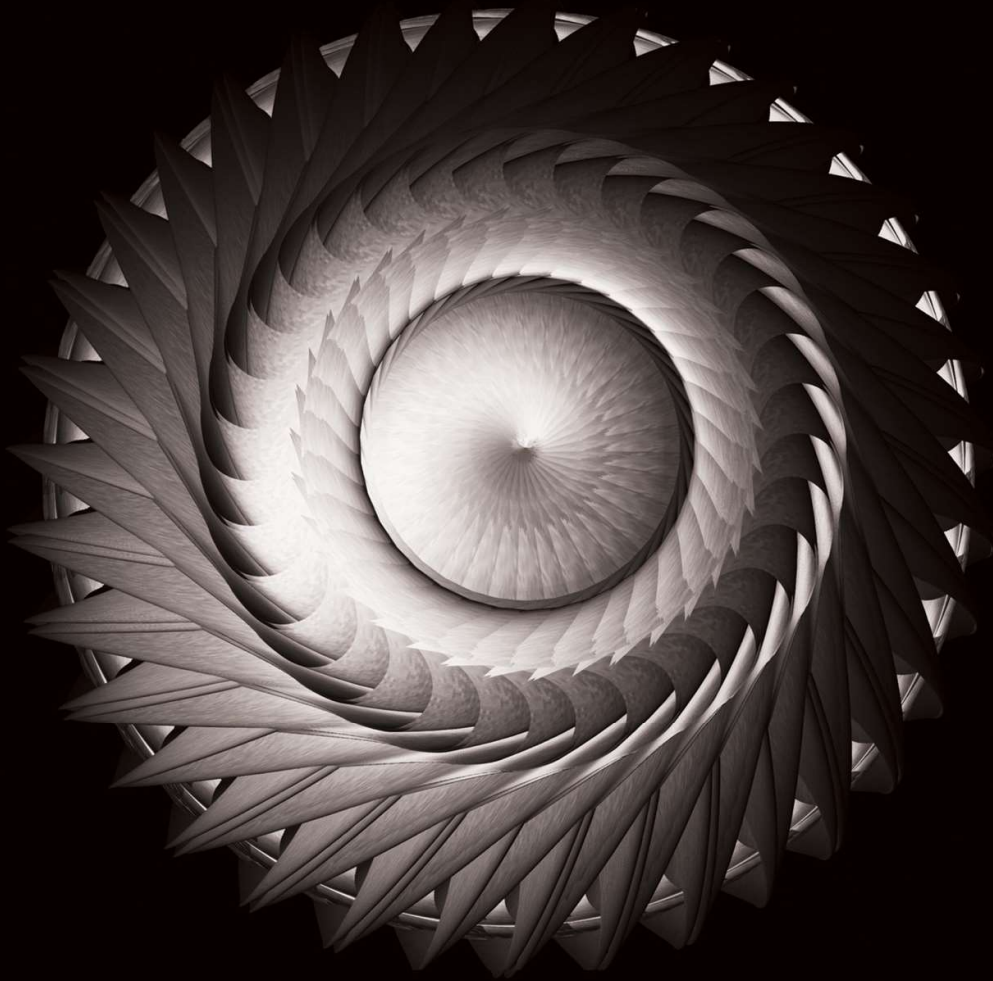


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Debt and Capital Advisory

Eliminating informational imbalances with lenders

Assisting clients to negotiate more favourable bank loan pricing and commercial terms

Case Study on Bank Loan Facility Review in the Construction Material Sector



Executive Summary

Our client was a listed company that needed to refinance its substantial banking facilities and was in the process of evaluating a term sheet for a packaged loan facility provided by a banking syndicate. As is often the case with similar companies, our client's Finance and Treasury teams lacked the necessary in-house expertise, technology, tools and access to loan-specific market data to enable them to quantitatively determine the appropriate pricing and covenants for the various loans in this facility, and called upon the Deloitte Debt and Capital Advisory team to assist with these elements of the transaction. With the assistance of our proprietary financial modeling methodology and technical pricing capabilities, our client was able to determine the optimal level and structure of debt for the loan package, accurately price each individual loan within the facility, identify the key financial risks resulting from it, conclude more favourable commercial terms and significantly reduce their financing costs by in excess of R75m over the loan horizon.

