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Private Equity – EME

July 2013

Private Equity Sound Bite

Trends, Market Polarisation & the Return of Cov Lite?

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We were recently asked how we would describe current debt financing trends, including interest rate and covenant trends, in the mid-market. The only, and possibly unhelpful, answer that seemed appropriate in the circumstances was that it is currently hard to extrapolate market trends for debt financing.

Our experience over the past 12 months is that financing terms, pricing and covenant packages vary quite widely between deals. As a result it is not really possible to formulate a meaningful view of "trends", even based on what would have historically constituted a mid-50 percentile market view—and we could question whether that mid-50 percentile meaningfully exists at the moment.

Financing activity for mid-market PE transactions appears to be on the increase and liquidity seems to be less tight. Deals are getting done. A significant proportion of that debt liquidity is coming from alternative finance providers and a perceived greater propensity to achieve structures that mix and match cash flow and asset-based lending to get to the right debt quantums (at least for those deals where an asset-based lending proposition can be meaningfully supported).

Perhaps the only accurate summary we can give is that we are seeing a much greater focus now on "what works for the deal in question". "Cookie cutter" financings will potentially only work or be achievable in the most vanilla of structures.

We would also observe that there is an increasing polarisation of what's on offer in terms of debt finance. Good credits and good deals are attracting a lot of interest and competitive tension from financiers. As a result, sponsors in those situations are enjoying significantly increased bargaining power. We have seen, and market reports have documented, the return in some transactions of financing techniques such as PIK, PIK toggle, cov-lite & favourable equity cure provisions. Whether there is an overall 'trend' towards the renewed acceptance of those types of provisions is hard to say, but they are certainly making a market re-appearance, and are definitely something sponsors should be thinking about requesting for the right reasons and in the right circumstances.

As always, competition to become a stakeholder (whether debt or equity) in what are perceived to be good target credits and the better deals in the market, will lead to an ability on the part of a sponsor to negotiate highly competitive terms. What is also becoming clear is that, outside of those types of deal, things are a lot tougher and accommodations on financing terms are hard fought and proving difficult to negotiate.

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In our view, so-called 'sponsor-friendly' financing provisions have never ultimately been unworkable from the perspective of all stakeholders in a PE transaction. It is perhaps just that, prior to 2007, these techniques were layered and cumulated in a way that relied too much on continued market growth and buoyancy. With a renewed focus on sensible leverage and gearing, there is no reason why it shouldn't be possible to revisit cov-lite and cov-friendly terms provided it works for the deal in question. For further questions or information on this topic, please contact Phillip Slater, Banking & Finance Team Partner, at +44 (0)20 3116 3663 or by email, pslater@reedsmith.com.

Transaction Highlights

Recent Deals Across Our Platform

The London private equity team, led by Perry Yam, has advised on the £14m (€16.6m) sale of Red Box Recorders Limited to a newco equity financed by ISIS Equity Partners. Red Box was founded in 1998 by Iain Worthington and Andrew Jackson, originally as an outsourced software developer for Racal Recordings. It developed Racal's voice recording software, which helps to reduce demand on telephony hardware and storage, and makes data more easily searchable and is still used today. Reed Smith acted for the founders on the exit. The deal team included James Cross, Emilia Valvano, Huw Morris, Kalish Mullen, Colin Cochrane, Caspar Fox, Annette Beresford, and Carl De Cicco.

Paris corporate partner Emmanuel Vergnaud advised the managers of Tifany Industries in its buyout from industrial group Windhurst, which previously owned Tifany. Tifany is made up of two subsidiaries, Tifany Industries specialising in disposable crockery, and Tifany Emballages, which manufactures cardboard yogurt pots. Tifany employs more than 100 people and now intends to extend its activites at an international level. Emmanuel was assisted by corporate associate Maëliss Bourbon on this transaction.

A team led by Justus Binder has advised Target Partners, which invested in JouleX in 2009, on the sale of JouleX to Cisco for US $107 million in cash and retention-based incentives in exchange for all the shares of JouleX.

Paris corporate partner Emmanuel Vergnaud advised Edmond de Rothschild Investment Partners (EDRIP) on its €8 million investment in MCI Group, a Swiss event communication group already supported by Iris Capital. The new funds should allow MCI to expand even further internationally. The group, which started in 1987 as a family business, now has more than 1300 employees in 23 countries and organises over 3500 events a year. Through a series of nearly thirty acquisitions, MCI has doubled in size over the past five years and is now looking into developing its activities in Asia. Emmanuel was assisted by corporate associate Mickaël Lévi.

The London private equity team, led by Perry Yam, has advised Resonance Asset Management LLP on the acquisition of Strath of Brydock wind farm in Scotland from Duncan GreenEnergy, two individuals acting as a partnership. The corporate and energy deal team included Stefan Schmitz, Nick Rock, Richard Wilkes, Emilia Valvano and Kalish Mullen. The funds team, Dale Gabbert and Matt Evans, also advised on the establishment of the fund (which is both advised by Resonance and has a strategic distribution arrangement in place via boutique investment bank, Dexion Capital). Initial commitments, totalling £35 million, were raised from pension funds, insurance companies and family offices, for wind energy projects throughout the UK. Perry was assisted by corporate associate Emilia Valvano.

Global Firm Recognition

Reed Smith Munich Office

International law firm Reed Smith is pleased to announce that Justus Binder (mergers and acquisitions, private equity and venture capital), and Michael Fischer (private equity) have been selected for inclusion in the 2013 edition of *Best Lawyers Germany*. *Best Lawyers* is based on an annual peer-review survey and was first published in the United States more than 30 years ago. Now based in almost 70 countries, this year marks the fifth edition for our Germany team.