Intrepid
Capital Advisory Group

Market Moments That Matter
August 2024

Football season is back, reminding us that teamwork makes the dream work! Utilization of equity kickers is an increasingly popular play for middle-market lenders to bridge the gap between the current yield that borrowers can pay and their own absolute risk-adjusted return thresholds. Properly designing the playbook is critical to a victorious outcome, particularly around two key goals:

- **Lowering a borrower's cash obligations.** Lenders who receive a portion of their returns via warrants or an equity co-investment are more incentivized to accept lower interest payments, allowing borrowers to reallocate cash toward growth initiatives (offense) or keep it on the balance sheet (defense).
- **Aligning the interests of borrowers and lenders.** Credit funds who have the potential for equity upside are encouraged to be more supportive of a company's long-term success. Uniting all players on a team towards a common goal is always a recipe for success – and capital partnerships are no exception.

Frequently Utilized Equity Kickers in the Middle Market

Warrants

- An agreement between an issuer and the lender, wherein the lender is entitled to purchase shares at a specified exercise price
- Can also be structured as a penny warrant, in which the lender purchases the securities at a nominal ($0.01) price
- Warrants typically account for 25% – 30% of total returns for a lender, with the remainder coming from yield
- Common negotiation points include exercise mechanics, anti-dilution provisions, and maturity

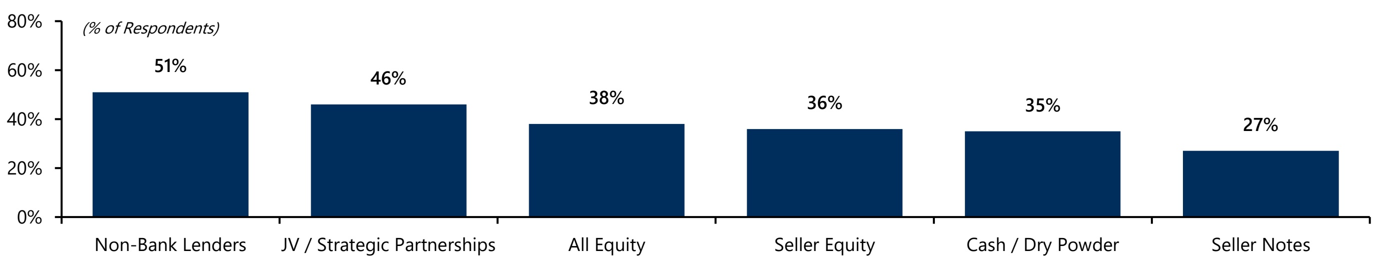
Equity Co-Investment

- An agreement in which a lender directly purchases common equity
- Often are subject to enhanced rights with respect to governance provisions, board observation and increased access to company information
- Can be offered to lenders as a "sweetener" to secure favorable loan terms
- Valuation negotiations frequently become a key sticking point, alongside anti-dilution provisions

Proprietary Insights from Our Colleagues at MUFG

"Buyers have utilized a myriad of deal structures, including joint ventures, club deals and consortium transactions to alleviate the challenges of higher interest rates and a more constrained lending environment. Buyers have also utilized financing options to provide a longer time horizon to successfully achieve financing."

Survey Question: Given the economic, regulatory, and other operational headwinds, which alternative financing vehicles (to traditional bank debt) has your company used in the past year or will very likely use in the next year to get deals done? Please select all that apply.



MUFG Capital Markets Strategy, Deloitte

Jonathan Zucker
Managing Director
Head of Capital Advisory
JZucker@IntrepidIB.com

Boris Zikratov
Director
Capital Advisory
BZikratov@IntrepidIB.com

Stephen Senior
Associate
Capital Advisory
SSenior@IntrepidIB.com

Jonty Nobbs
Analyst
Capital Advisory
JNobbs@IntrepidIB.com

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