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Acquisition Finance 2023

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Singapore: Trends and Developments
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Trends and Developments

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Market Outlook

While market sentiments in the South-East Asia region in early 2022 were optimistic on the back of strong momentum carried over from a resurgent 2021, this would eventually give way to a more muted year overall. This was owing to numerous geopolitical and macroeconomic factors, such as the conflict in Ukraine, rampant global inflation and rising interest rates. In the Singapore context, total M&A deal volume and value decreased by 36% and 72%, respectively, from USD64.6 billion across 214 deals in 2021 to USD18 billion across 138 deals in 2022.

However, even with these geopolitical and macroeconomic factors dampening M&A activity generally across the South-East Asia region, Singapore remained the top regional dealmaker in 2022. Significant acquisitions in Singapore were observed in the industrial, real estate, high technology and financial sectors.

On the acquisition financing front, there was a 3.01% year-on-year decrease in the total value of acquisition financings in Singapore. However, there were still a number of significant acquisition financing transactions undertaken in Singapore in 2022, such as the financing for the SGD666.1 million acquisition of South Korean waste management company Eco Management Korea Holdings by a consortium led by Keppel Infrastructure REIT.

Noteworthy trends and developments in the acquisition financing space include the increase in "amendment and extension" arrangements (in lieu of refinancings or fresh financings), and concerns relating to covenant-light financings, but perhaps the most significant trend was the move towards green and sustainability-linked loans. In this regard, 2022 saw the completion of the largest syndicated real estate green financing in Asia as at the end of 2022 – a SGD3 billion green financing granted to a consortium led by Perennial Holdings to finance the redevelopment of 8 Shenton Way, which is slated to be the tallest building in Singapore. These and other trends and developments are explored below in more detail.

Enterprise Financing Scheme, M&A Loans – Extension and Enhancement

While there is a tendency to focus on high-value M&A deals, there has been a noteworthy development in the small and medium enterprise (SME) M&A sector. This relates to the Enterprise Financing Scheme (EFS), which was rolled out at the end of 2019 by Enterprise Singapore as a streamlined umbrella initiative under which nascent SMEs could make simplified applications to certain participating financial institutions for various types of loans. There are a number of loan schemes under the EFS, one of which is the EFS – Mergers & Acquisitions loan scheme (the "EFS M&A Scheme"), which allows eligible local SMEs to access funding support for intended M&A transactions of an international nature with a view to growing and expanding their businesses.

It was announced in the Budget 2022 that the EFS M&A Scheme would be extended for a further four-year period, from 1 April 2022 up to 31 March 2026, and also that it would be enhanced. The enhancements to the EFS M&A Scheme include, significantly, the granting of loans for domestic M&A activities, which is over and above the support given to borrowers in relation to international M&A activities, which was initially provided when the EFS M&A Scheme was first introduced. The loans (whether used for domestic or international M&A activities) are subject to a maximum quantum of SGD50 million per borrower or borrower group.

It is noteworthy that most of the loan schemes under the EFS that constituted immediate support measures for SMEs in the midst of the pandemic have been or are projected to soon be discontinued as the economy recovers from the worst effects of the pandemic. For example, the EFS – Trade Loan and the EFS – Project Loan Schemes have both been discontinued. However, the EFS M&A Scheme's four-year extension suggests an intention on the part of the government to promote growth and expansion through M&A activity beyond just the short term. This supports the continued horizontal and vertical scaling and expansion of local SMEs, including the venturing by such SMEs into complementary businesses and emerging sectors both within and outside the Singapore market (eg, in emerging markets), allowing them to tap into new client bases to optimise their operations and to consolidate and take advantage of resources such as new intellectual property and talent. There is value in this approach as regards incentivising the expansion of SMEs as, according to the Singapore Department of Statistics, SMEs accounted for 44% of the value added to Singapore's nominal GDP and constituted 99% of all enterprises in Singapore in 2021.

