5 CFO tips for tapping today's abundant capital

Record monetary and fiscal stimulus is flooding markets with liquidity, giving CFOs an unusual opportunity to improve capital structure.

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Financial executives searching today's markets for ways to raise capital on good terms have rarely come across a more promising landscape.

Record monetary and fiscal stimulus has stoked equity markets and pushed down interest rates to historic lows. U.S. companies have seized on the low-cost capital, selling debt at unprecedented levels last year and launching the most initial public offerings since 2014.

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Yet today's easy money may become a bit less easy later this year. Stepped-up distribution of COVID-19 vaccines by the Biden administration has reinforced expectations that economic growth will pick up during the second half of 2021.

Optimism about a recovery pushed the yield on the benchmark 10-year U.S. Treasury note above 1% in early January for the first time since the onset of the coronavirus in March. The International Monetary Fund on Jan. 26 raised its estimate for U.S. growth this year to 5.1%, two full percentage points above its October forecast.

Before capital costs rise, many CFOs should consider reviewing their balance sheets and assessing whether they can alter the mix of debt and equity and make other improvements to their capital structure, financial executives said.

"There's that old adage about getting money when you can not when you have to — it's certainly a time when you can," said Frank Williamson, CEO at Oaklyn Consulting, a middle-market investment banking firm.

"The No. 1 thing I see among the people we work with is that there is money looking to go to work," said Williamson, chief investment officer (CIO) at Unum during the 2007-2008 financial crisis.

Every company needs to build a distinct capital structure based on several factors, including its industry outlook, risk tolerance and past performance. One size doesn't fit all.

Yet financial executives say companies of any stripe should consider a number of useful tools for raising debt and equity capital during the current period of high stock valuations and rock-bottom interest rates.

"When the window is open, you gotta go," said Tom Raterman, CFO at Runway Growth Capital, a provider of venture debt. "I would examine all of the markets that are available," asking "is there an opportunity to enter a market that you haven't been in before?"

Yields of asset-backed securities are especially appealing today, Raterman said, adding that Runway Growth Capital will likely tap into the ABS market in 2021, starting with small transactions.

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Revenue-based financing is helpful for start-ups with annual revenue ranging as high as $50 million, financial executives said. These loans are free of warrants, covenants and other encumbrances, with debt service set as a percentage of revenue. Payments rise when a borrower thrives and fall when a company hits a lull.

"It's a really good product for people with service businesses and long-term contracts," Williamson said.

CFOs today should not overlook time-tested borrowing, such as loan guarantees offered by the Small Business Administration (SBA) and U.S. Department of Agriculture, Williamson said. "SBA loans are one of the greatest economic development tools countries have ever come up with," he said.

On the equity side, private companies are avoiding the cost and time required in a traditional IPO and going public by merging with publicly traded special purpose acquisition companies (SPACs).

"It's pretty affordable," Raterman said. "From an issuer standpoint it doesn't seem like you're giving up much of a promote."

Often investors fund a SPAC — also known as a blank-check company — well before it has identified its acquisition target.

The number and total value of SPACs surged last year, with 248 launches raising $80.9 billion compared with 60 offerings raising $13.7 billion in 2019, according to EY.

"Momentum in the SPAC market is expected to remain strong in 2021 as more new SPACs are in the public pipeline every month, with many more behind them," EY said.

Regardless of which debt or equity tool CFOs choose, financial executives advise that they follow five best practices:

Plan for the full range of scenarios

Given today's unique mix of market, policy and economic conditions, CFOs need to consider how their capital structure would handle the best and worst outcomes for their business.

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"Plan for the upside but be prepared for the downside," said David Magdol, president and CIO at Main Street Capital.

The Federal Reserve after a two-day meeting on Jan. 27 flagged downside risks to recovery and pledged to sustain record accommodation.

Fed policymakers believe growth will likely pick up later this year as vaccinations curb the pandemic. But slow initial vaccine distribution and recent signs of economic weakness may jeopardize a recovery.

"The pandemic still provides considerable downside risk to the economy," Fed Chairman Jerome Powell said at a post-meeting press conference.

Scenario planning helped Runway Growth Capital blunt harm from the pandemic. Before the virus emerged, the firm exited transactions vulnerable to worsening China-U.S. trade tensions, Raterman said.

The company averted losses even though its "crystal ball wasn't polished enough to see a pandemic," he said.

CFOs also need to determine the impact of positive outcomes on their balance sheet, Williamson said.

"It is just as hard if not harder to beat a rising market than it is to deal with a cushion around a falling market," he said. "If there's a big tailwind coming in and they haven't thought ahead about how they're not going to miss that, then they need to do that right now."

Extend debt maturities

CFOs should consider lengthening the average maturity of their debt given the prospect for stronger growth and the Fed's reluctance to mimic central banks in Europe and Japan and push interest rates below zero, financial executives said.

"For all the companies in the growth sector it really makes sense to look at refinancing your existing venture debt and your existing term loans that may still be in the interest only period, and push out your maturities," Raterman said.

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Tell a future-oriented story

Many CFOs spend 80% of their time on accounting and controls and only 20% on financial planning and analysis, Williamson said. Now is the time to put more effort into FP&A, he said.

Financial executives need to approach capital providers with a vision that looks beyond disruption from the once-in-a-century pandemic. "It's a great time to polish up your realistic plans for the future," Williamson said. "Don't tell the story of the past 12 month's trailing numbers."

Get to know current or prospective holders of your debt and equity

The stress and uncertainty from the sharp downturn last year underscored the value to CFOs of understanding the interests, motivations and pain points of lenders and investors.

"Know your partner, whether it's your existing debt participant or equity partner or a future one," Magdol said. "Check out what's happening in the rest of their portfolio, how they are capitalized.

Take calls from lenders and investors

CFOs should hear out credible providers of capital from a broad range of markets, financial executives said.

If no attractive offers crop up in such conversations, CFOs will at least stay attuned to new market shifts, Williamson said.

"Go ahead and take the calls because somebody is pushing something that might turn out to be a good deal," he said. "You're missing a big opportunity if you're not current on capital markets as it relates to your business."