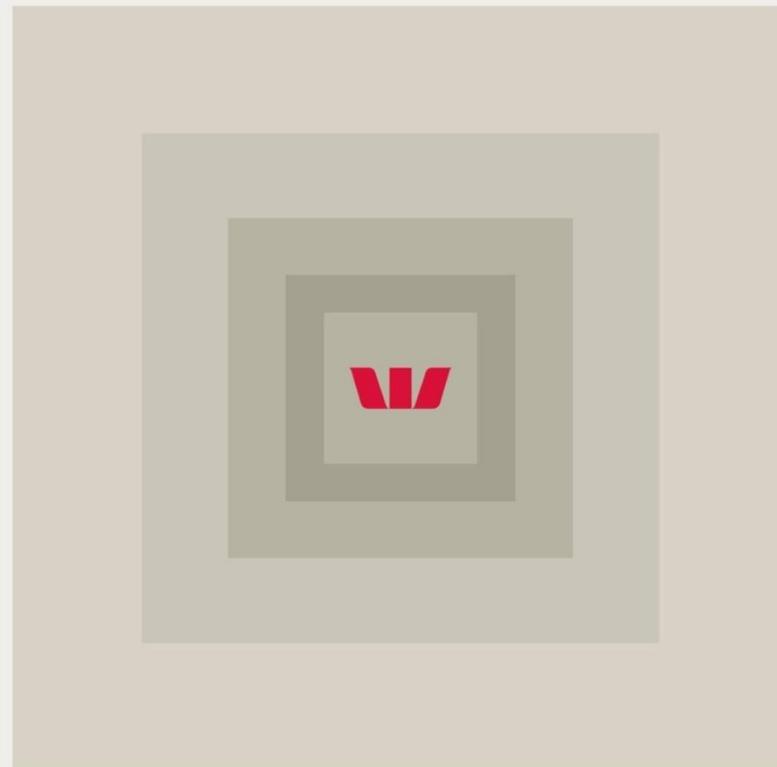


BFSLA Intercreditor Terms

August 2012



Introduction

- The buy-out industry has had a significant rethink on how Subordinated debt works with Senior.
- The practical experience during/post the GFC when dealing with intercreditors highlighted some areas that needed work
- Key Senior lenders have worked together with legal firms in seeking input from Subordinated lenders and their advisors.

Background

- Limited number of active players in the Australian & New Zealand subordinated debt market.
- Some poor experiences during the GFC led Senior & Subordinated lenders to be more sophisticated in understanding subordinated creditor rights.
- Default position post the GFC was to resist Subordinated debt enforcement rights.
- Limited transaction execution since the GFC.
- Limited Subordinated debt underwrite or hold appetite from senior lenders.
- Historical dislocation between return requirements of institutional investors and private equity investors.
- Historical trend has been for the local market to follow European precedent despite many differences in demand and supply dynamics and deal structures.
- Trading Banks have been leading an industry wide project to standardise intercreditor terms.
- Retail bonds have been an alternative for large buy-outs with strong brands.

Market needs to be reset for Aust and NZ

Approach

- Strategic aim is to improve liquidity.
- We believe the market works better as a Senior/Subordinated market vs Stretch Senior market (risks are more balanced).
- The aim of the project has been to take a balanced approach, recognising the needs of each of the players (Equity, Subordinated lenders and Senior lenders).
- The suggested framework has already been tested and accepted in a number of recent deals and widely communicated amongst the Subordinated Investor market. As a result the base terms outlined here have been used in
 - 3 Leverage Corporate acquisitions; and
 - 3 Sponsor acquisitions
- Outputs of the Project are:
 - Standardised key terms & definitions;
 - Downside protection for Senior and Subordinated lenders;
 - Greater flexibility to execute a restructure;
 - Standard set of principles with ability to negotiate around deal specifics.

Lessons Learned

- Retail chain purchased by Private Equity during the peak of acquisition finance activity.
- The business had a long track record spanning over decades and multiple economic cycles.
- As a traditional retailer the fixed operating expenses were invariably high.
- The quality of the sales proposition; range, price and the buying experience to the customer base helped limit volatility.
- The business displayed reasonable scale and efficient operational efficiency in supply chain, sourcing, shipping, warehousing and delivery.
- The decision to rent premises led to high fixed cost base and operating leverage.

Lessons Learned

- Initial strategy was to:
 - Defend & grow market share
 - Regional expansion
- Key risks included:
 - Overall market downturn
 - Reliance on overseas suppliers
 - Execution of store roll-out
 - Competition from National Retailers

Lessons Learned

- The following competitive advantages were thought to exist at origination:
 - Lowest retail prices
 - Lowest operating costs
 - Large range
 - Excellent value for money
 - Store locations
 - Supplier relationships
 - Customer focus

Lessons Learned

- Problems began.....
 - Consumer sentiment waned
 - Revenue dropped
 - Covenants were breached
- The Intercreditor
 - Allowed Senior to lock-up the Subordinated interest payments....indefinitely
 - Subordinated debt had very limited rights to enforce BUT Senior lenders needed their consent to:
 - Reduce scheduled amortisation
 - Increase the cash sweep
 - Increase the margins
- Ultimately a restructure was completed and the business is currently trading well....but the length of the restructure caused a lot of difficulties for the Company.

Lessons Learned

Are Enforcement Rights...or the lack thereof....the key to a 'good' intercreditor deed from a Senior lenders perspective

or is there more to it?

Summary Terms

Lock-Up on Sub Debt

- Payment blockage if any of the following events occur:
 - Senior Debt payment default
 - Breach of interest suspension covenant (usually linked to DSCR ratio set [0.05x] above the Senior covenant)
 - Senior EoD or Potential EoD → issue of Stop Notice
 - usually restricted to 180 days
 - limits on number of Stop Notices per 365 day period
- Additional proviso – payment of catch up interest only allowed if payment will not cause breach of financial covenants.