Under the EFS M&A Scheme, participating lenders also stand to benefit as they are partially shielded from the risk of borrowers' defaults. Generally speaking, Enterprise Singapore's risk share is 50%. However, in the case of young enterprises (ie, firms formed within the past five years with at least one employee, and with more than 50% of such firms' equity owned by individuals) and enterprises operating in a challenged market (ie, in countries with Standard & Poor (S&P) ratings of BB+ and below, and non-rated countries) Enterprise Singapore's risk share is 70%. In a default situation, a participating lender must first seek recourse through its usual commercial recovery procedures, including realising any security, before it may apply to Enterprise Singapore to claim against the proportionate 50% (or, as the case may be, 70%) of the outstanding amount. Repayment of the loan principal is, nonetheless, fully the borrower's responsibility, and the maximum repayment period is five years from initial drawdown.

It will be interesting to chart the effect that such enhanced financing support under the EFS M&A Scheme will have on the SME M&A sphere in the coming years.

Green Loans and Sustainability-Linked Loans

A greater emphasis on sustainability has been seen in various sectors in Singapore, including finance. To address their concerns, governments and institutions have introduced regulations and guidelines to steer lenders towards loan instruments that align with sustainability objectives. Such loan instruments include the following.

Green loans

These are loans where the proceeds are used for green purposes. In acquisition financing, green loans are specifically provided to acquire companies or assets that have a positive environmental impact (eg, acquiring renewable energy companies). While there are no official "green benchmarks" for the acquisition of companies in Singapore, there are awards that recognise the green achievements of companies, for example, the Singapore Environmental Achievement Awards, issued by the Singapore Environment Council in support of the Singapore Green Plan. By and large, the current market practice in Singapore is to refer to the Green Loan Principles (GLP), which are voluntary recommended guidelines developed by a working party (consisting of the Asia Pacific Loan Market Association, the Loan Market Association and the Loan Syndica-

tions and Trading Association), with refinements and adjustments as may be necessary to take into account the commercial and operational requirements of each bank when assuming the role of green loan co-ordinator.

Sustainability-linked loans (SLLs)

These are loans where the pricing is pegged to sustainability performance targets (SPTs), measured using key performance indicators, external ratings and/or equivalent metrics. Unlike green loans, the use of the proceeds is not a factor in categorising a loan as an SLL; instead, the emphasis is on improving the borrower's sustainability profile against specifically identified SPTs. The Sustainability-Linked Loan Principles (SLLP), which are voluntary recommended guidelines developed by the same working party that developed the GLP, commonly serve as the reference point for SLLs in Singapore. Numerous major SLLs have been entered into across various sectors including the SGD860 million syndicated SLL granted to Singapore real estate investment trust (REIT) Lendlease Global Commercial REIT for the acquisition of Jem, an integrated office and retail development. In the energy sector, a five-year SGD1.2 billion SLL was granted to Sembcorp Financial Services Pte Ltd, for the purpose of, among others, financing or refinancing 11 renewable energy and other sustainable projects.

In Singapore, there has been a notable rise in the granting of green loans and SLLs, with almost SGD40 billion of such loans made between 2018 and 2021. To bolster this trend, in 2021, the Monetary Authority of Singapore (MAS) introduced the Green and Sustainability-Linked Loan Grant Scheme (GSLS), which is valid until 31 December 2023, and which seeks to:

- encourage lenders to make green and sustainable financing available by reducing the costs of engaging independent service providers to certify the green and sustainability credentials of such loans; and
- incentivise banks to adopt green and sustainability-linked loan frameworks that are friendly to SMEs.

The GSLS incorporates the aforementioned GLP and SLLP as high-level frameworks to guide the origination of green loans and SLLs respectively, and market participants are encouraged to refer to them. In response, major financial institutions have rolled out their own green and sustainability-linked loan frameworks – for example, Oversea-Chinese Banking Corporation (OCBC) has been providing sustainability-linked loans to SMEs under the OCBC SME Sustainable Finance Framework since November 2020, with the total amount lent by OCBC to SMEs for sustainable projects estimated to exceed SGD3 billion as at the end of 2022.

Another major green financing initiative is the EFS-Green loan scheme (the "EFS-Green Scheme") which, like the EFS M&A Scheme, also allows participating lenders to benefit from being partially shielded from the risk of borrowers' defaults. Under the EFS-Green Scheme, Enterprise Singapore's risk share for green loans to eligible enterprises in qualifying green sectors (eg, clean energy and decarbonisation, the circular economy and resource optimisation, green infrastructure, and clean transportation) is 70%. The first loan granted under the EFS-Green Scheme was a SGD6 million green trade loan issued by HSBC Singapore to Singapore-based energy storage solutions company Durapower Group. Many more such loans have been granted since then, with over 30 SMEs having taken up close to SGD120 million in such loans

by February 2023. It is projected that 2023 will see continued growth in the green loans sector in conjunction with Enterprise Singapore's efforts to raise awareness of such schemes and develop green loan frameworks that are better bespoke to the needs of each sector.

