Standard Chartered Private Equity – Mezzanine Financing Fact sheet

What is mezzanine financing? Mezzanine financing is a capital investment that bridges the gap in a company’s capital structure between debt and equity. It is a hybrid instrument with both a debt component and an equity component. The debt component is typically a loan with cash interest and payment in kind (PIK) interest which accrues and is paid on maturity. It is non-amortising and has a tenor of 3-7 years. It typically shares the same security package as senior secured bank facilities but is contractually subordinated to them. The equity component is small (typically a 3-5% stake in the Company) and tends to be in the form of common shares or warrants.

How does mezzanine compare to senior debt and to equity? Mezzanine investment is more expensive than senior debt as it is more risky for banks, ranking behind senior debt in the capital structure of the Company. Mezzanine has a longer tenor than senior debt and is non-amortising, which puts less pressure on the Company’s cash flows. In terms of security, there is more of a focus on cash flows rather than on collateral. Mezzanine also has less restrictive covenants.

Mezzanine financing is less risky and thus cheaper than equity for companies. It is ideal for family businesses who need capital but who do not want an equity investor and do not want to dilute their shareholding.

What are the most important uses of mezzanine?
1. Balance sheet restructuring - to reduce debt amortization and extend maturity
2. Development Capital – to fund expansion of high-growth companies

What are the advantages of mezzanine to companies, particularly for family businesses?

- **No equity dilution** – Mezzanine keeps the family in control of the business and limits valuation negotiation between investor and company
- **Eases pressure on cash flows** – The non-amortizing nature of mezzanine and the use of PIK interest allows cash to be invested in the business for a longer period of time
- **Allows highly leveraged companies to access capital** - Companies that can no longer borrow senior debt may be able to borrow mezzanine to fund growth
- **Allows companies to restructure their balance sheet** - Allows companies to reduce debt amortization and extend maturity of debt
- **No heavy collateral focus as with senior debt** - Lending is based on company cash flows vs. fixed asset-based lending. This is especially advantageous during periods of economic downturn when collateral-based lending tends to discount sources of collateral (accounts receivable, inventories, fixed assets)
- **Cheaper than equity** – Mezzanine is a cheaper source of financing than equity
- **Flexibility and ease of execution** – Terms are flexible. Mezzanine can be raised relatively quickly and discreetly, making it attractive for small, private companies
- **Certain exit for the investor** - A Company typically uses mezzanine capital to grow and generate enough cash in 3-5 years to de-lever and refinance the mezzanine with cheaper senior debt

What is SCPE’s investment criterion for mezzanine? SCPE invests in companies in the MENA region, with an emphasis on the GCC. We invest across all sectors in mid to late stage companies with proven business models, robust cash flows and disciplined strong management teams. Our average investment is US $25-$100 million per transaction and we can team up with other investors on larger deals.