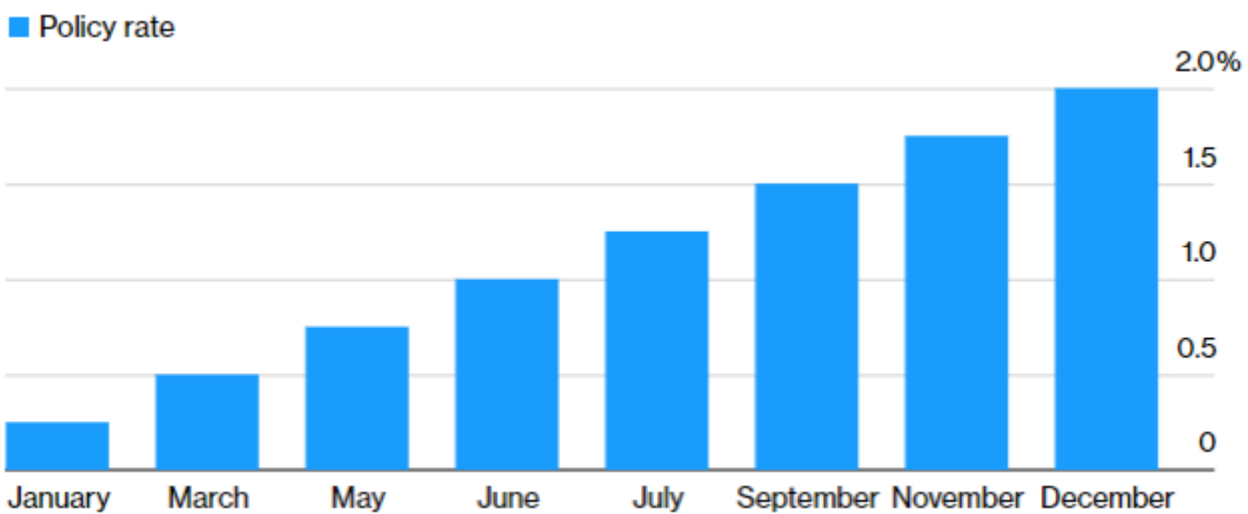
Dynamics that weigh on the minds of Boards

With the overarching dynamics of ongoing supply chain disruptions, rising oil and energy costs, staff shortages and rising inflation, this is leading to speculation that global interest rates will now rise rapidly this year. A medium impact, caused from the significant dislocation of communities in Queensland and NSW, will also contribute to how these dynamics take shape, as the high cost of the floods in terms of personal and economic losses hit Australia.

Goldman Sachs in February 2022 and prior to Russia invading Ukraine, stated they see the US Federal Reserve raising interest rates at 0.25bp over a staggering 7 times in the United States this year based on ongoing inflation concerns.

The Magnificent Seven

Goldman predicts the Fed will hike at every meeting from March



Source: Bloomberg

Note: No scheduled FOMC meetings in February, April, August or October

In fact, during March the US Federal Reserve did lift rates by 0.25% the first time since 2018 as they aggressively fight inflation. At the same time, we saw the Bank of England response to the UK's soaring inflation by lifting interest rates by 0.75%.

This week, the Reserve Bank of New Zealand raised rates again to 1.5%, with an expectation of more rises to come this year, as such it is only a matter of time before the Reserve Bank of Australia will follow, as our government like others rethink their forecasts.

Globally we are now moving away from the pandemic-induced extraordinary levels of monetary support from Governments and Central Banks. While higher inflation is signalling economies are recovering and demand for goods has risen, there are still many dynamics in play now, notably what will be the longer-term impact from Russia's aggression in Ukraine and the rising cost of fuel as the chart below depicts 1 January 2022-31 March 2022 movements.



Crude Oil WTI (NYM \$/bbl) Front Month

[ADD TO WATCHLIST](#)

 OPEN
\$108.12
 ▲ 3.42 3.27%

Last Updated: Mar 21, 2022 at 12:39 a.m. EDT
 - Delayed quote

SETTLEMENT PRICE 03/18/2022

\$104.70



Source: Market Watch Data



What does this mean for boards and senior management?

With these dynamics as a backdrop, we have seen the minds of boards and senior management being weighed down trying to understand the impact these factors will have on their companies. So far in 2022 we have seen more and more companies reviewing their capital management plans with a laser focus on what this myriad of external dynamics could bring to their overall funding and liquidity requirements as they undertake rigorous testing of various scenario outcomes.

