Acquisition / Leveraged Finance

The Bell IB Academy Presentation

October 2011

Table of Content

Introduction of Acquisition / Leveraged Finance

Acquisition / Leveraged Finance

Overview

Acquisition or leveraged finance is typically defined as debt financing supporting the acquisition of a controlling or sometime minority interest in a company's (the “**Target**”) equity by an investor, typically either a strategic or a financial sponsor (the “**Sponsor**”). Such debt financing usually represent a sizeable percentage of the purchase price, and typically includes the following features:

- Mostly recourse only to the Target company - non-recourse to the financial sponsor
- For strategic/corporate sponsors, mostly ‘recoursed basis’ (for most cost efficient financing)
- Provides a portion of the capital for the acquisition; usually around 50% (depending on sector)
- Boosts returns for the sponsor as pure equity is the most expensive form of capital (thus the “leverage” effect)
- Uses a combination of debt instruments from bank loans (term loan and bridge loans) to debt capital markets
- Usually non investment grade (mainly due to stand-alone nature and relatively higher leverage)

The following attributes in the Target make good candidates for an acquisition / leveraged finance transaction:

- A multi-year history of stable and proven cash flows
- Source of collateral - hard assets (PP&E or receivables from strong customers)
- Potential for new management to implement operational (other) improvements (i.e. what values are being added via the acquisitions?)

Acquisition / Leveraged Finance

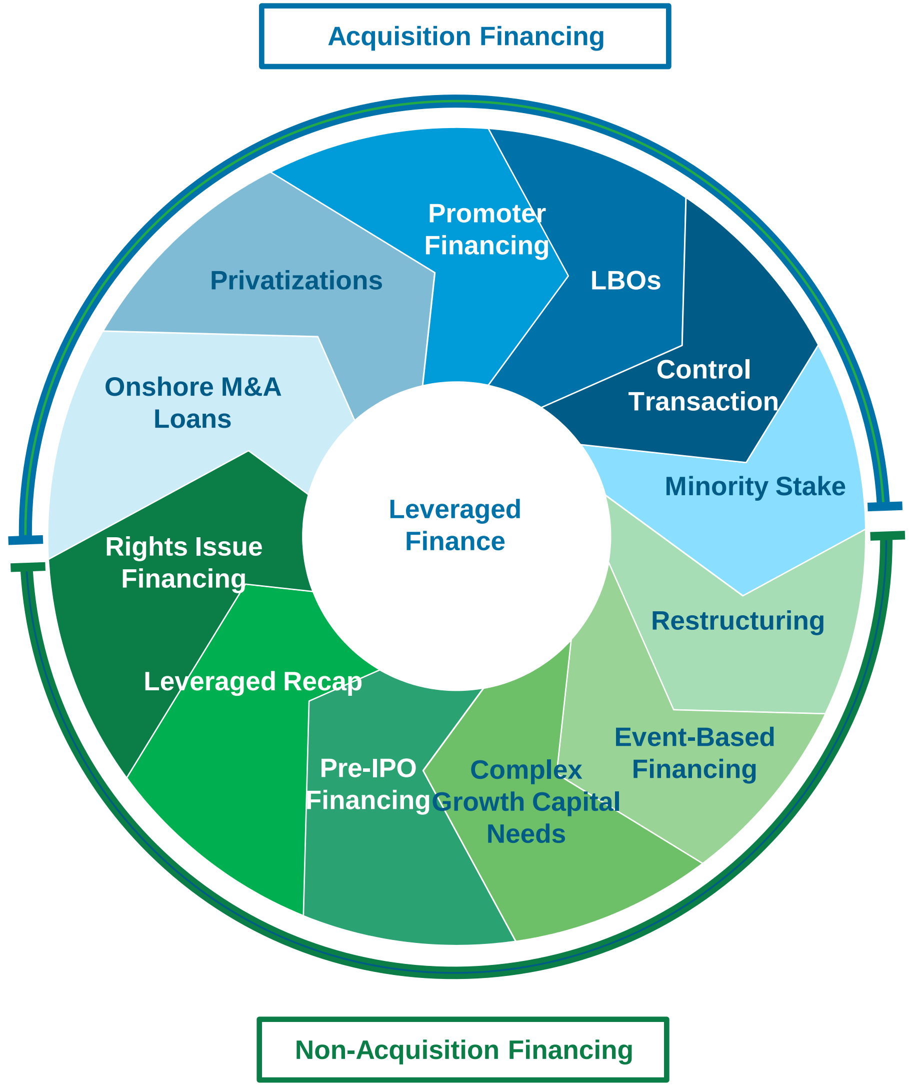
Taking a Broader View

A Broader View

Acquisition / leveraged finance includes direct acquisition financings and subsequent add-on financing opportunities

