HERBERT SMITH FREEHILLS

ACT TREASURY EXCELLENCE AS STANDARD

CORPORATE DEBT AND TREASURY REPORT

MAY 2024

Contents

Executive summary

- Corporate treasury has been, continues to be and must remain, agile in responding to unpredictable macro-economic and political events. This applies both to debt raising (and being ready to access markets at optimal times) but also in a wider treasury context, supporting their businesses across all treasury activities and markets.
- Whilst there is a sense of greater certainty of access to capital and fewer concerns of lack of access to debt as well as a perceived lower risk of financial distress, business investment (both through capital expenditure and M&A) is muted. Corporates are holding on to more cash as a buffer for the next unexpected economic shock or, potentially, with a view to cash funded M&A as conditions for investment improve.
- Banks remain the mainstay corporate debt providers having a number of advantages over non-bank lenders when lending to corporates. That is likely to remain the case though there is some caution that banks are becoming more selective in making capital available. 'Cash is king' and preserving it is a key focus. There is less focus on minimising gross debt and more focus on keeping funds for the next opportunity or economic shock.
- There is greater evidence of a bifurcation of approaches on ESG in debt finance, in particular for sustainability linked loans. Whilst those who have sustainability linked finance in place look likely to continue to do so, for others it has fallen considerably down the treasury agenda. For many, the benefit of establishing an SLL does not justify the time and cost of doing so nor does it meaningfully move forwards a corporate's ESG agenda. Some respondents query whether SLLs have had their day as a company's ESG strategy becomes part of a lender's binary lending decision rather than a minor margin adjustment.

About our research and report

This research comprises a survey of, and follow-up interviews with, finance and treasury professionals at 65 UK corporates (primarily FTSE 100, FTSE 250 and equivalents) conducted in January to March 2024.

We hope you find these findings informative and we would like to thank those who participated in our research. In particular, we are grateful to those who took part in our follow-up interviews to discuss the survey results. Their views added depth to the research findings and their input has been invaluable. Thank you.

If you have any feedback on the research or its results, we would be very happy to receive it. We would also be delighted to hear from you if you are happy to take part in our research next year as we aim to make this report as useful to the treasury community as possible.

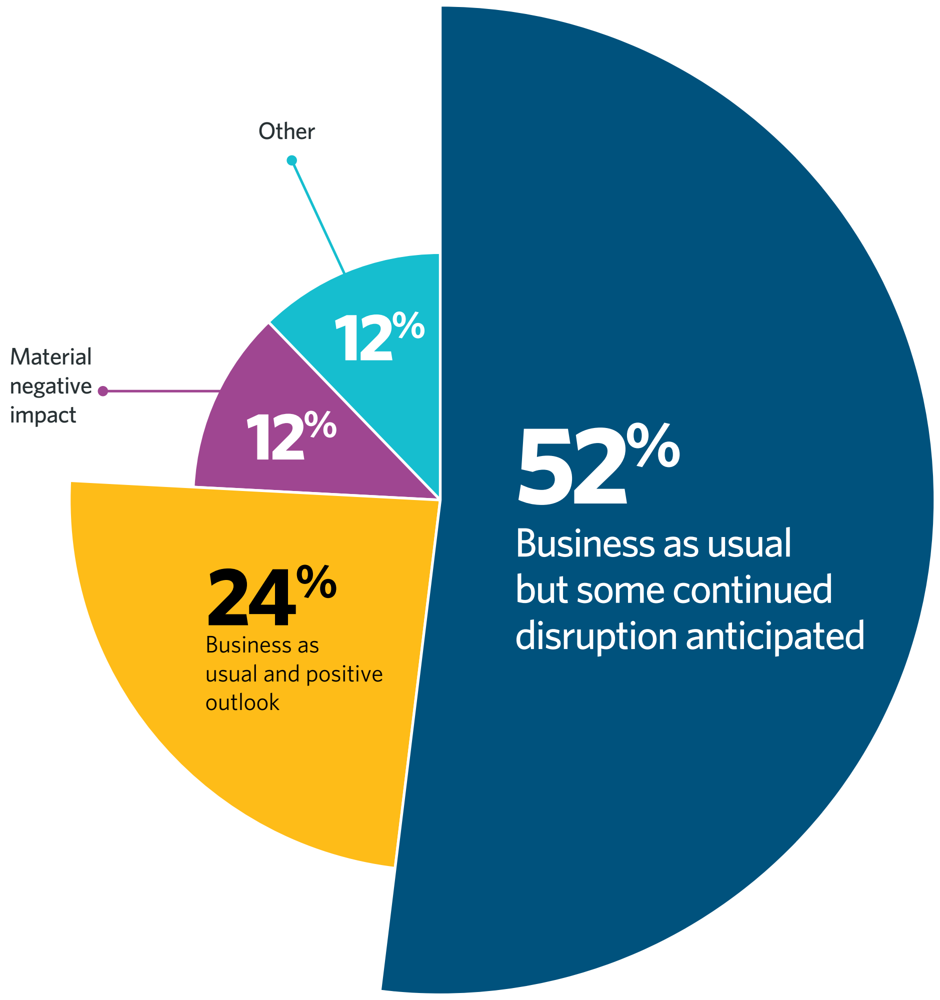
Some of the themes explored in this report are necessarily only addressed in headline terms. Over the course of the rest of the year, we will issue short form, practical insights on some of these issues and share views from other treasury professionals.
If you would like to receive those please email Rowena.Paskell@hsf.com.

1 MACRO-ECONOMIC AND GEO-POLITICAL EVENTS

1 MACRO-ECONOMIC AND GEO-POLITICAL EVENTS

1.1 IMPACT ON BUSINESS

What is the impact of current macro-economic events and geo-political events (supply-chain issues, interest rates, inflation, conflict etc) on your business?



- With 64% of respondents reporting a neutral to negative outlook, a 15% decrease from 2023, the dominant message from respondents in 2024 is that some level of continued business interruption is the new normal.
- Many respondents expressed confidence in the ability of corporates to cope with these challenges and to continue to manage systemic risk and uncertainty. For some respondents, the reality of managing continued high interest rates and persistent supply chain disruptions for a prolonged period has led them to build wider risk management processes into their business culture.
- Amidst the uncertainty, some corporates are finding a positive story, such as increased competitiveness as a result of running "fitter and leaner operations" and also how certain sectors were benefitting from these trends, which may account for the 24% of respondents reporting a neutral to positive outlook, an 8% increase from 2023.
- While CoVid restrictions have long since eased, the Russian invasion of Ukraine continues, and other geo-political issues, such as those confronting the Middle East, China's economic downturn and upcoming elections in the US, UK and other major economies contribute to an uncertain macro-economic environment. As a result, some respondents reported weighing their options when considering accessing the debt markets, managing their business size and growth more generally, including accelerating refinancing timelines and delaying capital expenditure.

"The experience of recent years means that we should expect the unexpected. The nature of geo-political events and the uncertain economic environment mean that the path is far from certain."

"We are all getting used to managing financial risk against the worst macro environment you could wish to think of. You think it can't get worse and then, guess what, it gets worse."

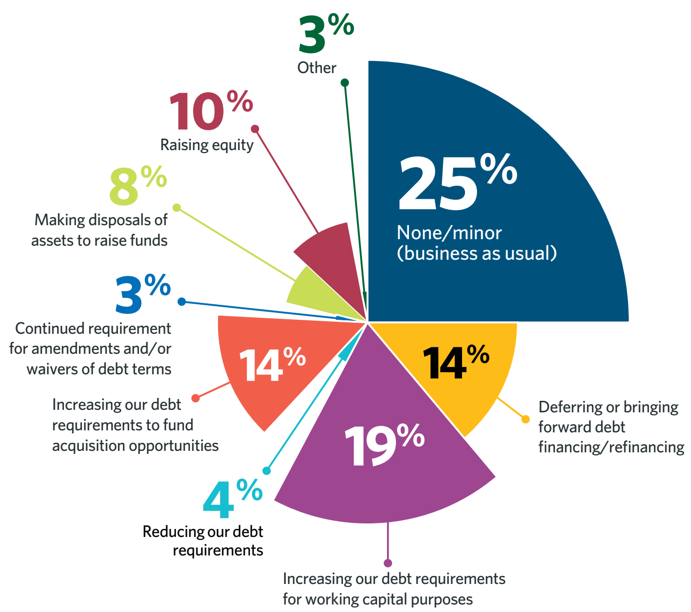
"The outlook seems to have settled a bit more but still feels like something else will arise which will impact the debt markets. I wonder what the next thing will be."