When there are so many external dynamics at play causing a shift in global capital markets, then the developing of a robust plan for resilience and recovery has become a key agenda item at most board meetings today with a range of questions often being asked such as:

- Should we be refinancing our debt early?
- Do we have the right debt and equity mix?
- Is our liquidity position and headroom enough to protect us for downside risks?
- Ought we diversify our funding sources beyond our existing lenders?
- FX volatility is a concern for our business have we hedged enough?
- Should we do stress testing of our financial forecasts?
- Does our capital management plan provide us with clear funding options?
- Have we enough capacity to undertake acquisitions, large capex, pay dividends?
- Do we have a fit for purpose borrowing platform and flexible funding structure?
- What do we need to do to satisfy our lenders and investors regarding ESG?

Here is an actual example of a particular Boards enquiry to us recently:



Quote from a major ASX listed client

I've been following the commentary around interest rates uncertainty particularly given the US yield curves. We have our corporate loans maturing July 2023. I had planned to refinance it as part of the broader reworking of our capital structure prior to our next acquisition. A question our Board has asked me is to check in with you on is if we need to be refinancing the loan earlier in light of the interest rate uncertainty.

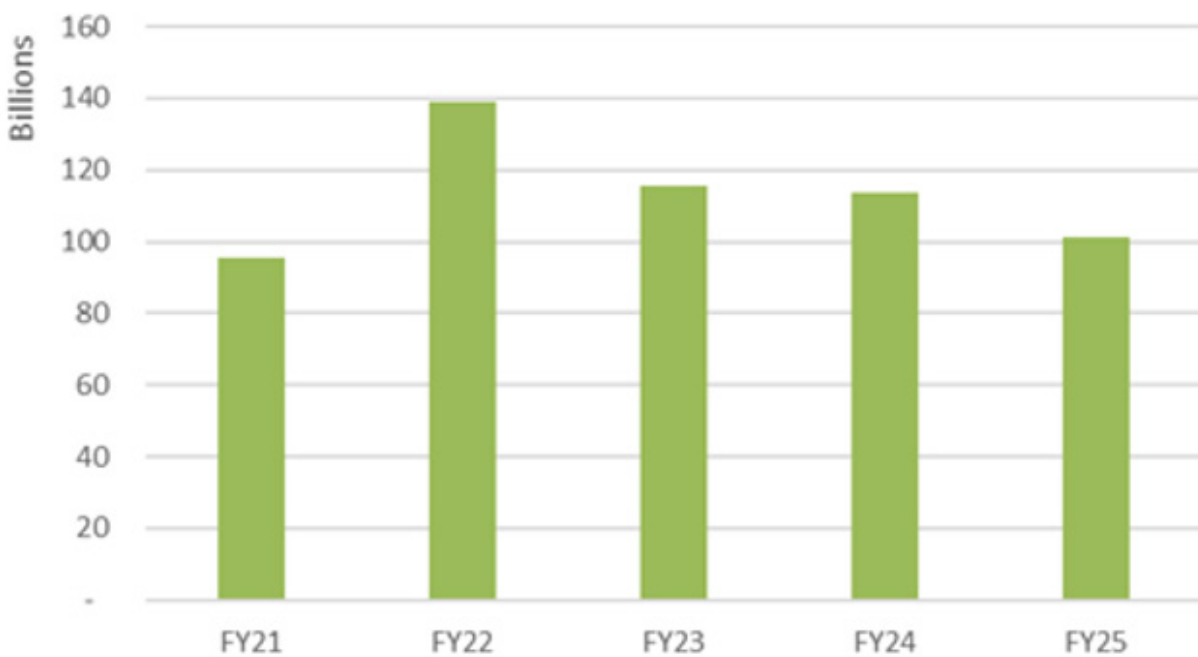


What about debt levels and fund raising?