Challenges

Our client had recently completed a recapitalisation to deleverage its balance sheet, after a prolonged downturn in the cyclical sector it operated within had negatively impacted upon its credit profile. The term sheet provided by the bank syndicate appeared to favour the lenders, without fully recognising the improvement in our client's financial position which had resulted from the infusion of new equity from the rights issue.

Quantitative analysis of different maturity, currency and credit priority profiles helped our client to find the optimal tradeoffs between borrowing costs and refinancing risks.

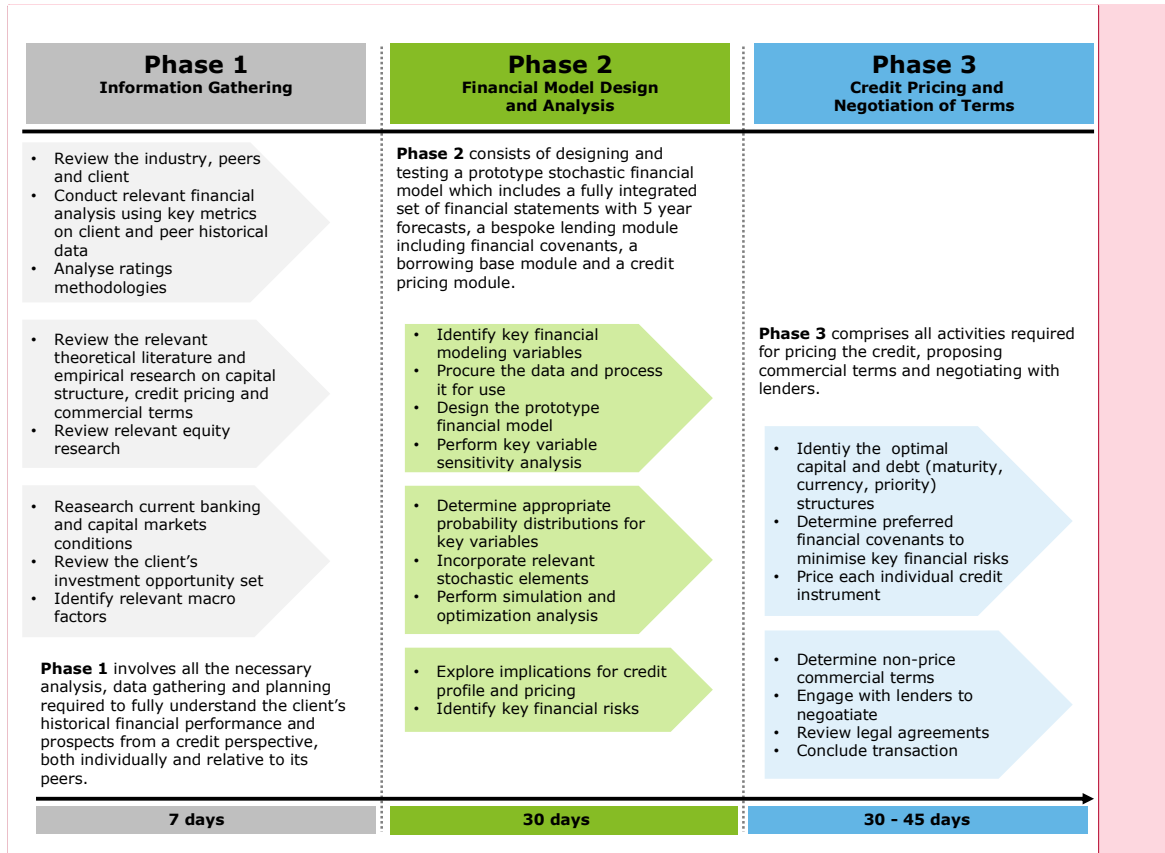
Even though our client had a sophisticated Finance and Treasury team, some of whom had been bankers themselves, they decided that this project would require specialised quantitative finance skills, processes, tools, technology and loan-specific market data that they did not have. They also realised that they would benefit from engaging an advisor, who would be using the same methodologies as those employed by the lenders, to evaluate and price the credit instruments. Given the oligopolistic structure of the South African bank loan market, our client was well aware of the deficiencies in running a competitive auction process for price discovery, and preferred to bilaterally negotiate the pricing and terms directly with the syndicate, relying on the information, data and analytical tools delivered by our process to assist them in their decision-making.

