Article Archive: August 2002

The Making of a Syndicated Deal

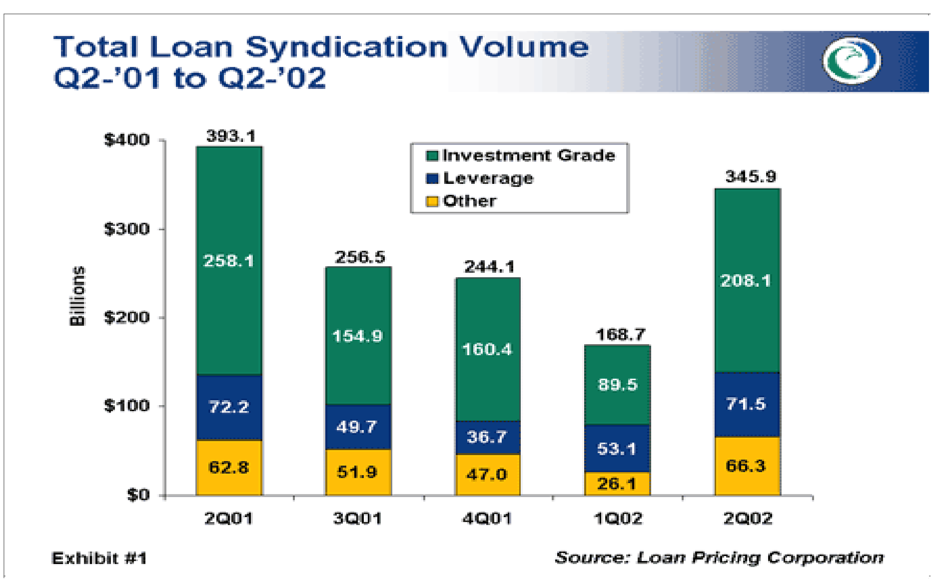
August 2002

To say these are turbulent times is an understatement. The major stock indices are seeing double-digit declines. Enron, billed as the largest bankruptcy in history, relinquished that title to WorldCom in short order. Many companies are now reassessing and restating their earnings and the corporate valuations picture isn't expected to get any prettier. Amid all this, a host of companies will be forced to refinance or restructure their debt. For many of them, their capital needs will exceed the capacity of a single lender.

"If you're looking to borrow more than $50 to $75 million, then there's likely to be more than one bank involved," says Jeff McLane, vice president of syndications for Fleet Securities. "At $100 million plus, it's in the interest of both borrowers and lenders to attract more players to ensure that no single lender ends up with too much exposure to any one company."

Syndicating loans, or spreading debt among a number of players, helps lenders manage their portfolios by reducing risk, improving returns and increasing fee business. A syndicated loan is typically structured and priced by the lead arranger or agent, who then sells portions of the deal to other lenders or investor groups under terms negotiated by the agent.

Syndicated loan volume totaled $345.8 billion in the second quarter of 2002, more than double the volume in the first quarter. Both investment grade and leveraged loans posted increases (Exhibit #1—Total Loan Syndication Volume Q2 '01 to Q2 '02). Mergers and acquisitions accounted for less than 10 percent of the total, which suggests the bulk of the activity was to refinance or restructure debt.



Browse Article Archive

Asset-Based Finance

Bankruptcy / Turnarounds / Restructuring

Buyouts / Private Equity / Hedge Funds

Capital Markets

Economy

M&A

Subordinated Debt

Surveys / Research

Treasury & Risk Management

RSS Feed

XML CapitalEyes e-Newsletter

Contact Us

I would like to discuss a financing need of $15 million or more.

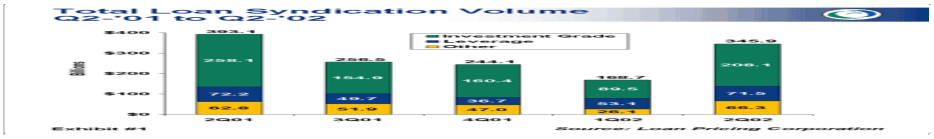


Exhibit #1
Source: Loan Pricing Corporation

Growing Complexities

Syndication clearly has become more complex over the last several decades. Distributing debt among lenders isn't as easy today simply because there aren't as many lenders as there used to be. Consolidation over the last few years has reduced the pool of bank players from 110 in 1999 to 35 today. "Consolidation clearly has had an effect on how we do business," says McLane. "With fewer banks to sell debt to, you have to be more cognizant of who is actively buying paper."

In addition to commercial banks, today's investors include finance companies, insurance companies, securities firms, CDOs (collateralized debt obligations) and prime rate funds (Exhibit #2—Shift in the Share of the Credit Markets). While domestic banks remain the largest investor category, their average commitment level per deal has decreased significantly. The growth in non-bank investors has been essential in filling the gap in syndicated transactions.