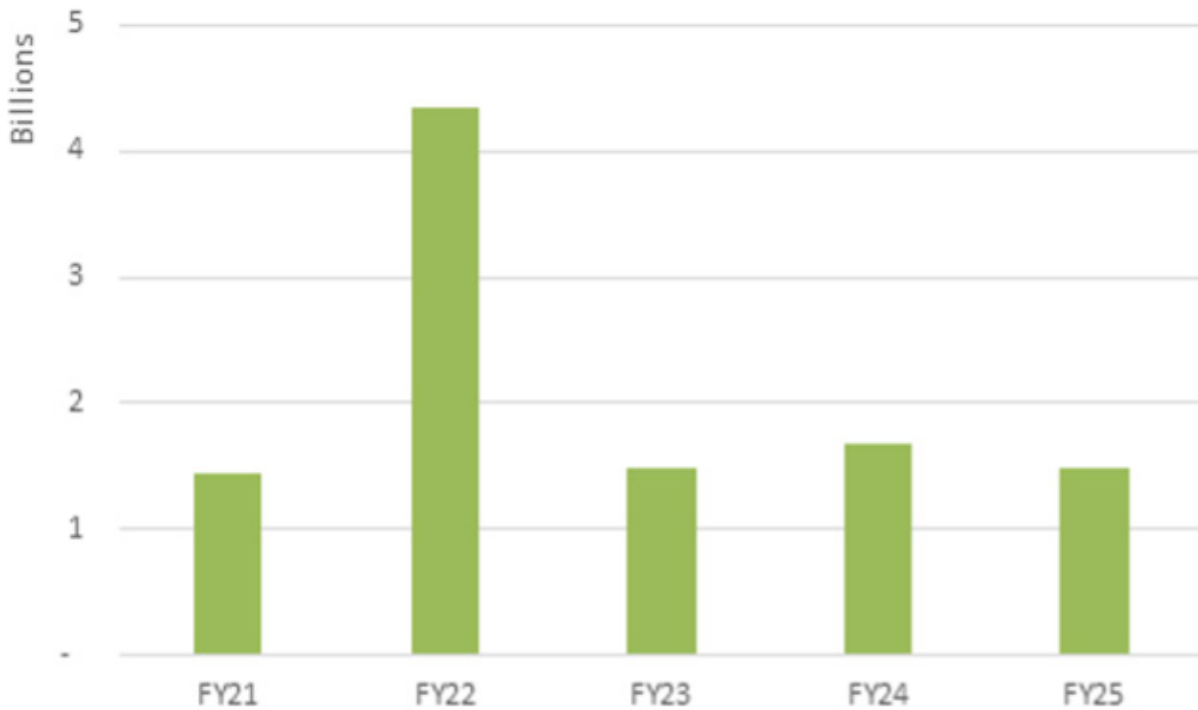
Another factor that is also important to note is that during the COVID pandemic corporate debt levels globally increased significantly along with leverage as a large number of companies raised more debt to cover liquidity headroom and acquisition opportunities. Australian companies followed a similar trend with them raising funding from a variety of markets including bank loans and local and international bonds.

According to Debtwire and Bloomberg the following debt levels and maturity towers reflect that 2022 and 2023 has over A\$260 billion of loans and bonds that need to be refinanced this year and next and this excludes a similar figure in the private debt markets.

Loans – Tranche Maturities (Debtwire - as at 14/02/2022)



Bonds – Tranche Maturities (Debtwire - as at 14/02/2022)



Source: Debtwire and Bloomberg's

With the rapidly changing dynamics in the debt markets and with the longer-term impact from the conflict in Ukraine, we are seeing the banks cost of funds rising quickly, which will contribute to the cost of credit and with the anticipated overall higher interest rate environment providing another major area of concern for Boards.

We are continuing to notice an increasing number of Board members becoming more hands on with probing questions to understand what the hazards can be to accessing future capital along with liquidity to support any potential growth opportunities. Board members are turning to their CEO's and CFO's for answers,

and in recent weeks we have seen a change in their approach with many of them seeking independent advice.

Board members are not sitting back to see what happens but rather are often vigorously seeking answers to such perceived risks with a view to moving to implement appropriate protective action plans.

Below is a further example of what is weighing on the mind of this particular companies Board as they seek independent advice to this question:



Quote from a major Private client

At last week's board meeting the Chair asked me what happens to the banks cost of funds and appetite to lend if the triffecta happens – Russia invades Ukraine and causes havoc; global interest rates and energy costs rise and supply chain disruptions continue. We need to have options to deal with our financing requirements next year.



ESG – another cause for concern

Another cause for concern that board members and senior management are facing is what will be the impact from global and local regulators recent decision to implement a range of new climate change policies requiring banks to adhere to in their standard credit assessment processes. In Australia, APRA and our major banks are now largely obligated to align themselves with the global push to decarbonise global economies.

To achieve this, Board members are needing to spend more time with senior management to set clear targets for their companies to meet or exceed key Environmental, Social and Governance (ESG) metrics such as the reduction of green gas emissions, waste recycling and renewable energy targets along with core OH&S staff related KPI's. In addition, companies are needing to achieve