1 MACRO-ECONOMIC AND GEO-POLITICAL EVENTS

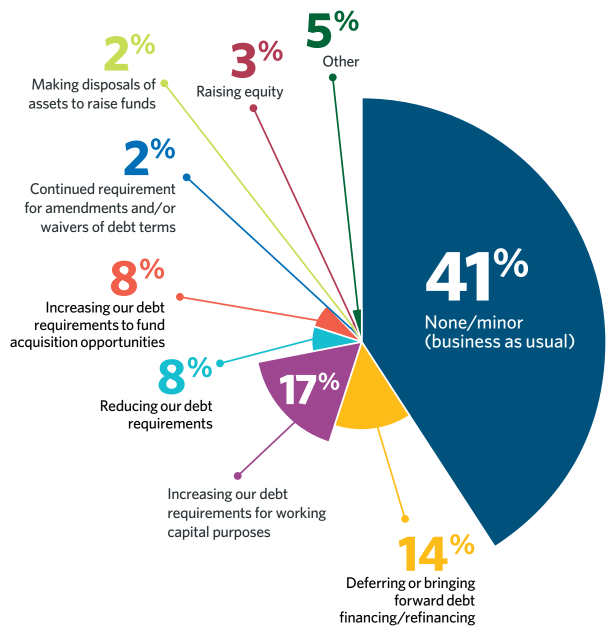
1.2 IMPACT ON DEBT STRATEGY

What is the expected impact of such events on your 2024 debt strategy?

2023



2024



CORPORATE DEBT AND TREASURY RESEARCH
HERBERT SMITH FREEHILLS

- A large portion of respondents (41%, as compared with 25% in 2023) reported that macro-economic and geopolitical events would have no, or a minor, effect on their 2024 debt strategy. The overwhelming sentiment from respondents in 2024 is that markets are open, accessible and trading through crises. As one respondent phrased it, "*Markets stopped at the risk of Grexit…and now you don't see the dislocation in credit markets that you once did as a response to economic and political issues*". These responses reflect an assumption, whether accurate or not, that macro-economic and geo-political disruptions are no longer creating fragility in the corporate debt markets.
- For 14% of our respondents (no change from 2023), macro-economic and geo-political uncertainty has catalysed plans to defer or bring forward debt financing/refinancing. Some respondents reported implementing financing arrangements now to cover the next disruptive event and avoid being caught out, such as putting in place USPP shelf-facilities and having DCM programmes ready to access markets at short notice.
- In general, respondents emphasised the impact of inflation less than in 2023, pointing to factors such as cost of funds and market access as drivers of when to access the corporate debt markets. Instead of waiting for interest rates to fall, respondents are now asking whether the environment is sufficiently stable and whether they should be accessing the market now rather than waiting until later when there might be more execution risk due to potential macro-economic events.
- The importance of cash and conserving it on balance sheet was a recurring theme in interviews.
- Only 8% of respondents are seeking to increase debt requirements to facilitate M&A activity, a 5% decrease from 2023. Anecdotal evidence from respondents also suggests that corporate M&A is often being funded with equity or retained cash, as opposed to debt and that there remains some way to go before vendor price expectations reduce enough in order to absorb some of the higher cost of debt.
- A decreasing number of respondents anticipate current macro-economic and geo-political events will necessitate waivers of debt terms (2%, down from 3% in 2023); them raising equity (3%, down from 10% in 2023) or making disposals of assets to raise funds (2%, down from 8% in 2023), reflecting a less distressed outlook and greater certainty and availability of debt funding.

"Cash is king. Before, quantum and tenor [of debt] were key. Now, it is interest rates and management of working capital that are important."

"One point I see is the increasing importance of cash as a resource. Where there were flat yield curves and low interest rates, cash was an unfortunate by-product of doing business, having to park it somewhere. Now cash is a clear driver of shareholder value in terms of conserving cash."

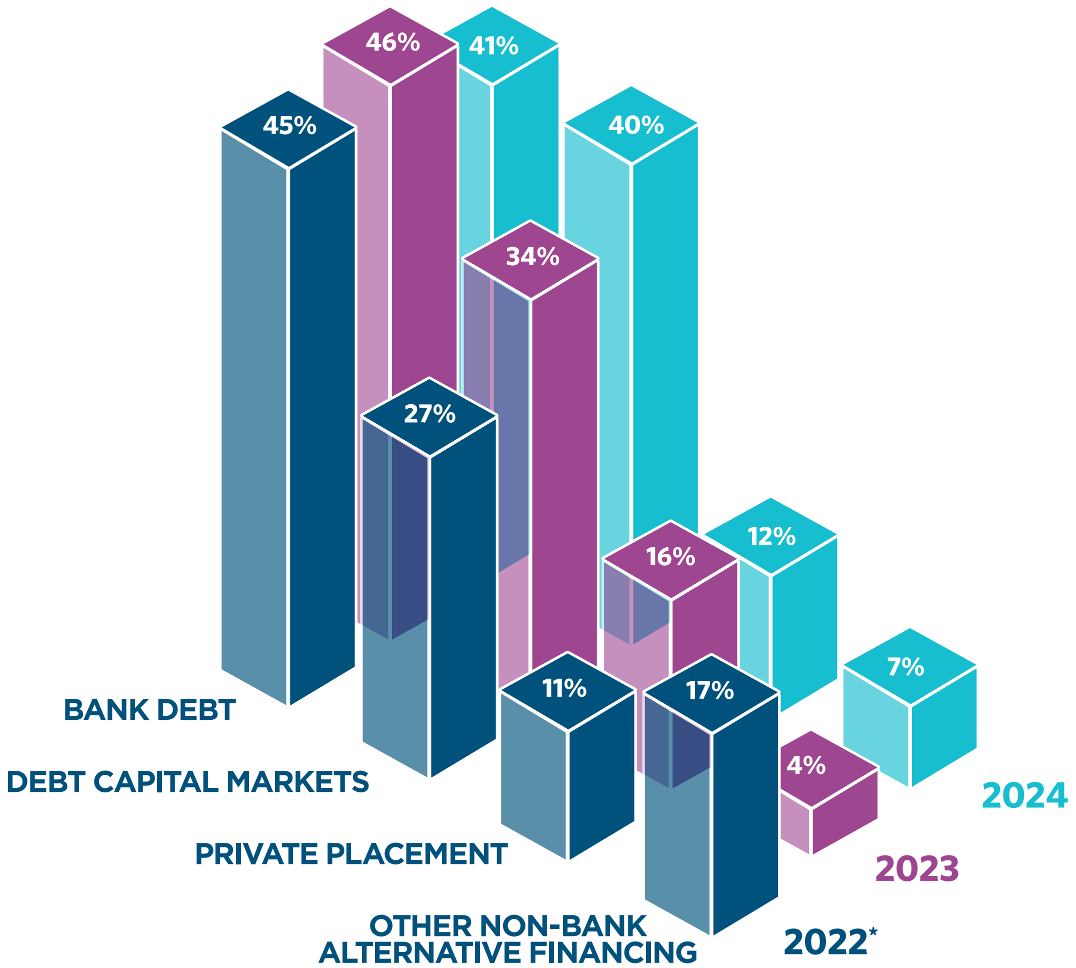
"Get it [debt raising] done, who knows what is going to happen."

2 DEBT FINANCING

2 DEBT FINANCING

2.1 CURRENT DEBT FINANCING

At the start of 2024, approximately what percentage of your total debt funding is provided by each of the following?



