European Leveraged Finance Association | Akin Gump STRAUSS HAUER & FELD

INSIGHTS

4 February 2021

The Upside of the Downside: Tightening Terms at the Negotiating Table

Lenders will no doubt have spent much of 2020 reviewing and responding to amendment and waiver requests from their borrowers. Those requests often took the form of consents to urgent liquidity injections, or waivers of the now rare financial maintenance covenant. This year will likely bring more of the same, although the underlying themes of borrower requests may vary.

Even in a world of "cov-lite" and "cov-loose", borrowers don't always have the flexibility they need to weather their own unique storms. It is important to bear in mind that for each "give" that a lender is prepared to furnish to a borrower, there is an opportunity for lenders to tighten terms elsewhere.

With valuable input from our partners Akin Gump, this Insights report sets out certain provisions that lenders may wish to focus on in this context, depending on the nature of the underlying borrower and its business.

Setting the scene

This report highlights loan documentation terms and protections that lenders may want to consider tightening, or that they may wish to request including, when approached by a borrower with a waiver request. We have contextualised these points using the borrower's business strategy (e.g., if the company is acquisitive) or financial position (e.g., a liquidity shortfall looming down the road).

The extent of documentary changes or additions that lenders will be able to request and achieve will of course depend on several factors:

- the level of difficulty the borrower is facing and how material the waiver request is;
- the makeup of the syndicate (e.g., banks vs. institutional investors);
- the timeframe provided to consider documentary terms; and
- whether the documentary changes secured as part of a waiver request are temporary or permanent in nature (e.g., if a covenant test is being temporarily suspended, more restrictive covenants might only apply until the covenant testing resumes).

Whilst each loan document is different and the below list is by no means exhaustive, these are some of the key areas that ELFA would highlight for consideration.

We will look at different 'typical' types of borrowers.

The Serial Acquirer

Bio: Management of this borrower has a track record of gobbling up assets, and likes to be able to use whatever means they can to do so (including leveraging up the balance sheet as much as possible). The company likes to surprise lenders by buying itself attractive assets, even when it looks like there might not be much money left in the bank to finance the deal.

Lender Goal: Addressing artificially inflated EBITDA to get a true reflection of leverage, taking control on the borrowers' ability to raise additional debt, avoiding large pricing discrepancy in different tranches.

Areas of focus:

- Limit / tighten caps on pro-forma synergy add backs and limiting time horizons
- Tighten broad exceptional items add back to EBITDA – this is especially true in the context of COVID add-backs (e.g., are they top line or cost and should there be some form of control/audit?) See, e.g., the ELFA Insights report "EBITDAC" is an Inappropriate Metric for Calculations of Covenant Capacity under Leveraged Finance Agreements and subsequent guidance from ESMA, the FRC, and the Board of IOSCO.

- Tighten incremental debt capacity:
  - Remove the no worse concept/Pick Your Poison provision
  - Reduce the size of the freebie basket
  - Replace the 2x FCCR with a net total leverage test
  - Remove the contribution debt basket
  - Include RCF drawings in ratio tests
- Improve MFN protection language (to include the freebie basket, making it applicable to yield rather than margin, and extending the sunset period)

The Cash Starved Company

Bio: This borrower could be accused of spending beyond its means. Management is always on the lookout for new financiers, rather than building long-term relationships with lenders. This borrower sometimes struggles with communication.

Lender Goal: Remove any priming ability, ensure all lenders have the ability to participate in a potential exchange transaction, avoid dilution of existing collateral package.

Areas of focus:

- Restrict any ability to up-tier existing debt (and leave the stub behind)
- Restrict any ability to incur super senior debt
  - Remove unrestricted subsidiary baskets
  - Cap non guarantor baskets
  - Check Intercreditor provisions for concepts such as New Debt Financing
  - If super senior debt is to be incurred, restrict the ability to be side-lined by tightening consent thresholds and reviewing structural adjustment provisions
- Remove any inside maturity basket
- Reconsider the asset sales covenant
  - Assess how broad it is
  - Tighten any de minimis thresholds
  - Reduce reinvestment periods
  - Include disposal amount above which consent is required
- Review security package
  - Extend security jurisdictions
  - Take additional security over free assets
  - Check whether any reorganisation is required to have a single point of enforcement
  - Tighten Agreed Security Principles and guarantor coverage
  - Tighten consents to release borrowers/guarantors/collateral
- Remove inclusion of non-wholly owned restricted subsidiaries/excluded jurisdictions in guarantor coverage test.
- Insert a minimum liquidity covenant
  - Liquidity levels to be tested at regular intervals, with monthly being the most common but this could be more frequent depending on the borrower's financial situation
  - The covenant should ideally test actual liquidity (look-back) and forward liquidity (look-forward), in conjunction with the delivery of liquidity forecasts, such as a 13-week STCFF
- Insert enhanced information rights, board observer etc.