- **Acquisition financing:**
  - > LBO financing
  - > Control transaction financing
  - > Minority stake purchase financing
  - > Privatization
  - > Promoter financing

- **Non-acquisition financing:**
  - > Restructuring
  - > Event-based financing
  - > Complex growth capital needs
  - > Pre-IPO financing
  - > Leveraged recapitalization



Sample Structures

Acquisition / Leveraged Finance

Acquisition Finance: Structure 1

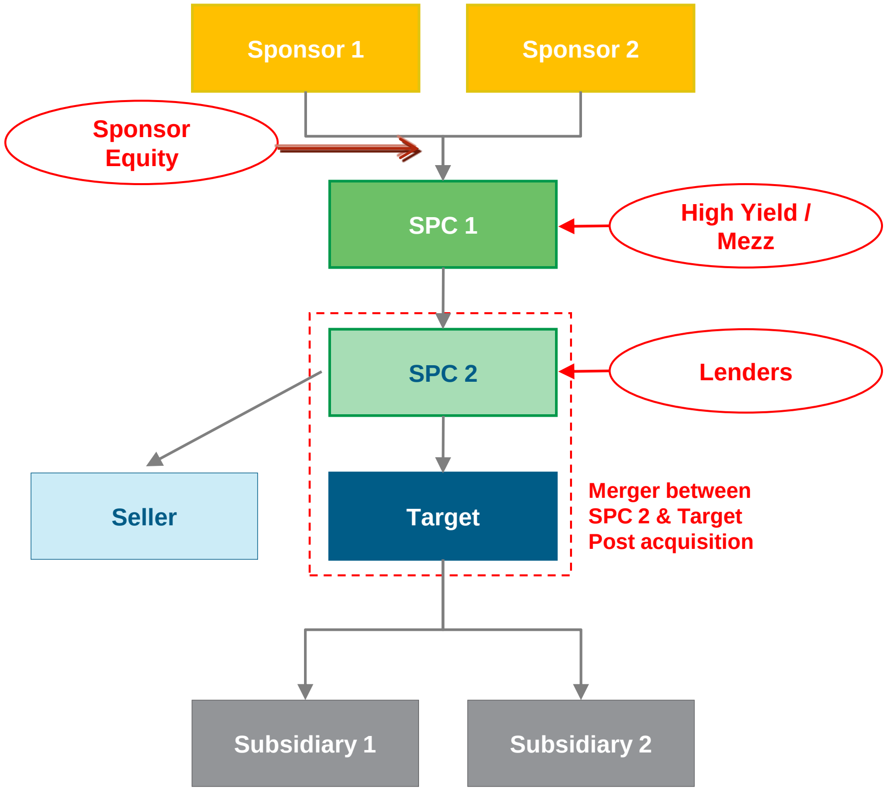
Financial Sponsored LBOs

Structure Overview

- Set up Special Purpose Company ("**SPC**") 1 financed with equity and High Yield / Mezzanine (Non Investment Grade) instruments. SPC 1 sets up SPC 2 with proceeds
- SPC 2 further finances itself with senior loans and buys out the Target shares from its existing shareholder
- Post acquisition, merger between SPC 2 and Target
- The merger enables direct access to the Target's cashflow and assets by the lenders
- Post-merger, structural subordination exists for the High Yield Mezzanine issued at SPC 1

Key Characteristics

- Nature of the funds does not allow for any recourse
- No dividend up flow to Sponsors during the loan exposure
- Equity contribution of [40 to 50]%
- 3~5 year investment horizon with >20% target return