Comment

This is a typical construct and has not been contentious in Aust/NZ deals. From a Senior Lenders' perspective there was previously discussion on:

- Whether the 'catch-up' should be pre or post the Excess Cashflow Sweep, with the market settling on a pre-sweep construct

Summary Terms

Amendments and waivers

- Greater flexibility to amend following provisions (and related definitions) in Senior Documents without Sub Debt consent:
 - repayment profile provided not more onerous
 - cash sweep up to a maximum of [#]% of Excess Cashflow
 - pricing increase up to a maximum of [#]%
 - reasonable restructure fees
 - financial covenants within [#]% of current applicable levels
 - additional finance debt within pre-agreed thresholds/parameters
- Drag-along rights - do not extend to:
 - Sub Debt CPs
 - certain Sub Debt Events of Default: usually insolvency, Change of Control / sale of all or substantially all assets and changes to Core Business, breach of financial covenants
- Drag-along to be consistent with greater flexibility on amendments

Comment

During/post GFC Senior lenders often struggled to provide Borrowers with an agreed Senior restructure without Subordinated lenders. These Amendment & Waiver provisions allow Senior lenders to complete restructures more efficiently.

Summary Terms

Refinancing and Additional Senior Debt	<ul style="list-style-type: none"> • Refinance on terms + quantum (including headroom) consistent with current Senior Facility but only with term equal to the current Sub Debt maturity. If longer maturity, Senior and Sub will then rank pari passu • Additional Senior Debt up to an agreed headroom • Additional ability for Senior to re-set financial covenants and lock-up levels <p>Comment: Our review of intercreditor arrangements found some inconsistency, particularly on the ability to raise additional Senior Debt.</p>
Acceleration	<ul style="list-style-type: none"> • Acceleration and enforcement to be subject to same restriction <p>Comment: we occasionally saw regimes where Acceleration & Enforcement were treated differently, from a practical perspective we did not see a clear rationale for the differing treatment.</p>
Enforcement	<ul style="list-style-type: none"> • Traditionally in the Aust market, Sub Debt can only enforce if: <ul style="list-style-type: none"> ➤ Senior Debt is accelerated/enforced; ➤ Sub Debt not repaid on the Sub Debt maturity date (usually 6 months following maturity of Senior); ➤ standstill period elapsed after Sub Debt has been locked up or Sub Debt EoD has been subsisting (more recent development).

Summary Terms

Enforcement – standstill periods

- Suggested additions - Sub Debt permitted to enforce if Sub EoD is subsisting after the following standstill periods:
 - where Sub Debt has not been paid by Borrower's wilful default and a period of [#] days has elapsed
 - 180 days elapsed since:
 - Sub Debt has not been paid (except by reason of wilful default or Lock-Up)]
 - occurrence of any other Sub EoD (without waiver/remedy) where $SLR < [#]x$
 - 360 days elapsed since occurrence of Sub EoD (without waiver/remedy) where $SLR > [#]x$
 - where Sub Debt has not been paid by reason of a Lock-Up but no other Sub EoD:
 - 180 days elapsed since 1st Calc Date or Stop Notice which triggered Lock-Up (and Lock-Up is still subsisting); and
 - further 180 day standstill period
- Senior Debt controls enforcement proceedings

Comment: Various regimes were in place and lacked consistency. Post GFC Senior lenders strongly resisted any form of Sub debt lender enforcement rights. This is considered the key trade-off for the improved Waiver & Amendment regime. Discussions continue on the impact of a Lock-up and whether this allows Sub debt lenders to enforce or not. There are deal-by-deal solutions on this point.

Feedback from Subordinated Lenders

- The Project team has sought and received feedback from key market players.
- Key items for discussion:
 - Minimum sale standards; Deemed Release
 - Right to attend meetings.
 - The key negotiation points are Senior Lender amendment rights, drag along carve outs, Mezz Lender amendment rights
- Otherwise terms are agreed and are being widely used.

Summary Terms

<p>Minimum sale standards</p>	<ul style="list-style-type: none"> • Subordinated Debt lenders are predominantly offshore based – offshore markets typically do not afford the same protection as s420A of the Corporations Act in Australian markets • As a result Minimum Sale Standards clauses are typical in offshore documents and their absence in the local drafting caused some concern to offshore players. • Provisions relating minimum sale standards by which Senior Lenders must abide to be negotiated on a deal by deal basis and may include: <ul style="list-style-type: none"> ➤ Specifying the statutory sale standard under s420A of the Corporations Act ➤ Inclusion of tests such as an auction conducted with the advice of a recognised Big 4 accounting firm or investment bank • The Minimum Sale Standards clause then works in conjunction with the standard Deemed Release provisions, which provides if the shares/units of an Obligor are disposed of, then all Subordinated Secured Moneys will be released. Subordinated Debt lenders feel less aggrieved with Deemed Release given the Minimum Sale Standards clause
<p>Anti-Layering</p>	<ul style="list-style-type: none"> • Terms to include provisions such that no financial indebtedness that ranks between Senior and the Subordinated debt can be raised without consent.
<p>Right to Attend Meetings</p>	<ul style="list-style-type: none"> • Positive clause allowing Subordinated Lenders to attend meetings called by the Security Trustee. <ul style="list-style-type: none"> ➤ Potentially an issue when there is a conflict of interest (real or perceived)

Next Steps

- ✓ **Second stage feedback still being received from Subordinated lenders and other players in the market**
- ✓ **Posting of document with APLMA to make it more widely available**