
HERTER & CO
FINANCIAL ADVISORY

LBO financing instruments
in M&A auctions

May 2018

Agenda

Private Equity and Leverage Loan Market Update

Typical financing requirements in M&A auctions

LBO financing instruments and suitability in M&A auctions

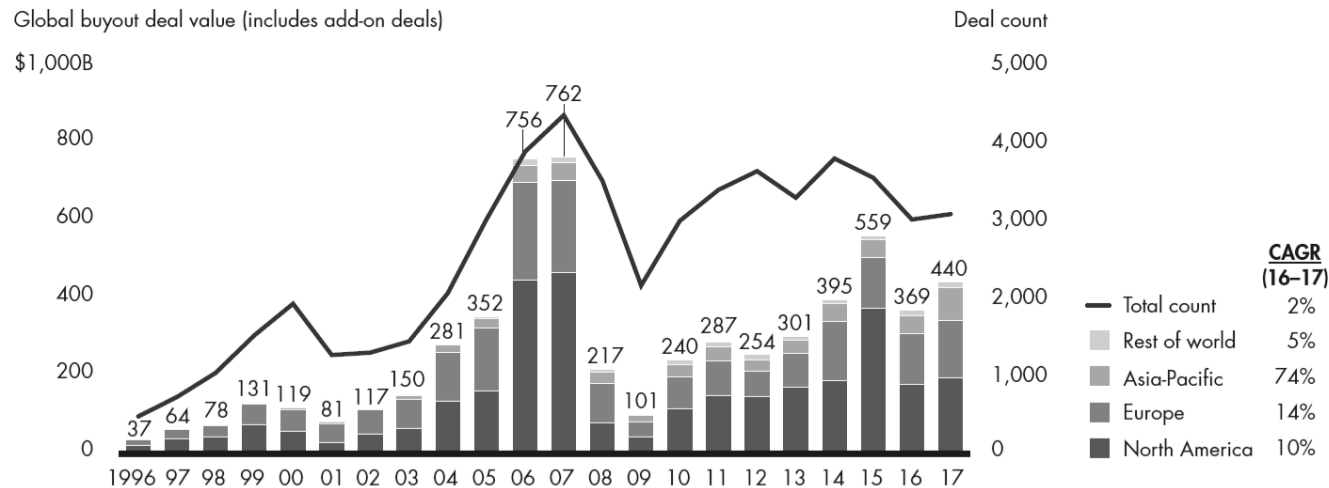
Conclusion and outlook

Q&A

Global PE markets remain buoyant in 2017/18

Historical development of global buyout deal values

Comment

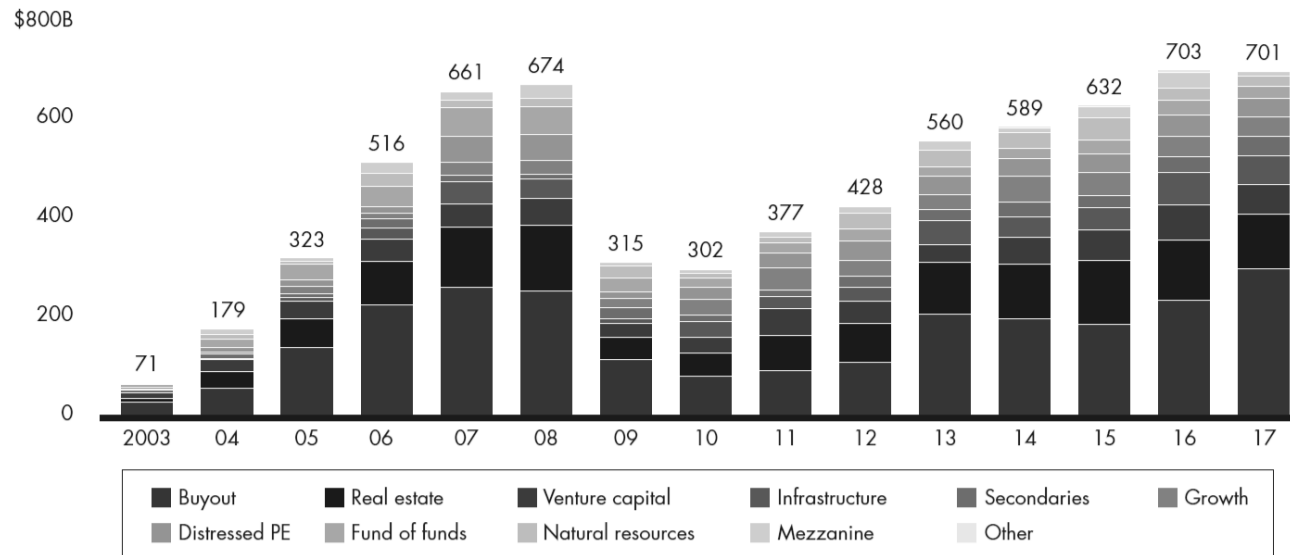


Source: Dealogic

- Record highs of 2006/07 not reached yet
- Solid double-digit growth in Western markets since 2009

Buyout fund-raising at record high

Global PE capital raised (by fund type)



