From: Berkenfeld, Steven <sberkenf@lehman.com>
Sent: Friday, June 15, 2007 1:26 PM (GMT)
To: Goldfarb, David <dgoldfar@lehman.com>; Muller, Catherine V <catherine.muller@lehman.com>
Subject: Re:

Saw it. Thanks.

We have the moratorium in place right now and definitely are all looking at this even more critically now following the initial information from the KKR syndication of First Data. For instance, as I mentioned to you, we gave the deal team a firm no on an equity bridge on Intelsat for BC Partners. Also glad that CDW is down with Providence coming in as partner to Madison Dearborn.

----- Original Message -----
From: Goldfarb, David
To: Berkenfeld, Steven; Muller, Catherine V
Sent: Fri Jun 15 09:15:03 2007
Subject: FW:

fyi

From: McDade, Bart
Sent: Friday, June 15, 2007 8:39 AM
To: Goldfarb, David
Subject: FW:

From: Donini, Gerald
Sent: Friday, June 15, 2007 7:26 AM
To: Johnson, Matt; Wieseneck, Larry
Cc: McDade, Bart
Subject:

DealTalk: Concerns grow over risky equity bridge loans
Thu Jun 14, 2007 10:13AM EDT
By Michael Flaherty

NEW YORK (Reuters) - The recent popularity of a risky private equity financing agreement, known as an equity bridge loan, is raising concerns among analysts, regulators and even the bankers who arrange them.

Equity bridge loans allow private equity firms to get investment banks to share in the cash payment on deals. Such loans are great for buyout firms wanting to pursue takeovers without joining forces with competitors, but carry huge risk and skimpy pay-offs for the investment banks.

While this type of lending has been around for decades, the size and frequency of the loans has risen to the point where Goldman Sachs (GS.N: Quote, Profile, Research) has told its mergers and acquisitions staff to avoid them, according to a banker who works there. Goldman declined to comment about its policy.

The Ontario Teachers-Providence Equity Partners group pursuing Canadian telecoms group BCE Inc. (BCE.TO: Quote, Profile, Research) is asking investment banks to pony up a roughly $4 billion equity bridge, leaving the banks on the hook for about $800 million each, according to two people involved with the deal.

That's a staggering amount of exposure given that just last year, the equity bridge commitments for buyouts of media companies Univision and Clear Channel Communications Inc. (CCU.N: Quote, Profile, Research), which ranged from $100 million to $350 million, were deemed large, according to sources involved with the deals.

"Equity bridges are a really bad business," said an investment banker who arranges private equity deals. "You have a very small amount of reward for a huge risk. But people are doing them because it's forced on them in terms of being competitive. The pain is going to be immense if one of these bridges falls apart."

The best-case scenario is that the investment banks quickly sell the equity exposure to other buyers. But even then, banks typically earn only a 1.5 percent return on the loan. That means for risking $500 million, they earn just $7.5 million.

The worst case is that banks can't sell down the equity. Then they are left holding the bag, in some cases with hundreds of millions of dollars in exposure.

Chief executives, credit officers, strategists and investment banking heads are all signing off on these loans. Bankers interviewed for this article say a tremendous amount of time is spent dissecting deals before handing over a big check. Some say no to equity bridges.

But bankers also admit that the private equity players -- whose deal frenzy is throwing off billions of dollars in fees for Wall Street -- call the shots, and equity bridges are simply the price you pay to play with them.

"It concerns us every day," said JP Morgan (JPM.N: Quote, Profile, Research) global equity strategist Abhijit Chakrabortti, referring to the rise of equity bridges.

Chakrabortti, speaking at the Reuters Investment Outlook Summit this week, said while JP Morgan keeps a close eye on these loans, he does not see any near-term pull-back that would hit the leveraged buyout (LBO) market. Private equity firms buy and sell companies, borrowing most of the money to finance the deals. Frothy debt markets have fueled the current LBO wave.

"You always need a catalyst and we're not convinced that yields or the interest rate outlook is at that level where we're going to get that hit," he said.

Indeed, LBO deals are still being pumped out with no end in sight. But the growing prospect of interest rate rises has led some analysts to believe the frothy debt days are numbered.

The heavy borrowing and risky financings fueled by cheap debt have not escaped the attention of U.S. Federal Reserve Chairman Ben Bernanke.

"There are some significant risks associated with the financing of private equity including bridge loans," Bernanke said last month. "We are looking at that."

Equity bridge loans appeared in the late 1980s but then went dormant, for the most part. They became popular again late last year when private equity firms started pursuing larger companies on their own, or with one other LBO partner.

Citigroup (C.N: Quote, Profile, Research) and RBS Securities (RBS.L: Quote, Profile, Research) arranged an equity bridge of $450 million in a $25 billion LBO of wireless company Alltel Corp. (AT.N: Quote, Profile, Research), according to a proxy filed on Wednesday.

Morgan Stanley (MS.N: Quote, Profile, Research), Citigroup and JPMorgan have offered a $1 billion equity bridge in an LBO offer for Texas utility TXU Corp. (TXU.N: Quote, Profile, Research).

An equity bridge was also part of a proposed $17.1 billion buyout of casino company Harrah's Entertainment Inc. (HET.N: Quote, Profile, Research).

"It's just further evidence that the private equity folks are calling the shots," said Tom Marshella, a managing director in leveraged finance for credit-ratings agency Moody's Corp.

"It's astonishing the degree of risk they're able to lay off, including underwriting the equity. I haven't seen anything like this in the (11 years) I've been involved with leveraged finance."