

Changing Capital Markets: Raising Debt and Equity In Uncertain Times

Moderator: **Michael Carsella**, Senior Vice President, Manager—
Cross Border Finance, LaSalle Business Credit, LLC

Panelists: **Frank Ballantine**, Partner, Reed Smith LLP
Thomas Bagley, Senior Managing Director,
Pfungsten Partners, LLC
John Fiore, Executive Director,
Syndicated and Leveraged Finance Group,
JPMorgan Securities, Inc.
Bradley Stewart, Vice President of Financing,
Audax Group

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2008 ACG International Conference: *Changing Capital Markets: Raising Debt and Equity in Uncertain Times*

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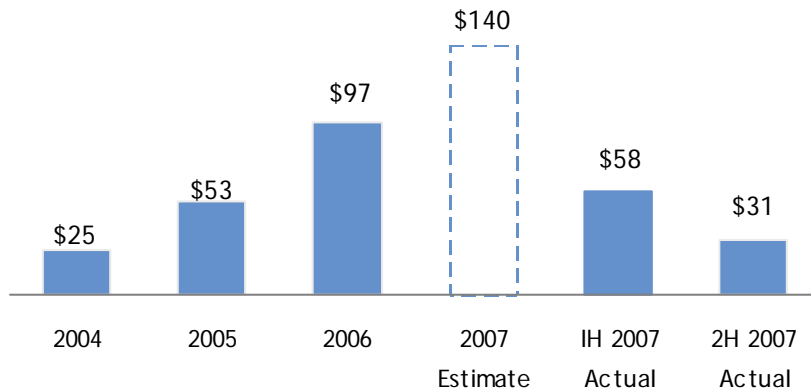
I. PANELIST AND FIRM INTRODUCTIONS

- Moderator Introduction of Each Panelist:
- Panelist Description of His Firm Covering:
 - Profile of financing product
 - Industry Focus
 - Geographic Focus

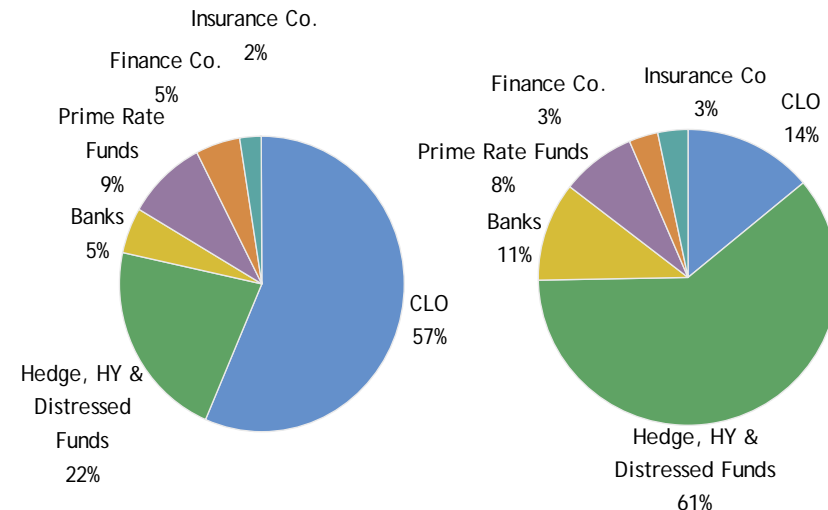
II. CURRENT TRENDS IN THESE TURBULENT CAPITAL MARKETS: HOW BAD IS IT?

- ❑ PLAYERS: Collapse of the CLO market: where have all of the institutional investors gone?