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Acquisition Finance: Structure 2

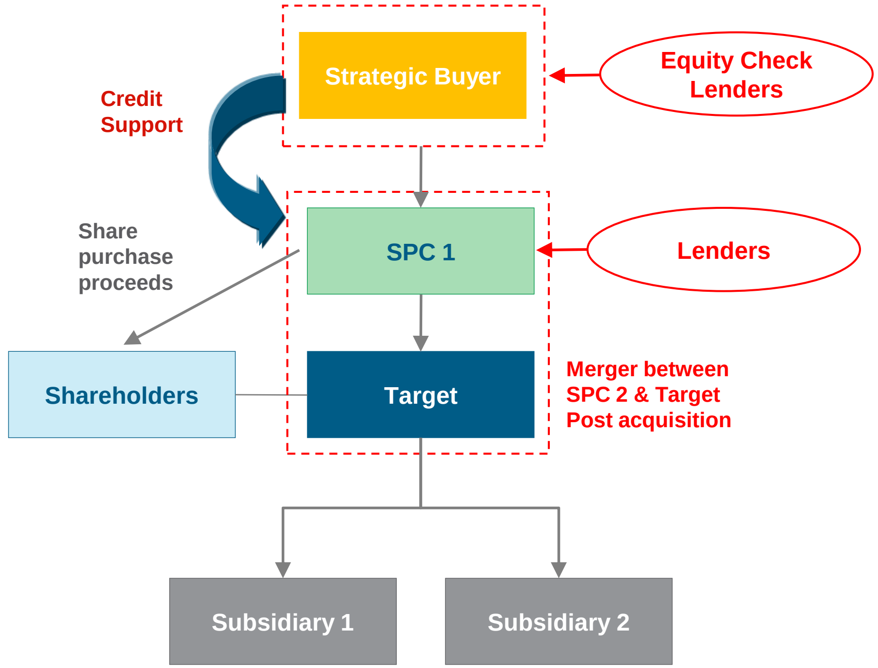
Strategic Investor LBOs

Structure Overview

- The structure will largely depend on the strategy and financial standing of the buyer (Equity check financing OR credit support)
- Depending on the strategy and financial standing of the buyer, the structure can vary between a sponsor driven transaction and a corporate backed loan

Key Characteristics

- Strategic investor's ability to extend credit for the financing – opens up a larger pool of investors as well as minimizing costs
- Unless the investment is driven by financial purposes, typically no set exit horizon
- Target returns are expected to be lower than financial sponsors
- Potential synergies (including cost cutting) created between the buyer and Target



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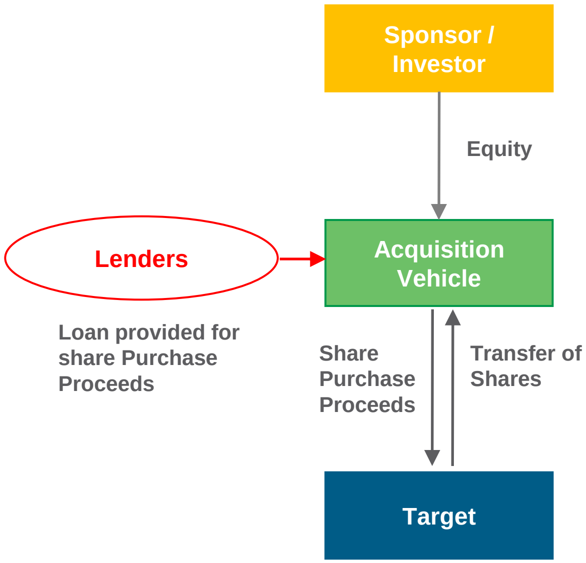
Acquisition Finance: Structure 3

Share Backed Financing

Structure Overview

- Acquisition vehicle set up to finance the transaction
- Transaction subject to definitive agreement to purchase the target shares
- Purchase Target shares with the equity and loan proceeds injected in the acquisition vehicle
- Security for the transaction to include Target company shares to meet the agreed Loan to Value (“**LTV**”)



