Davis Industries

Credit Memo

[●] 2020

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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
Total Sources	**$126.0**

Uses ($mm)	
Repay Tranche A	80.0
Repay Tranche B	46.0
Total Uses	**$126.0**

Pro Forma Capitalization Table

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

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Financial overview

Davis Industries Corporation - Financial Summary

$ in millions	FYE July 31, 2015	2016	2017
Income Statement:			
Revenue	**$353.1**	**$415.8**	**$480.3**
% growth		*17.7%*	*15.5%*
Cost of Goods Sold	188.0	215.2	242.5
Gross Profit	**165.1**	**200.6**	**237.7**
Gross margin	*46.8%*	*48.3%*	*49.5%*
Total operating expenses	116.3	142.6	172.9
Operating income	**48.8**	**58.0**	**64.8**
Operating margin	*13.8%*	*14.0%*	*13.5%*
Net income	**27.8**	**34.9**	**40.8**
Net profit margin	*7.9%*	*8.4%*	*8.5%*
Balance Sheet:			
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
Total assets	**365.0**	**443.3**	**501.1**
Accounts payable	10.1	16.4	17.2
Total debt	78.5	116.0	126.0
Equity	224.6	249.7	289.8
Liabilities and equity	**365.0**	**443.3**	**501.1**

$ in millions	FYE July 31, 2015	2016	2017
Cash Flow Statement:			
Cash flow from operations	$39.1	$49.0	$59.9
Capital expenditures	(7.9)	(11.4)	(16.8)
Free Cash Flow	**31.1**	**37.5**	**43.1**
Acquisitions	(20.4)	(65.0)	(43.8)
Dividends paid	(2.6)	(3.1)	(3.6)
EBITDA calculation:			
Adjusted EBITDA	$70.2	$86.3	$99.8
Credit ratios:			
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%

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Business and industry overview

Company overview

- **Davis Industries** is a leading provider medical equipment and sanitation products and services in the healthcare market:
  - **Surgical Instruments: D**esigns, 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, the majority of which are single-use products used by medical practitioners, which include the following:
    - Hypodermic needles and syringes
    - Applicators
    - Bandages and wraps
    - PP&E: Exam gowns, face masks and gloves
    - Suction catheters
    - Surgical sponges
- **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 Sterilizers: ~$1.0 billion TAM growing at ~5%
- Single-Use Medical Disposables: ~$1.2 billion TAM growing at ~2-3%

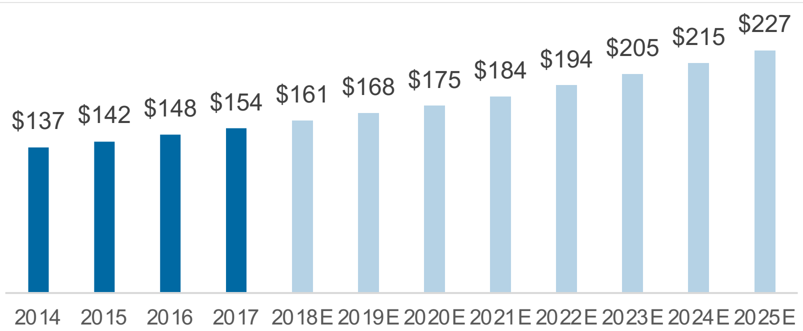
Market drivers

- Aging US population
- Improvements in medical technology and upgrading clinics
- Federal funding for Medicare and Medicaid

Competition

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

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	80%	$55,262
Inventories	$61,795	50%	$30,898
Property and equipment, net	$55,211	50%	$27,606
		Total collateral available	$113,766
		Less: (commitments)	$126,000
		Excess / (deficiency)	**($12,234)**

Borrowing base recommendation

A/R, Inventory and Net PP&E retrieved from company 10-K balance sheet (Note: that a typical borrowing base only includes A/R and Inventory). Noted in the borrowing base background, characteristics that typically warrant the need to be monitored under a borrowing base include a company that is: asset heavy, has intensive working capital needs, is underperforming and/or does not have other collateral that can be used as security. 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
✓	*Maximum* Cash Flow Leverage	**Ratio:** (Total Debt / EBITDA) **Rationale:** Assures adequate debt coverage
✓	*Minimum* Interest Coverage	**Ratio:** (EBITDA / Total Interest) **Rationale:** Assures operating earnings can cover interest
	Minimum Fixed Charge Coverage	**Ratio:** (EBITDA less Capital Expenditures divided by Total Fixed Charges) **Rationale:** Assures sufficiency of operating earnings for fixed requirements
	Minimum Tangible Net Worth	**Ratio:** (Net Worth – Intangible assets) **Rationale:** Limits investments, directing cash flow to debt repayment
	Minimum Liquidity	**Ratio:** (Permit at any time its total of cash and marketable securities, to be less than a $ amount) **Rationale:** Assures satisfactory liquidity and tracks performance vs. plan