Covenant-Light Loans

In general, debt structures for the financing of major corporate transactions often involve strong financial or maintenance covenants that favour lenders, particularly in the case of financings granted by traditional financial institutions like banks. However, covenant-light loans significantly cut down on (and in some cases, remove) such covenants. This affords borrowers freedom from having to police and satisfy such tests, allowing borrowers to focus more on value creation. In particular, private equity-backed borrowers are, for certain financings, able to obtain more generous terms such as provision for unrestricted subsidiaries (ie, subsidiaries that are part of the borrower group, but to whom covenants do not apply) and substantial grower baskets (giving such borrowers more breathing room in the form of exceptions or carve-outs from restrictive covenants, such as covenants restricting further borrowing).

Covenant-light loans have seen a record-breaking increase in popularity in the US and Europe over the past few years, although this is showing signs of slowing in 2022 due to push-back from lenders and investors amid fears of a global recession and the effects of the conflict in Ukraine. According to S&P Global Market Intelligence, covenant-light loans formed 91% of institutional loans in the US and 96% of issuance in the European institutional loan market. By contrast, the reception for covenant-light loans in the Asia-Pacific region (including Singapore) has been far more measured, despite the rise in private equity-backed M&A deals. In particular, concerns over the inherent nature of covenant-light loans have made lenders and government authorities cautious of adopting the covenant-light approach in financings. Back in November 2011, the MAS raised concerns that the increase in the number of covenant-light loans could render banks and investors more susceptible to potential losses in the future. In this regard, lenders in the Asia-Pacific region may be more willing to accept a trade-off for strong covenants in exchange for weaker yields, and acquisition financing loan documentation in Singapore commonly includes maintenance covenants. As such, the observation is that covenant-light loans in the forms used in the US and Europe have not made their mark in Singapore in the same way.

However, certain types of more flexible loans with covenant-light features are seeing increased use in the Asia-Pacific region. These include the Term Loan B (TLB), also referred to as an "institutional term loan", which is a term loan issued by institutional investors that is designed to maximise the investors' long-term total returns and typically contains sponsor-friendly terms and excludes maintenance covenants and mandatory prepayment. Significant TLB transactions include the USD1.35 billion TLB granted by Commonwealth Bank of Australia to private equity firm KKR to finance its acquisition of a 55% stake in wealth management business Colonial First State Investment in 2021, and the TLB granted to US investment firm Carlyle in 2022 to partially fund its acquisition of China-based packaging company HCP Holdings. In Singapore, ride-hailing and food delivery giant Grab obtained a USD2 billion TLB financing in 2021. Therefore, while US/Europe-style covenant-light loans may not be common in the Asia-Pacific context, lend-

ers here have been more tolerant towards TLB structures.

"Amendment and Extension" Exercises

With the prevailing high cost of funding, many borrowers are arranging for amendment and extension (A&E) exercises with their existing lenders in relation to their financing, instead of obtaining refinancing or fresh financing. In practice, A&Es involve the amendment and restatement of existing facility agreements and, apart from documenting extension to maturity dates, may also include the introduction of new commitments in addition to the amounts that are to be extended or rolled over. In some instances, certain terms of the financings in question may be renegotiated for re-alignment with each party's commercial intention.

Although this appears to be a trend that has come and gone at various times in the past decades, most significantly during the credit crunch following the 2008 global financial crisis, A&Es tend to prove popular when:

- the availability of refinancing funding is insufficient to meet borrower demand; and
- the secondary loan market is surging, which lowers the costs for borrowers seeking further financing to negotiate directly with existing lenders on their maturing loans.

For investors and lenders, in an environment where demand for new primary financing deals outstrips supply, a slight increase in margin while retaining such assets on their books is often preferable to not being able to secure financing.