Key Characteristics

- Target shares need to be liquid (i.e. listing preferred) and commonly minority shares
- LTV are done at 40 – 50+% levels with pre-agreed LTV top up resources
- First source of interest payment is dividends from Target
- Investor retains voting rights on the stock
- For minority deals, certain minority protection rights would help the financing

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Non-Acquisition Finance

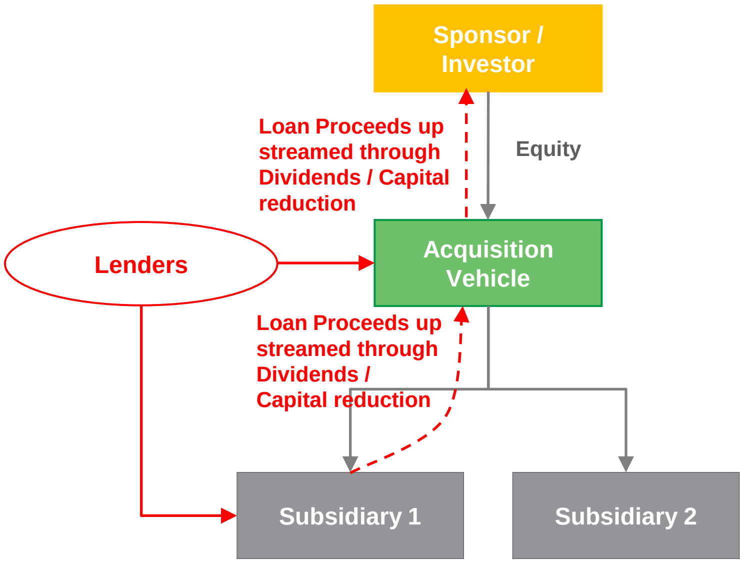
Dividend Recap

Structure Overview

- Loan proceeds are injected to the company which is then up-streamed to the investor by way of dividends or capital reduction
- Dividends and capital reduction will be subject to regulatory constraints such as sufficient retained earning applicable to most jurisdictions
- The borrowing entity will need to have sufficient economics to service the debt upon inception

Key Characteristics

- Suitable Targets for non-acquisition finance typically display:
  - ✓ Mature business with lazy balance sheet
  - ✓ Minimal future capital expenditure
  - ✓ Minimal expansion plans



A Closer Look into Sponsor-Based Finance

Sponsor-Based Finance

Overview of Acquisition & Financing Process (Auctioned Style)

	Planning & Preparation (1 month)	Marketing (1 month)	Due Diligence (1 month)	Preferred Bidder Selection (3 weeks)	Closing
Process	▪ Understand sale process and structure and determine strategy to maximize value ▪ Review public information and develop preliminary valuation ▪ Prepare for high level due diligence ▪ Identify potential competition	▪ Receive Teaser ▪ Execute CA ▪ Receive IM and process letter (Round 1) and prepare round 1 bids ▪ Submit bids and appoint on round 2 qualified bidder	▪ Shortlisted and receive bid instructions (Round 2) ▪ Access to data room and prepare questions ▪ Sit for management presentation and Q&A ▪ Receive draft SPA and discuss with seller ▪ Initiate shareholders agreement discussions if needed	▪ Submit binding bids ▪ Preferred bidder appointment ▪ Final negotiations of SPA ▪ Final negotiation of SA (if needed) ▪ Prepare final announcement upon signing the SPA	▪ Closing due diligence ▪ Shareholders' vote ▪ Ensure proper approvals are obtained
Financing Bank	▪ Initial tapping to banks – Head line appetite	▪ Reviews available information upon CA execution ▪ Understand key credit/issues and high level syndication strategy ▪ Provide indicative termsheet to potential bidder upon discussion on headline terms ▪ Most banks require credit/risk blessing	▪ Due diligence - Independent bank due diligence items can be asked ▪ Sit in for management presentation if needed ▪ Understand key SPA terms/issues impacting the financing/security structure (ie earn out) ▪ Comfort on bidding consortium ▪ Monitor market, checking for high level syndication appetite ▪ Negotiate detailed financial termsheet	▪ Check all internal risk/compliance issues ▪ Finalize credit package ▪ Credit approval (including detailed termsheet) ▪ Upon credit approval, appoint bank legal counsel and initiate documentation	▪ Finalize documentation including the security and inter-creditor agreements if needed ▪ Ensure no significant change has incurred to the Company from last due diligence date to closing