CLO Volume (\$Bn)



1H'07 vs Current (new issue activity)



Source: S&P LCD

¹ Early Jan. '07 estimate for total 2007 CLO volume

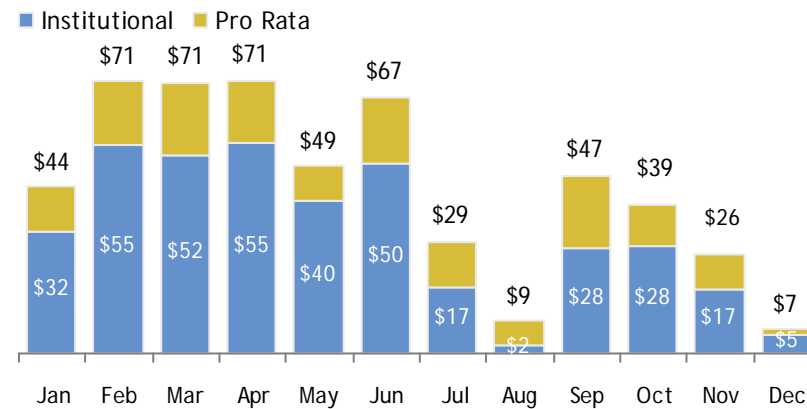
II. CURRENT TRENDS IN THESE TURBULENT CAPITAL MARKETS: HOW BAD IS IT? *(cont'd)*

- Current market favors lenders with strong balance sheets
- Broadly syndicated transactions more difficult—more “club” deals
- Hedge funds and other “specialty” yield-focused lenders filling void
- New entrants as ABL lead arrangers (Goldman, Lehman Bros.)
- Greater involvement of corporate (strategic) buyers vs. financial as liquidity (hence leverage) no longer an advantage

II. CURRENT TRENDS IN THESE TURBULENT CAPITAL MARKETS: HOW BAD IS IT? (cont'd)

- TRANSACTION/LOAN VOLUMES:
 - Commensurate dropoff in number and volume of LBO transactions

2007 Leveraged loan monthly new issue volume¹ (\$ in billions)



Source: S&P LCD

¹ October volume data represents volume through October 25

II. CURRENT TRENDS IN THESE TURBULENT CAPITAL MARKETS: HOW BAD IS IT? (cont'd)

- Impact has not been as great on smaller middle market transactions
- Big difference between larger capital markets financing (> USD 100MM) and more traditional lower middle market financing
 - Much more relationship driven

II. CURRENT TRENDS IN THESE TURBULENT CAPITAL MARKETS: HOW BAD IS IT? (cont'd)

□ STRUCTURE

- Return to more traditional lending standards
- Need for strong fundamentals and/or market niche
- “One Stop Shop” across capital spectrum still popular, but more difficult to achieve
 - UK clearing banks have aggressively moved in this direction
 - Hedge funds and BDCs sell “one-stop” and then partner or sell off strips (i.e. senior ABL)
- Greater appeal of cross-border transactions for geographic diversity, but...

