

Banking Briefing

# Coming to America?

## Raising Debt in the US Term Loan B and High Yield Bond Markets

### The Current Climate in the US

The past eighteen months has seen a rally in the US "Term Loan B" ("TLB") and high yield bond ("HYB") markets driven by a combination of inter-related factors: US investors' search for yield in the face of declining interest rates, an increased focus by investors on TLB and HYB as an attractive investment, an increased allocation by traditional HYB investors of their portfolios in TLB's as a means to hedge against the prospect of rising interest rates, a revived CLO market looking for TLB assets to allocate to portfolios (\$55bn of new CLO issuances in 2012 and \$38bn in the first half of 2013) and increased competition and over-subscription among investors for TLB syndicate allocations, all squeezing pricing further in the borrower's favor.

The concern as to the impending 2013/14 wall of maturity for leveraged loans is waning (an average pace of \$30bn of refinancings in the US per month during 2012) and borrowers are finding investors with a renewed appetite for more aggressive financings such as dividend recaps. Increased demand from investors has, as in prior cycles, led to more issuer-friendly financings featuring higher leverage, lower spreads, less or no original issue discount and more flexible covenant packages, with a resurgence of TLB covenant-lite deals.

### Opportunities for European Corporates

The current climate in Europe and the US continues to foster the trend of European corporates seeking to raise US Dollar-denominated debt in the US markets in lieu of, or as a supplement to, a concurrent financing in their home market. European corporates have been doing so for two principal reasons: first, constrained demand from banks and investors in local markets and second, potentially cheaper pricing offered by US investors. According to statistics produced by Standard & Poors, US-Dollar denominated bank loans

and high yield financings by non-investment grade European corporates in 2012 represented 53.5% and 43.0%, respectively, of total issuance in Europe during that period (source: S&P Capital IQ LCD).

This is despite the added complexities that US-sourced financings may pose for both the European Borrower, on the one hand, and US investors, on the other.

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For the European Borrower there is a foreign currency exchange risk in borrowing and repaying in US Dollars and the cost of hedging the foreign exchange exposure will impact any pricing differential offered by a US financing. However, a company should benefit from a natural hedge to the extent that it generates revenue in US Dollars sufficient to service the US Dollar debt.

From a US investor's perspective, it must understand and be comfortable with the applicable local collateral, tax and bankruptcy laws. In addition, a portion of the US Dollar term loan financings have been done as part of a local law governed credit agreement based on the LMA (Loan Market Association) model form with LMA-style covenants and other provisions (ie: a US Dollar tranche with other euro or sterling tranches) which may differ from the market terms that a US investor is accustomed to in a US syndicated credit agreement.

## Term Loan B's and High Yield Bonds Structures

There are various permutations of TLB and HYB financing structures in the US. An acquisition may be financed through a bank or bond issuance, or a combination of the two. A bond deal may take the form of senior secured or unsecured notes or senior subordinated notes. A bank financing may take the form of first and second lien facilities, include an amortizing term loan "A" tranche, or take the form of a "uni-tranche" facility (a blended senior and mezzanine tranche). A borrower may need to opt for mezzanine financing or other forms of junior debt to supplement its senior debt issuances. A company may have significant inventory and receivables to support an asset-based revolving facility versus a cash flow based alternative and its revolving facility may take priority as a "super senior" tranche.

The TLB and HYB markets are not the only source of US Dollar debt financings that may be available to a non-US issuer. In addition to the traditional private placement market (ie: a direct issuance to a limited number of sophisticated institutional investors such as insurance companies and pension funds), we are seeing the rise of credit funds as buy-and-hold investors of a company's debt. Credit funds, not constrained by traditional bank credit protocol or capital requirements, may be able to offer bespoke solutions to companies in situations where banks cannot.

The suitability of a particular financing solution for a company, including the type of debt and in which market to source it, will depend upon a multitude of interrelated factors including market conditions, investor demand, current pricing, a company's credit rating and financial performance, available collateral, the relevant industry and, in the case of a foreign issuer of debt securities in the US, whether it currently reports to the SEC.