- Unsurprisingly, bank debt continues to represent the most widely utilised source of debt. Whilst the data for 2022 opposite was a forecast of views taken in 2019, the role of bank debt has remained stable and consistent (despite the macro-economic and geo-political upheaval both generally and specifically for banks and the entrance of non-bank lenders that we have seen more generally). Respondents noted that the bank market is increasingly resilient, highlighting that the US regional banking crisis did not spread more widely to banks operating in the UK, whereas a higher level of contagion risk would have been expected several years ago.
- There has been another notable increase in those selecting the debt capital markets. As we noted last year, 41% of debt funding sourced from DCM is unlikely to be representative of listed corporates generally. Yet, the increase in the proportion of DCM issuance is likely reflective of corporates who do have access to DCM seeking to take advantage of the windows of liquidity that have been and are expected to be available.
- The number of respondents raising debt in the private placement markets has been relatively stable; for those corporates who do not have access to the debt capital markets or who choose not to be involved in the disclosure requirements of the debt capital markets, the private placement or bank term loan markets are the most typical alternatives. Larger corporates however sometimes issue in both the private placement and debt capital markets over time in order to take advantage of arbitrage opportunities across those markets though some respondents queried whether the cost savings justified the more intrusive contractual controls over a business in private placements compared to DCM issuance.
- Alternative lenders continue to struggle to gain a consistent foothold in the corporate debt markets. Respondents noted that there is a perception that alternative debt providers are likely to demand more restrictive terms and there is uncertainty as to how those providers will react to consent/amendment requests, both of which compare unfavourably to bank debt and DCM issuance (particularly at a time when corporates are finding those markets provide sufficient liquidity). Some corporate treasury teams therefore consider the alternative lender markets an unnecessary risk in the current environment, foreseeing difficulties in convincing boards of the merits of novel sources of debt or relationships. Structurally, it is challenging for alternative lenders to match the pricing and flexibility that is available to corporates in the bank and debt capital markets, and alternative lenders do not have the same resources available to banks in order to target corporate lending mandates.

"Banks moan about RCFs as a loss leader but they all still rush in to participate."

"Why go private when the public markets are so competitive...the effort and restrictiveness of PPs means that they are a fall back option."

"It would be a brave move [to borrow from non-bank RCF/term loan lending market] when there's no need to go there."

"We have not seen non-bank alternative financing in the corporate debt markets."

*Please note 2022 data was a forecast obtained in our own research in 2019.

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

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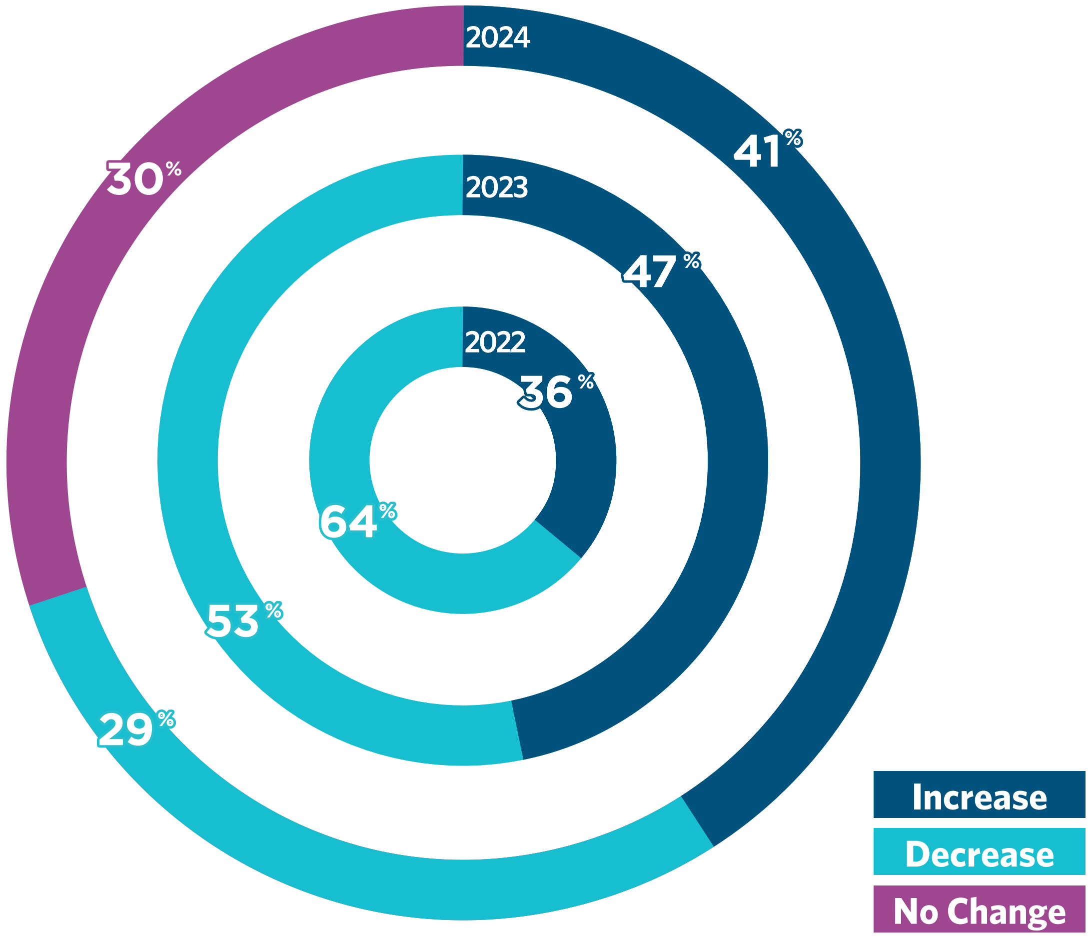
2 DEBT FINANCING

2.2 INCREASE IN NET DEBT

Do you plan to increase your net debt this year (other than as part of usual seasonal adjustments)?



- In a change from last year's survey, we gave respondents the option to state that they had no intention to change their net debt over the coming year.
- Some respondents noted that the fall in those intending to decrease net debt could signify increased pressure on cash flows given the high cost of debt; with interest rates at their current levels the expectation would be to reduce debt as much as possible. In contrast, others noted that their interest return on higher cash holdings was greater than their existing fixed term debt in some cases.

The variety of perspectives reflected differing views across sectors and sizes of balance sheets.

- The survey also revealed a slight reduction in the number of those looking to increase net debt. As we will see below, forecast expenditure (including in relation to M&A activity) is expected to remain static or fall, potentially removing (for some) the need to increase debt levels.
- Other respondents noted that they target a fixed leverage ratio when determining whether to increase or decrease net debt, increasing debt as EBITDA grows. Whilst this may help to facilitate returns to shareholders, others noted that such an approach ignores the potential business impact of interest costs in a higher interest rate environment.

"Had been thinking of liability management of a bond but now not worth it given [the] deposit rates [are] higher than [the] bond coupon."

"If debt was more expensive I would want to repay it rather than keeping more cash on balance sheet given the difference between interest cost and interest return."

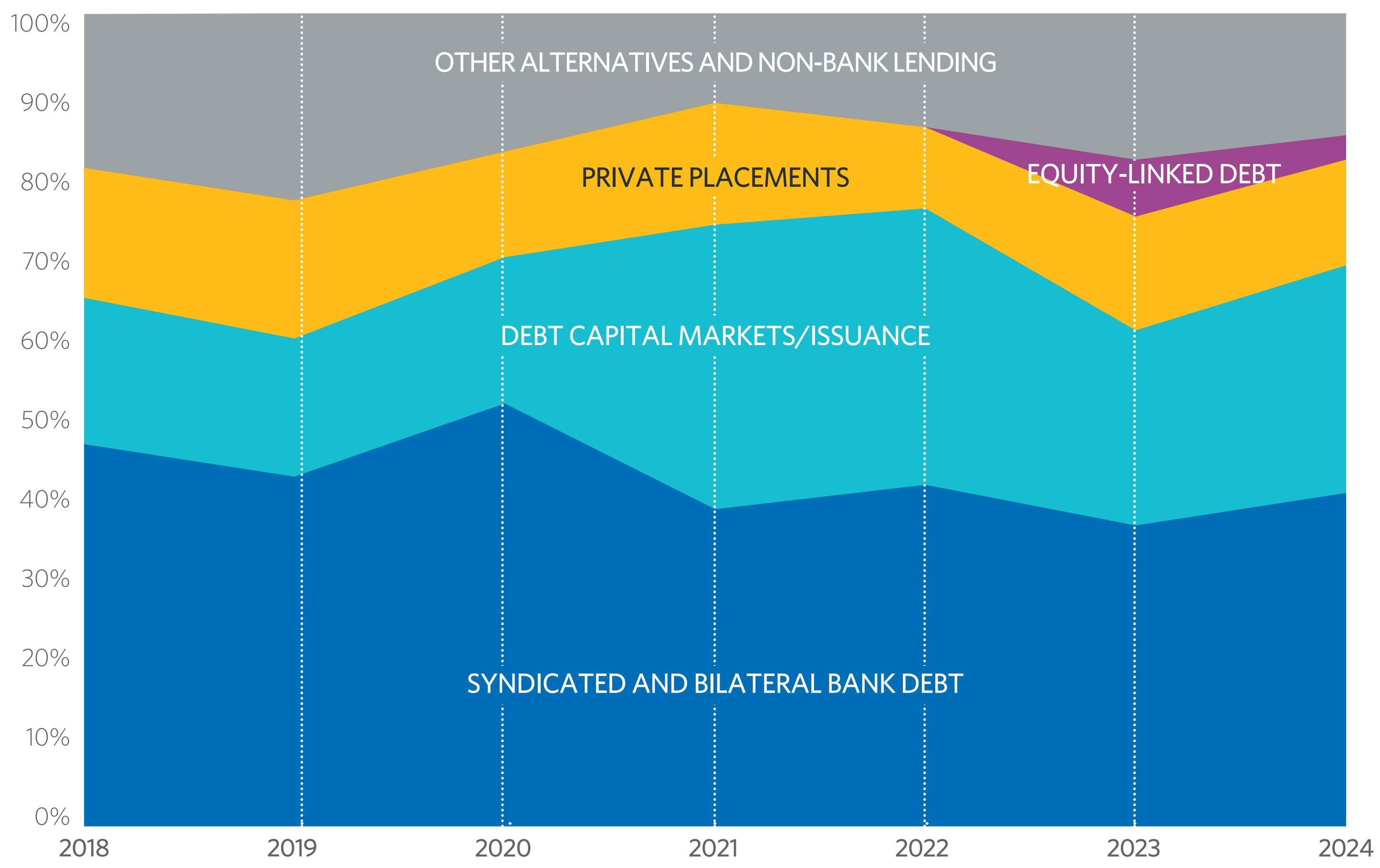
"Most people were battening down the hatches last year."