II. CURRENT TRENDS IN THESE TURBULENT CAPITAL MARKETS: HOW BAD IS IT? (cont'd)

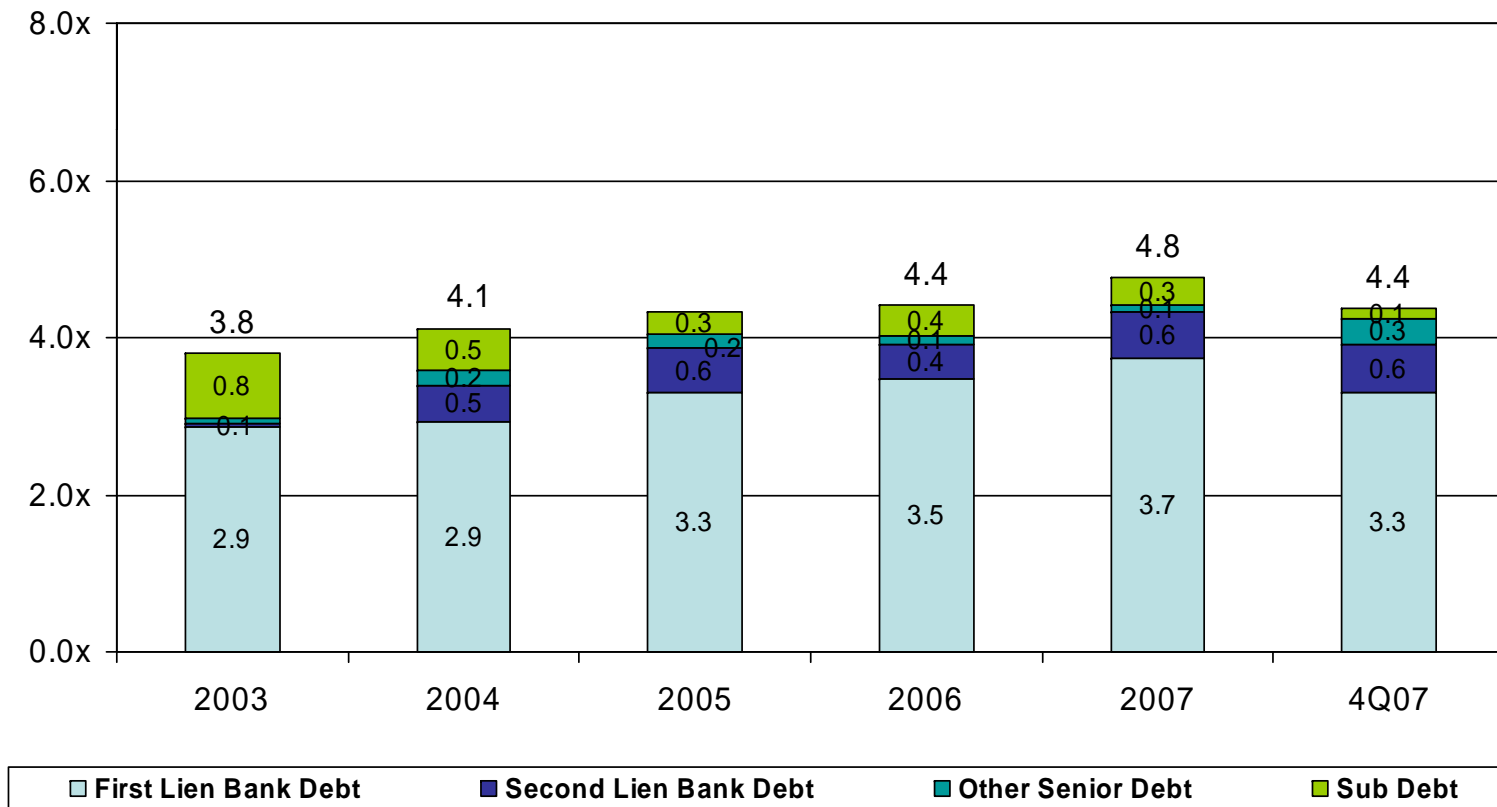
□ Leverage Levels and Covenants:

- Average debt multiples down 0.5 -1.0 turn (*graph*)
 - Senior at 3.0-3.5 with 4.0-5.0 total
 - General total debt levels in Europe still tend to be higher (1 to 1.5 turns)
 - » Competition for yield, Euros
 - » Better loss return in Europe
- Purchase multiples dropping and equity contribution rising (*graph*)
- Collapse of “covenant lite” and reduced use of PIK interest and bullet amortization
- Full flex or index-based is now market standard