For purposes of this article, we will look at US TLB and HYB for non-investment grade companies, the key differences between them and where we are seeing a convergence in certain terms.

### What are Term Loan B's and High Yield Bonds?

TLB is a floating rate term loan tranche of a bank financing held by institutional investors (versus traditional banks) with a maturity in the 5-7 year range and nominal amortization of 1% of principal per annum prior to a bullet repayment on final maturity, which as a result, is an attractive investment to investors seeking longer term paper. A TLB loan is often one tranche within senior secured credit facilities comprising term loan and revolving credit facilities. It differs to a term loan "A" tranche, which amortizes in full over the life of the loan and, is traditionally held by bank (versus institutional investor) lenders.

HYB are fixed rate non-investment grade debt securities, referred to as "notes", with a maturity of 5-10 years, issued to institutional investors in either a registered offering subject to the requirement of the Securities Act 1933 (the "'33 Act") or a private placement in reliance upon available exemptions from registration (typically Rule 144A and Regulation S offerings) under the '33 Act (*see "Taking a Deal to the Market" below*). Notes may take the form of senior secured, senior unsecured or senior subordinated (ie: subordinated to certain debt in the capital structure, such as existing bank facilities, but ranking senior to or pari passu with all other debt of the issuer).

The applicable market terms and process of execution differs significantly between a TLB and HYB financing. One of the key distinguishing features between TLB and HYB is that of maintenance versus incurrence-based covenants, respectively. The latter are generally less restrictive than the former and are therefore more attractive to companies, although there has been a recent convergence in covenant packages between TLB and HYB (*see "Covenants" below*). Such differences are important factors in a company's decision to undertake a financing comprising of either or both components.

## Some Key Differences Between TLB and HYB

	TLB	HYB
<b>Minimum Deal Size</b>	No minimum threshold – the smaller the size, the fewer number of lenders required to participate.	Threshold amount to undertake a 144A/Reg S offering is generally deemed to be \$100-150 million.
<b>Requirement to register with the Securities &amp; Exchange Commission</b>	Not applicable to TLB, since loans are not deemed to be "securities" for purposes of the Securities Act 1933.	HYB issued in a registered offering or a private placement with registration rights, involve registration procedures required by the '33 Act. The process is generally more time consuming and costly than a TLB financing. (See "Taking a Deal to the Market" below.)
<b>Interest Rates and Pricing</b>	Floating rate based on LIBOR or the agent's prime rate (as elected by the Borrower) plus an applicable margin. The margin is often determined by a pricing grid based on agreed leverage ratios offering the borrower a lower margin upon achieving a pre-agreed decreased leverage ratio. Interest is payable at the end of the relevant LIBOR period (ie: 30 days, 3, 6, 9 or 12 month as agreed) or calendar quarters for loans bearing interest at the Base Rate.	Fixed rate "coupon" payable semi-annually. Some deals may feature a "PIK" (payment-in-kind) toggle feature allowing the issuer to elect to have a portion or all (depending on what portion of the interest rate is available to PIK) of the interest payment added to the outstanding principal balance of the note, instead of paying cash interest for the period.
<b>Amortization</b>	Nominal amortization of 1% per annum (payable in quarterly installments) with the balance payable as maturity.	No amortization, all principal is payable on maturity as a "bullet" repayment.
<b>Voluntary Prepayments and Call Protection</b>	Lenders in bank financings do not traditionally receive the benefit of any protection against early repayment. However, "soft call" provisions began to appear for TLB (not TLA or revolving facilities) circa 2006 to compensate lenders for repricings or refinancings with new loans carrying an overall yield (based on margin and any original issue discount) that is less than the TLB loans being refinanced. The premium is typically 101-102%. Unlike HYB, a "soft-call" is only payable where yield is decreased as a result of a repricing or refinancing.	Note holders typically receive greater protection against repayment by way of call premiums. A note is usually non-callable (ie. not redeemable or able to be prepaid by the issuer) for a period equal to the halfway point to maturity (ie: a 7 year note may have a 3 year non-call feature) with a premium payable on the principal repaid after expiry of the non-call period. The amount of the premium will decline towards maturity, for example a 7 year note may be non-callable prior to the 3 <sup>rd</sup> anniversary of issuance and repayable at 103% in year 4, 102% in year 5, 101% in year 6 and at par thereafter. The non-call feature is subject to the issuer's ability at any time to repay the principal (ie. before the 3 year mid point in the above example) subject to a "make-whole" payment, which is calculated based on the net present value of future payments owed to the holders through maturity. Electing to repay bonds under the make-whole option is costly and rarely invoked by issuers.
<b>Mandatory Prepayments</b>	A borrower would typically be required to use the net cash proceeds of an asset sale or insurance event, that are not otherwise reinvested within an agreed time frame, to prepay term loans. Term B lenders usually have the ability to refuse acceptance of their share of any payment, in which case, such amount would be retained by the borrower.  Term loans also typically include prepayments for excess cash flow, equity issuances and non-permitted debt issuances.	Issuers are required to make offers to holders with net cash proceeds of asset sales and insurance events in excess of an agreed threshold, to the extent not otherwise applied to repay other senior debt or be reinvested in new assets.  HYB deals do not include the concept of prepayments from excess cash flow or equity issuances.