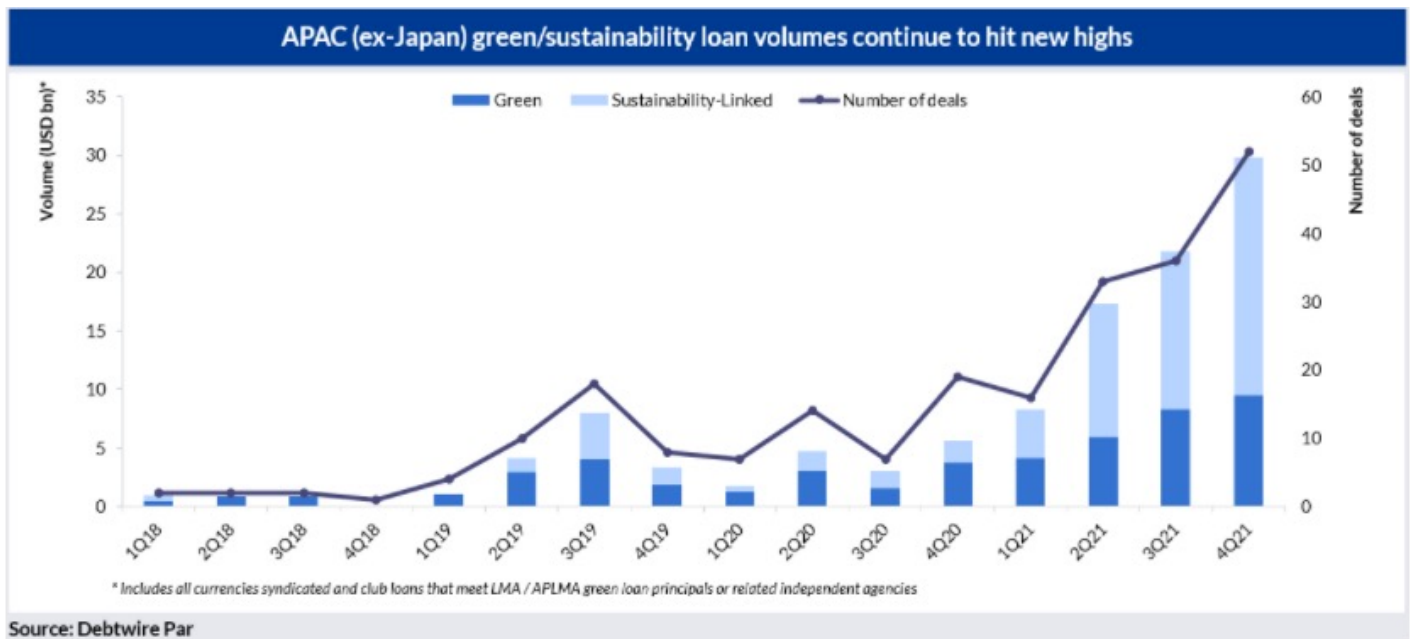
a B Group Accreditation across their business, which relates to the measurement, accounting and ongoing reporting of such ESG strategies to ensure they meet the high standards of verified performance.

ESG is becoming increasingly important for equity investors but now also for financiers. Companies are refinancing debt with ESG related funding structures to ensure they can maintain market access and lower their overall cost of funding. We have also seen government stepping in to provide funding to support new green energy related projects.

According to Debtwire the number of ESG related financings in APAC alone have increased rapidly in the past 12 months as see by the graph below.

ESG

Green and sustainability-linked loans (SLL) continued to hit new highs in 4Q21 with a combined USD 29.78bn raised in the region, surpassing the previous high of USD 21.78bn in 3Q21. Such deals in 2021 totaled USD 77.27bn, more than 5x of the USD 15.26bn completed in 202.



Source: Debtwire and Bloomberg's

Australia took the lead in this space by taking 29.5% share, or USD 22.81bn, of the annual tally in 2021, followed by Singapore with 24.4% (USD 18.83bn) and Hong Kong with 17.8% (13.74bn). Green and SLLs obtained by Singaporean companies accounted for one-third of the country's total loan volumes in 2021, a progressive increase of share since 2018 (17.3% in 2020, 9.3% in 2019 and 3.2% in 2018).



Moving forward

Board members from a wide range of public and private companies will find one of their most valuable resources, being 'time', heavily weighed down by various risks and uncertainties taking place in the local and global markets.

Subsequently, we are witnessing many Board members actively seeking help and advice from a range of sources, but often the best outcome is to seek input from those parties that are independent and experienced in the area.



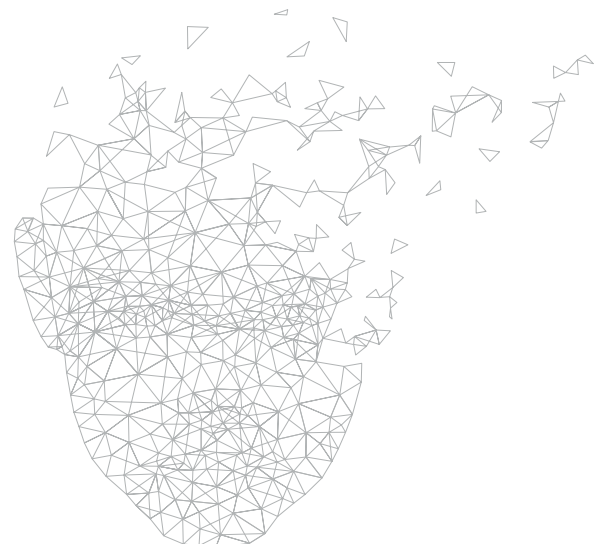
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