"There needs to be some caution in adhering to old leverage ratios, they may need to adapt to a different business environment where companies preserve more cash."

2 DEBT FINANCING

2.3 SOURCES OF ADDITIONAL DEBT

If you plan to raise new debt or refinance existing debt in 2024, how will this be achieved?



- In broad terms, anticipated debt raising is expected to follow the predictions made in 2023 but with less focus on equity-linked debt.
- Last year respondents noted that that equity-linked debt is typically more popular at times when other debt options are more limited or in a higher interest rate environment where equity values are suppressed. It would therefore seem surprising that current appetite for equity-linked debt among UK listed corporates has declined. However a number of respondents flagged equity dilution risk (and shareholder opposition to that) as well as such an issuance being at odds with share buyback programmes as explaining this trend.
- It is striking that the composition of corporate debt has remained broadly flat over the last six years, despite the various headwinds that corporates and the various debt markets have faced in that period. Respondents commented that this composition is unlikely to change unless there is a material change in risk appetite amongst treasurers or a particularly significant adverse event affects a particular market or sector. With investors being increasingly selective about the sectors and corporates they lend to, including as a result of ESG policies, we may start to see debt composition increasingly vary from sector to sector.

"Would only issue equity linked debt if there was an issue to address."

"Just kicking off our refi process. We did consider [the political] elections in terms of timing, but we have bank debt so are less worried than if it had been DCM."

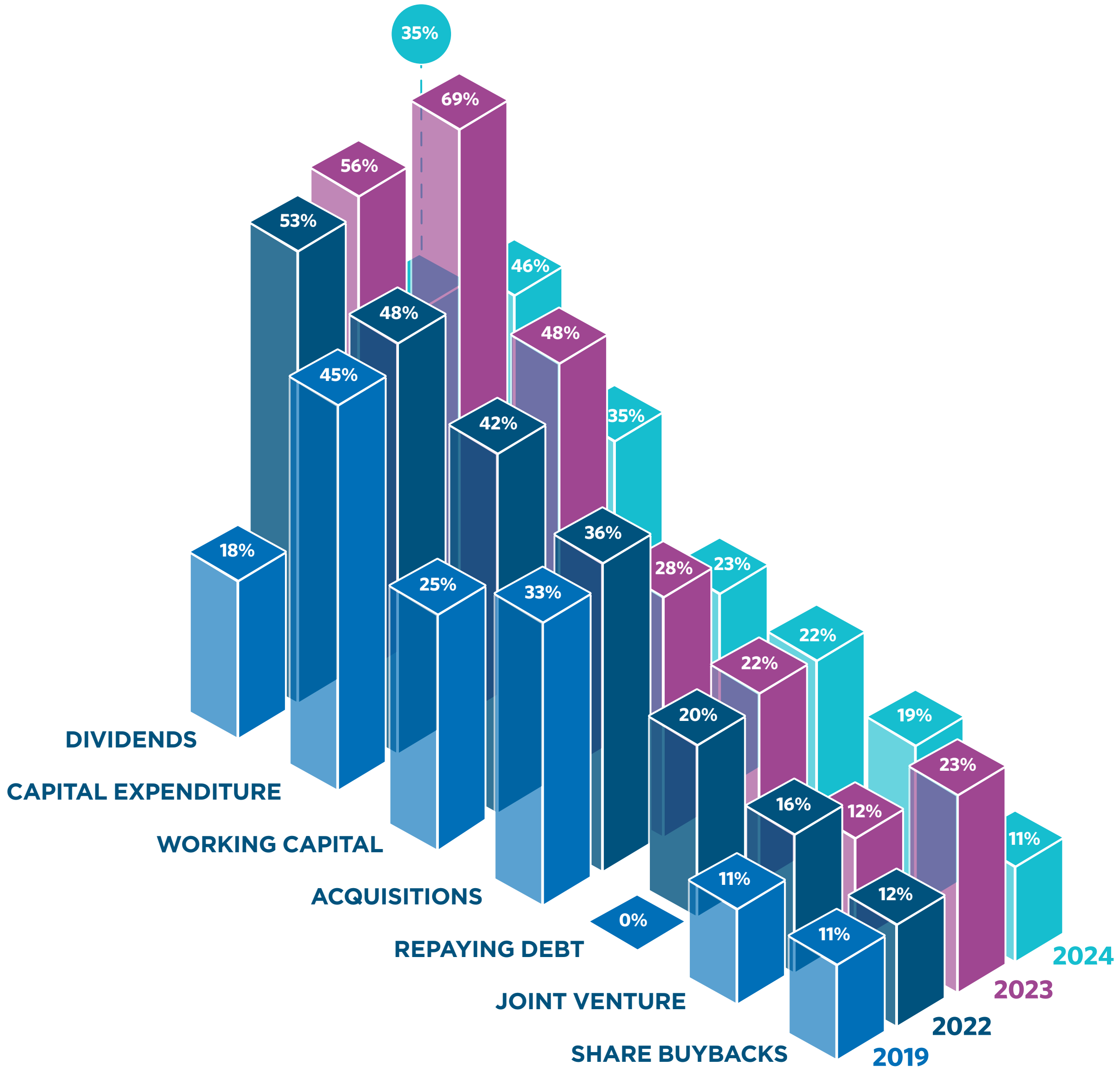
"Elections are just one of the issues driving an early refinancing."

2 DEBT FINANCING

2.4 EXPENDITURE

Looking ahead, how do you anticipate that your expenditure on the following will compare to last year?

THOSE REPLYING "HIGHER"



- It is notable that there are year-on-year decreases in those reporting higher expenditure and that this applies in almost all areas. This may be a reflection of a more cautious environment with corporates conserving cash, in part due to higher inflation, interest costs and macro-economic uncertainty. However, respondents commented that these reductions may in fact be a return to more normal levels of expenditure. Certainly, capital expenditure has returned to levels consistent with those seen in 2019 and 2022, with the spike in 2023 potentially being driven by changes to the capital allowance regime. Similarly, dividends are reducing from recent highs which may have been reflective of completing the post-CoVid dividend catch-up.
- More broadly, the reduction in capital expenditure is something to monitor; a lack of investment will impact on overall as well as productivity growth.
- The continued fall in M&A expenditure is unsurprising and echoes the more cautious sentiment expressed elsewhere but it is interesting that expenditure in joint ventures is anticipated to increase. This is perhaps reflective of businesses focussing on organic growth and their existing businesses.

"More capex is a good thing…it will over time deliver more productivity."

"The drop [in capex and dividends] may come from pressure to conserve cash."