	TLB	HYB
<b>Financial Covenants</b>	Typically include financial maintenance covenants (debt to EBITDA, interest or fixed charge coverage ratios) tested on a quarterly basis, unless a "Covenant Lite" loan (see "Covenants" below).	No maintenance covenants in an HYB, which instead includes covenants that are "incurrence-based". ie: a financial covenant (either a fixed charge coverage ratio or leverage ratio) is tested only when the issuer is seeking to incur debt, make an investment or restricted payment in excess of pre-agreed baskets.
<b>Change of Control</b>	A change of control is structured as an event of default, giving the majority lenders the ability to accelerate the loans and demand repayment. A change of control therefore typically triggers a refinancing of the existing credit facilities.	Different to a TLB, in that a change of control is structured as a put right for the holders with a 1% premium. Therefore, upon a change of control, the HYB would remain in place unless a holder elects to be repaid at 101% of its outstanding principal.
<b>Events of Default</b>	Generally more restrictive than compared to an HYB. Affirmative covenant breaches typically have the benefit of a 20-30 day grace period, with no grace periods for negative covenant breaches and agreed \$ thresholds for other categories of default including judgments, ERISA and environmental liabilities.  Lenders may call an event of default for defaults occurring under other material debt upon (i) a payment default thereunder and (ii) other non-payment defaults with the expiration of applicable grace periods. Lenders do not have to wait for the other material debt to have been accelerated.	HYB default provisions are relatively more lenient than those for a TLB credit agreement. Breaches of significant covenants may have a 30 day grace period, extending to 60 days for less significant covenants.  HYB contain cross-acceleration (versus cross default) giving the holders the ability to call a default only where a default under other material debt has resulted in the lenders of such material debt taking action to accelerate.
<b>Acceleration</b>	Upon an event of default, lenders holding at least 50.1% of loans may instruct the agent to accelerate the loans.	Holders of at least 25% of the bonds may instruct the trustee to accelerate the bonds following an Event of Default. The lower threshold in an HYB indenture is due to the typically larger number of holders of the notes than in a TLB.
<b>Amendments</b>	Amendments are generally easier and quicker to obtain than in an HYB and are managed through the administrative agent. The process and timing of gathering consents will depend on the size of the syndicate.	Due to the broad base of holders, HYB deals are typically not amended after issuance since the procedure (a "consent solicitation") can be costly and time consuming involving the engagement of a solicitation agent (ie: there is no administrative agent to manage the noteholders) and payment of consent fees. This is one reason for why HYB covenants traditionally offered greater flexibility compared to bank financings.
<b>Replacement of Lenders/holders</b>	A TLB would typically include a "yank-a-bank" provision giving the borrower the right to force individual lenders out of the syndicate (through a transfer of its loans to an existing or new lender) (i) if a lender is a hold-out lender in a vote requiring unanimous consent and a majority threshold has been reached and (ii) if a lender asserts its rights to compensation under the increased costs or tax gross-up provision.	No equivalent in an HYB deal providing the issuer with the ability to force a non-consenting holder to sell its notes.  An issuer would typically be able to redeem notes where a change in law triggers a tax gross-up.
<b>Debt Buy-Backs</b>	Credit facilities typically include a restriction on the ability of the borrower or affiliates from acquiring loans from lenders on the basis that (i) the borrower should not be able to influence any voting within the syndicate and (ii) lenders should receive all payments from the borrower on a pro rata basis, without individual lenders being able to receive payment ahead of or	There are typically no documentary restrictions (other than applicable securities laws) around the ability of the issuer to purchase the issuer's notes in the open market from individual bondholders.

