



## Credit Memo

2020

# Executive summary

## Transaction overview

**Davis Industries Corporation (“Davis Industries” or the “Company”)** is a medical devices manufacturer that delivers innovative infection prevention products and services for the healthcare market

- Davis Industries specializes in the following reportable segments: Endoscopy, Water Purification and Filtration, Health Disposables, and Dialysis
- For the LTM period ended July 31, 2017, Davis Industries generated revenue of \$480.3 million and adjusted EBITDA of \$99.8 million

**Davis Industries is currently exploring how to refinance existing debt on its balance sheet**

- Davis Industries has \$126mm of existing debt that is split into two tranches (“Tranche A” and “Tranche B”) that both mature later this year
- Davis Industries is considering putting in place a \$200 million Revolving Credit Facility, the proceeds of which would be used to refinance Tranche A and Tranche B
- Pro Forma for the transaction, total leverage will be 1.3x based on LTM Adjusted EBITDA of \$99.8 million

## Sources & Uses

Sources (\$mm)	
New Revolving Credit Facility	126.0
<b>Total Sources</b>	<b>\$126.0</b>
Uses (\$mm)	
Repay Tranche A	80.0
Repay Tranche B	46.0
<b>Total Uses</b>	<b>\$126.0</b>

## Pro Forma Capitalization Table

(\$mm)	Before Transaction		After Transaction	
	Amount	x EBITDA	Amount	x EBITDA
Tranche A	80.0	0.8x	126.0	-
Tranche B	46.0	0.5x		-
New Revolving Credit Facility	-	-		1.3x
<b>Total Debt</b>	<b>126.0</b>	<b>1.3x</b>	<b>126.0</b>	<b>1.3x</b>
<b>Adjusted EBITDA</b>	<b>\$99.8</b>		<b>\$99.8</b>	

# Financial overview

## Davis Industries - Financial Summary

	FYE July 31,		
\$ in millions	2015	2016	2017
<b><u>Income Statement:</u></b>			
<b>Revenue</b>	<b>\$353.1</b>	<b>\$415.8</b>	<b>\$480.3</b>
<i>% growth</i>		17.7%	15.5%
Cost of Goods Sold	188.0	215.2	242.5
<b>Gross Profit</b>	<b>165.1</b>	<b>200.6</b>	<b>237.7</b>
<i>Gross margin</i>	46.8%	48.3%	49.5%
Total operating expenses	116.3	142.6	172.9
<b>Operating income</b>	<b>48.8</b>	<b>58.0</b>	<b>64.8</b>
<i>Operating margin</i>	13.8%	14.0%	13.5%
<b>Net income</b>	<b>27.8</b>	<b>34.9</b>	<b>40.8</b>
<i>Net profit margin</i>	7.9%	8.4%	8.5%
<b><u>Balance Sheet:</u></b>			
Cash and cash equivalents	\$19.8	\$26.8	\$32.5
Accounts receivable	43.5	58.4	69.1
Inventory	45.1	57.3	61.8
<b>Total assets</b>	<b>365.0</b>	<b>443.3</b>	<b>501.1</b>
Accounts payable	10.1	16.4	17.2
Total debt	78.5	116.0	126.0
Equity	224.6	249.7	289.8
<b>Liabilities and equity</b>	<b>365.0</b>	<b>443.3</b>	<b>501.1</b>

	FYE July 31,		
\$ in millions	2015	2016	2017
<b><u>Cash Flow Statement:</u></b>			
Cash flow from operations	\$39.1	\$49.0	\$59.9
Capital expenditures	(7.9)	(11.4)	(16.8)
<b>Free Cash Flow</b>	<b>31.1</b>	<b>37.5</b>	<b>43.1</b>
Acquisitions	(20.4)	(65.0)	(43.8)
Dividends paid	(2.6)	(3.1)	(3.6)
<b><u>EBITDA calculation:</u></b>			
<b>Adjusted EBITDA</b>	<b>\$70.2</b>	<b>\$86.3</b>	<b>\$99.8</b>
<b><u>Credit ratios:</u></b>			
Total Debt / EBITDA	1.1x	1.3x	1.3x
Debt to total capitalization	25.9%	31.7%	30.3%
FCF / Total Debt	39.7%	32.4%	34.2%

# Business and industry overview

## Company overview

- **Davis Industries** is a leading provider of medical equipment and sanitation products and services in the healthcare market:

- **Surgical Instruments:**

- The company Designs develops, manufactures, sells, and services a comprehensive offering of products for surgical use

- **Medical Sterilizers:**

- Designs, develops, manufactures, sells, and installs sterilization systems for medical and pharmaceutical instruments and areas used for dialysis, medical and pharmaceutical other industries

- **Single-Use Medical Disposables:**

- Design, manufacture, sell, supply and distribute a broad selection of single-use infection prevention healthcare products

- **Customers**

- No customer accounted for more than 10% of consolidated net sales during FY2017, FY2016, or FY2015

## Industry overview

- **Total addressable markets (“TAM”)**

- Surgical Instruments: ~\$4.5 billion TAM growing at ~7%
- Medical Sterilization: \$1.0 billion TAM growing at ~5%
- Single-Use Medical Disposables: ~\$1.2 bil TAM growing at ~2-3%

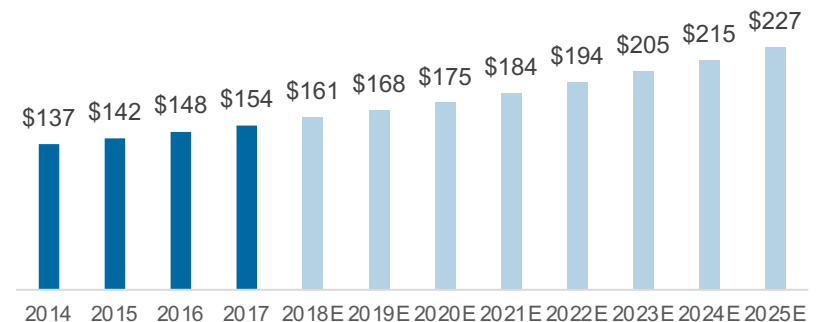
- **Market drivers**

- Aging US population
- Improvements in medical technology and upgrading clinics
- Growing urbanization & increased healthcare spending

- **Competition**

- The overall market is highly competitive with peers such as:
- Delta Corp, Omega Inc and Kappa GmbH

## Medical device manufacturer market growth (\$bn)



# Deal structuring

## Collateral analysis

Collateral description	Eligible collateral value (\$k)	Authorized advance rate (%)	Available collateral (\$k)
Accounts receivable	69,078.00	80%	55,262.40
Inventories	61,795.00	50%	30,897.50
Property and equipment, net	55,211.00	50%	27,605.50
		Total collateral available	113,765.40
		Less: (commitments)	126,000.00
		<b>Excess / (deficiency)</b>	<b>-12,234.60</b>

Company does not meet the warranted criteria therefore it is recommended that the company is not monitored under a borrowing base.

## Financial covenant package

Covenant	Rationale
✓ <i>Maximum</i> Cash Flow Leverage	<b>Ratio:</b> (Total Debt / EBITDA) <b>Rationale:</b> Assures adequate debt coverage
✓ <i>Minimum</i> Interest Coverage	<b>Ratio:</b> (EBITDA / Total Interest) <b>Rationale:</b> Assures operating earnings can cover interest
<i>Minimum</i> Fixed Charge Coverage	<b>Ratio:</b> (EBITDA less Capital Expenditures divided by Total Fixed Charges) <b>Rationale:</b> Assures sufficiency of operating earnings for fixed requirements
<i>Minimum</i> Tangible Net Worth	<b>Ratio:</b> (Net Worth – Intangible assets) <b>Rationale:</b> Limits investments, directing cash flow to debt repayment
<i>Minimum</i> Liquidity	<b>Ratio:</b> (Permit at any time its total of cash and marketable securities, to be less than a \$ amount) <b>Rationale:</b> Assures satisfactory liquidity and tracks performance vs. plan

## Risks and Mitigants

### Risk

**Competition** - Company faces rapid technology changes in the medical device and water purification industry.

**Regulation** - Industry is experiencing significant scrutiny and regulation by governmental authorities, which may lead to greater regulation in the future.