Sponsor-Based Finance

Key Debt Terms

Sponsor	▪ Usually in the form of a Private Equity Fund
Borrowers	▪ Tranche A: An onshore special purpose vehicle (“Holdco”) to be formed by the Sponsor for the purpose of consummating the Acquisition and; ▪ Tranche B: The operating company of Target (“OpCo”) (mainly for working capital purpose)
Transaction	▪ Buyout of 100% equity stake in Opco by Holdco
Facilities	▪ Tranche A: To partially finance the Acquisition through Holdco ▪ Tranche B1: To refinance the existing debt at OptCo ▪ Tranche B2: To effect capital reductions and/or pay dividends for HoldCo to repay Tranche A before Debt Collapsing Merger takes place
Final Maturity Date	▪ Tranche A, B1: Usually 5 years ▪ Tranche B2 : Until Debt Collapsing Merger takes place
Repayment	▪ Amortization depends on cashflow profile
Debt Collapsing Merger	▪ A merger between the Holdco and the OpCo (the “Debt Collapsing Merger”) which results in all debt being booked at and serviced by the surviving Opco entity
Capital Reduction / Dividend	▪ Prior to Debt Collapsing Merger OpCo to upstream dividends and/or redeem capital to service the HoldCo Facilities ▪ Holdco (prior to merger) and/or surviving entity (after the merger) shall neither pay dividends nor redeem capital
Security	▪ A perfected first priority pledge of all the capital stock of OpCo and HoldCo ▪ A perfected security interests in tangible and intangible assets (if any) of HoldCo ▪ A perfected first priority security of all interests in OpCo’s material assets (for Opco Tranche only)
Covenants	▪ Cash sweep (grid to be agreed) ▪ Debt-to-EBITDA ▪ EBITDA / Interest ▪ Debt Service Coverage Ratio ▪ Restrictions on capital expenditure
Interest Rate / Upfront Fee	▪ Base Rate + Margin / % of Facilities amount

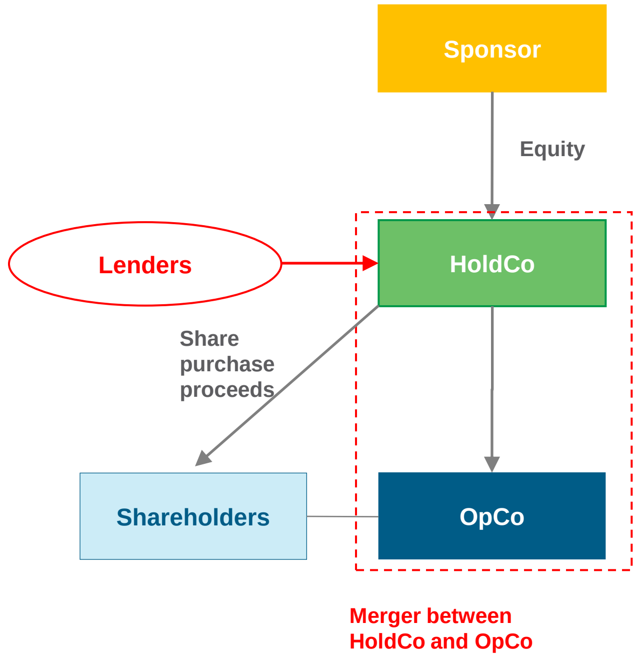
Sponsor-Based Finance

Debt Collapsing Merger

Debt Collapsing Merger

Objective and structure

- With no recourse to the sponsors, lenders' primary source of repayment is the cashflow and asset base of the operating company ("**Opco**")
- However, as financing needs are primarily to pay out the existing shareholders (share purchase proceeds), lenders will initially lend into the holding company ("**HoldCo**") to channel its proceeds
- This structural subordination will adversely impact the lenders in both accessing the OpCo cashflows and assets and eventually impact the key terms of the debt creating a "loose loose" situation without a Debt Collapsing Merger
  - ✓ There are also fiduciary breach issues in Korea in pledging OpCo assets to HoldCo lenders
- The merger will situate the lenders with clear access to OpCo cashflow and assets
- Prior to the Debt Collapsing Merger, lenders can also lend into OpCo to effect capital reductions and/or pay dividends for HoldCo and pay down its debt. This creates a defacto merger effect to the loan pushed down to OpCo



