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Debt Structure: Selecting The Right One

Presented By:
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and
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Agenda

- Overview of debt financing options
 - Corporate perspective – Chris Black
 - Lender perspective – Ira Kreft

- Outline key considerations in decision making
 - Primary focus on senior debt.

Determining The Level

- Senior debt market – a very important capital structure building block
 - Provides the foundation of the entire capital structure
- Including working capital
- Applies to a wider range of companies

First Step

- **Determine**

- Level of senior debt and total debt leverage appropriate for the company
- The company's growth trajectory
- Debt rating (to the extent of a consideration)

- **Consider**

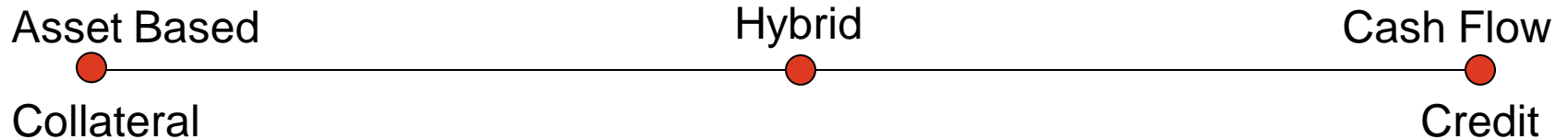
- Cost of capital
- Availability and terms of junior capital (i.e., subordinated debt and equity)
- The risk tolerance of management and the board of directors and other key constituents
 - Suppliers
 - Investors
 - Rating agencies

Senior Debt Financing Options

- Categorized in several ways
 - Secured versus unsecured
 - Cash flow versus asset based

- Secured Lending
 - Often the primary financing option when companies:
 - Increase their level of leverage to make an acquisition
 - Complete a recapitalization
 - Have deteriorating performance or are undergoing a restructuring

Secured Lending – A Continuum



- **Asset Based Lending**
 - Higher leverage levels
 - More earnings volatility
 - Lower overall credit quality

- **Cash Flow Lending**
 - Higher credit quality
 - More loan availability for asset-light companies
 - Lower leverage levels