	TLB	HYB
	<p>disproportionately to other lenders (whether through a sale of the loans or otherwise).</p> <p>It is now common for credit agreements to include provisions permitting the borrower to purchase loans from lenders at a price less than par via modified dutch-auction procedures, as an alternative to prepaying loans at par under the optional prepayment provision. Loans purchased are deemed to be immediately cancelled. Affiliates of the borrower (such as the sponsor/equity investors) may also be permitted to become lenders, but subject to limitations as to voting rights and participation in lender meetings.</p>	
<b>Inspection Rights for Lenders</b>	<p>A typical feature of a credit facility is to provide the lenders with visitation and inspection rights of the borrower's properties, books and records. Usually limited outside of a default to a few visits per annum and acting through the Agent on behalf of the lenders.</p>	<p>No equivalent right for noteholders. This illustrates the difference between a TLB, where lenders are more involved in the borrower's business, and an HYB where holders are expected to remain as more passive investors.</p>

## Taking a Deal to the Market

The process by which a company would raise debt through either a high yield issuance or a syndicated term loan differs significantly, in large part due to the fact that bonds are debt "securities" falling under the ambit of the '33 Act, while bank loans are not deemed to constitute securities.

### High Yield Bond issuances

Pursuant to the '33 Act, an offering of securities is required to be conducted either as a "registered offering" or rely on one of the available exemptions to registration, resulting in what is referred to, generically, as a "private placement". HYB offerings are typically consummated under the exemptions available under Rule 144A or Regulation S and each provides the issuer with a number of advantages over a registered offering (see *"Registered offerings vs private placements" below*).

In a Rule 144A offering, the issuer will initially issue the bonds to its investment bank in a direct private placement (under the exemption provided by Section 4(a)(2) or Regulation D of the '33 Act) and the investment bank will resell the bonds in reliance on Rule 144A to an unlimited number of qualified institutional buyers ("QIB's"), being large institutional investors with at least \$100 million of assets comprising securities. Regulation S provides an exemption for offerings of securities conducted outside of the US in offshore offerings. A company will often conduct an HYB offering under a combination of both 144A and Regulation S exemptions, which will result in the bonds

being sold to QIB's within the US and other investors outside of the US.

### Registered offerings vs. private placements

- SEC Scrutiny:** the Securities and Exchange Commission (the "SEC") requires detailed information from an issuer conducting a registered offering describing the offering and the issuer. A Rule 144A or Regulation S offering affords an issuer greater leeway in that it is not subject to the same rules or level of disclosure. In practice, however, the offering memorandum (the "OM") for each of a registered offering, a Rule 144A or a Regulation S offering will contain a similar level of disclosure, but an issuer in a Rule 144A or Regulation S deal will not be subject to the same liability for failing to comply with those SEC disclosure rules.
- Time & Cost:** the registration process takes additional time and cost to complete, since it requires review by the SEC of the offering materials. This is not necessary for a private placement and is the

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principle reason as to why most HYB offerings are conducted as a Rule 144A or Regulation S deal.