Sponsor-Based Finance

Syndication Aspect of a Deal

- Typically, acquisition financing tend to be large deals and one bank may not be able to lend the entire amount due to 1) limited risk appetite or 2) legal restriction (i.e. single legal lending limit)

- As a result, on most cases, banks would try to either Club the transaction or Syndicate to other institutions in order to avoid putting 'all eggs into one basket"

- Club deals are transactions where all banks join the same transaction on equal footing (i.e. in terms of both economics and title)

- Syndicated transactions typically feature one or a group of leading banks (i.e. "Mandated Lead Arrangers"). MLAs would 'underwrite the transaction and would attempt to 'sell' the loan to other institutions. Usually, there would be a difference in title as well as economics (MLAs need to be compensated for taking an underwriting position)

- If Syndicated, especially under an auctioned M&A process, Sponsors would seek for a firm underwriting as the level of the financing commitment would have to match that of their own obligation under the SPA

KKR & Affinity / Oriental Brewery Case Study

KKR & Affinity / Oriental Brewery Case Study

Overview

KKR & Affinity / Oriental Brewery

USD820 million

Acquisition Financing for the acquisition of Oriental Brewery Co., Ltd

MLA and Bookrunner

Standard Chartered 2009

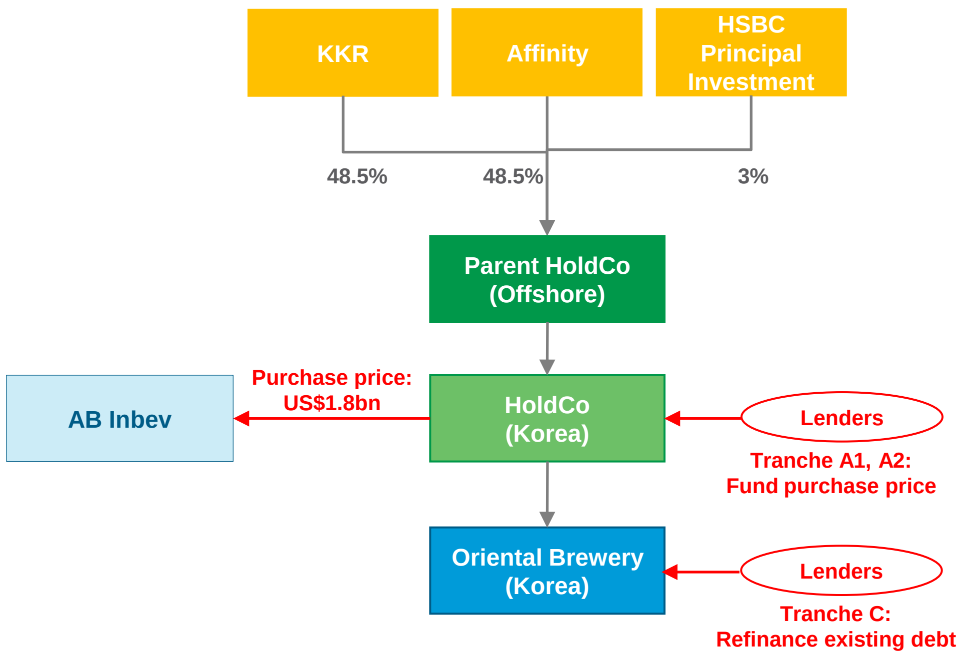
Transaction Summary

KKR & Affinity / Oriental Brewery	
Transaction Background:	On 24 July 2009, Anheuser-Busch InBev NV/SA ("AB InBev") sold 100% of Oriental Brewery Co. Ltd. ("OB"), South Korea's second largest brewery, to Malt Acquisition Co. Ltd., jointly controlled by Kohlberg Kravis Roberts & Co. L.P. ("KKR") and Affinity Equity Partners ("Affinity") (the "Acquisition"), for US$1.8 billion. Post-signing of the Sale & Purchase Agreement ("SPA"), KKR syndicated part of its equity commitment to Affinity (48.5%) and HSBC Principal Investments (3%).