Average Debt/EBITDA Ratio for Middle-Market Transactions

2003 – 2007

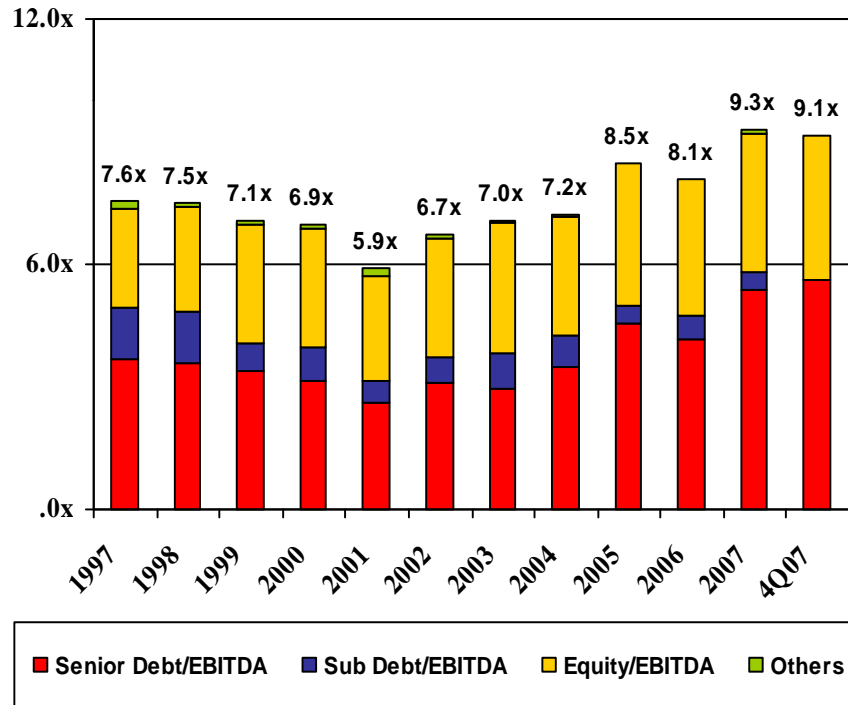
Defined as Issuers with EBITDA of \$50 Million or Less



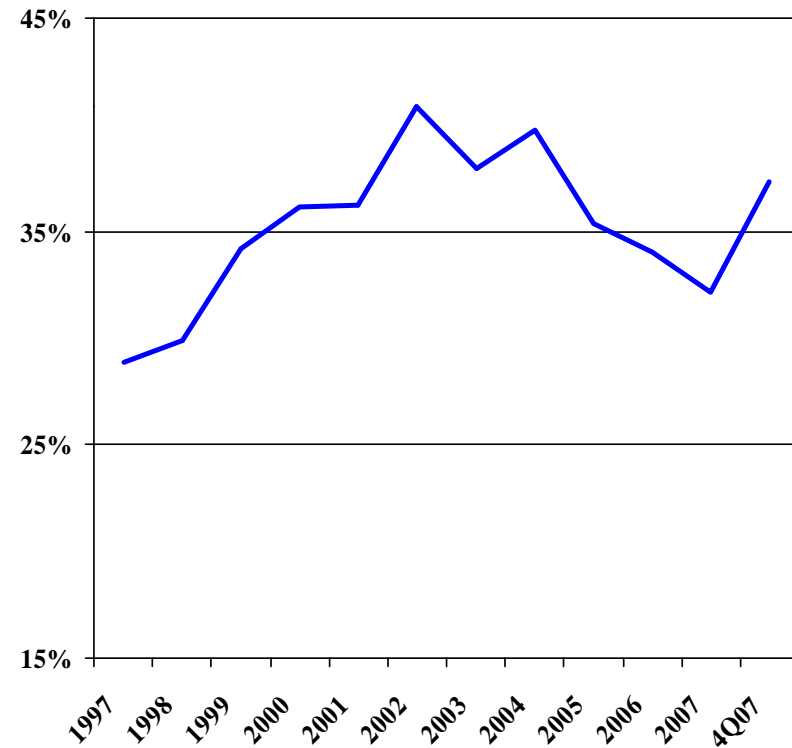
Average Purchase Price and Equity Contribution by Sponsors for Deals With EBITDA of \$50M or less

