



Snapshot of the current Underwriting Criteria being used by a sampling of Senior Secured Lenders*

“Confronting Reality”

AM&AA Winter Conference 2010

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PERFORMANCE CRITERIA

- Trailing Twelve Month (TTM) revenues, margins, and operating profit are not subject to a serious turndown.
- Adjustments and add-backs are okay in developing numbers, but should be identifiable as truly: *1. Discretionary* or *2. Extraordinary*.
- Leverage multiple preferably under 2.0x with FCC above 1.20x for cash flow lending
- Cyclical and seasonality can be challenging
- Prospective borrower must demonstrate strong management team with consistent, sustainable and defensible cash flows.
- Prospective borrower must demonstrate that the business has real reason to exist in a defensible niche.
- Subordinated debt lenders require warrants and 2nd lien behind Senior Lender or 1st lien on boot collateral, if available

COLLATERAL CRITERIA

- Collateral coverage for entire senior debt is usually mandatory or preferred in this market
- Under-secured “air balls” (over advances) need very fast amortization – fewer than 3 years.
 - ❖ *Very difficult to obtain, at least for the moment*
 - ❖ *Must be temporary or supported by personal guarantees and consistent cash flow*
 - ❖ *Coupled with strong collateral position in the current structure*
 - ❖ *Fixed Charge Coverage hurdle is considerably higher with an air ball*
- Liquidity Cushion or “excess availability” must allow for overdue payables (60 days or more past due) and provide ample liquidity in the eyes of lender for 3-6 months or what lenders perceive as “sufficient.”

COLLATERAL COVERAGES (ADVANCE RATES)

- Not to exceed 85% of eligible accounts receivable
- 70% of eligible inventory with appraisal required
- 85% of NOLV of appraised M&E
- 70% of FMV appraisal of real estate

There is a trend to lower these advance rates across the collateral spectrum

INDUSTRY RISK TRENDS

- **Quality of collateral** has deteriorated (i.e. contract receivables)
- **Industries in transition** with a fundamental change (i.e. the publishing industry).
- Domestic industries shrinking due to **global dynamics**.
- **Consolidation** is occurring due to economies of scale, or the need to increase purchasing power.
- The higher risk niches
 - Contractors with **progress billings**
 - **Automotive** mfrs. or suppliers
 - **Capital intensive** businesses with large term loans
 - Companies subject to **litigation** due to nature of products

BUSINESS RISKS

- **Customer concentration** greater than 25%
- Same for **Supplier concentration**
- Lack of **investment of resources** for the future, or lack of a game plan or strategy
- Lack of management **talent or depth**
- **Illiquid collateral** or difficult to liquidate collateral
- Revolver balance should exceed term loan balances to minimize risk in eyes of lenders
- **Inconsistent cash flow** or non-defendable business niche or market share

CURRENT CREDIT MARKET CONDITIONS

- Cash flows have been negatively impacted by economic conditions
- Recent cash flow trends weak – late 2008 and early 2009.
- **Uncertainty** for the next few quarters going forward
- **Collateral values are lower** and unpredictable and do not match up with original loan commitments from lenders
- Owners running out of time to recover as lenders transfer customers to SAG or Workout Divisions
- **Liquidity gaps** on balance sheets harder to fill due to tighter credit markets

PRICING

- Credit spreads are up, but rates are still relatively low for asset-based loans.
- Total cost of capital for qualified ABL Borrowers is still lower than several years ago despite the recession
- Remaining credit providers (not experiencing distress) can require higher pricing and more fees

WHAT TO EXPECT IN THE NEAR TERM

- Fewer credit providers due to market uncertainty and distress among financial institutions.
- Fewer options for Borrowers
- More refinancing risk for remaining lenders
- Tighter credit markets are creating less flexibility and creativity
- Higher priced lenders gaining market share
- Bridge funds and opportunistic funds are emerging to replace banks in many cases
- More due diligence since borrower's options are limited

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