Piles of cash for mid-market companies in Western Europe - alternative capital providers and international banks keen to lend

Following the financial crisis and tighter regulations on capital requirements for banks, local bank credit has become harder to tap for mid-market companies, even for those performing strongly. Fortunately some international banks have remained active, while alternative capital providers have been filling the gap, providing a vast array of attractive and customizable solutions.

Key findings:

- **Non-bank capital**: The number of capital products available to mid-market companies has increased substantially in recent years - beyond simple bank debt, to include alternative debt, mezzanine/subordinated debt and naturally equity financing.

- **International capital**: Capital can be sourced from further abroad. International capital providers have become important players in the European mid-market, filling the gaps left behind by traditional bank lenders.

- **International bank appetite**: Traditional bank credit will always play an important role in the financing of mid-market companies, both locally and internationally. A growing number of international banks are also looking to exploit opportunities outside their home market.

- **Non-transparency of capital**: The market for financial solutions has never been known for its transparency. Paradoxically, there are now so many new and sometimes complex alternative financing products to choose from that management run the risk of missing the best possible solution.  

- **International advice**: Mid-market companies are increasingly seeking (international) professional financing advice to support their strategic objectives. Financing advice is a high-level ‘contacts game’ that requires an accomplished track-record and genuine knowledge of all the national and international capital providers, including banks, debt, mezzanine and equity funds.

"The market for non-bank debt is booming. Debt and mezzanine funds in Europe and further abroad are more than ever interested in financing mid-market companies. Even businesses that have traditionally relied on banks and Private Equity investors are also turning to alternative (international) capital providers for different layers of finance and risk."
International banking landscape

Local banking markets have become highly concentrated in recent years; only a small number of banks are effectively serving the needs of mid-market companies in Western Europe. Whilst local banks remain useful for cash and treasury management purposes, mid-market companies should be looking to forge partnerships with international banks in nearby European countries. To do business with these banks, it also helps to have active operations in one or more of these countries; this is also a good door-opener for financing larger group operations.

Figure 1: Some of the leading Western European banks for mid-market companies (Source: Capitalmind)

Although debt financing by banks in Europe has decreased substantially since the financial crisis, there is still sufficient liquidity and a healthy appetite for lending in the current market environment. Success depends on a number of factors, such as the size of the company, the (sub)sector, and the type of financing required (e.g. growth, refinancing, restructuring). Notwithstanding, as a general rule, international banks are seeking lending opportunities in Europe and outside their homemarkets.

Restrictions on (leveraged) lending from banks has given rise to an abundance of new debt (like) funds in Western Europe. Financing options for mid-market companies have substantially increased.

Figure 2: The emergence of debt funds since 2008 (in the USA this trend is even much more advanced)

Lender/arrangers in 2008

Lender/arrangers in 2016

While they may be active in other above-mentioned countries, banks are mentioned in their 'headquarter country' only.
Financing the Future

Development of non-bank lending in Europe

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<td>• Lending is dominated by European banks.</td>
<td>• At the height of the market in 2008, roughly two-thirds of all leveraged loans are ultimately held by institutional lenders in syndicates.</td>
<td>• After the crisis, underwriting appetite of arranging banks almost completely disappeared.</td>
<td>• The banks’ poor underwriting appetite paired with more restrictions on their own balance sheet has given rise to the growth of debt and alike funds.</td>
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<td>• Most deals are being arranged on a domestic basis.</td>
<td>• Nevertheless, the vast majority of leveraged deals are arranged by European banks with international banks from the US, Canada and Japan becoming active in the mid-market as well.</td>
<td>• New loans are made by European banks in club deals again.</td>
<td>• Unitranches (6-8 year bullet tranches combining senior and mezzanine loans in one tranche at 7-8% margins) allow lenders to negotiate with one debt provider (fund) rather than with a club of banks.</td>
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<td>• We used to see more underwritten deals (by one bank), but club deals (several banks), started to become more predominant.</td>
<td>• Mezzanine and increasingly second lien products account for 10-20% of the overall market.</td>
<td>• Senior loans are structured as A/B loans with 5/6 year maturities and amortising A tranches.</td>
<td>• In 2016, the market appeared to have reached an equilibrium, with some 25% of all deals being arranged by unitranche funds, and 75% by banks.</td>
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<td>• Leveraged loans typically arranged as fully covenanted amortizing loans with mostly 7 year maturities (mezzanine: 8 years).</td>
<td>• Senior loans are structured as B/C loans with bullet repayments after 8/9 years (second lien/mezzanine bullet after 9.5/10 years).</td>
<td>• Subordinated debt products such as mezzanine and second lien are rarely seen.</td>
<td>• Also, debt funds have been expanding further, with new senior funds being raised at 4-5% margins.</td>
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Debt and other ‘debt-like’ funds often provide greater flexibility, in terms of:

- Repayments (‘bullet’ versus amortization)
- Interest payments (e.g., Payment-In-Kind, ‘pay if you can’)
- Financial covenants (‘cov-lite’)
- Additional facilities for capex/acquisitions
- Due diligence requirements
- Leverage

Case study

Founded in the Netherlands in 1998, Interxion is a leading pan-European provider of carrier and cloud-neutral colocation data centre services (45 data centres in 13 European cities). The Nasdaq-listed company serves 1,600+ companies and is a highly profitable business, with revenues of more than €420 million and EBITDA of €191 million in 2016.