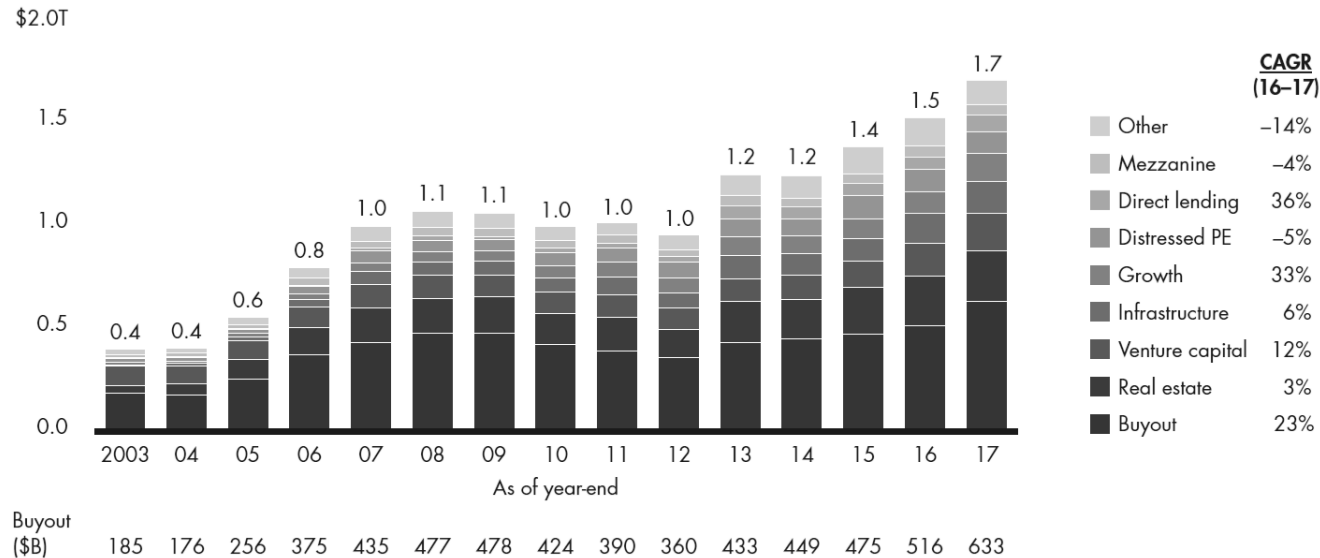
Source: Prequin

Comment

- Record highs of 2006/07 have been surpassed
- PE type asset classes have increased in overall importance
- Buyout fund-raising has hit a new record high in 2017

Increasing capital deployment pressure

Global PE dry powder



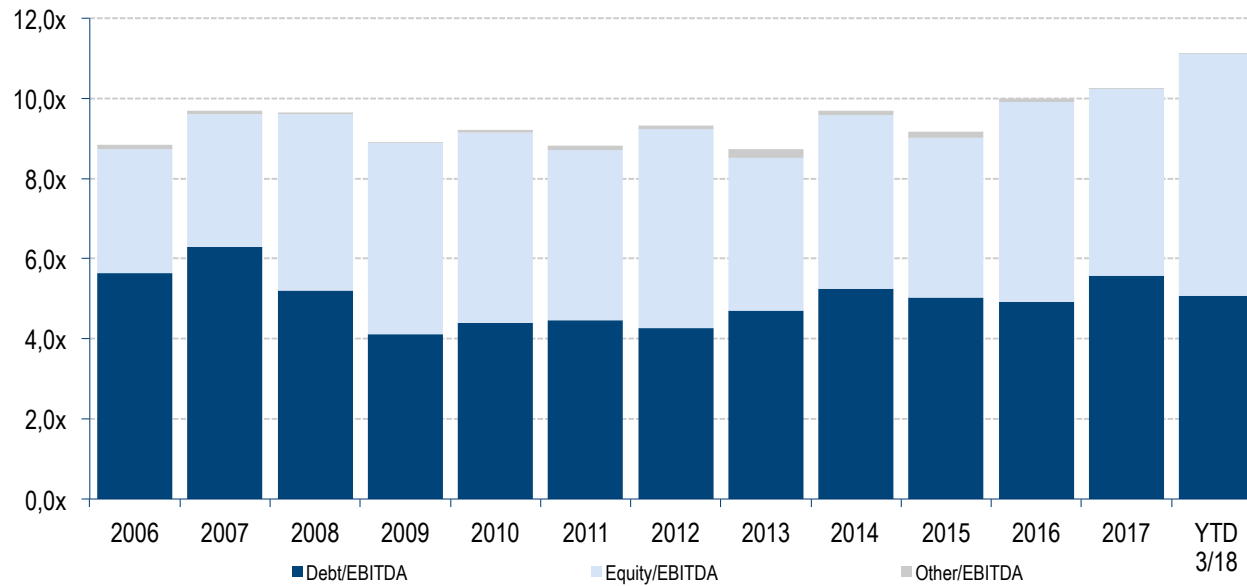
Source: Preqin

Comment

- Uncalled capital continues to pile up globally
- Highest rates in buyout, growth and direct lending strategies, setting new records in 2017

Purchase price multiples at record high

Average purchase price multiples



Source: S&P LCD Capital IQ

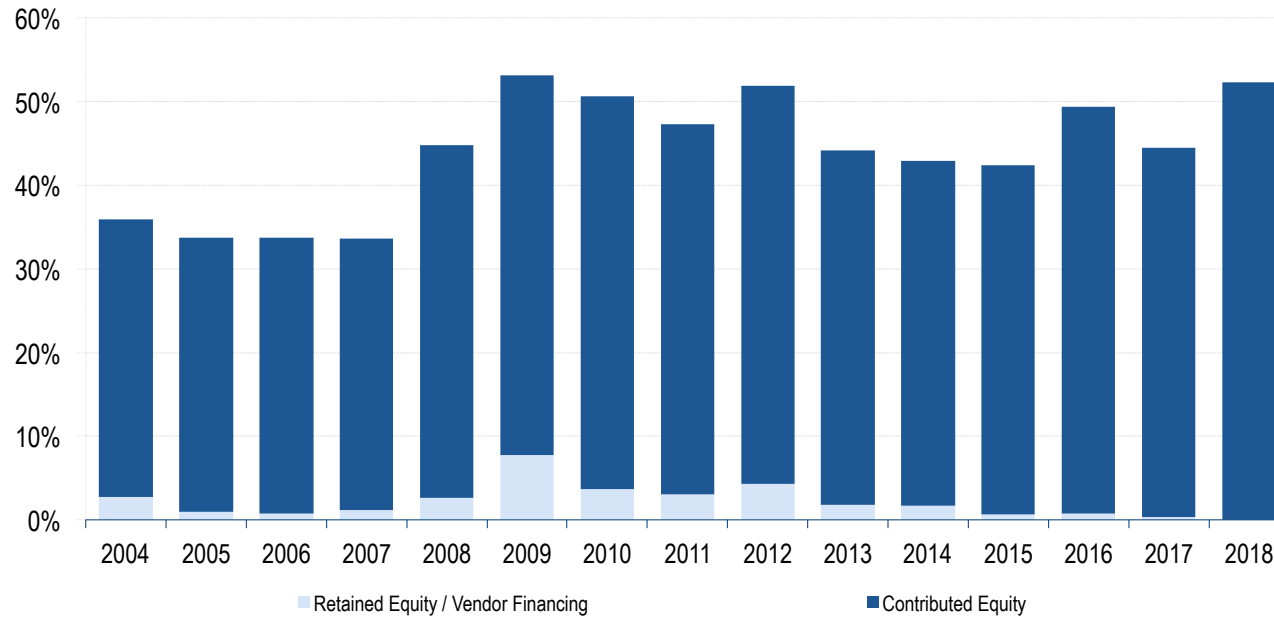
Comment

- Average purchase price multiples have reached > 11.0x
- Capital deployment pressure is evident in high equity contributions despite increased leverage levels