3 COUNTERPARTY BEHAVIOUR AND IMPEDIMENTS TO RAISING DEBT

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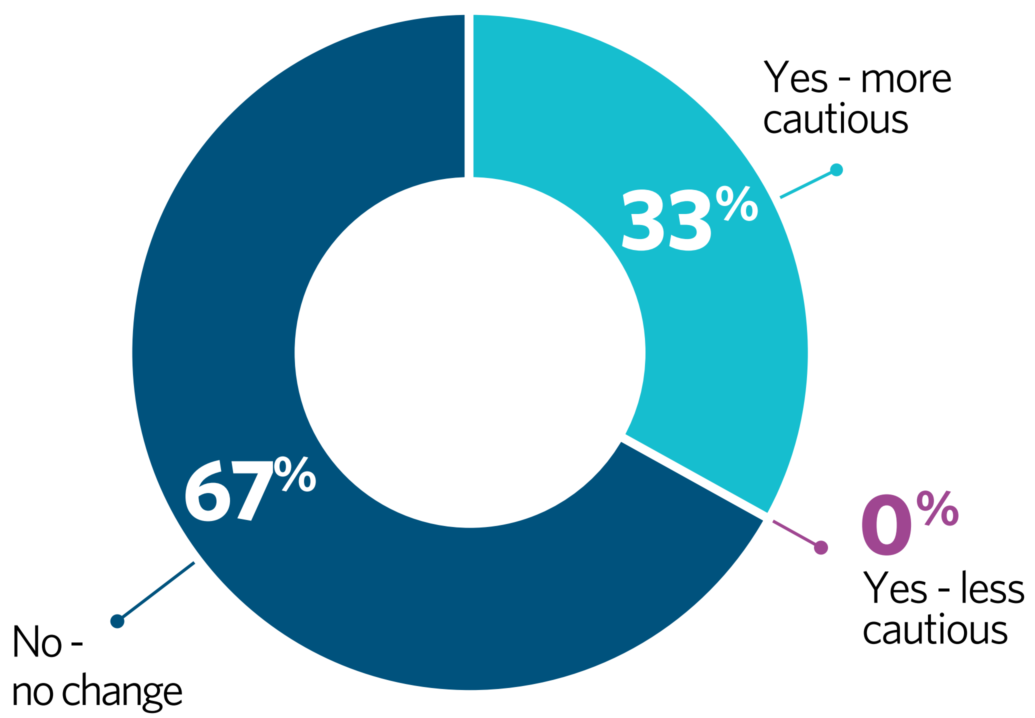
3.1

Are you experiencing changing credit behaviours from your lenders and/ or debt investors in the way that they transact with you?



- The data illustrates the resilience of the debt markets with the vast majority of respondents not experiencing any change in the behaviour of their financial counterparties.
- However, some respondents commented that they are aware of banks being more selective in their lending decisions with bank approaches varying depending on the sector and the particular business concerned. A number of respondents commented that this was not driven by bank lending capacity but more a cyclical realignment by banks (with certain sectors no longer considered as steadfast or profitable to lend to).

"Banks are being more selective about who they lend to. This is a combination of sectoral issues but it's also business specific."

"Credit spreads are a green flag for corporates to raise debt if they want to."

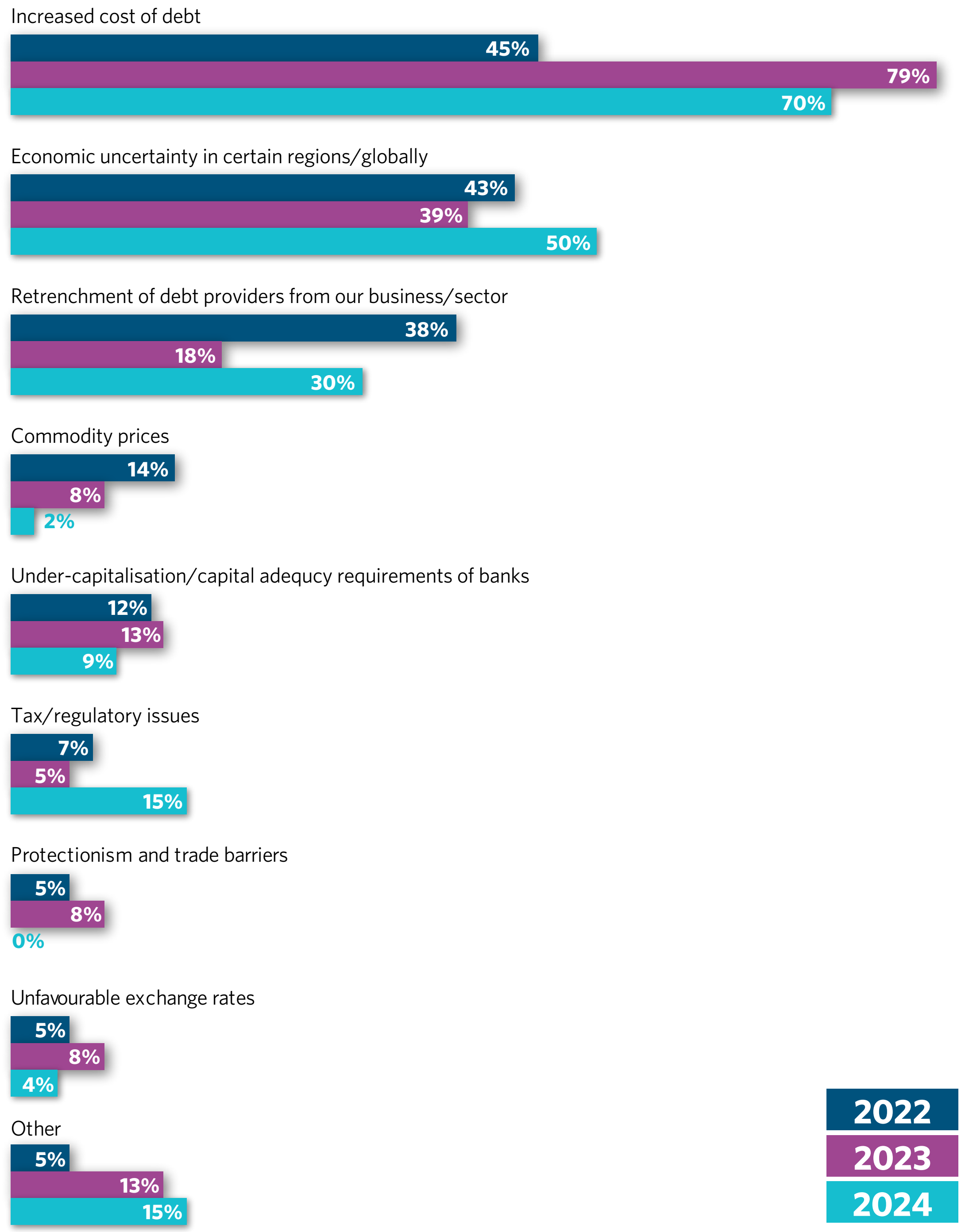
"Banks rein in their business when things get difficult."

"There are definitely sectoral issues at play."

3 COUNTERPARTY BEHAVIOUR AND IMPEDIMENTS TO RAISING DEBT

3.2

What do you consider to be the major impediments to raising debt in the year ahead (if any)?



- The persistent challenge of higher debt costs continues to weigh on corporates, although not to the same extent as last year. Whilst still a significant impediment to raising debt, there are signs that corporates are acclimatising to the current interest rate environment.
- Macro-events continue to exert an influence on debt raising, with respondents more concerned than in 2023 (though worth noting that, in 1.2 above, this was less of an impact on debt strategy than last year). The uncertainty caused by factors such as inflationary pressures, changing interest rate expectations and geo-political tensions continue to influence decision making within corporates. Particularly prevalent this year are political concerns given the number of elections that are taking place globally in 2024, and although respondents are clear that this is just one of many factors influencing their decision making, there is an expectation that we will see increased debt raising before the US elections in the Autumn.
- The increase in the retrenchment of debt providers echoes the themes discussed above and highlights the need for corporates to maintain access to multiple sources of liquidity to accommodate changing investor policies.
- The increasing impact of tax and regulatory considerations on debt raising has emerged as a surprising development. Some respondents attributed this development to the impending implementation of Basel IV, with some banks, particularly in some geographies, raising this on recent financings as a reason for being unable to participate at targeted pricing levels. However, we have not yet seen any evidence that this is leading to a wider re-pricing of debt.

Banks are "moving very quickly if they are not hitting their return models and need to move out of relationships."

"With more than 40 countries, accounting for over 40% of the world's population, will hold national elections, making it the largest year for global democracy."

"Boards will be happy that you've refinanced before [the spate of political elections being held this year]."

3.3

What are you doing in response to these impediments?

