

GE Commercial Finance

In a Changing Market, GE's Leveraged Loan Expertise Meets Borrowers' Needs

As the global economy struggles to make headway during a time of rising interest rates and seesawing energy prices, companies seeking debt financing are finding that their options are expanding, observes Sage Nakamura, Senior Vice President with of GE Capital Markets. "The leveraged loan market has blossomed in recent periods, and is becoming both a mainstream financing source for companies and a solid investment for cash-rich investors" he says. "Even companies with less-than-stellar credit ratings, Moody's: B3 - Ba3 and/or S&P: B- - BB+, are finding a wider array of financing options available on competitive terms." But while pricing is important, it's also critical to work with a lender that's committed to your success, say experts from the Wharton School of the University of Pennsylvania.

The Marketplace Seeks Quality Deals

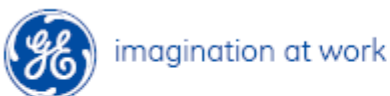
In a typical syndication, the lead lender or lenders and the borrower agree on the terms of the loan; this requires a balance that terms are acceptable to both the issuer and the investors. Syndication allows the lead lenders to reduce their credit exposure to a borrower without damaging the business relationship—but unlike many lead banks, GE tends to hold a substantial portion of the loan post syndication. After the syndication is complete, participating institutions may sell their loan shares in the secondary market typically through an assignment, which requires the consent of the borrower since the purchaser becomes a direct lender, or alternatively through participations which are exceptionally rare today. (In a participation the seller retains the relationship but passes on the payments to the purchaser.)

Either way the lead lender then assembles a group, or syndicate of lenders. The actual syndicate can take several forms. A common example is an underwritten commitment, under which the loan amount is set and the lead bank's share shrinks only if it is successful in syndicating (selling) part of the loan.

Richard J. Herring, professor of international banking and co-director of the Wharton Financial Institutions Center, has previously noted that the quality of a match between a financial institution and a borrower can depend on a number of variables, including the size and age of the borrowing firm.

"When a small business looks for a lender, the issues are usually not very complicated," according to Herring. "But middle-market [and larger] loans may be harder to syndicate, and require a different set of structuring skills on the part of the lending institution."

GE's abilities have been recognized by the marketplace, says GE's Nakamura. He notes, for example, that industry surveys consistently rank GE Capital Markets as a top lead arranger as measured by dollar volume and by number of deals.



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In September 2005, Delta Air Lines, Inc entered into a \$1.9 billion Debtor In Possession credit agreement, where GE served as the administrative agent. In fact, this was one of GE's largest syndicated transactions to date. According to Nakamura, the deal was well oversubscribed with commitments far exceeding the \$1.9 billion from the more than 145 participating investors.

"This represented a watershed deal for GE and demonstrates robust investor demand for a well-structured, competitively priced financing deal," Nakamura says. "Although traditional banks have retreated from the leveraged loan market compared to their historical involvement—driven by consolidations that have thinned their ranks, and concern about non-investment grade exposure—institutional lenders like CLOs [Collateralized Loan Obligations], CDOs [Collateralized Debt Obligations], hedge funds, insurance companies and finance companies like GE have filled the gap."

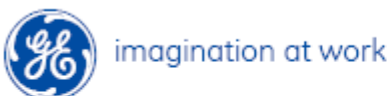
He adds that a tremendous increase in liquidity has enabled financial providers to place senior debt at historically low rates, giving debtors an attractive alternative to more costly strategies like mezzanine debt and the high-yield bond market. At the same time, however, providers are closely examining the risk-reward ratings of potential borrowers.

As Debt Structure Shifts, Lenders focus on Quality

"During the past few years the prevailing loan structures for leveraged non-investment grade companies have changed," notes GE's Nakamura. "As investors prefer a non-amortizing asset to preserve their investment, borrowers moved away from the Term Loan A format and instead embraced the non-amortizing Term Loan B format." Today, he observes, the debt market is oriented towards a small, revolver component with a large Term B—often with 1% amortization during the life of the loan, and the balance amortized in the final year or two.

"Simultaneously, leveraged non-investment grade borrowers moved away from mezzanine loans and instead embraced the Second Lien Loan structure," adds Nakamura. He says that second lien financing is less expensive than mezzanine or equity-based capital, and is typically non-dilutive to the borrower. Other advantages include greater flexibility than mezzanine, less onerous call provisions, and the additional liquidity it offers to borrowers.

"These alternatives generally offer borrowers more flexibility and a lower weighted average cost of capital," he adds. "The spreads on revolvers, Term Loan As, Term Loan Bs and second-lien loans are all LIBOR based; LIBOR rates themselves have climbed significantly from 1.5% a few years ago to a current rate of about 4.75%."



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Financing Structure	High Yield	Second Lien	Term B	Cash Flow Revolver	Asset-Based Revolver
Security	Yes/No	2 nd lien	Yes	Yes	Yes
Cost	6-12%	L+3.5%-9%	L+1.25%-4%	L+1.25%-4%	L+1%-3%
Fees	2-3%	2-3%	1-2%	1-2%	0.5%-1.5%
Term, years	7 to 10	3 to 5	3 to 7	3 to 5	3 to 5
Amortization	bullet	bullet	1% amortization plus bullet in final year	n/a	n/a

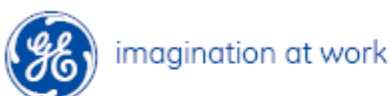
Issues to Consider

“There’s no single best structure for a debt facility—instead a company’s individual circumstances need to be considered,” notes Karen Van de Castle, Senior Vice President with GE’s Capital Markets team. “With this in mind, a corporate borrower will be best served by maintaining close contact with its lender, who should closely examine the company’s unique situation and the current options in the ever-changing debt markets.”