Equity contributions by sponsors have recently increased

Average equity contribution to buyouts

Comment

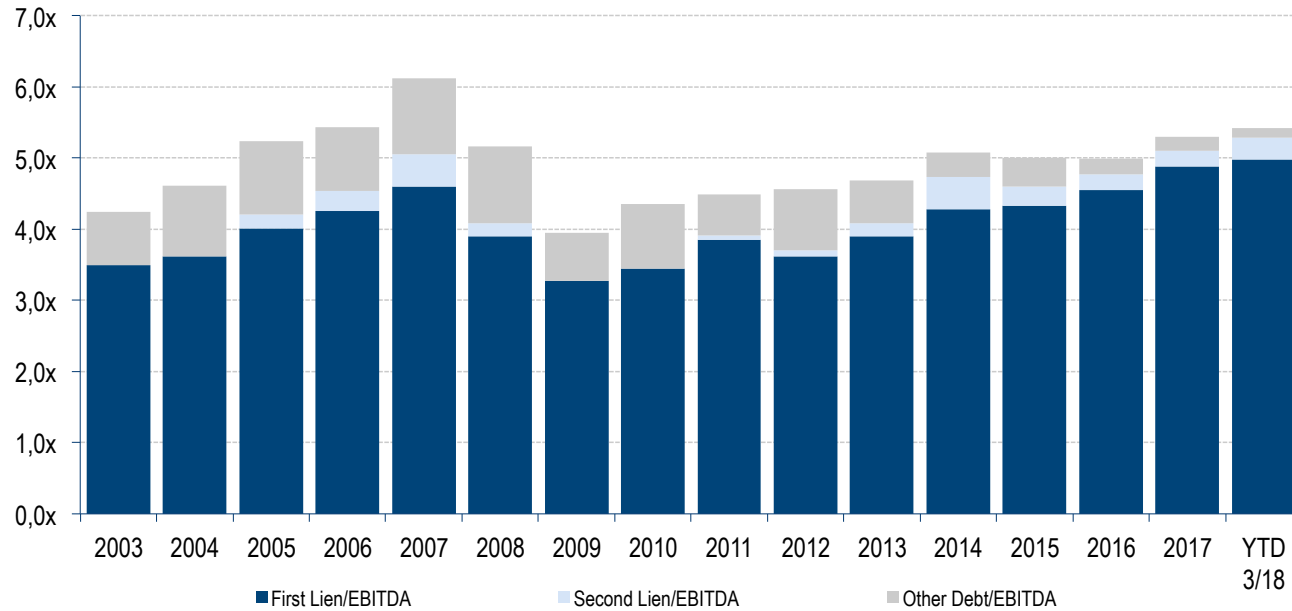


- Average equity cheques by sponsors have increased to >50.0%

Source: S&P LCD Capital IQ

Ample supply of inexpensive debt has driven leverage levels

Pro-forma Debt/EBITDA ratios of sponsored deals



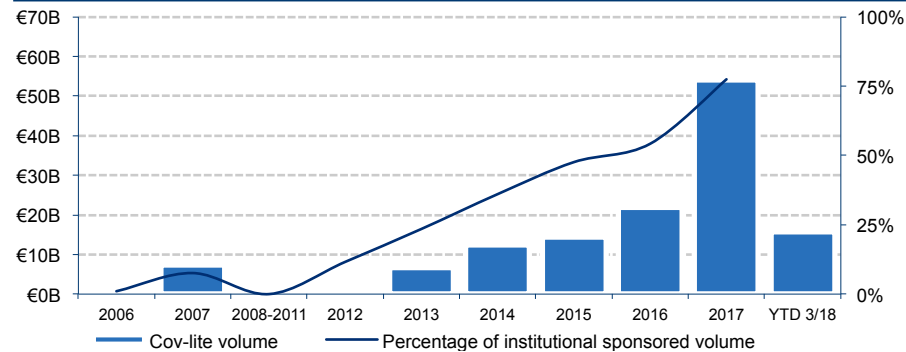
Comment

- Senior leverage level at record high > 5.0x
- Overall leverage still below 2006/07

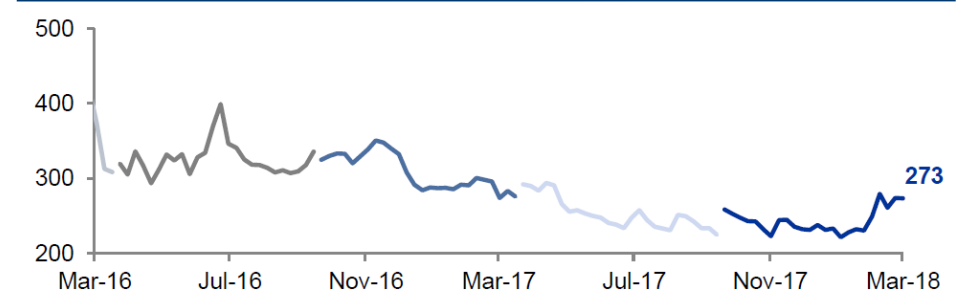
Source: S&P LCD Capital IQ

Ample supply of inexpensive debt has driven leverage levels

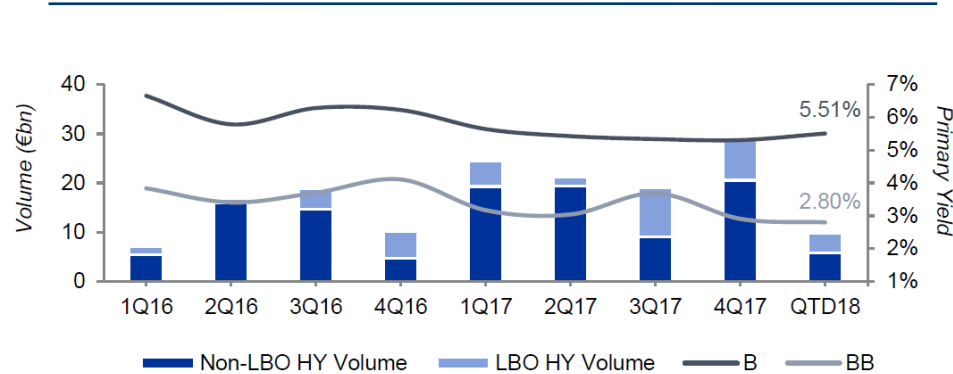
Sponsored covenant-lite institutional volume