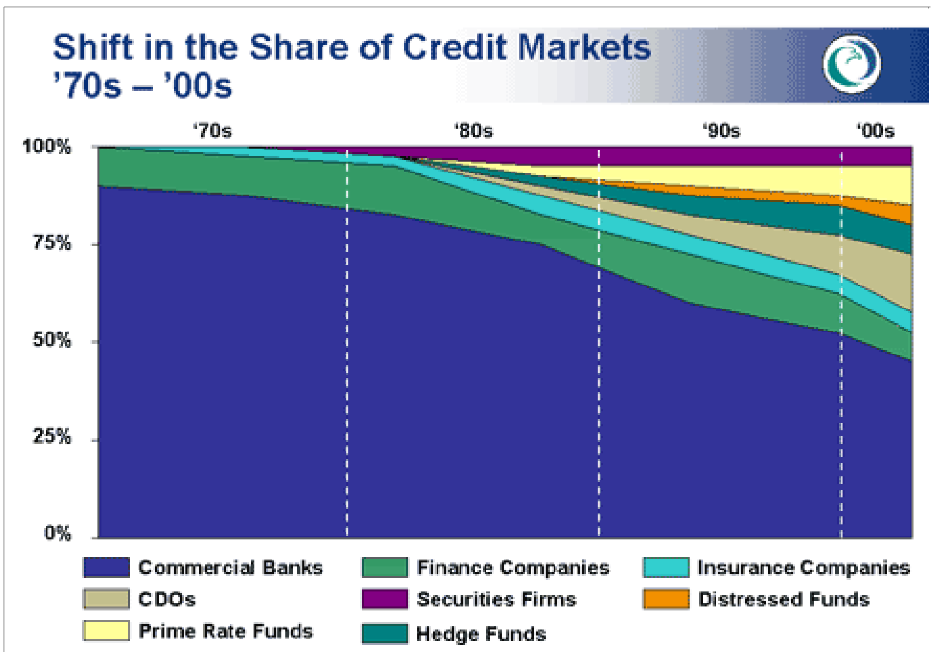
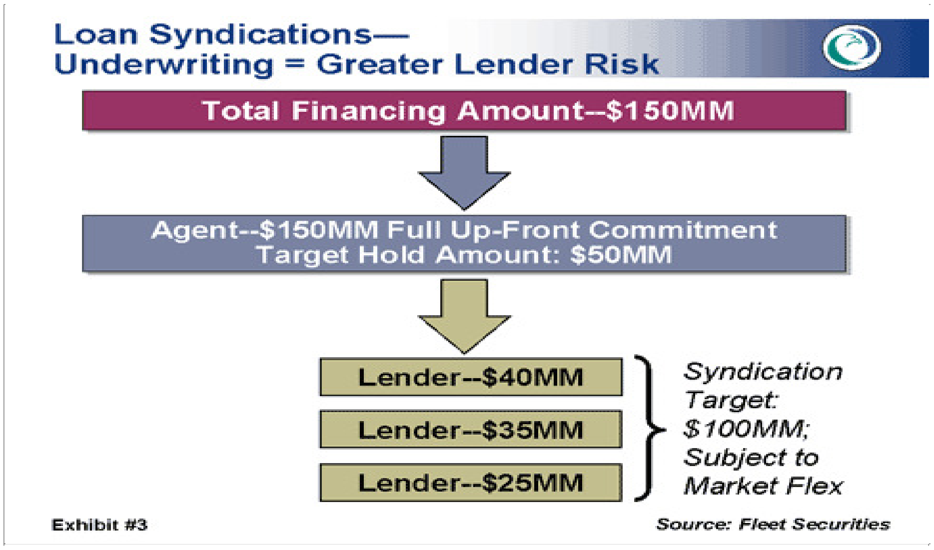


Exhibit #2
Source: Fleet Securities

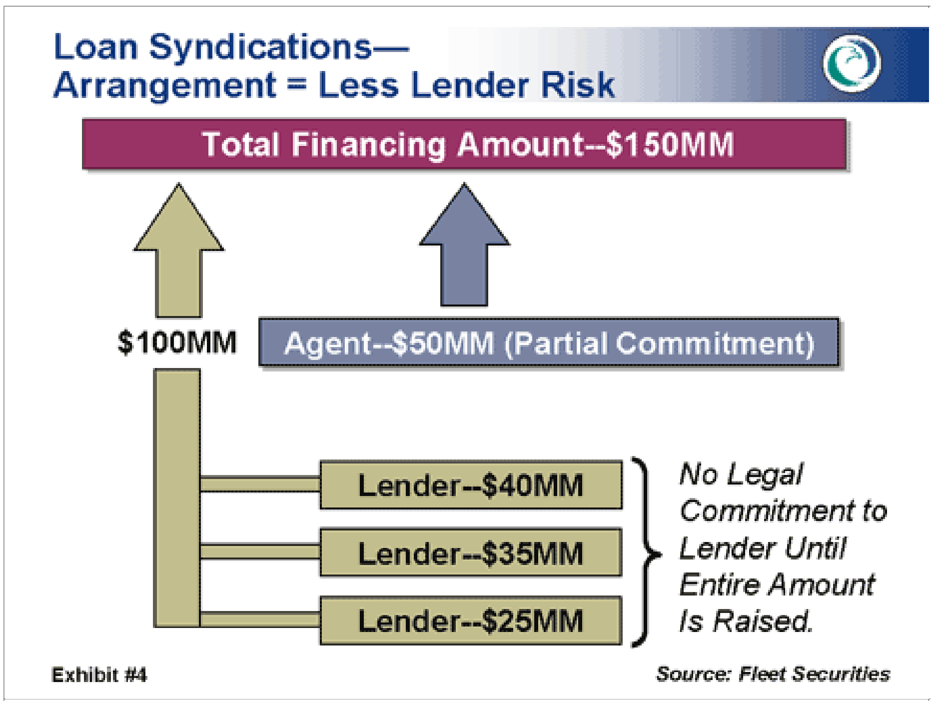
Today's more diverse investor base often requires that a loan be structured to meet the needs of the market. "There is often a revolver and a term loan A and more commonly a term loan B in large deals," says McLane. "The A tranche is targeted at the commercial banks since generally they will hold only the revolver and the shortest term loan. The B tranche is targeted to institutional investors. It tends to be made up of bond-like structures with longer maturities—six years is typical—and deferred amortizations."