- **SEC Reporting:** registration of securities triggers an ongoing requirement that the issuer reports periodically to the SEC, including disclosure of its financial statements on a quarterly and annual basis. A Rule 144A or Regulation S offering avoids this onerous obligation and the associated liability for private issuers.
- **Transferability:** note however that securities issued in a private placement are restricted and subject to minimum holding periods before they are freely transferable to the market. This holding period is 12 months for holders who are not affiliates of an issuer that does not report to the SEC. Any sale prior to the expiration of the holding period must be made in reliance on the applicable exemption from registration under the '33 Act, ie: Rule 144A or Regulation S.

A key and time-consuming component of an HYB offering, is the preparation of an OM which contains details as to the issuer, its business and the transaction, audited financial statements, an overview of the industry and associated risk factors. The OM operates as both a marketing tool and satisfying disclosure requirements to comply with anti-fraud provisions of the securities laws.

The material terms of the HYB are negotiated as the "Description of Notes", which is incorporated into the OM. Those terms are subsequently documented in an indenture, but this is largely a mechanical process, since the principal terms and covenants will have been finalized for the Description of Notes.

### Term loan B financings

Since bank loans, including TLB's, are not deemed to be securities for purposes of the '33 Act, they are not subject to the same requirements or limitations as to disclosure and transferability. The speed at which a TLB

financing may be consummated is dictated by the extent of the syndication required to find lenders to advance funds. In practice, this may require lender presentations similar to a road show conducted as part of a high yield offering together with a prospectus (a "bank book") that, due to disclosure requirements for an HYB offering, is less extensive than the OM in an HYB offering.

### Committed Financings

One of the key differences between a term loan and high yield financing is the fact that a term loan may, typically in the context of a financing supporting an

acquisition, be "committed" or underwritten by the arranging bank(s), whereas a high yield deal would not. A committed TLB financing would enable a corporate borrower to engage one or more lenders to provide a financing commitment on pre-agreed pricing and terms, subject in the case of a syndicated financing, to the ability of those lenders to "flex" the pricing and certain terms within agreed parameters, in order to ensure that the arranging lenders can syndicate the deal into the market.

In the immediate aftermath of the credit crisis lenders were cautious in providing commitments that could not be syndicated. However, as the market continues to improve and syndication confidence has returned (and in certain deals may be oversubscribed), committed financings have returned to the arena.

In an HYB offering an investment bank is engaged as an underwriter or initial purchaser, but this is typically done on a best efforts basis without a commitment from the bank to purchase the notes. Where an HYB issuance forms part of a financing, and a committed financing is required (ie: an acquisition scenario), the company would seek a committed bridging loan that would be drawn in the event that it is not possible to consummate an HYB offering within the required time frame or at the desired price. Such bridge loans are typically set with a 365 day maturity and an increasing interest rate serving as an incentive to the company to attempt to issue the bonds and refinance the bridge loan, at the earliest possible time.

### Covenants

Covenant packages for bank facilities comprising term loans, versus those for high yield deals, traditionally differ in that the latter do not contain financial maintenance covenants. A term loan facility would include a quarterly compliance test of all or any of the following financial covenants: leverage (Debt: EBITDA), interest coverage (EBITDA: interest expense) and fixed charge coverage (EBITDA: fixed charges (including debt service, tax and other fixed expenses)), calculated using a 10-30% cushion to the financial model agreed with the banks. It would also include separate restrictive covenants that would limit the ability for the borrower to incur debt, make investments, pay dividends, etc., other than a prescribed set of carve-outs or "baskets" permitting certain actions to be taken and usually subject to \$ caps.

Conversely, high yield covenants are "incurrence-based" by nature, meaning that a financial covenant (typically either a 2:1 fixed charge coverage ratio or an agreed leverage ratio) would only be tested if the issuer wanted to consummate certain actions, such as incur

additional debt. Provided that the issuer satisfied the financial covenant on a pro forma basis (ie: after giving effect to the intended action), it could incur the debt, etc. without restriction. In the event that the issuer could not satisfy the covenant test, it would need to rely upon an agreed set of baskets permitting certain limited actions to be taken irrespective of whether the covenant test could be met.