* Excludes Media, Telecom, Energy and Utility Deals

Purchase Price Breakdown



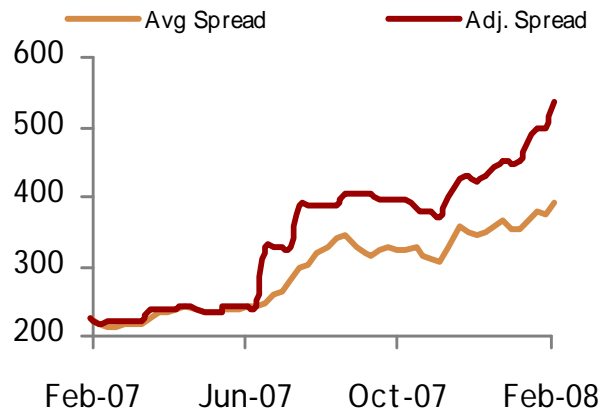
Equity Contribution



II. CURRENT TRENDS IN THESE TURBULENT CAPITAL MARKETS: HOW BAD IS IT? (cont'd)

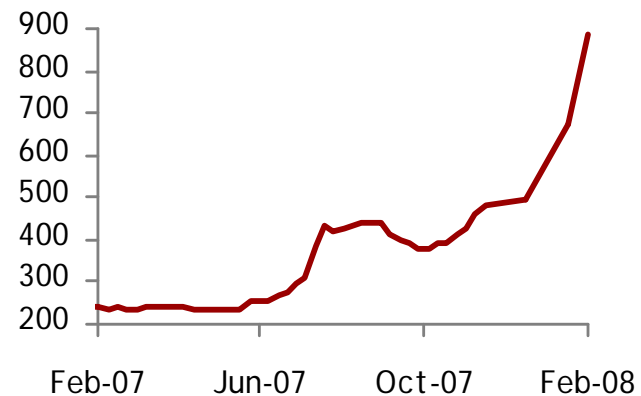
- **PRICING AND FEES:**
 - Pricing increasing across markets, particularly for institutional money (*graph*)
 - Single B risk in 400 to 500 bps range
 - Use of LIBOR floors to protect yield

Weighted Avg. Institutional and All-in New-issue Spreads of B/B+ Loans



Source: S&P LCD; ¹Adj. spread indicates 3yr OID amortization

Average Secondary Spread of Single "B" Loans ¹



Source: S&P LCD; ¹Indicates 3yr OID amortization

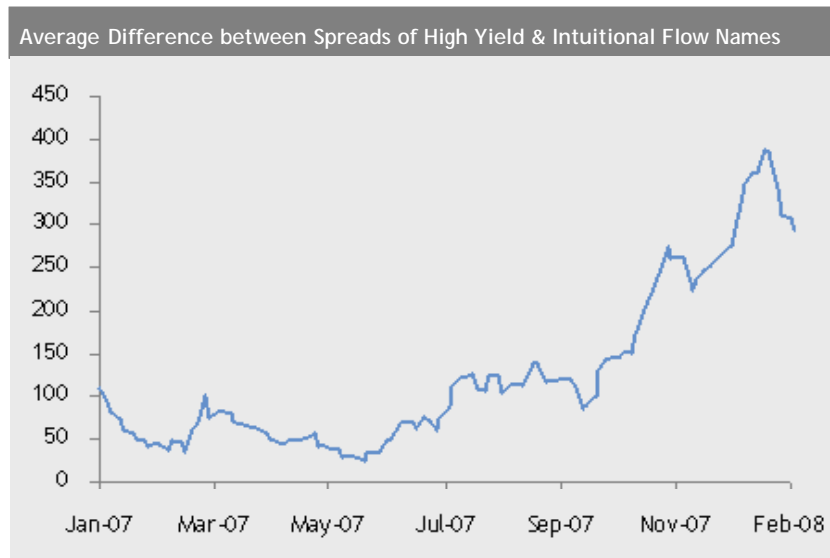
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- ❑ Call protection in Term Loan Bs is now more prevalent
- ❑ Clear Shift in Risk-Reward Balance
- ❑ Lead arrangers getting “full” or even “premium” fees
 - Emphasis on lead’s proven ability to execute

III. A CLOSER LOOK AT EACH LAYER OF THE CROSS-BORDER FINANCING MARKET

☐ Institutional Term B vs. High Yield:

- Since implosion of CLO market, greater correlation between loan and high yield markets
- As high yield spreads widen, loan product becomes less attractive



Source: S&P LCD



III. A CLOSER LOOK AT EACH LAYER OF THE CROSS-BORDER FINANCING MARKET (cont'd)

Senior Cashflow vs. Secured:

- Normal SME change of control event in Europe is via cashflow, but ABL getting greater attention
 - Recent Woolworths ABL retail transaction w/ senior (£350 MM) and 2nd lien (£35 MM)
 - Generally larger ABL deals are driven by US sponsors
- Greater use of syndicated deal structures and multiple tranche facilities in larger middle market and above

III. A CLOSER LOOK AT EACH LAYER OF THE CROSS-BORDER FINANCING MARKET (cont'd)

- Second Lien vs. Mezzanine:
 - Delineations between capital market products becoming more blurred
 - Mezzanine is different in Europe
 - Origin of mezz with warrants, but before credit turmoil as much as 85% was warrantless (Fitch, H1 06)
 - Generally mezz is in larger syndicated, highly leveraged transactions
 - Preferred sub debt instrument for financial sponsors, challenging HY (Fitch: since Q403 HY CAGR of 10% vs 121% for second lien/mezz)
 - Although was second lien explosion in US market and growing in Europe (especially as a “stretch” senior with cross defaults), seems to be losing favor in current market

III. A CLOSER LOOK AT EACH LAYER OF THE CROSS-BORDER FINANCING MARKET_(cont'd)

Securitizations:

- Fully rated/SPV structures generally not typical in middle market transactions and very difficult in current institutional market, but A/R Purchase Programs (“securitization light”) becoming more common and competitive
 - Smaller “club” arrangements kept on lenders’ balance sheets
 - Much more aggressive with costs dropping
 - Generally assign accounts to one favorable jurisdiction

Trade Services:

- Growing emphasis on supply chain and export finance
- Very common in Asia Pacific and other regions where straight corporate finance is lacking

IV. EQUITY MARKETS SEEM TO BE MUCH LESS AFFECTED

- ❑ Still significant amounts of equity available
 - Turmoil in the debt markets does not seem to have impacted fundraising for PE
 - Plus hedge funds still manage huge amounts—USD 2.5 trillion as of 1/08)

- ❑ Becoming more common for U.S. companies to access foreign capital, such as through London AIM (Alternative Investment Market)
 - Important for expansion capital, but currently limited liquidity
 - Growing roster of U.S. companies listed on AIM

IV. EQUITY MARKETS SEEM TO BE MUCH LESS AFFECTED (cont'd)

- ❑ “Over-Equitization” as a way for PE firms to alleviate credit crunch
 - 35% and above is becoming standard
 - Returning to greater (and more traditional) focus on asset values in acquisitions as opposed to financial engineering

- ❑ Effect of Sovereign Investment Funds
 - Probably limited to large cap transactions, since so much money to invest

-Might see impact in smaller deals where SIF money is invested in other funds

- ❑ In U.S. IPOs have become very difficult

- ❑ Inbound alliances with Asian and European capital sources are on the horizon

V. Top Ten Tips To Surviving Today's Capital Markets Turmoil

10. Access capital today—tomorrow may be even worse!
9. If possible, try not to trip trigger events (i.e. change of control threshold) that will result in refinancing
8. Focus on fundamental credit quality and sustainability of earnings as key to successful financing/refinancing
7. With U.S. interest rates declining, it is important to focus on the aggregate rate and not just the spread, since overall coupon is still attractive
6. Give serious consideration to foreign equity/alliances for inbound investments

Top Ten Tips (cont'd)

5. Consider companies with a solid mix of global, diversified earnings in the “right” jurisdictions
4. Larger equity investments may be the only way to assure completion
3. Choose the lead lender/arranger carefully, since execution risk is now much greater
2. Do not be intimidated by turmoil in the larger ticket capital markets, since most middle market transactions are still getting done
1. *Quit lamenting the deal that you “had” and take the best deal that you can get now*