- The prevailing theme that emerged from respondents was the importance of taking a proactive stance towards accessing debt markets in anticipation of capitalising on optimal borrowing opportunities when they arise. Corporates are increasingly mindful of the impact that geo-political events may have on their ability to meet their financing requirements and so are taking whatever steps they can to be ready for such events. As discussed in Part 1, aside from conserving cash and/or reducing debt, many corporates are taking steps to be more nimble in their approach to debt raising. This may range from ensuring that debt can be issued promptly should a suitable window appear, maintaining access to a broad range of debt markets and debt providers or even re-examining the composition of their debt capital structure. We have heard respondents re-assessing the balance of fixed rate versus floating rate debt as well as the currency mix of their debt. In addition, some respondents noted that they had issued debt more regularly and with shorter maturities to manage their maturity profiles and take advantage of windows of cheaper financing.

"We have open relationships with other debt providers to ensure, if required, we have open access [to debt] as required."

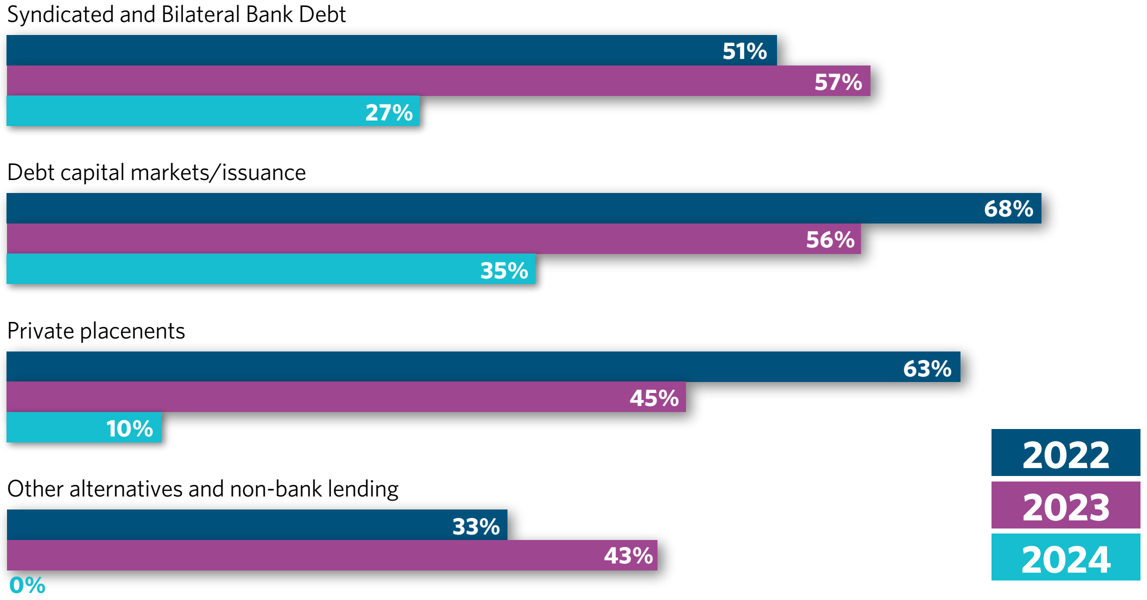
"Cash is king again; IRs are higher, businesses are going earlier to refinance to ensure that they have enough liquidity."

4
ESG

4 ESG

4.1

Sustainable Finance as a percentage of new debt/refinancings



- Sustainable finance seems significantly less popular than it was in 2023, which was already less than at the peak of the market in 2021/2022. This mirrors the downward trend flagged in the 2023 edition of this report and general market sentiment in the second half of 2023.
- While ESG and sustainability remain a central element of corporates' strategies, many businesses are reluctant to agree separate sustainability performance targets in their debt financings.
- Many corporates prefer lenders to take a more holistic approach to their sustainability strategies in their credit discussions. This is in contrast to the forensic approach required for specific "labelled" sustainable finance products (where either the proceeds of the loan must be used to fund specific eligible green projects (a green, use-of-proceeds loan), or specific sustainability performance targets must be identified and there is a small pricing adjustment if those targets are attained (sustainability-linked loans, or SLLs)).
- We discuss common concerns with SLLs, in particular, in section 4.3. However, in contrast, the commentary suggested that there are some corporates who would see entry into new debt arrangements without specific sustainability features (whether larger syndicated loans or bonds) as inconceivable, which demonstrates that there is still a degree of variation in the market. Much of this divergence seemed to depend on whether a corporate already had sustainable finance in place or not. Those who are able to grandfather existing terms typically have a much easier time negotiating terms than those starting afresh due to the continued evolution in approach and terms.

*For simplicity, we use the term Sustainable Finance to cover the plethora of ESG, sustainability-linked, green and other related financings.

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

- The commentary overall reinforces the view of sustainability-linked loans, in particular, as a transition product and that SLLs may soon become the first (relatively short) stage to have passed in the evolution of how debt providers drive sustainability.
- There is evidence that some early-adopter corporates who included specific sustainability features in their last round of loan financings in 2020/2021 feel that that specific sustainability-linked loans are no longer necessary. Some have removed specific sustainability-linked loan provisions from their revolving credit facilities when they recently refinanced.
- Others are more reluctant to actively remove the sustainability-linked features (or are reluctant to enter into a sustainability-linked loan in the first place) in case subsequently reverting to a financing without sustainability provisions were to be perceived less favourably by investors, with one interviewee commenting "*can you back out of it now? Would it send the wrong message? But it's more and more of a headache*".
- A view was also expressed that lenders are content not to label loans as sustainability-linked. For banks, sustainability is becoming part of the overreaching financing approval process; rather than seeking to drive improvement it is becoming a more binary: a lend/don't lend decision.
- There remains strong appetite for sustainable bonds, particularly use-of-proceeds bonds, among some corporates. In some sectors there is also interest in the issuance of blue bonds at a corporate level (where the proceeds may be used for financing water supply or sanitation, offshore renewable energy production or sustainable shipping and port logistics, for example). However, one interviewee from a corporate with a sustainability-linked loan and a heavy focus on sustainability said that they were concerned about the difficulty of explaining meaningful sustainability performance targets for that business to investors, and that had so far dissuaded them from issuing a sustainable bond of that type.
- The very low appetite for sustainable finance in non-bank lending appears to be a feature of a lower take-up of those types of debt arrangements more generally by corporates.

"In 2021 it [sustainable finance] was really in vogue…how could you not do it? A few years on far fewer are doing so."

"It's no longer important to have the ESG badge on corporate funding."

"The sustainability agenda is embedded in what the business is doing, which is a much more compelling argument to judge whether the company is following a sustainable business strategy than looking to an SLL."

"When we have been speaking to banks they have said if you decide not to do an SLL we don't mind, it's a lot of work and not driving how we look at you as a sustainable business."

"Despite the RCF KPIs reflecting group strategy, banks were insisting the targets were not challenging enough and the RCF shouldn't be impacting the group's strategy."

"When you have done so much on ESG and sustainability, you appear to be punished by the banks [by] the incremental ESG targets that you need to fulfil for the ESG loan [in contrast to] if you had done very little on ESG and sustainability."

"We do a lot on ESG but may not tick the banks' boxes."

"The underlying deals have to be ESG positive in any case."

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

4 ESG

4.2

What impact do you expect ESG to have on your financing strategy in the next 12 months?

- The fact that almost half of respondents do not see ESG impacting on their financing arrangements at all is perhaps the strongest bellwether to date that corporate treasury is less now a key driver in a corporate's sustainability journey.
- Another 24% do not foresee considering a sustainable finance product in the next 12 months. Together these points suggest that there will be muted debut SLLs/bond issuance and that future issuance in the short term at least will be be largely confined to those with existing sustainable financing arrangements in place. Anecdotally we see significant evidence of this and many treasurers breathing a sigh of relief as a result.
- The growth of sustainability teams has also lightened the burden on treasury, many treasurers previously finding themselves at the heart of developing ESG frameworks precipitated by financing timetables.
- There was also some sentiment that debt providers had been seen to be pushing corporate sustainability targets beyond a corporate's published framework either due to the targets requested or suggesting alternative KPIs thereby creating additional complexity in discussions between treasury and ESG teams which this had resulted in some treasurers putting an SLL to one side.

"Companies are just getting on with it; financing does not change what they do [on ESG]."

"Our ESG guy looks 20 years older than he is due to all of the regulation coming down the track."

"Investors want a clear sustainability narrative and to ensure that their sustainability strategy is aligned to their core values regardless of the ESG product label."