Acquirers:	▪**KKR:** One of the world's oldest and most experienced private equity firms in the buyout industry, with over US$44 billion of equity invested in more than 185 transactions with a total value of over US$435 billion. ▪**Affinity:** One of the largest independent financial sponsors for buyout investments in the Asia Pacific region, managing funds and assets of US$4 billion. Affinity has made seven investments in Korea over the past 10 years, including Korea Digital Satellite Broadcasting, Himart Co Ltd, and The FaceShop Korea.
Target:	AB Inbev is the leading global brewer and one of the world's top five consumer products companies with 120,000 employees based in over 30 countries across the world. AB Inbev manages a portfolio of nearly 300 brands that includes Budweiser, Stella Artois, Beck's, and Hoegaarden.
Facility:	Dual currency (KRW and US$) 5-year senior amortizing term loan of US$820 million
SCB Role:	▪Joint underwriter ▪Joint mandated lead arranger ▪Joint mandated bookrunner
Transaction Highlights:	▪Largest LBO done (then) worldwide post crisis ▪Successfully syndicated prior closing despite turbulent markets ▪Best Cross-border M&A / Best LBO 2009 (Triple A Awards 2009) ▪Best Leveraged Financing 2009 (Finance Asia Awards 2009)

KKR & Affinity / Oriental Brewery Case Study

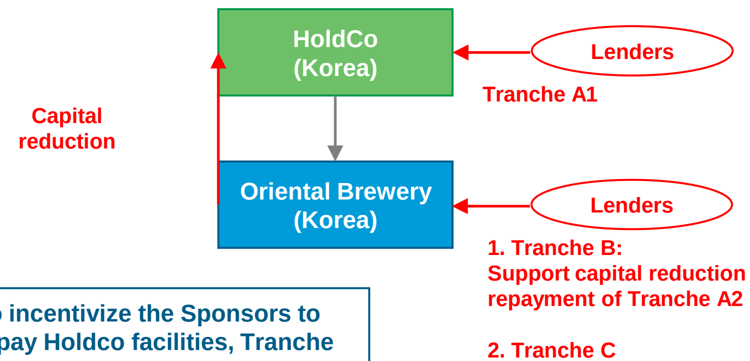
Mechanism

1 Acquisition of OB



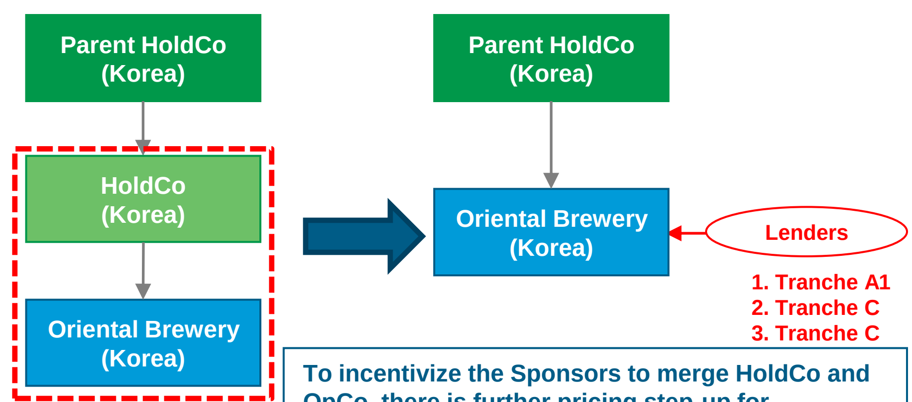
2 Capital Reduction by Opco

Tranche B @ OpCo Partially Repays Tranche A @ HoldCo



To incentivize the Sponsors to repay Holdco facilities, Tranche A2 bears a high step-up in margin shortly after the acquisition

3 Merger of HoldCo and Opco



To incentivize the Sponsors to merge HoldCo and OpCo, there is further pricing step-up for outstanding tranches @ HoldCo a certain period after the Capital Reduction (in case of no merger)