Investec

How thoughtful structuring can maximise returns

Leverage is often the key to reaching return targets, and something which sponsors are understandably keen to take full advantage of in order to avoid leaving money on the table.

In most cases, it's fairly straightforward to maximise leverage at the operating company level.

However, we're increasingly being approached by sponsors who face a challenge: although they want to optimise leverage, they face constraints on the amount of debt that they can put onto the associated operating company.

There are a few potential reasons for this, with some of the most common being:

- The asset may be a regulated entity, where a regulator effectively places restrictions on the amount of leverage a company can take on
- In certain industries (such as energy), supplier-imposed leverage limits can be common
- In the case of a minority investment by the sponsor, a management team may be unwilling to take on additional leverage
- LLPs or partnerships often involve specific restrictions on partnership level debt for succession planning reasons, despite being coupled with a financial investor who still requires leverage to drive value

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"We can support sponsors by creating structures which allow them to leverage their equity further, without maximising debt at the operating company level."

Callum Bell

How does it work?

At a high level, this is typically done by structuring debt further up the sponsor's ownership chain, at a holdco (rather than opco) level. This increases sponsor leverage, without affecting leverage for the opco.

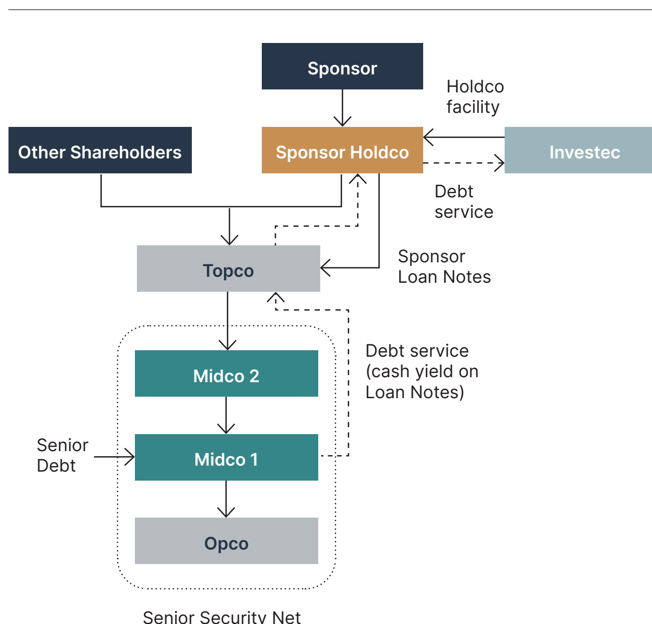
The diagram opposite illustrates an example where a minority investor had inherited a relatively conservative debt package, leaving significant equity value behind the senior debt. The sponsor approached Investec with the intention of leveraging its preferred loan notes to help fund the share purchase.

In this case, Investec was the incumbent lender to the operating business, and therefore already knew the underlying credit and management well – but this isn't a requirement for holdco lending.

Another example is a high-growth but relatively young business with limited day one debt capacity. In this case, the business was purchased by a sponsor who took a minority position, which caused them to exceed their fund concentration limit.

To solve this problem, we created a structure where Investec purchased a portion of their loan notes for a discounted share of the equity by effectively taking security over their loan note stack. This married Investec's desire for downside risk protection with the borrower's need to maximise returns – while leaving the opco clear to increase leverage at a later date.

Indicative deal structure



"Whilst every set of circumstances is unique, the broad principle of success lies in using surplus value in the group structure to support bespoke lending."

Helen Lucas

Who provides it?

Many banks aren't able to provide holdco financing due to the relatively complex structuring required. Some funds are willing to lend at a holdco level, although because the amounts involved are usually relatively small, it might not reach the required size for some larger funds. As a result, the universe of providers is relatively small.

What next?

Investec is an experienced lender in this market, and is able to provide fully bespoke solutions designed to use available leverage by lending at a holdco level. Whether it's in response to the opco restrictions mentioned, to boost a sponsor's returns by taking a bridge to an impending exit or because calling down equity from LP's is returns dilutive, we can help. Investec matches a strong credit underwriting capability with a positive mindset, allowing us to find creative solutions.

If you would like to find out more, contact Alexander Geyer or Helen Lucas

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