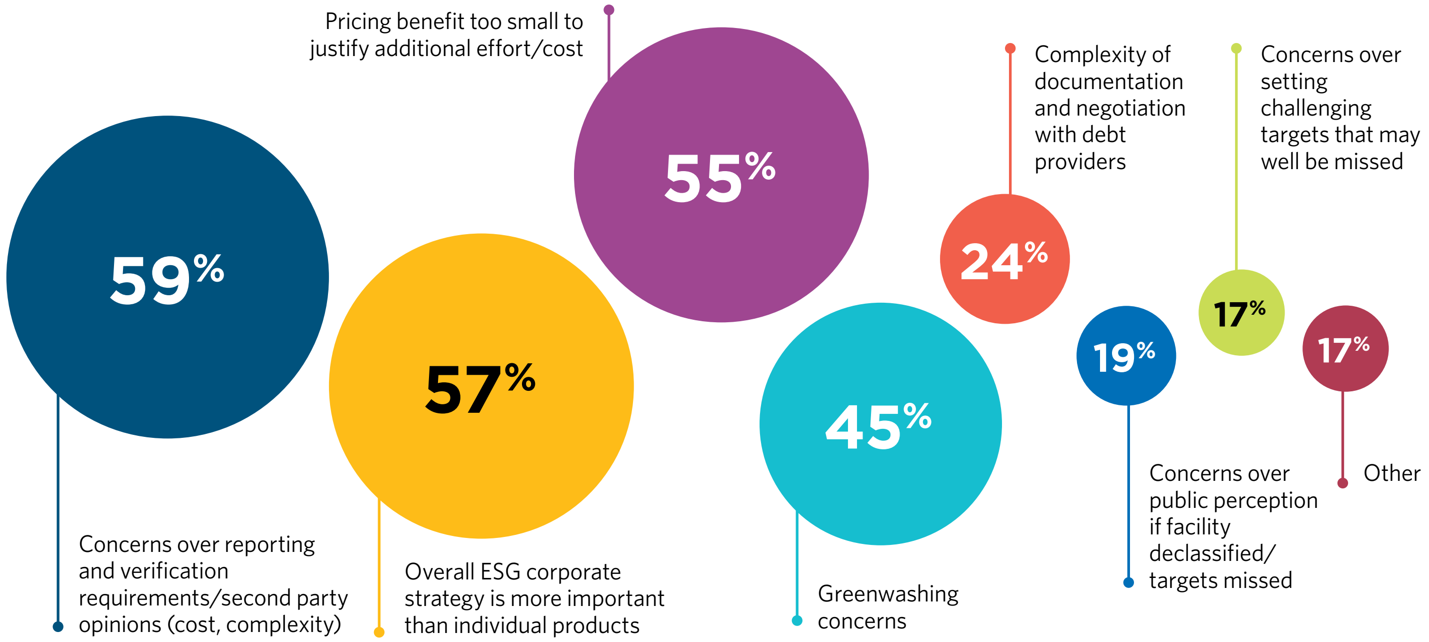
"We intended to have a sustainability-linked bank loan but the administrative burden was far greater than the interest rate savings [so] we decided not to pursue this option."

"We need to balance adding more complexity to our funding arrangements with the financial effect."

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

4.3

What is inhibiting a greater adoption of sustainable finance products?



- As the graphic illustrates, a number of widely held concerns emerged from respondents:
  - in particular, the additional verification requirements which lenders and other debt providers are imposing was a worry. The percentage of respondents who are concerned about this has risen significantly from 10% in 2022 and 2023 to 59% in 2024.
  - The requirements for various forms of external review have increased in complexity markedly since 2021. They are now multifarious and include second-party opinions and various levels of verification. This seems to be driven by a desire to align with the ICMA 2022 Guidelines for Green, Social, Sustainability and Sustainability-Linked Bonds External Reviews. However the public bond market and the private syndicated corporate loan market are quite different and close alignment of the requirements for the two is not always appropriate.
  - The minimal pricing changes for achievement of the targets in an SLL are not sufficient to offset the cost of this process, with one interviewee from a corporate with a strong focus on sustainability saying that they saw "*no need to add extra complications or audit requirements into the bank facility*".
  - Lenders' concerns about greenwashing can lead them to seek sustainability performance targets that deviate from the corporate's own sustainability strategy (interviewees from corporates with developed sustainability strategies were concerned that lenders were seeking to "*lead the group ESG strategy*" and that the "*RCF shouldn't be impacting the group's [ESG] policy*").
- The complexity of SLL and sustainable finance contractual provisions has also added cost and delay into financing processes at a point in the economic cycle where there is the most acute focus on both. For some respondents the desire to pursue sustainable finance was muted by these factors and a desire to wait until the market had settled on terms before reconsidering sustainable finance.
- In addition, the cost and administrative burden of updating the targets through the life of the loan as the business evolves may well not be sufficiently compensated either by the loan being labelled as "sustainability-linked" or by the small pricing differential.
- Finally, respondents raising debt in the US also pointed to the difference between the US market, where sustainable finance products are less of a feature, and the European market, where they are more popular.

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

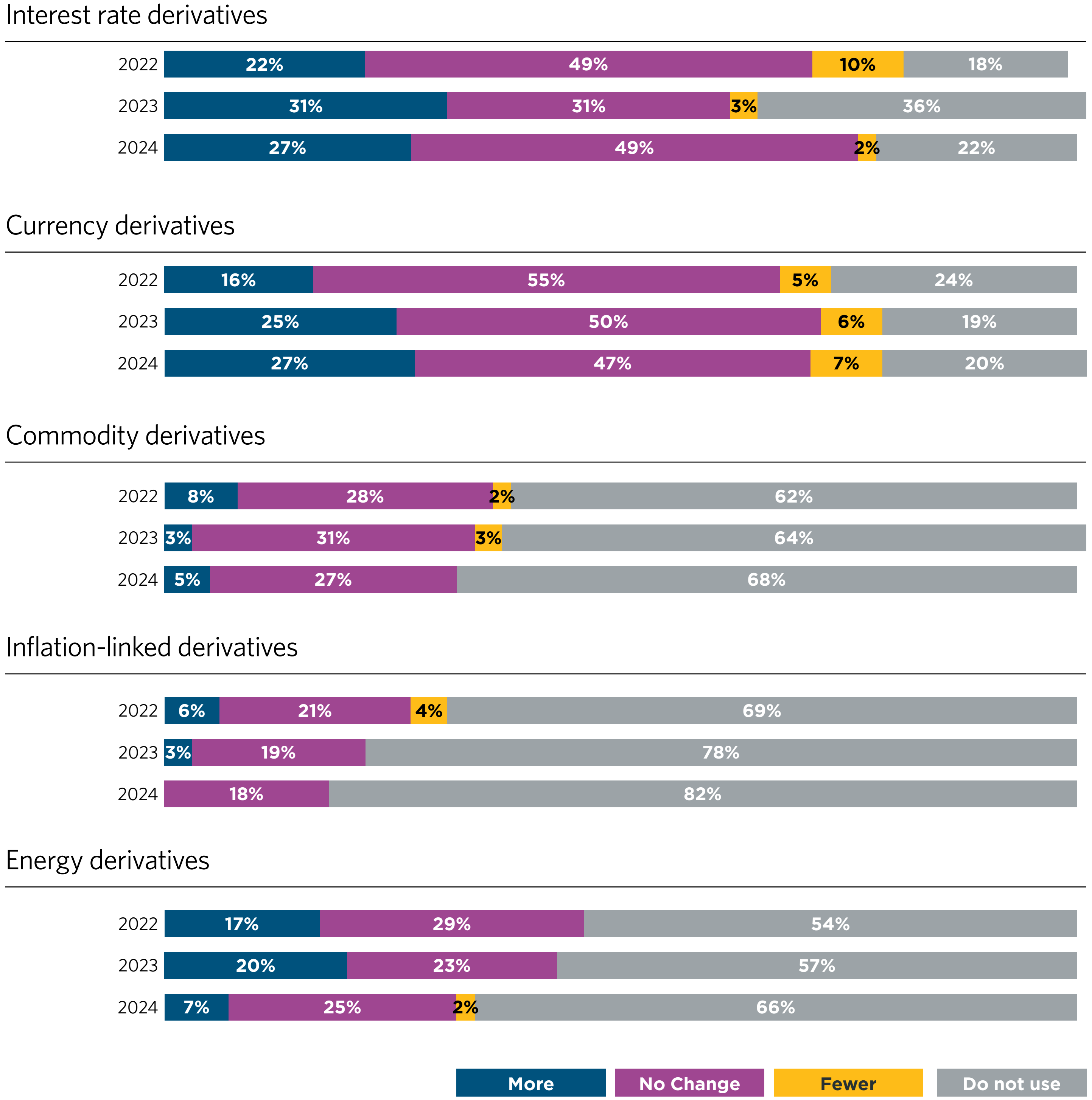
5

DERIVATIVES FORECAST

5 DERIVATIVES FORECAST

5.1

Compared to 2023, do you anticipate that you will enter into more or less of the following treasury products in 2024?