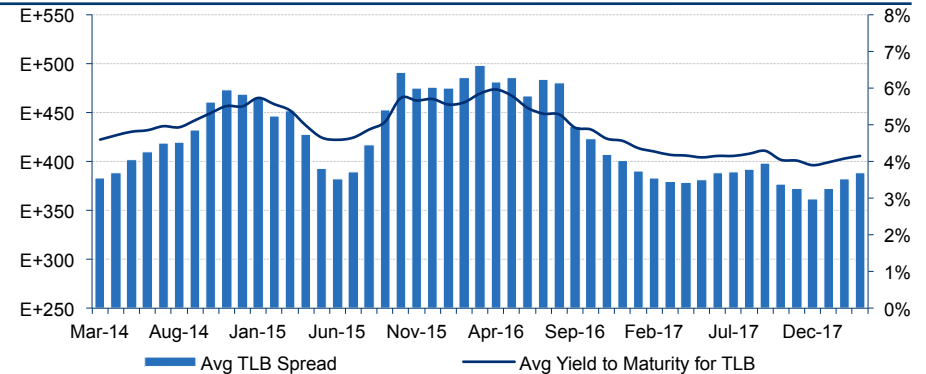
Markit itraxx crossover 5 years



HY Volume & primary yield



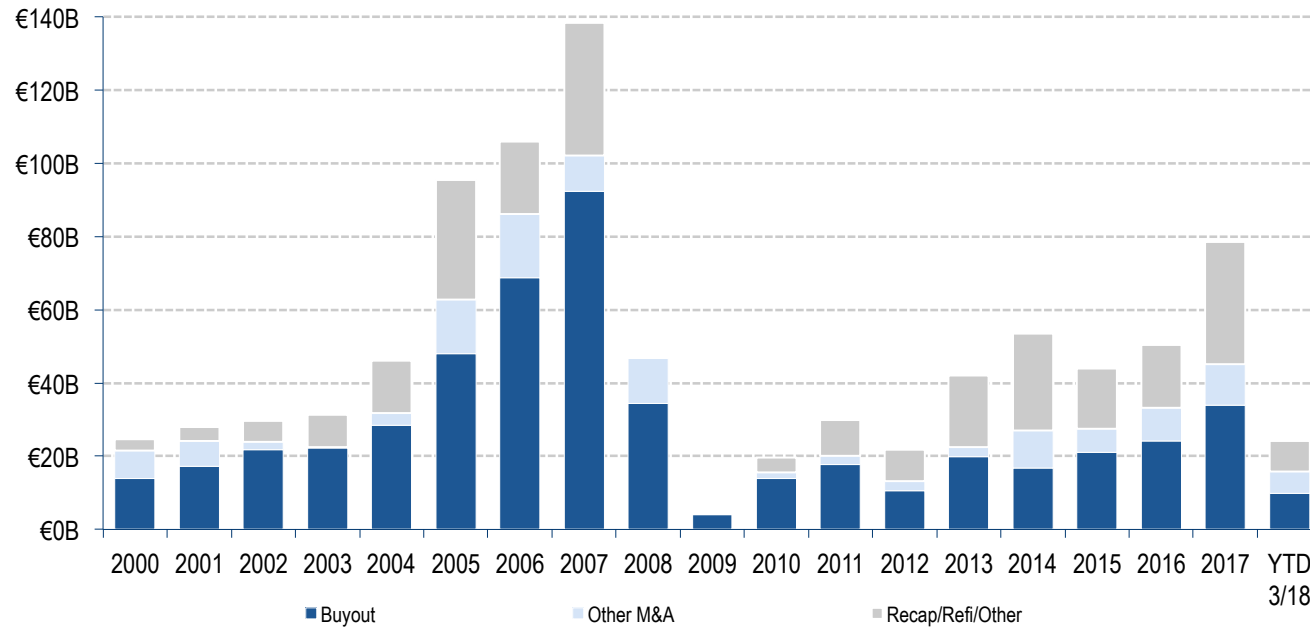
Average New Issue Spreads



Source: Standard & Poor's

Leveraged loan volume has reached post-crisis record high

Annual sponsored LBO loan volume (by use of proceeds)



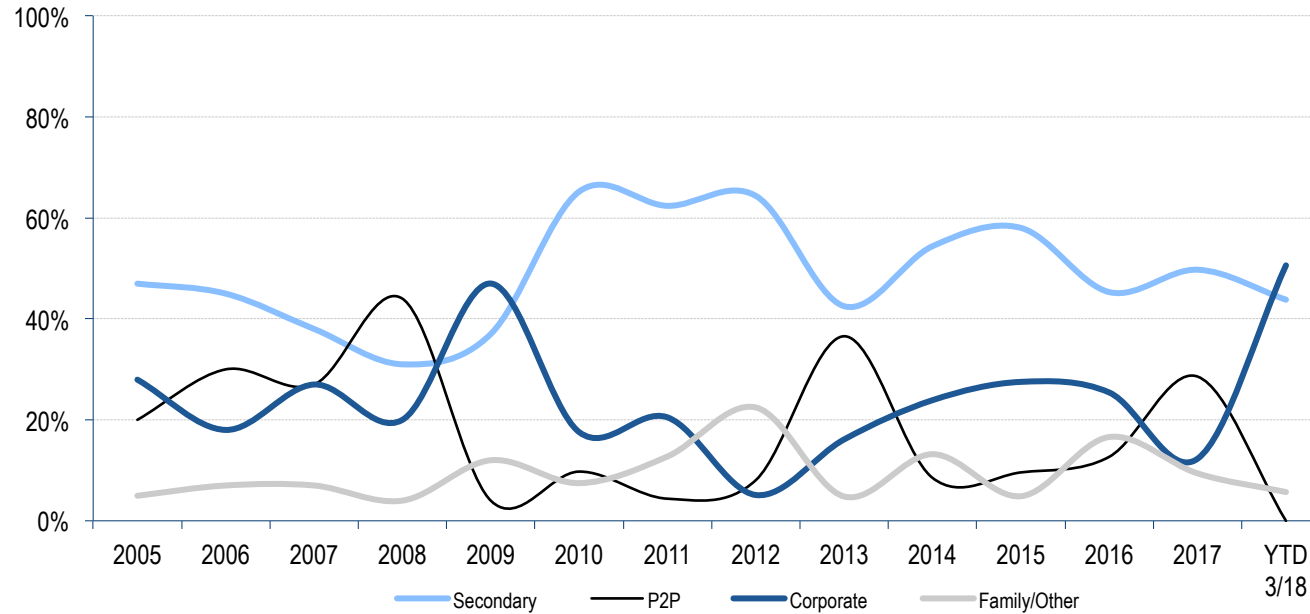
Comment

- Annual sponsored loan volume has reached a post-crisis record high of almost €80bn in 2017
- Despite strongly increased Recap and Refi activity, funding of M&A transactions remains the backbone of the loan supply
- M&A drives volumes in 2018

Source: S&P LCD Capital IQ

Auctions have driven M&A activity

Buyouts by type (volume)