**Commodity Risk** - Company is heavily reliant on certain raw materials and can be adversely impacted by rising prices.

**Collateral shortfall** - \$86,000m deficiency if revolver is fully drawn

### Mitigant

[●] Company shows top line growth year over year [●] Company research leads to patents resulting in a competitive advantage [●] Company has communicated to the bank that they have significant R&D investment in process

[●] Company regularly participates in seminars and webinars for proper regulation education [●] Company has not presented any significant regulation issues historically

[●] Historically the company has been able to maintain strong margins [●] Company has a hedging strategy in place

[●] Company has maintained strong and consistent cash on their balance sheet [●] Company has low cash flow leverage under 1.50x and has had low cash flow leverage historically [●] Company patents and performance warrants enterprise valuation which will be used as bank security

# Term sheet

## Proposed terms and conditions

Borrower:	Davis Industries Corporation (the “Company”)
Facility Type:	Revolving Credit Facility
Amount:	\$200,000,000
Tenor:	5 years
Maturity:	5 years from closing date
Spread (Interest Rate):	4.00%
Undrawn Fee:	50 basis points
Use of Proceeds:	General corporate purposes
Financial Covenants:	<div><div>■ Cash Flow Leverage covenant not to exceed 3.50x<ul style="list-style-type: none"><li>■ Cash Flow Leverage calculated as Total Debt / EBITDA</li></ul></div><div>■ Interest Coverage covenant not less than 3.00x<ul style="list-style-type: none"><li>■ Interest Coverage covenant calculated as EBITDA / Total Interest</li></ul></div></div>

FCF Model (\$mm)											
	2017PF	2018P	2019P	2020P	2021P	2022P	2023P	2024P	2025P	2026P	2027P
Revenue	480.3	525.0	588.0	646.8	695.3	747.5	803.5	863.8	928.6	998.2	1,073.1
% Growth	15.5%	9.3%	12.0%	10.0%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%
EBITDA	99.8	105.0	117.6	129.4	139.1	149.5	160.7	172.8	185.7	199.6	214.6
% Margin	20.8%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%
Interest Expense	(5.4)	(3.8)	(2.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
Cash Tax Expense		(20.9)	(23.5)	(25.8)	(27.7)	(29.8)	(32.1)	(34.5)	(37.0)	(39.8)	(42.8)
Δ in NWC		(11.1)	(15.0)	(14.0)	(11.5)	(12.4)	(13.3)	(14.3)	(15.4)	(16.6)	(17.8)
Capex		(18.4)	(20.6)	(22.6)	(24.3)	(26.2)	(28.1)	(30.2)	(32.5)	(34.9)	(37.6)
Dividend payments		(4.2)	(4.7)	(5.2)	(5.6)	(6.0)	(6.4)	(6.9)	(7.4)	(8.0)	(8.6)
Free cash flow		46.6	51.9	60.8	68.9	74.1	79.8	85.8	92.3	99.4	106.9
Cumulative free cash flow		46.6	98.6	159.3	228.2	302.4	382.2	468.0	560.3	659.7	766.6
								371.4%	7-yr Payout		
Mandatory debt repayments		-	-	-	-	-	-	-	-	-	-
Cash available for debt service		46.6	51.9	60.8	68.9	74.1	79.8	85.8	92.3	99.4	106.9
Cumulative free cash flow for debt service		46.6	98.6	159.3	228.2	302.4	382.2	468.0	560.3	659.7	766.6
		Year Ended July 31,									
Covenant Projections (\$mm)	2017PF	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E
R/C facility	126.0	79.4	27.4	-	-	-	-	-	-	-	-
Term Loan A	-	-	-	-	-	-	-	-	-	-	-
Total Debt	126.0	79.4	27.4	-	-	-	-	-	-	-	-
Leverage Ratio	1.26x	0.76x	0.23x	0.00x	0.00x	0.00x	0.00x	0.00x	0.00x	0.00x	0.00x
Leverage Covenant	3.50x	3.50x	3.50x	3.50x	3.50x	3.50x	3.50x	3.50x	3.50x	3.50x	3.50x
EBITDA Cushion (\$)	63.78	82.32	109.76	129.36	139.06	149.49	160.70	172.76	185.71	199.64	214.61
EBITDA Cushion (%)	63.92%	78.40%	93.33%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Interest Coverage Ratio	18.44x	27.79x	59.99x	129.36x	139.06x	149.49x	160.70x	172.76x	185.71x	199.64x	214.61x
Interest Coverage Covenant	3.50x	3.50x	3.50x	3.50x	3.50x	3.50x	3.50x	3.50x	3.50x	3.50x	3.50x
EBITDA Cushion (\$)	80.84	91.78	110.74	125.86	135.56	145.99	157.20	169.26	182.21	196.14	211.11
EBITDA Cushion (%)	81.02%	87.41%	94.17%	97.29%	97.48%	97.66%	97.82%	97.97%	98.12%	98.25%	98.37%