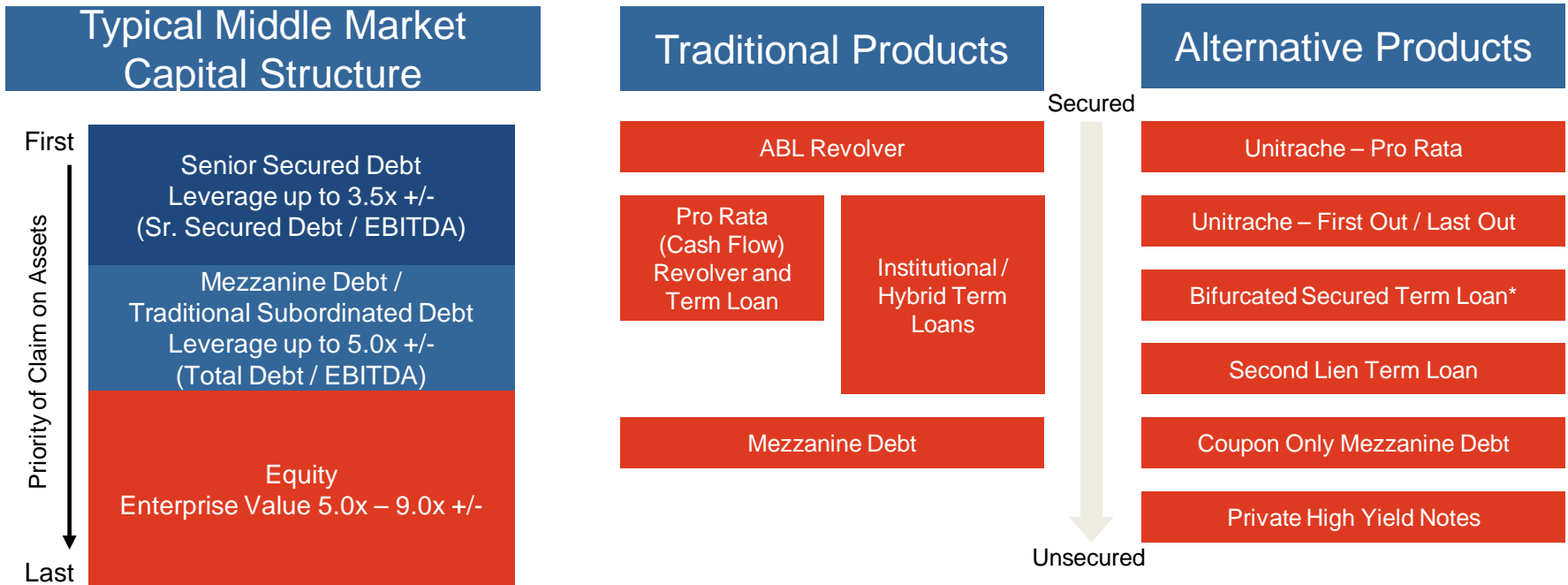
Cash Flow Structure

- Predicated on a company's earnings or Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA)
- Many companies opt for unsecured or cash flow loans because of
 - Concerns about their level of underlying assets to support the loan
 - The perception of offering their assets as collateral and potential ongoing collateral examination, appraisal and reporting requirements.

Asset-Based Structure

- Structured based on the liquidation value of the company's current, fixed, and sometimes intangible assets
- Monitoring and reporting requirements for asset-based loans is fewer and less restrictive covenants
- No financial covenants provided the company stays above an excess availability threshold.

Middle Market Debt Financing Structures



*Bifurcated Term Loans have first lien on fixed assets and are used in conjunction with and ABL Revolver

- Each of the products listed above (except ABL) base their availability to the Borrower upon a leverage test as well as cash flow coverage tests
 - Concept is to lend a multiple of recurring cash flow assuming there is an existing enterprise value base
 - Leverage multiple will be heavily influenced by total enterprise value, industry sector, recurring cash flows, etc.

Leveraged Senior Debt Financing

	<u>Leverage</u>	<u>Libor Spread</u>	<u>Upfront Fees</u>
• Asset Based Loans	Varies	175-225bp	25-50bp
<u>Cash Flow:</u>			
• EBITDA < \$10mm	2.0-3.0x	350-500bp	100-150bp
• EBITDA > \$10mm	2.5-4.0x	300-400bp ¹	100-150bp

1 – May include a Libor floor of 125-150bp

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The Borrowers Perspective

From the Borrower's Perspective

- Priorities tend to be consistent regardless of the industry but may vary based on the company
- The following characteristics are consistently the most important when weighing financing options:
 - Certainty of execution
 - Breathing room
 - Future flexibility
 - Pricing
 - Relationship

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The Lenders Perspective

Considerations for Cash Flow Loans

- Generally Companies with at least \$10 million of EBITDA
- Leverage capacity judged on several factors including:
 - EBITDA
 - Level of free cash flow and deleveraging story
 - Predictability and resiliency “stickiness” of cash flow
- Structured with a revolver to meet company’s working capital needs rather than being based on asset levels and a term loan with customized amortization
- Covenant levels typically will be tighter and there will be more covenants
- Add-backs for cost savings and synergies may be allowable provided they are supportable and realizable within 12 months (but may still be subject to “haircut” for conservatism)

Considerations for Asset Based Loans

- Predicated on the value of the underlying assets versus cash flow with such value being liquidation not going-concern
- Lenders will typically advance 75% to 85% against “eligible receivables and the appraised value of inventory, M&E and R/E.
- Key issues include
 - Customer concentration
 - Product being sold
 - Terms of sale
 - Dilution
 - Turnover of assets
 - Trade support
 - Obsolescence
 - Technological risk
- May be willing to provide an over advance depending on the quality of the credit