This differs to a bank financing, including maintenance financial covenants, in that while the credit agreement may provide a borrower with a debt covenant basket permitting it to incur additional debt up to, say \$5 million, the pending quarterly financial maintenance covenant test would dictate whether there was any room to incur additional debt under that \$5 million basket without tripping a default.

### Covenant lite

The past decade has seen an evolution in the TLB market, principally with the emergence of "covie-lite" deals. Such deals are "lite" in their absence of financial maintenance covenant testing and emerged circa 2005, driven by private equity sponsors financing LBO activity and accepted by institutional investors who were competing for syndicate allocations and willing to accept a lesser degree of control over a borrower. From the viewpoint of a borrower, a large syndicate of lenders with a broad profile of investor-types, including banks, hedge funds, pension funds and vulture funds, may have divergent interests and prove to be a

*"The past few years has seen a trend of convergence in negative covenant packages between TLB and HYB deals, in that borrowers of TLB have been obtaining covenant terms more similar to, and in some cases, identical to, those available in an HYB issuance."*

An immediate effect of the credit crisis was to eliminate new covie-lite deals and in some cases, refinancings saw the addition of maintenance covenants. However, covie-lite deals re-appeared in 2012 as confidence in the credit markets improved and are enjoying a resurgence in 2013. Year-to-date, 2013 has seen in excess of \$90 billion of covie-lite loan issuances,

challenging group to coordinate in a covenant breach or work-out scenario. A covie-lite approach therefore works well from a borrower's perspective to reduce lender involvement when it is experiencing a period of financial strain.

representing more than 50% of the overall US TLB market for 2013 (data according to S&P Capital IQ/LCD). This, in turn, has been reflected in the CLO market, where newly-issued CLOs in 2013 are allowing for a greater percentage of portfolios to be comprised of covie-lite loans.

However, not all covie-lite deals are free of maintenance covenants. A variation frequently seen in recent years is the inclusion of a financial maintenance covenant, tested quarterly, but where a default may only be called by the revolving facility lenders. This formulation provides a means of appeasing banks as revolving lenders, who are naturally uncomfortable in funding a new advance into a scenario of deteriorating EBITDA, whilst also giving the borrower the benefit of a covie-lite approach for the TLB tranche and limiting the number of lenders it will need to negotiate with in a downside scenario.

### The convergence of covenants

Setting maintenance covenants aside, a covie-lite TLB and an HYB deal may still differ in their approach to restricting activities of an issuer. For example, while an HYB deal might test the ability to incur debt based on meeting a pro forma 2:1 fixed charge coverage ratio, a typical TLB might permit additional debt up to a specified \$ cap, or perhaps, a pro forma maximum leverage test.

Where a company's debt capital structure comprises both a senior secured TLB financing and existing (or the ability to issue future) HYB, that company may find itself with two different sets of covenants, different capacities to take certain action and different accounting definitions used in formulating Consolidated Net Income, EBITDA, etc. To the extent that the TLB credit facility negative covenants are more restrictive than those of the HYB indenture, the company would not be able to fully access the flexibility offered by the HYB, while the TLB credit facility remains outstanding.

This, combined with the additional time and effort on the part of the company to monitor compliance with two covenant regimes, makes it important to attempt to align the covenant packages between a TLB credit agreement and an HYB indenture as closely as possible.

The past few years has seen a trend of convergence in negative covenant packages between TLB and HYB deals, in that borrowers of TLB have been obtaining covenant terms more similar to, and in some cases, identical to, those available in an HYB issuance. Again, the extent of this convergence for a particular deal will be dependant upon various factors including investor demand for the TLB, the issuer or debt credit rating and

whether an HYB features as part of the capital structure. The presence of an asset-based revolving credit facility (an "ABL") in the capital structure may further constrain covenant flexibility offered by the HYB and TLB. The lenders of an ABL are, typically, commercial banks who adopt a more conservative approach and outlook than institutional investors in an HYB or TLB deal. A borrower will likely meet greater resistance from a syndicate of ABL lenders in its efforts to obtain one uniform set of covenants to apply across all facilities.