In the first half of 2022, A&E deal volume in the US hit USD58.4 billion. Similarly, in the European Union, new loan issuance in the leveraged loan market plunged to one of the lowest levels in nearly a decade as funding costs skyrocketed. In Singapore too, more borrowers were observed shunning traditional refinancing in favour of A&E options in 2022.

There are several reasons why A&Es prove popular in times such as these. Firstly, borrowers negotiate directly with their existing lenders, thereby avoiding the uncertainties of the primary markets and achieving a bespoke transaction that works for the parties involved. For borrowers, a revision in the loan margin, along with an update of other terms to more accurately track prevailing market conditions, may involve less cost than entering into a brand-new transaction.

Secondly, for extending lenders, A&Es may involve attractive upfront or commitment fees. The extending lenders may also use this opportunity to tighten financial covenants against the borrower so as to better manage their lending risk.

The year 2022 also coincided with a global move towards the use of risk-free rates as the new benchmark interest rate for many loans, which saw many borrowers in Singapore amending their existing facilities to include new provisions relating to the Singapore Overnight Rate Average (SORA). The reason behind this sense of urgency is the scheduled discontinuation of the Singapore Dollar Swap Offer Rate (SOR) on 30 June 2023, after it was announced that the USD London Interbank Offered Rate (USD LIBOR), which the SOR references in its computation, would similarly be discontinued.

With the confluence of the above factors, it is no surprise that A&Es have once again dominated the Singapore loan market in 2022 and will likely continue to be a prevailing trend for some time to come.

Special Purpose Acquisition Companies

While bank loans remain a reliable and constant source of acquisition financing, there has been a surge of interest in alternative methods of financing M&A through investments in publicly-listed blank-cheque companies (special purpose acquisition companies, or SPACs). These would then pick a suitable target company to acquire and take public, and provide liquidity to such target from the capital raised from the initial public offering of the SPAC. Seen as a vehicle for a more efficient listing process of a potentially high-growth target company, SPACs caught a second wind in recent years with participation from big celebrity names like tennis star Serena Williams and Olympic gymnast Li Ning. While SPACs proved popular in the US market, with the New York Stock Exchange listing more than 60 SPACS between 2017 and 2020, the introduction of SPACs (and the putting in place of SPAC listing regimes) in Singapore only started in September 2021. As at the end of 2022, SPACs did not appear to have gained significant traction in Singapore.

This may be attributed to the strict listing regulations in Singapore. Wary of information asymmetries among investors, and low-quality assets being publicly available to investors via "backdoor listings" that circumvent the high standards of the listing rules, regulators introduced a strict set of proposed rules for SPAC listings in Singapore in 2021. For example, the track record and reputation of a SPAC's sponsor and its management team are among the significant factors considered in a thorough assessment by the Singapore Exchange ("SGX") before the SPAC is deemed suitable for listing, curtailing the very efficiency of the process that made SPACs attractive in the first place. The minimum market capitalisation requirement for SPACs was initially SGD300 million, before it was revised down to SGD150 million following a public consultation. Furthermore, the United States Federal Reserve triggered a hike in global interest rates in March 2022 which tempered interest and further slowed the growth of SPACs in the region. As a result of the aforementioned circumstances, SPACs are viewed by many investors in Singapore as an unattractive investment option as compared to, for example, fixed deposits (in view of the prevailing high interest rates).

For a concept that was first introduced in 1993 in the US at a time when blank-cheque companies were not yet allowed, and that has since seen its popularity wax and wane over time, it will be interesting to note how the Singapore market will receive SPACs in the years to come.

Conclusion

The outlook for acquisition financing for the rest of the year will very much be shaped by the geopolitical and macroeconomic landscape. While early signs in the first quarter of 2023 may point towards a continued slowdown in M&A activity, the expectation is that South-East Asian economies (including Singapore) will be resilient in the face of strong global headwinds as they embrace economic reopening, even as inflation and geopolitical challenges remain key overhangs for the US and Europe.

One development that is almost certain to persist into 2023 and beyond is the increasing prevalence of green and sustainability-linked loans, as greater emphasis continues to be placed on the accountability of businesses and corporate actors for environmental, social and governance issues. Unlike other current trends and developments, it is likely that green and sustainability-linked loans will continue to thrive irrespective of uncertainty in the global economy and will be a crucial part of not just acquisition finance, but financing in general, for the foreseeable future.

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