- Survey results illustrate the number of respondents indicating no change in their use of interest rate derivatives significantly up from last year, and the number of respondents intending to use interest rate derivatives down from last year, perhaps reflecting expectations that the height of the interest cycle has passed.
- The number of respondents using currency derivatives increased slightly on last year, again perhaps reflective of macro-events and strength of the US dollar.
- Responses indicate use of energy and commodity derivatives broadly static to last year, albeit with a limited number of respondents indicating these are used, suggesting that likely users for these assets classes remain sector dependent.
- More generally, accounting rules can influence a corporate's derivative strategy. "*If you are in a sector where to hedge that risk is more important than P&L volatility then you will probably use derivatives*".
- Another respondent highlighted the importance of natural hedges in the business as a means for corporates to protect against rate volatility, eg by passing costs on to customers.
- This seems a surprise given recent inflation highs, however some respondents suggested that these remained specialist products.
- One interviewee noted the need for corporates to have sophisticated hedging strategies if IR derivatives are to be used: *"[usage] is very industry specific, looking at specific risks and having specific and efficient hedging policies."*

"[We] implemented IR hedges that are currently positive to the business, given our business view that IR will not fall as quickly as the current curves predict."

"Our core strategy remains unchanged but we are reviewing developments closely."

"There are other ways to hedge eg smart procurement to lock in pricing, pass costs on to customers."

5 DERIVATIVES FORECAST

5.2

Indications are that the current interest rate cycle has peaked. Has that impacted your treasury planning and interest rate management strategy?

67% NO
33% YES

- Interview responses indicate corporates are raising shorter term bank lending until market conditions improve before borrowing long term fixed rate debt. As one respondent noted, "*[we are likely to use] slightly short term funding until the rate decrease comes through*" and another noted "*[we will] delay longer term debt until rates fall again.*"
- On the interest rate cycle, the view from respondents seems to indicate the cycle has peaked although the general sentiment was that interest rates are likely to stay higher for longer and will not return to the historically low levels seen in the recent past.

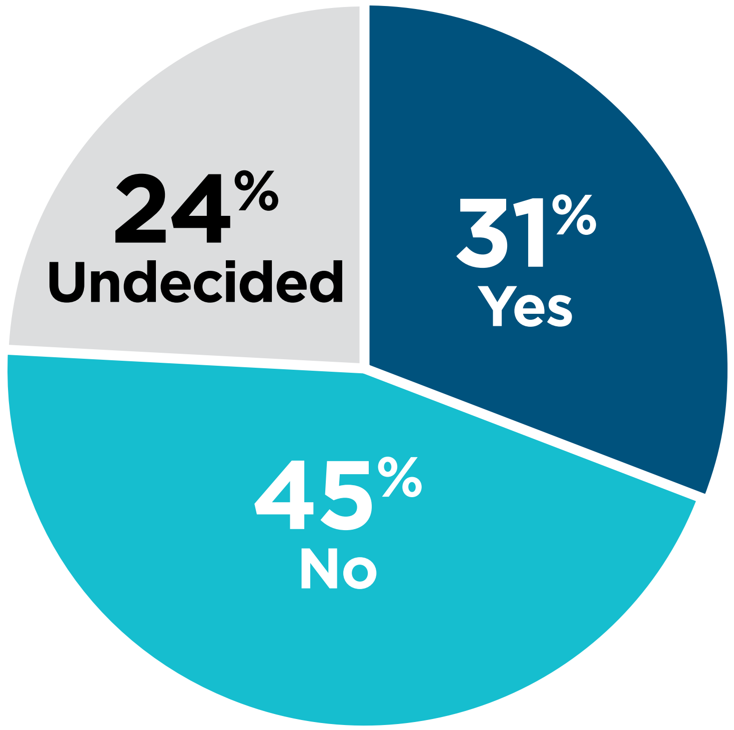
"People are getting used to a higher interest rate environment....and recognising that we are in a world where interest rates in the medium term will stay the same"

"[We] wouldn't be surprised if rates remain broadly flat over the next 12 months"... "[It] doesn't make sense to hedge interest rates – coming in too late – [we] hope it will come down later this year.."

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

5.3

In order to address mismatches between functional currencies and the currencies of debt raised, do you anticipate that you will enter into currency derivatives in 2024 (to take advantages of opportunities in certain markets?)



- Interviewees were split on whether the results suggested any meaningful trend towards to arbitraging across debt market and currencies to take advantage of cheaper pockets of liquidity, however size of market was certainly relevant.
- One interviewee noted that a lack of strategy on this subject is surprising: "*How can 24% be undecided?*" but overall sentiment is that this would be a strategy for larger corporates pursuing opportunistic events and so willing to bear the additional complexity.
- One interviewee noted the depth of the US dollar bond market: "*everything screams dollars at you*". This could illustrate a trend in replacing sterling debt with USD debt and hedging the resulting currency exposure.

"The Sterling market is small and we need a bigger liquid market so went to Euro market which was cheaper."

"Markets are liquid and competitive enough to avoid arbitrage."

"[We are] changing the currency mix of our debt and swapping back to GBP so increased use of FX products."

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

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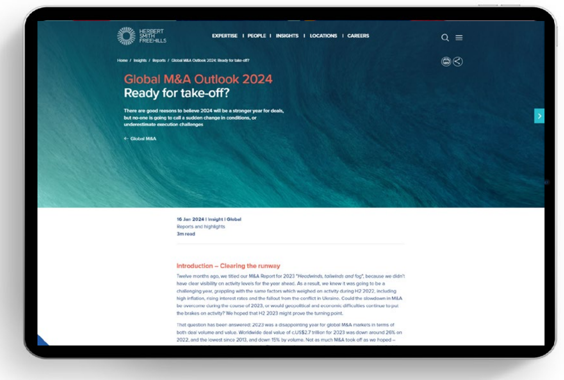

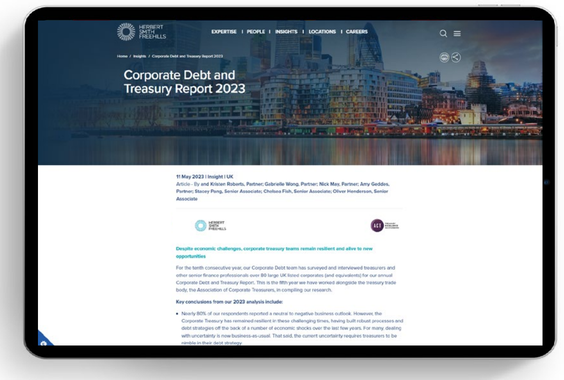

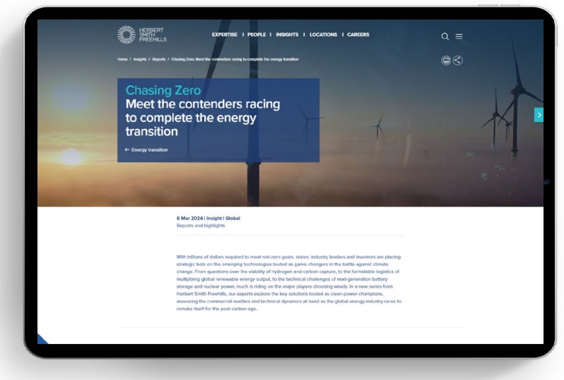

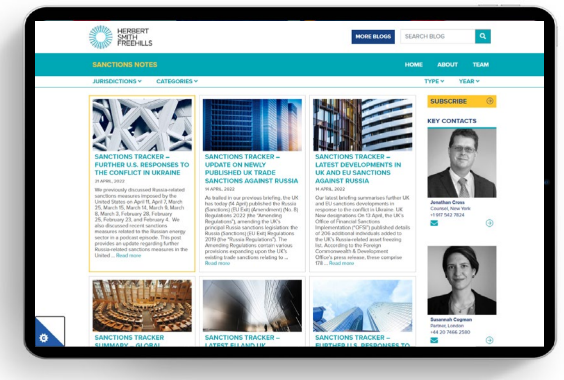

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