Our Process Explained

The Deloitte team comprised of a multi-disciplinary team of specialists from various divisions of the organisation, many of whom were ex-investment bankers. We assisted our client to implement the robust process detailed below:

Credit Profiling and Pricing Advisory Services Model ('CPPSM')

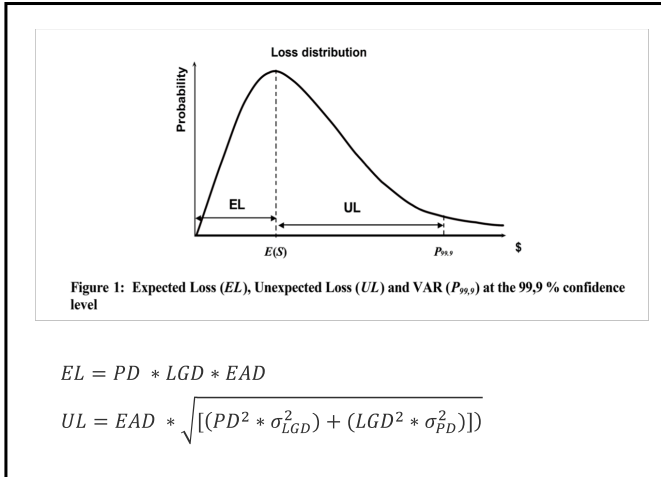
Three key phases to reducing borrowing costs and improving credit terms



Pricing Credit Risk

Stepping into a bank lender's shoes

Stepping into a bank lender's shoes



Where:

- EL = Expected loss (i.e. the industrial cost of lending) PD = Probability of default
- LGD = Loss given default
- EAD = Exposure at default
- UL = Unexpected loss

Considerations	Description
Determination of the term structure of credit risk	Achieved using default rates
Adjustments for credit cyclicity	Required to reflect systemic component of recovery rates and the probability of default
Structural versus reduced form models	Merton approach versus Altman approach, banks prefer reduced form approaches
Adjustments to internal ratings	Notching down when mapping internal ratings for publicly traded corporates to PD's
Probability distributions	Selecting the appropriate distribution and corresponding parameters
RAROC	Determining economic capital
Regulatory effects	Minimising regulatory costs

Benefits to our Client

Cost Savings

Significant reduction in borrowing costs

Prior to our involvement, the lending syndicate had resisted making any substantial concessions to the facility pricing and terms, but facing a client now armed with the data, information, tools and insights obtained from our process, they agreed to reduce funding costs in excess of R75m over the term of the facility.

Additional benefits

- The process led to our client increasing their balance sheet flexibility by changing the mix and maturities of the term and revolving debt instruments initially proposed by the lenders.
 - Optimising the debt structure also reduced the amount of debt that our client actually borrowed versus what they had originally intended, without negatively impacting upon the refinancing risk.
 - The financial covenant analysis revealed certain key risks which could then be mitigated by negotiating more favourable ratios, which provided for additional headroom.
 - Our client gained some deep insights into certain of the key cash flow sensitivities arising from its business, together with an understanding of how these particular variables could impact on its credit profile, the price of its borrowings and ultimately its share price, which facilitated higher quality decision-making.
 - Deloitte's active involvement in the overall process freed up important internal resources for our client, enabling them to focus on other priorities that may otherwise have been delayed or compromised.
 - From a corporate governance perspective, utilising an independent advisor in the specialised area of credit profiling and pricing, where the client's own in-house skills, tools, systems and experience were less developed, provided the Risk Committee and Board with additional comfort.
 - The client was able to preserve the quality of its banking relationships by pointing to its independent advisor as the reason for its improved position.
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