### **Restricted subsidiaries**

In a typical HYB deal the issuer and its "Restricted Subsidiaries" are subject to the covenants, while "Unrestricted Subsidiaries" are not. This concept is now frequently seen in TLB deals, where borrowers are offered similar flexibility as in an HYB deal.

An "Unrestricted Subsidiary" is a subsidiary designated as such by the issuer and consequentially, (i) is not subject to the covenants and is thereby not limited in its ability to conduct business, including incurring debt, making investments and divesting of assets and (ii) is not required to guarantee the HYB notes.

In exchange for this flexibility, (i) the net income and EBITDA generated by an Unrestricted Subsidiary is not counted in the issuer's consolidated net income or EBITDA, which impacts ability to meet the fixed charge coverage and leverage ratio tests and (ii) the issuer and its Restricted Subsidiaries are limited in their ability to make investments in, or make loans and payments to, Unrestricted Subsidiaries. Designating a subsidiary as "Unrestricted" equates to making an investment in that subsidiary, and is therefore subject to the Issuer having capacity under its restricted payments covenant to make the designation.

A covenant would typically include a specific basket for investments in Unrestricted Subsidiaries up to an amount determined by the greater of \$ $\chi$  and  $\chi\%$  of total assets. Investments through designating Unrestricted Subsidiaries over and above that basket amount, would be made in reliance on the "Building Basket" generally available to the Issuer for investments and restricted payments (*see "Restricted Payments" below*).

An Unrestricted Subsidiary can be re-designated as "Restricted" and brought back into the group, though this is often limited to one iteration in order to prevent abuses of the mechanism to bypass or satisfy the fixed charge coverage or leverage ratio tests.

## Covenant Comparison

The table below summarizes certain key covenants in HYB and TLB financings. While the nature of a covenant package for a particular financing will be determined by various deal-specific factors, this illustrates the type of flexibility that is currently being seen in the market and how the prevalence of covie-lite TLB's is resulting in a convergence with HYB deals.

Covenant	HYB	TLB
<b>Debt</b>	<p>Issuer will have the ability to incur additional debt subject to meeting a pro forma 2.00:1.00 fixed charge coverage ratio test or a specified leverage ratio test (ie: the "incurrence test"). Additionally there will be agreed carve-outs ("baskets") for specific categories of permitted debt (bank credit facilities, capital leases, etc.) available to the issuer irrespective of whether the incurrence test can be met at such time.</p>	<p>Traditionally, additional debt was subject to a \$ cap, but has evolved to offer greater flexibility. For example, a borrower may incur additional debt subject to pro forma compliance with a leverage test based on any of total debt, senior debt (ie: not limiting the borrower's ability to incur additional junior debt) or senior secured debt (ie: not limiting the borrower's ability to incur additional senior unsecured or junior debt).</p> <p>If the TLB is issued as part of a financing comprising an HYB deal, it may obtain the ability to incur debt based on the same 2.00:1.00 fixed charge coverage test.</p> <p>TLB lenders may require that additional debt is issued with a maturity outside of the TLB (and control the borrower's ability to prepay such debt, to the extent issued as junior debt, through the Restricted Payments covenant – see below).</p>
<b>Liens</b>	<p>The extent to which the granting of liens over assets is restricted depends upon whether the HYB are senior secured, senior unsecured or senior subordinated.</p> <p>Senior subordinated HYB typically permit liens, provided that the issuer does not grant liens to secure other subordinated debt.</p> <p>Senior unsecured HYB would permit other debt to be secured by liens to the extent that the issuer secure the HYB on an "equal and ratable" basis.</p> <p>Senior secured notes would have a more restrictive covenant limiting the issuer's ability to grant additional liens, subject to a pro forma secured leverage test.</p>	<p>TLB lenders are always focused on the issue of sharing collateral with other creditors of the Borrower and the ability to incur additional secured debt is typically restrictive.</p> <p>Traditionally a \$ cap, but a movement towards permitting liens based on a senior secured leverage test (but a tighter test than that for incurring debt) or permitting the Borrower to secure additional debt but only in the form of 2nd liens on the TLB lenders' collateral. Permitted 2nd lien financings would be subject to a pre-agreed form of intercreditor agreement that would be attached to the TLB credit agreement. Permitted 2nd lien financings are generally formulated as "silent seconds" ie: subordinated with as few rights as possible.</p>
<b>Restricted payments (ability to make dividends, redeem equity, prepay other debt or make investments)</b>	<p>An Issuer may make Restricted Payments using either (i) its "Building Basket" or (ii) prescribed permitted baskets.</p> <p>The Building Basket concept is a basket amount available to the Issuer to consummate certain actions, including Restricted Payments and investments, that grows over time based on 50% of Consolidated Net Income accumulated from the closing date through the relevant date, plus other items such as additional equity contributed to the Issuer.</p> <p>The other prescribed permitted baskets, may for example, include a general basket based on either a \$ cap or the greater of a \$ cap and a % of total assets (to allow the \$ cap to grow commensurate with the size of the Issuer group).</p>	<p>Lenders are always focused on the ability of a Borrower to leak cash out of the credit group via dividends or repayments of junior debt, etc. A Borrower would traditionally have limited capacity to make such Restricted Payments (and may be limited to a nominal \$ cap general basket).</p> <p>TLB deals have evolved towards a HY approach in (i) permitting the Borrower to use "Retained Excess Cash Flow" (ie: the portion of Excess Cash Flow in any fiscal year that is not required to be applied by the Borrower to prepay loans under the excess cash flow mandatory prepayment provision) or (ii) a similar building basket, typically called the "Available Amount" based on 50% of accumulated Consolidated Net Income and other items as per an HYB formulation.</p>