Source: S&P LCD Capital IQ

Comment

- Secondary buyouts have remained a strong pillar of PE investment activity
- Corporate primary deals have recently picked up again
- Both M&A categories are typically organised as sell-side auctions in the mid-market

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Private Equity and Leverage Loan Market Update

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Typical financing requirements in M&A auctions

4 main criteria



- **Certainty**
 - Reliability of financing provider (1st round feedback vs. final credit approval)
 - Degree of certain funds (full CP satisfaction / Draft ILA / Commitment subject to docs)
- **Volume**
 - Max. leverage (→ max. purchase price)
 - Underwriting capabilities / ticket sizes of financiers
 - Add-on liquidity
- **Speed/efficiency**
 - Credit approval process
 - Admin process (KYC, regulatory policies)
- **Cost/terms**
 - Fees, interest
 - Capital structure
 - Other terms

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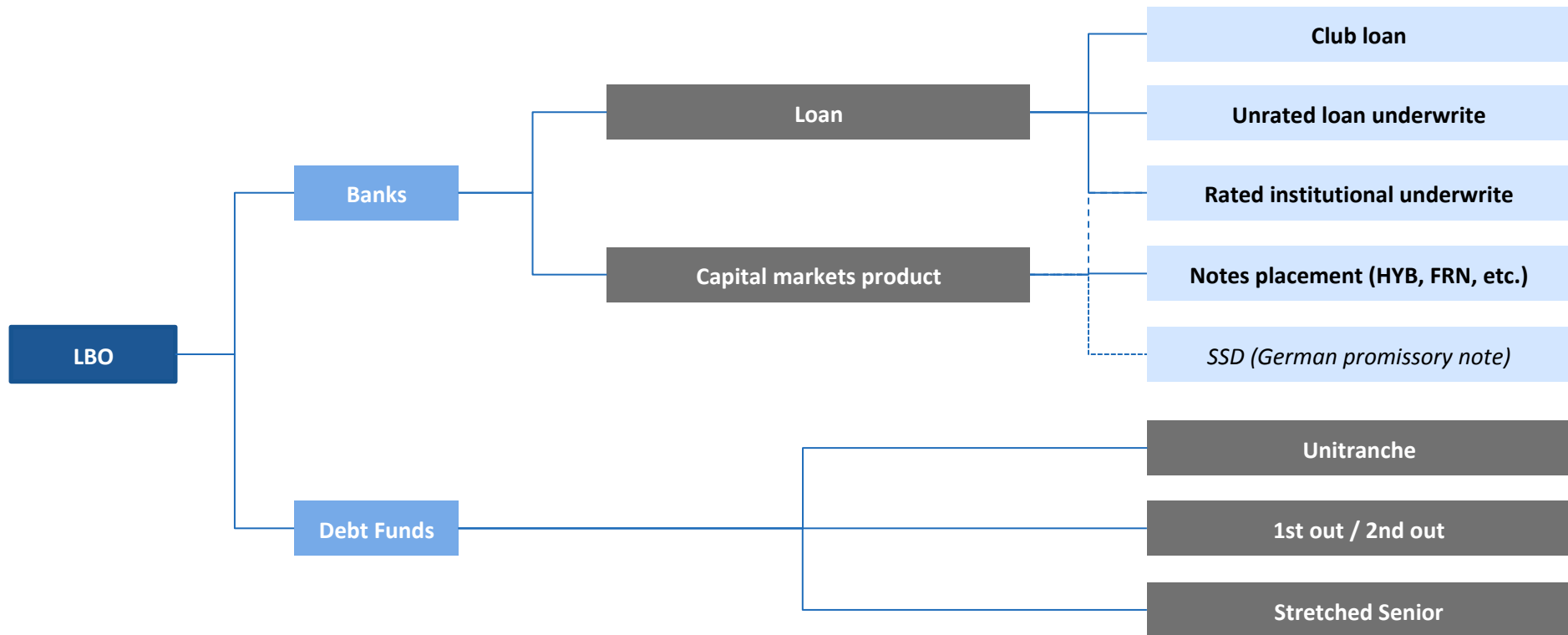
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LBO financing instruments

Classification of financing instruments for LBOs



Bank Financing – Club Loan

Typical characteristics of German Club Loans

Evaluation for auctions

■ Certainty

- Reliability varies from bank to bank, final credit approvals can sometimes have erratic outcomes, however in-depth pre-discussions and key relationships can mitigate this
- Degree of certain funds is typically medium, ILAs are not uncommon, full CP satisfaction relatively rare

+ / o

■ Volume

- Bank senior leverage appetite is typically limited to <5.0x, there are rare exceptions for proven credit stories
- Ticket sizes vary from bank to bank, usually up to €30m. Typically the total loan volume is limited to some €200m due to the high number of banks involved.

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■ Speed/efficiency

- Credit approval processes normally take between 2-3 weeks depending on the quality of information provided
- Admin processes are usually cumbersome (KYC, regulatory policies, etc.) and have to be passed for every single club lender
- Later changes/amendments in the ongoing credit relationship often relationship driven, however depending on bank name

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■ Cost/terms

- Normally cheapest form of LBO financing (upfront fees roughly 2.0-2.5%, TLB margins 350-375bps)
- Many mid-caps banks still require a TLA
- Current market standard is one maintenance covenant (Leverage), depending on deal size. Tight regulations on debt incurrence, acquisitions, dividend distributions, baskets, etc.

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Bank Financing – Unrated Loan Underwrite

Typical characteristics of Unrated Loan Underwrites

Evaluation for auctions

■ Certainty

- Reliability varies from bank to bank, final credit approvals typically less erratic than and depending more on capital markets input
- Degree of certain funds is typically high, the market is accustomed to ILAs and sometimes full CP satisfaction

+

■ Volume

- Bank senior leverage appetite is typically limited to <5.0x, there are rare exceptions for proven credit stories
- A bank-liquidity loan underwrite is typically the result of a limited deal size (roughly up to €250m). If the deal gets larger, there is actually upside by adding more institutional accounts to the syndications process (however non-rated, therefore limited).

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■ Speed/efficiency

- Credit approval processes normally take between 2-3 weeks depending on the quality of information provided
- Post SPA-Signing, Syndication work is started, this creates additional workload aside of doc negotiation
- Admin processes are same as in club deals, however limited number of underwriters normally more manageable

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■ Cost/terms

- Normally cheap form of LBO financing (upfront fees roughly 2.5%, TLB margins 375-400bps)
- Underwritten deal → Flex Risk! (100bps)
- Current market standard is one maintenance covenant (Leverage), depending on deal size. Looser regulations on debt incurrence, acquisitions, dividend distributions, baskets, etc.