The Dividend Payer

Bio: This borrower frequently looks to impress its owners. This can be an admirable trait, but there's no "I" in "team", and sometimes other interested parties could believe the company is a bit too busy looking upwards, at the expense of considering wider stakeholders' interests.

Lender Goal: Whilst a dividend recapitalisation may not be on the agenda if a company is facing immediate difficulties, lenders may nonetheless look to tighten "Restricted Payment" language. Lenders should encourage deleveraging before any dividend can be paid to the equity holder.

Areas of focus:

- Remove or reduce the starter or general baskets
- Adjust the ratio condition – include a leverage test/tighten the existing leverage test. Alternatively, if an FCCR test is used, replace it with a tight leverage test
- Limit or remove the number of carve-outs
- Consider imposing a complete block on dividends during any requested covenant testing suspension period

The Non-Transparent Borrower

Bio: This borrower is run by the strong and silent management team; sometimes you'd have to be a mind-reader to know what they're thinking. They might need to be reminded that a problem shared is a problem halved, and that communication is the key to all good relationships.

Lender Goal: Improve quality and frequency of disclosure and transparency, particularly during a challenging period for the Borrower.

Areas of focus:

- Improve reporting frequency and shorten time period to deliver reports
- Require that management host quarterly lender calls instead of annual
- Require that management publish budget reforecasts at specific intervals
- Require that management provide liquidity forecasts
- Request better information such as key KPIs, etc. where reporting requirements are narrow
- Request permanent changes to some reporting provisions (e.g., quarterly calls), depending on a borrower's financial position and nature of its waiver request, whilst others may be more appropriate to request for a temporary period (e.g., liquidity forecasts)
- Request access rights (i.e. to books, records etc.) at least once per FY, prior to an Event of Default

In any of these contexts, transfer provisions and portability may also be important terms to consider, as may amendments preparing a group to access a particular restructuring regime (e.g. a Scheme under English law). However, as these could be the subject of a report onto themselves, we have not gone into detail here.

Happily ever after?

This report highlights key terms which lenders might wish to tighten in the context of a consent or waiver request. However, covenant "technology" never ceases to evolve, and lenders should keep a watchful eye out for new developments that might require future focus. For example, a recent high yield bond offering in the US capped voting rights of lenders (unless they were affiliated to the sponsor). Whilst it is in the interests of borrowers and lenders to work together when businesses are navigating choppy waters, with a view to emerging harmoniously on the other side, there's a reason they both bring their lawyers along for the ride...

About the European Leveraged Finance Association

The European Leveraged Finance Association (ELFA) is a professional trade association comprised of European leveraged finance investors from over 35 institutional fixed income managers, including investment advisors, insurance companies, and pension funds. ELFA seeks to support the growth and resilience of the leveraged finance market while acting as the voice of its investor community by promoting transparency and facilitating engagement among European leveraged finance market participants. For more information please visit the ELFA website: www.elfainvestors.com.

Our Mission Statement:

The ELFA seeks to create a more transparent, efficient, and resilient leveraged finance market while acting as the voice of its investor community. To that end, our diverse forum of investors engages with other industry professionals in order to educate and to promote best practices and transparency.

About Akin Gump

Akin Gump is a global law firm with more than 900 lawyers and advisors who pride themselves on their dedication to clients and their communities. With 20 offices worldwide, the firm is renowned for numerous market-leading practices, its strengths in complex transactions and restructurings, high-stakes litigation, and public policy and regulatory matters as well as its commitment to pro bono. Partnering with clients to deliver creative solutions to business-critical issues, Akin Gump helps clients seize opportunities and anticipate challenges. Driven by forward-thinking leadership, the firm has built a culture of innovation and collaboration as well as a talented and diverse workforce. For further information, please visit www.akingump.com.