Risks and Mitigants

Risk	Mitigant
Competition - Company faces rapid technology changes in the medical device and water purification industry.	[•] 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
Regulation - Industry is experiencing significant scrutiny and regulation by governmental authorities, which may lead to greater regulation in the future.	[•] Company regularly participants in seminars and webinars for proper regulation education [•] Company has not presented any significant regulation issues historically
Commodity Risk - Company is heavily reliant on certain raw materials and can be adversely impacted by rising prices.	[•] Historically the company has been able to maintain strong margins [•] Company has a hedging strategy in place
Collateral shortfall - $86,000m deficiency if revolver is fully drawn	[•] 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:	■ Cash Flow Leverage covenant not to exceed 3.50x ■ Cash Flow Leverage calculated as Total Debt / EBITDA ■ Interest Coverage covenant not less than 3.00x ■ Interest Coverage covenant calculated as EBITDA / Total Interest

Financial Model

FCF Model ($mm)	2017PF	2018P	2019P	2020P	2021P	2022P	2023P	2024P	2025P	2026P	2027P
					Year Ended July 31,						
Revenue	**480.3**	**525.0**	**588.0**	**646.8**	**695.3**	**747.5**	**784.8**	**824.1**	**865.3**	**908.5**	**954.0**
% Growth	*15.5%*	*9.3%*	*12.0%*	*10.0%*	*7.5%*	*7.5%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*
EBITDA	**99.8**	**105.0**	**117.6**	**129.4**	**139.1**	**149.5**	**157.0**	**164.8**	**173.1**	**181.7**	**190.8**
% 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)	(31.3)	(32.9)	(34.5)	(36.2)	(38.1)
Δ in NWC		(11.1)	(15.0)	(14.0)	(11.5)	(12.4)	(8.9)	(9.3)	(9.8)	(10.3)	(10.8)
Capex		(18.4)	(20.6)	(22.6)	(24.3)	(26.2)	(27.5)	(28.8)	(30.3)	(31.8)	(33.4)
Dividend payments		(4.2)	(4.7)	(5.2)	(5.6)	(6.0)	(6.3)	(6.6)	(6.9)	(7.3)	(7.6)
Free cash flow		**46.6**	**51.9**	**60.8**	**68.9**	**74.1**	**82.0**	**86.2**	**90.5**	**95.1**	**99.9**
Cumulative free cash flow		*46.6*	*98.6*	*159.3*	*228.2*	*302.4*	*384.4*	*470.6*	*561.1*	*656.2*	*756.2*
								373.5%		*7-yr Payout*	
Mandatory debt repayments		-	-	-	-	-	-	-	-	-	-
Cash available for debt service		**46.6**	**51.9**	**60.8**	**68.9**	**74.1**	**82.0**	**86.2**	**90.5**	**95.1**	**99.9**
Cumulative free cash flow for debt service		*46.6*	*98.6*	*159.3*	*228.2*	*302.4*	*384.4*	*470.6*	*561.1*	*656.2*	*756.2*

Covenant Projections ($mm)	2017PF	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E
					Year Ended July 31,						
R/C facility	126.0	79.4	27.4	-	-	-	-	-	-	-	-
Term Loan A	-	-	-	-	-	-	-	-	-	-	-
Total Debt	**126.0**	**79.4**	**27.4**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Leverage Ratio	**1.26x**	**0.76x**	**0.23x**	**0.00x**	**0.00x**	**0.00x**	**0.00x**	**0.00x**	**0.00x**	**0.00x**	**0.00x**
Leverage Covenant	3.50x	3.50x	3.50x	3.50x	3.50x	3.50x	3.50x	3.50x	3.50x	3.50x	3.50x
EBITDA Cushion ($)	*63.78*	*82.32*	*109.76*	*129.36*	*139.06*	*149.49*	*156.97*	*164.81*	*173.06*	*181.71*	*190.79*
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**	**156.97x**	**164.81x**	**173.06x**	**181.71x**	**190.79x**
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*	*153.47*	*161.31*	*169.56*	*178.21*	*187.29*
EBITDA Cushion (%)	*81.02%*	*87.41%*	*94.17%*	*97.29%*	*97.48%*	*97.66%*	*97.77%*	*97.88%*	*97.98%*	*98.07%*	*98.17%*