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Bank Financing – Rated Institutional Underwrite

Typical characteristics of Rated Institutional Underwrites

Evaluation for auctions

- **Certainty**
 - Reliability usually high, liquid placements (>€250m) are much more sought after than bank deals, however depending on market environment
 - Degree of certain funds is typically high, the market is accustomed to ILAs and full CP satisfaction
- **Volume**
 - In principle ,unlimited', however very large deals tend to get layered (2nd lien, HYBs, etc. > €500m)
 - Stretched senior deals between 5.0x-6.0x possible for proven credit stories, however depending on sector, size & rating
- **Speed/efficiency**
 - Credit approval processes normally quite short between 1-2 weeks depending on the quality of information provided
 - Post SPA-Signing, Syndication work is started, this creates additional workload aside of doc negotiation (esp. Rating)
 - Admin processes same as for bank underwrites, for some reason slightly more reasonable
- **Cost/terms**
 - Normally cheap form of LBO financing (upfront fees roughly 2.0%, TLB margins 375-425bps), with dependency on market environment.
 - Underwritten deal → Flex Risk! (175bps)
 - Current market standard is covenant lite (no maintenance testing), depending on rating and deal size. Looser regulation of debt incurrence, acquisitions, dividend distributions, baskets, etc.

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Bank Financing – Notes placement (HYB, FRN, etc.)

Typical characteristics of notes placements

Evaluation for auctions

■ Certainty

- Reliability fully depending on market environment, larger bond players tend to have better market read
- Certain funds only possible through bridge financing

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■ Volume

- In principle ,unlimited‘, however very large deals tend to get layered (Secured, unsecured, etc. > €500m)
- No general limitation on leverage, however depending on quality of credit story, size, sector & rating

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■ Speed/efficiency

- Credit approval processes normally quite short between 1-2 weeks depending on the quality of information provided
- Post SPA-Signing, bond prospectus drafting and rating creates tremendous workload for management aside of doc negotiation (Lead Managers prefer not to fund the bridge)
- Admin processes cumbersome due to prospectus liability and exchange related admin

-

■ Cost/terms

- Currently more expensive form of LBO financing (compared to covenant-lite loans) with full dependency on market environment
- Bridge → Exploding margins (up to caps)!
- Market standard is no maintenance testing, no business plan discussions with lenders, etc. Loose regulation of debt incurrence, acquisitions, dividend distributions, baskets, etc.

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Bank Financing – *Excursus: SSD (German promissory note)*

Typical characteristics of SSDs (Schuldscheindarlehen)

Evaluation for auctions

■ Certainty

- Reliability fully depending on risk appetite of investors (= mainly banks and Sparkassen, i.e. focused on investment grade)
- Certain funds only possible through bridge financing which no bank wants to provide (therefore not suitable for auctions)

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■ Volume

- For the typical LBO rating cluster (quasi single-B), factually not available (no bank appetite, might differ for large names)
- For slightly more conservative ratings (crossover BB), typically limit of c. €100m (except for really large companies), however corporate style equity ratio (deducting goodwill) makes internal rating highly difficult for Sparkassen, etc.
- Bank senior leverage appetite is typically limited to <3.0x (driven by investment grade rating)

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■ Speed/efficiency

- Due to lack of underwriting, whole process normally around 6 weeks depending on the quality of information provided
- Rating report drafting, diligence Q&A requires significant management involvement (however similar to SynLoan)
- Any follow-on changes (amendments, waivers, etc.) cumbersome as technically each investor has its own bilateral financing with its own rights, etc.

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■ Cost/terms

- Very cheap form of financing (upfront fee <1.0%, margins <2.00%), but reflective of investment grade to crossover rating
- Market standard consists of very loose covenants (in line with SynLoans), very loose regulation of debt incurrence, dividend distributions, etc.

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Debt Fund Financing – Unitranche

Typical characteristics of Unitranche financings

Evaluation for auctions

■ Certainty

- Reliability varies from fund to fund, however typically if appetite was signalled at early stage, degree of deliverability is high
- Degree of certain funds is typically high, the market is accustomed to ILAs and full CP satisfaction
- SS RCF usually has to be placed with additional banks (however normally not relevant for SPA signing)

+

■ Volume

- Depending on the quality of the credit story, leverage is theoretically unlimited, however in Germany many Unitranche providers struggle with the risk appetite of competing, cheaper banks
- Additional layers of PIK and/or Pref. Equity are generally possible (depending on fund appetite)
- With more and more firms raising new record funds, deal sizes > €300m are no longer an issue.

++

■ Speed/efficiency

- Credit approval processes normally take between 1-2 weeks depending on the quality of information provided
- Admin processes (KYC, etc.) are usually outsourced and far less cumbersome as in bank deals
- SS RCF requires additional approach of banks, however there are arrangements in place between many funds and banks

++

■ Cost/terms

- Expensive form of LBO financing (upfront fees 3.0%, margins 650-700bps)
- Current market standard is one maintenance covenant (Leverage). Individual regulations on debt incurrence, acquisitions, dividend distributions, baskets, etc.

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Debt Fund Financing – 1st out / 2nd out

Typical characteristics of 1st out / 2nd out financings

Evaluation for auctions

■ Certainty

- Reliability varies from fund to fund, however typically if appetite was signalled at early stage, degree of deliverability is high
- Degree of certain funds is typically high, the market is accustomed to ILAs and full CP satisfaction
- SS pieces usually have to be placed with additional banks (however can be underwritten for SPA signing)

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■ Volume

- Depending on the quality of the credit story, leverage is theoretically unlimited, however in Germany many providers struggle with the risk appetite of competing, cheaper banks
- Additional layers of PIK and/or Pref. Equity are generally possible (depending on fund appetite)
- With more and more firms raising new record funds, deal sizes > €300m are no longer an issue.

+

■ Speed/efficiency

- Credit approval processes normally take between 1-2 weeks depending on the quality of information provided
- Admin processes (KYC, etc.) are usually outsourced and far less cumbersome as in bank deals
- SS pieces require additional approach of banks, despite standard arrangements, this can create additional delays

+

■ Cost/terms

- Cheaper form of LBO financing compared to Unitranche (upfront fees 3.0%, blended costs 500-600bps), however still more expensive than banks
- Current market standard is one maintenance covenant (Leverage). Individual regulations on debt incurrence, acquisitions, dividend distributions, baskets, etc.