Capitalmind has been advising Interxion and their PE firm shareholders since 2005 - on inter alia strategy, valuations and financing arrangements:

- We initiated relationships with several international banks;
- We assisted in a step-up financing from EUR6 million, to more than EUR300 million;
- We advised on a EUR135 million revolving credit facility during the height of the financial crisis in 2008, arranged with Rabobank and ING Bank (widely regarded as a leading bank deal);
- We advised on the refinancing of a large French real-estate project in 2013, in which a club deal was formed with three leading French banks: Oseo, CIC and BNP Paribas;
- We advised on the acquisition of a data-center business from Vancis, in 2017;
- We assisted with the issuance of a high-yield bond.
**Non-bank capital providers: features and risk/return**

Capital providers (excluding traditional banks) include (*):

- Debt funds and other debt providers;
- Mezzanine funds, which offer a mix of debt and equity financing;
- Equity providers such as Private Equity (PE) firms, Venture Capital (VC) funds, Family Offices, and other investors;
- Alternative capital initiatives such as crowdfunding.

Although crowdfunding is growing strongly, the European market is currently still small, with a relatively modest ticket-size - up to EUR 1-2 million. As a result, this segment is not explored in any detail herein.

*Excludes Initial Public Offerings (IPOs) and other capital market possibilities.

These providers offer genuine alternative financing solutions across the globe, and make capital raising for mid-market companies more akin to the opportunities enjoyed by large corporates. In addition, these capital providers can jointly fund companies, working together in different layers of financing and risk.

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**Table 1: Different types of financing: general features**

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<th>Types of funding</th>
<th>General features (exceptions and combinations possible)</th>
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| Senior Debt            | - Provided by banks, debt/unitranche funds or via private placement;  
                        |   - Based on collateral and/or cash flows;  
                        |   - Fully secured (by collateral) most of the time;  
                        |   - Tenor: 1 to 7 years; cash interest;  
                        |   - Amortizing or bullet repayment;  
                        |   - **Unitranches** are a specific offering by dedicated funds that combine senior and subordinated structure elements.                                                                                                                             |
| Junior Debt / Subordinated Debt | - Provided by banks, debt funds, and/or private placement;  
                                |   - Based on cash flows and/or collateral;  
                                |   - Generally secured ranking after senior debt;  
                                |   - Tenor: 6 to 8 years; cash interest or capitalizing (PIK) elements and sometimes capital gain via warrants/options  
                                |   - Bullet repayment;  
                                |   - Ranks after senior debt.                                                                                                                                                                                                                       |
| Mezzanine              | - Provided by mezzanine funds and/or debt funds;  
                        |   - Based on cash flows;  
                        |   - Combination of interest and capital gain (via warrants/options);  
                        |   - Tenor: 6 to 9 years;  
                        |   - Bullet repayment;  
                        |   - Ranks after senior and junior/subordinated debt;  
                        |   - **PIK notes and loans**, also provided by mezzanine and hedge funds, are not described here.                                                                                                                                                   |
| Equity                 | - Provided by PE and VC investors, in most cases;  
                        |   - Based on valuation considerations (often cash flows);  
                        |   - Capital gain at exit (plus dividend when tenor is longer);  
                        |   - Holding period: 3-20 years (average 5-7 years);  
                        |   - Ranks behind all types of funding: risk bearing capital.                                                                                                                                                                                        |
Some 300 of these debt (like) and mezzanine funds are based in Frankfurt and London.

Thorsten Gladiator, Partner Capitalmind (Frankfurt)
has almost 25 years experience in the European debt markets, working with many specialized products.

Before joining Capitalmind in 2016, Thorsten was Head of Leveraged Finance at Commerzbank (the leading German Mittelstandsbank), where he arranged more than 100 deals, ranging from bilateral loans to multi-billion underwritten LBOs including high-yield financings. He previously worked at UBS Investment Bank and Dresdner Kleinwort.

Andrew Shellard, Partner UK (London)
has 25+ years experience in the corporate and leveraged finance/debt markets, including traditional bank financing, as well as debt capital markets and private placement markets.

Before joining our UK firm, Andrew was Global Head of Debt Advisory at Barclays, responsible for raising more than £100 billion of debt capital for a wide range of companies across multiple sectors.

Selection of the main international debt (like) and mezzanine funds in(to) Western Europe
International debt and mezzanine funds

Substantial regulatory pressure is forcing banks to review their credit lending policies, especially with respect to higher-risk loans (i.e. sub-investment grade), which has led to reduced credit funding for mid-market companies. Even long-term lending arrangements with (large) corporates are being heavily scrutinized by relationship banks. Meanwhile, alternative lenders such as direct lending funds and other non-bank financial institutions are looking to fill the funding gaps with products such as senior debt loans (e.g. unitranche), subordinated loans (e.g. second lien, mezzanine loans, PIK loans) and/or asset-based loans (e.g. factoring, leasing).