Covenant	HYB	TLB
<b>Asset sales</b>	<p>Rather than restrict the issuer's ability to dispose of assets, the covenant is intended to direct what the issuer does with the proceeds. Issuer would be permitted to dispose of assets (in addition to other specific baskets) provided that the sale is at fair market value and at least 75% of sale proceeds comprise of cash.</p> <p>Net cash proceeds not applied by the Issuer to other senior debt (ie: mandatory prepayments under a bank facility) or reinvested in other assets, are deemed "Excess Proceeds". When Excess Proceeds exceed a specified threshold amount, the Issuer is required to make an offer to the holders to repurchase HYB notes using such Excess Proceeds. The Issuer would retain Excess Proceeds where holders elect not to accept the offer.</p>	<p>One difference here to an HYB approach is that a Borrower's ability to use the Available Amount may also be subject to meeting a pro forma leverage ratio test and/or liquidity test (ie: minimum cash and revolving facility availability).</p> <p>Traditionally, Borrowers would only be permitted to dispose of assets in sales outside of the ordinary course of business up to a limited \$ amount per fiscal year or over the life of the loan.</p> <p>Net cash proceeds of those sales would be subject to a mandatory prepayment, subject to the Borrower's ability to re-invest the proceeds within a specified period of time (typically 180-365 days).</p> <p>Some recent TLB deals have seen a movement towards an HYB approach permitting unlimited asset sales subject to fair market value and 75% cash proceeds conditions. Lenders may be comfortable with this approach where the proceeds are applied to de-lever and pay down the loans.</p>

## Conclusion

The trend of European corporates looking to the US to raise debt financing was initiated as a result of constrained regional demand and more competitive pricing terms offered by US investors. However, we may be seeing the emergence of a permanent feature in the global capital markets landscape, where non-US companies might routinely consider a US financing among its range of financing options. The US possesses a deep bench of institutional investors that has recently demonstrated an appetite for TLB and HYB issuances by European companies and the trend appears to be continuing. Of course, a variety of deal and company-specific factors will determine whether a US syndicated loan or private placement is feasible for a particular transaction. We are always happy to work with our clients and answer any questions related to a potential US financing.

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## Ashurst German Banking Group

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