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Debt Fund Financing – Stretched Senior

Typical characteristics of Stretched Senior financings

Evaluation for auctions

■ Certainty

- Reliability varies from fund to fund, however typically if appetite was signalled at early stage, degree of deliverability is high
- Degree of certain funds is typically high, the market is accustomed to ILAs and full CP satisfaction
- RCF usually has to be placed with additional banks (however normally not relevant for SPA signing)

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■ Volume

- Leverage is theoretically between typical Unitranche and bank leverage multiples, however in Germany many providers struggle with the risk appetite of competing, cheaper banks
- Additional layers of PIK and/or Pref. Equity are generally possible (depending on fund appetite)
- Less liquidity in the market for dedicated 1st lien senior, however deal sizes > €100m are doable.

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■ Speed/efficiency

- Credit approval processes normally take between 1-2 weeks depending on the quality of information provided
- Admin processes (KYC, etc.) are usually outsourced and far less cumbersome as in bank deals
- RCF requires additional approach of banks, however there are arrangements in place between many funds and banks

+

■ Cost/terms

- Cheaper form of LBO financing compared to 1st out / 2nd out and Unitranche, however at lower leverage (upfront fees 3.0%, margins 400-500bps)
- Current market standard is one maintenance covenant (Leverage). Individual regulations on debt incurrence, acquisitions, dividend distributions, baskets, etc.

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Overview of LBO financing instruments and evaluation for auctions

Typical characteristics of German Club Loans

	Certainty	Volume	Speed/efficiency	Cost/terms
Banks				
Club loan	+/o	o	+	+
Unrated loan underwrite	+	o	o	+
Rated institutional underwrite	++	++	o	++
Notes placement (HYB, FRN, etc.)	-	++	-	+
<i>SSD (German promissory note)</i>	--	--	-	++
Debt Funds				
Unitranche	+	++	++	--
1st out/2nd out	++	+	+	o
Stretched Senior	++	o	+	+

Conclusion

- Unrated bank financings are still the cheapest form of LBO and standard for small to mid-caps deals
- For large transactions, the gold standard is currently the rated covenant-lite underwriting route
- Debt Funds are moving closer and closer to the bank financings. Especially with regard to Certainty and Speed, Debt Funds have some advantages which are convincing more and more PEs.

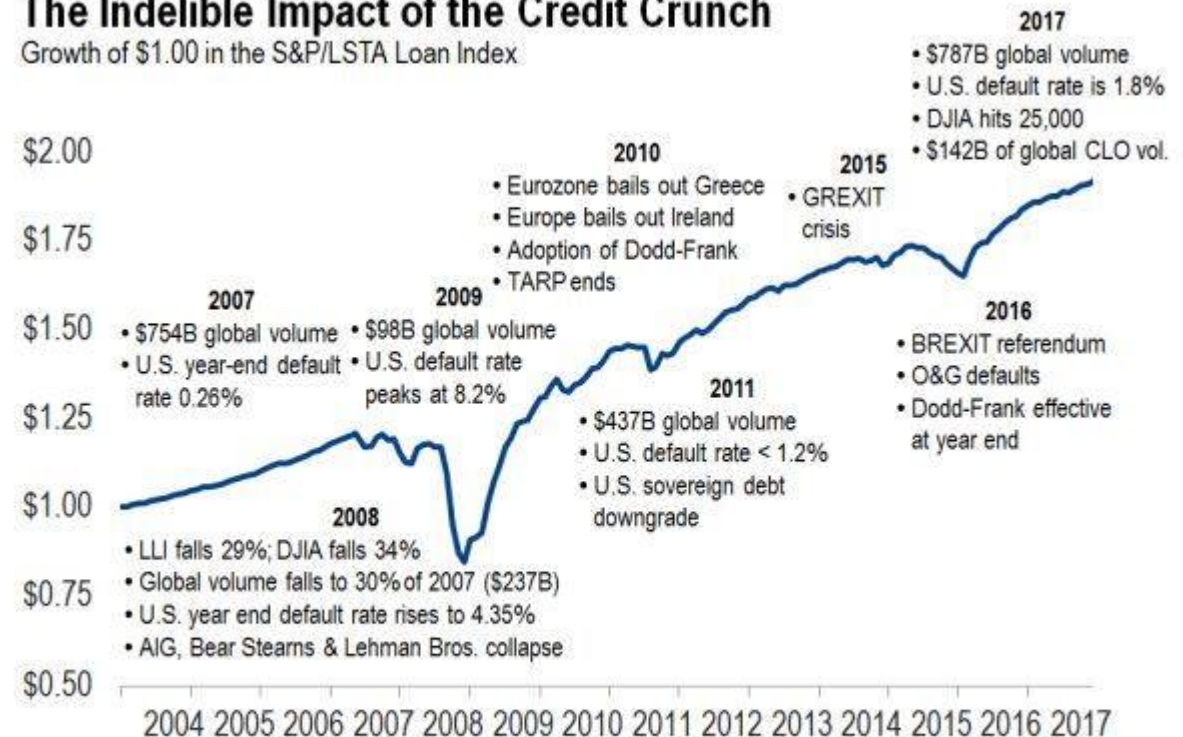
Outlook

Outlook

- Capital deployment pressure for PE and Debt Funds, no end in sight regarding record fund-raising due to low interest rate environment
- Lending banks facing various regulatory and structural challenges while earning less money
- Competition between banks and debt funds ever increasing with debt funds gaining ground
- Deal terms have become more and more aggressive, however recently some pushback from investors, causing some fluctuations in the liquid markets.
- We are seeing first signs of defaults in the mid-market, however, with general default rates still remaining low and in absence of any exogenous events, currently no end of market development in sight.

The Indelible Impact of the Credit Crunch

Growth of \$1.00 in the S&P/LSTA Loan Index



S&P Global
Market Intelligence

Source: LCD, an offering of S&P Global Market Intelligence

Q&A

ABOUT HERTER & CO

About Herter & Co.