Senior debt funds

In the aftermath of the financial crisis, an increasing number of private debt funds started to dip into the European mid-market, providing senior debt directly to borrowers - i.e. sometimes without an arranging bank. These debt funds have since won significant market share, thereby displacing a large amount of traditional bank lending. Numerous debt funds from the UK, Germany, France, the Nordics and even the US have become active across Europe.

Highlights:
- Senior debt funds usually offer greater flexibility than banks in terms of repayment schedules, maturity, additional facilities (e.g. to fund capex and acquisitions), and documentary terms (e.g. covenant headroom or even ‘cov-lite’ loans).
- Senior debt funds accept higher risks than banks, e.g. unitranche loans tend to be 0.5-1.0x EBITDA - higher than similar bank loans.
- In return, margins and fees tend to be slightly higher than bank loans of the same risk.
- Banks often syndicate larger loans to other banks, however international senior debt funds can individually commit up to EUR 300+ million, while local funds can also provide smaller amounts.
- The speed of the decision making process is typically quicker than banks.
- As local banks are usually required for services such as cash management and letters of credit, senior debt funds often lend to mid-market companies in cooperation with local banks, which may mean super-senior status with respect to collateral, if necessary.

Subordinated debt / Mezzanine funds

Like senior debt funds, subordinated debt funds such as mezzanine funds are actively looking for opportunities in the European mid-market. Most of these subordinated debt funds originate from the UK, Germany, France, the Nordics and even the US. For example, the Benelux banks NIBC and ING and the Dutch insurer Delta Lloyd are all offering mezzanine/hedge financing. Due to the higher risk profile than senior debt, subordinated debt can be viewed as a hybrid product that lies somewhere between (senior) debt and equity.

Characteristics include:
- Subordinated debt includes second lien loans, mezzanine, PIK notes and similar local products (e.g. preferred equity, silent participations, etc.).
- Providers will generally seek a risk profile between senior debt and equity with corresponding pricing.
- Margins may contain PIK (i.e. capitalising margin) and upside elements (e.g. equity warrants).
- As a general rule, subordinated debt ranks below senior debt and therefore increases the overall debt capacity of the borrower. On the other hand, subordinated debt does not dilute owners’ equity in the company.
- It may be issued by holding or financing companies, which rank above operating companies.
- Subordinated debt may require a higher level of involvement e.g. board observer rights.
- It is offered by mezzanine funds, direct lending funds such as unitranche funds, PE firms and sometimes even banks.
- Subordinated debt is often used to fund strategic growth such as acquisitions, capex, new product lines & international expansion.

Critical success factors for financing

- One of the most important steps in the funding process is to clearly define the Request For Funding Proposal: what is the exact funding requirement and where will the proceeds go? Companies need to determine their objectives and needs (e.g. on operational flexibility).
- Compile a realistic and concise Information/Financing Memorandum that adheres to the outlines (do not write a novel).
- Ensure that all the (audited) financial information is available in a timely fashion. This includes (audited) annual accounts, half-year figures and YTD figures.
- A financial model is also needed, including P&L and definitely (monthly!) cash-flow projections.
- Keep the financial model simple.
- It is also important to set a realistic timeline for the funding process. For example, by sending a procedure letter to all potential financiers in the process.
- Last but not least, it is strongly recommended that companies approach several (international) financiers in order to gauge interest and compare opportunities - to find the best possible fit and solution.
Our selected Financing deals

We can help to finance your future (or refinance your past)

Since 1999, Capitalmind has developed extensive experience in the field of capital raising, working with international financiers across the full range of capital solutions. We have advised a large number of mid-market companies, while our regular clients also include corporates and private equity firms - we arrange funding for many of their group/portfolio companies. Most importantly, our discrete and down-to-earth approach opens doors with financiers at the appropriate (high) level.

We raise international capital, including:
- Debt
- Alternative debt
- Mezzanine capital
- Private Equity
- Venture Capital
- Family Offices

Contact us
Capitalmind has a highly experienced Financing team.
If you would like to discuss this report in more detail or opportunities for your business, call:
Capitalmind is one of the largest independent corporate finance advisory firms in Europe, owned by its partners. Since 1999 we have provided unbiased advice to mid-market companies, entrepreneurs, (private equity) investors and large corporates on selling, buying and financing businesses all over the world, and in the following sectors:

- 200+ closed transactions in the last 5 years - 500+ since 1999
- Worldwide access to strategic/financial players and likely buyers
- Team of 60 experienced professionals in Europe; plus 300 worldwide, via our international partnership
- European Headquartered advisory firm, with offices in Benelux, France, Germany & the Nordics
- We have received numerous awards

Smart advice, by your side, worldwide