One initial consideration is the amount and tenor of the facility (in other words, how much “leverage” the company can comfortably handle), since this issue tends to have a significant effect on the terms of the deal. Fortunately for borrowers, the market currently is accepting a historically high level of leverage; although recent rate increases have tempered the option of even higher leverage.

A borrower’s ability to get the kind of financing it needs may also depend upon its willingness to accept flex in the final pricing structure. Just a few years ago that used to imply a price “flex up,” or a closing price that was higher than what was discussed at the beginning of the transaction. Today though, if demand is strong and if there’s significant oversubscription during the syndication, it’s common for pricing to flex down.

The decision to seek a third-party credit rating for a loan, or to proceed without a rating, may also affect the ability of a lender to syndicate the debt. Although the process means more paperwork and may add to the expense of the transaction, many investors use the ratings as a primary indicator of risk, and will base their loan investment decisions on them. An experienced lender will be familiar with the way ratings are conceptualized, designed, operated and used in risk management, and will be able to advise borrowers accordingly. Term Loan Bs, for example, are usually rated by Moody’s and S&P and are sold to institutional investors that require loan ratings. These term loans are often attractive assets for a CLO pool whose pool assets must comply with rating agency criteria for the CLO, including a minimum rating requirement.



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GE Keeps Up With Changing Trends

As activity increases in the Term B loan markets, more borrowers are discovering the value of working with a lender that has an in-depth understanding of underlying valuation, pricing and other issues.

“In the early 1990s the U.S. leveraged loan market was dominated by banks,” says GE’s Van de Castle. “Since 1997, traditional banks’ share of the market began declining while GE and other financial institutions expanded their role. In this environment and going forward, GE’s broad-based expertise and ability to underwrite and syndicate big-ticket debt facilities like Delta Air Lines, Inc are increasingly valuable. As this market sees even more expansion, GE’s long-term commitment to clients—and the resources we have in place to support that commitment—will enable us to continue to meet the needs of a growing number of companies.”

“GE has unique expertise gained from a long history of involvement with industrial businesses,” adds Van de Castle. “Banking and other institutions generally can’t offer this broad experience. Another significant advantage is that borrowers take comfort that GE typically holds a large portion of the deals we syndicate.”

The leveraged lending market continues to rapidly expand domestically in the U.S., and across Europe,” observes Van de Castle. “Companies are seeking competitive financing, and GE is working hard to meet their needs,” she says.

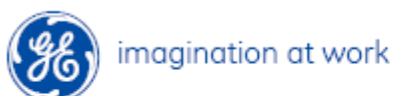
GE Plays Central Role in Delta Air Lines, Inc Financing

When Delta Air Lines, Inc which is operating under Chapter 11 protection, wanted to regain access to the credit markets as part of its proposed reorganization, the company turned to GE for Debtor-In-Possession financing. GE Capital Markets served as lead arranger and bookrunner for the competitively priced and well-structured facility, which generated excess demand. It was oversubscribed by a factor of nearly three, with over 145 investors eventually committed to it.

The transaction was upsized from an initial \$1.7 billion to the final \$1.9 billion deal, comprised of a 30-month, \$600 million Term A tranche, a 30-month, \$700 million Term Loan B, and a 30-month \$600 million Term Loan C tranche.

In March 2006, the DIP was repriced at more attractive pricing to the company, with spreads on all three tranches decreased. GE remains committed to meeting customer needs long after the deal is structured.

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Case Study: Benchmark Medical Turns to GE to Meet its Financing Needs

When Benchmark Medical Holdings, Inc. wanted to secure \$150 million to refinance existing indebtedness and issue a dividend to the existing shareholder, the Malvern, Pa.-based company discovered that having the loan underwritten and subsequently syndicated to the leveraged loan market would result in the lowest cost of capital. So Benchmark, the fourth largest provider of outpatient rehabilitation services in the U.S., turned to GE for a solution.

“Based on Benchmark’s EBITDA [earnings before interest, taxes, depreciation and amortization] our team of underwriters was able to structure a multi-tiered facility that met the borrower’s needs,” says Sage Nakamura, Senior Vice President with GE’s Capital Markets team. “The deal encompassed a five-year, \$30 million revolver at LIBOR+300, an \$85 million, seven-year Term Loan B at L+300, and a second-lien loan for \$35 million for seven-and-a-half years at L+700.”

He notes that there’s a growing demand for Benchmark’s services, which include a broad array of value-added, synergistic physical therapy that encompasses Outpatient Rehabilitation, Orthotics & Prosthetics, and Industrial Rehabilitation (workers’ compensation).

“Investors were initially concerned over the high leverage, especially for a dividend recapitalization, but a new management team led by the former CEO of Caremark, Lance Piccolo, and strong recent financial performance drove the positive market reception for this deal,” says Nakamura. “The fact that Wind Point Partners has maintained a controlling ownership share in the company since 1999 was also viewed as a vote of confidence in the firm.”

As things developed, the deal was oversubscribed, and pricing on the Term Loan B was reverse flexed from L+325 to L+300. Following the flex announcement, all of the committed lenders remained with the deal, which indicated an appropriate balance between achieving the lowest cost for the company, and ensuring investors were satisfied with the yield on the loan.

“Due to its size and geographic diversification, Benchmark Medical Holdings achieves significant economies of scale while still leveraging strong local market relationships with referring physicians,” Nakamura adds. “Besides working with middle-market companies like Benchmark, GE has also demonstrated its expertise with larger clients like US Airways, which recently benefited from a syndicated \$1.25 billion refinancing.”