Herter & Co. offers its debt advisory services in four business areas

4 Business Areas

1	Corporate Debt Advisory	2	Financial Sponsor Debt Advisory
3	Financial Restructuring	4	Real Estate Financing

Marcel Herter *(Founding Partner)*



- > 20 years of experience in financing transactions
- Former Head of Debt Advisory & Financial Restructuring Germany at Lazard and Head of Leveraged Finance Dresdner Bank

Paul H.F. Kim *(Managing Partner)*



- > 15 years of experience in financing transactions
- Former positions at IKB, Augusta & Co., and Dresdner Kleinwort

Joachim Koolmann *(Senior Partner)*









- > 20 years of experience in financing transactions
- Former Managing Director for Special Situations at JP Morgan / Bear Stearns and Deutsche Bank

Pool with 6 additional professionals


Selected Credentials⁽¹⁾

Long-standing experience in financing processes

Selected Transactions

<p>SUN EUROPEAN PARTNERS, LLP</p>  <p>Debt Advisor Leveraged Buy-Out</p> <p>Ongoing</p>	<p>LINDSAY GOLDBERG</p>  <p>Debt Advisor Leveraged Buy-Out</p> <p>Ongoing</p>
<p>silverfleet capital</p>  <p>Debt Advisor Leveraged Buy-Out</p> <p>Undisclosed</p>	<p>ARDIAN</p>  <p>Debt Advisor Leveraged Recap</p> <p>€390,000,000</p>
<p>TRILANTIC CAPITAL</p>  <p>Debt Advisor Leveraged Buy-Out</p> <p>Undisclosed</p>	<p>LINDSAY GOLDBERG</p>  <p>Debt Advisor Refinancing / Factoring</p> <p>€280,000,000</p>

Selected Transactions (Cont'd)

<p>ARDIAN</p>  <p>Debt Advisor Leveraged Recap</p> <p>Undisclosed</p>	<p>ARDIAN</p>  <p>Debt Advisor Leveraged Refi & Repricing</p> <p>Undisclosed</p>
<p>Deutsche Beteiligung AG</p>  <p>Debt Advisor Leveraged Recap</p> <p>Undisclosed</p>	<p>SUN EUROPEAN PARTNERS, LLP</p>  <p>Debt Advisor Leveraged Recap</p> <p>Undisclosed</p>
<p>ARDIAN</p>  <p>Debt Advisor Leveraged Recap</p> <p>€286,000,000</p>	<p>capiton</p>  <p>Debt Advisor Leveraged Buy-Out</p> <p>Undisclosed</p>

1. More credentials can be found on our website: www.berter-co.de

Selected Herter & Co. Team Credentials

Selected Financing Credentials

2018	LBO of 7Days, LBO of Coveris Rigid Europe (ongoing), LBO of ESIM Chemicals (ongoing), Post-IPO financing for listed corporate (ongoing), SSD for German industrial corporate (ongoing)
2017	Refinancing of WDI, Recap of Löwen Play, LBO of Oberberg Group, Refinancing of VDM Metals, Recap of Schleich, Refi & Repricing of d&b audio, Recap of Infiana
2016	Refi of FLABEG Automotive, Recap of Riemser Pharma, Refi of OHB SE, LBO of Hamm Reno Group, LBO of d&b audio
2015	Lindal Group, LBO of ESIM, TRIMET, Rege, TOM TAILOR
2014	SEISSENSCHMIDT, TRILUX, Ströer
2013	OHB AG, Gehring Technologies, TOM TAILOR (SSD), Lindal Group, TRIMET
2012	TOM TAILOR/Bonita (Acq. Fin.), Ströer, TOM TAILOR (Refi) LBOs of Fotolia, Spheros, 360T, Scotch & Soda
2011	LBOs of Keymile, SLV, Versatel, Westfalia Automotive, Paccor
2008-10	LBO of Neochimiki, Profine (Refi), LBO of ESE/Otto, LBOs of Kaffeepartner, paper+design, Ranger Marketing
2007	LBOs of HC Starck, Takko, AHT, IWKA Packaging (Oystar), EDS, Süddekor (2D Group), Bavaria Yachting, SLV, Deutz Power Systems, Profine, Schenck Process, SAG, Azelis, LR International (Recap), Vinnolit
2006	LBOs of Basler, BSN Medical, LuK Hydraulics (ixetic), Pfeiderer Track Systems, Sports Group, Techem, RWE Solutions, Sportfive (Recap), KSM (Recap), Jack Wolfskin (Recap)

Selected Restructuring/Distressed Credentials

2017/18	Industrial manufacturing company (ongoing), retail textile company (ongoing)
2015	LOEWE, AnVaMa
2014	RENA
2013	Neumayer Tekfor, FLABEG
2012	Pampus / Westfälische Drahtindustrie
2011	Honsel, Pfeiderer, German printing company, German shipping company, German logistic company, Componenta
2010	Bavaria Yachting, large German Corporate, A-Tec Industries, Jost Werke
2009	Profine, Monier, Honsel, German auto supplier, Schuler, Highstreet/Karstadt
2008	Oystar, Premiere (Sky Germany)
2007	Witex, Meryl Fiber
2006	NICI, Neschen, Ruwel



Marcel Herter

Marcel Herter, * December 1969, dipl. Bankbetriebswirt (BA)

Since 2012	Herter & Co. Founding Partner
2011-2012	Independent Debt Advisor
2008-2011	Lazard & Co. Managing Director / Head of Debt Advisory & Financial Restructuring Germany
1990-2008	Dresdner Kleinwort / Dresdner Bank
2006-2008	Head of Leverage Finance Germany and EEC
2004-2006	Head of Capital Markets Non-IG Loans Germany
2002-2004	Head of Non-Investment Grade Credit Sales Germany
2000-2002	Transaction Director Leverage Finance Frankfurt
1997-2000	Düsseldorf Relationship Management Corporate Customers
1994-1997	Corporate Loans Risk Management
1990-1994	Retail and Private Customers



Paul H. F. Kim

Paul Han-Ju Franz Kim, * March 1977, Dipl. Kfm. (Univ.)

Since 10/2012	Herter & Co. Managing Partner – Financial Sponsor Debt Advisory
2010-2012	IKB Deutsche Industriebank Executive Director – Acquisition Finance & Sponsor Coverage
2009-2010	Augusta & Co. Merchant Bankers Assistant Director – Debt Advisory & Restructuring
2005-2009	Dresdner Kleinwort Vice President – European Leverage Finance
2002-2005	Ernst & Young Senior Consultant – Transaction Advisory Services (TS / Valuation)
2001-2002	Dresdner Kleinwort Wasserstein Analyst – Investment Banking Division (M&A / Equities)



Joachim Koolmann

Joachim Koolmann, * July 1957, Bankfachwirt

Since 01/2013	Herter & Co. Managing Director – General Debt Advisory
2010-2012	Augusta & Co. Merchant Bankers Managing Director – Debt Advisory & Restructuring
2006-2009	Bear Stearns / J.P. Morgan Senior Managing Director – European Special Situations Group
2004-2006	Deutsche Bank Managing Director – Distressed Products Group
1999-2004	Dresdner Kleinwort Wasserstein Head of High Yield Capital Markets / Co-Head European Leverage Finance
1995-1999	Bankers Trust Managing Director – High Yield Capital Markets
1987-1995	J.P. Morgan / Morgan Guaranty Trust of New York Executive Director – Corporate Finance
1977-1986	Commerzbank Corporate Credit and International Division

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