The decline in the number of bank lenders isn't the only factor that has affected how large deals get done. Tightened credit, the increase in default rates and the rise in non-performing loans have made banks more risk-averse. Consequently, instead of pure underwriting, lead agents more frequently are arranging deals (Exhibits #3 & #4—Arranging vs. Underwriting).

Exhibit #3
Source: Fleet Securities



"When you underwrite, you're agreeing to write the check for the entire transaction up front, and then sell off pieces of the deal to spread the risk. If you're arranging, you're only committing to a portion of the deal and you have to sell the remaining portion prior to the deal closing. In either case, you want to be the lead arranger and administrative agent," says McLane.



Underwriting typically nets the agent a higher reward than arranging because it carries greater risk. What's more, "market flex" has emerged in fully underwritten transactions. Terms for these deals are dictated more by the market because of flex language in the agreements that allows for shifts in pricing and terms.

Russell Corporation: A Case Study

Bank of America Business Capital recently syndicated a $325 million credit facility for athletic sportswear company Russell Corporation. Russell, the number one supplier of team uniforms and men's fleece, has a long heritage of quality products and customer service, but it was going through a major effort to redirect its business.

"It was a challenge for Russell's large domestic manufacturing operation to remain competitive. Russell was in the process of transitioning production and manufacturing to overseas operations," says Harold Blatt, executive vice president, marketing manager for

Bank of America Business Capital's Southeast/Atlantic region. "Margins were declining and Russell was restricted by its existing debt structure at the very time it required fresh capital to execute its new production strategy."

Russell needed a new, senior-secured credit facility to refinance its cash flow structure, but it was apprehensive about asset-based financing. Bank of America Business Capital Capital assembled a team of people from syndication, high-yield and asset-based lending to develop a proposal. "Long before we got there, we went through a thorough analysis so that we could offer them several opportunities right out of the box," says Blatt. "We went in and said, 'Here's where you are, here's where the market is and here are three or four alternatives that might work for you.' They were impressed with that."

Thomas Johnson, director of investor relations for Russell told *Loan Market Week*, "We liked what we saw in the proposal. Good pricing, terms and their capability were the reasons to switch to Bank of America Business Capital."

Bank of America Business Capital underwrote the full $325 million and was mandated as administrative agent and lead arranger. It brought in J.P. Morgan and SunTrust as co-syndication agents to the deal. CIT and Bank of America were co-documentation agents, and Wachovia and GE Capital were co-agents. The credit line is comprised of a $300 million revolver and a $25 million term loan.

According to McLane, "The former facility wasn't as flexible as the company needed. What we put in place was a supportive bank group and a covenant-light deal that will allow the company to restructure and execute its growth strategy."

Blatt says the Russell transaction is a good example of how asset-based lending has come of age. "Here you had an unsecured company in an out-of-favor industry that needed financing options that would give it flexibility. A lot of former investment grade companies think asset-based lenders are heavy-handed. With Russell, we were able to show that we can build trust, support the business objectives and deliver."

Keys to Successful Syndication

Although the Russell brand name was helpful in putting together the syndication, McLane says having a household name isn't critical to getting a deal done. "If a borrower has a big name—like Russell—it can only help, but it's fine if a borrower doesn't. What's really critical in syndication is the reputation of the lead arranger and administrative agent. If people don't know and trust you in the marketplace, they won't participate. We've been fortunate as Bank of America Business Capital has a great reputation in all parts of the country."

In fact, Bank of America Business Capital is one of the largest asset-based lenders in the country in deals over $100 million. According to McLane, syndicating asset-based deals requires a particular set of skills. "It's a much different approach than with cash flow deals. Asset-based lending requires collateral exams as well as machinery, equipment, and real estate appraisals. There's a lot more collateral due diligence, so you need that experience as well as syndication expertise."

While having a strong agent with a good reputation is the key to successful syndication, McLane says there are other factors as well. "For large transactions of $200 to $300 million, you want good momentum from the beginning. By that I mean commitments early on in the transaction from tier one agents with meaningful sized holds of $40-50 million. With those in place, there's greater certainty that the deal can get done."