LevFin Quarterly

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Editors' Welcome

Welcome to the inaugural edition of LevFin Quarterly, a quarterly newsletter published by Weil's US Finance practice to keep our clients and colleagues updated on current topics and trends in the US Leveraged Finance market. We hope you find LevFin Quarterly to be informative and we are of course happy to discuss the topics in this issue and other developments in leveraged finance with you.

Best regards,

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and the Weil Finance Practice

In This Issue

Q2 Market Trend: European Issuers Continue to Access the US Loan Market

In recent months, an increasing number of European borrowers (including companies with little or no US presence) have been looking to access the US loan market (using NY law, US style loan documents) for refinancings, dividend recaps and acquisition financings in order to obtain various benefits, including higher leverage and more favorable economics and terms. As the US and European loan markets approach financings quite differently, we note the following items for consideration. We would refer you to our client alert distributed in May for additional information.

- **Location of the Loan Parties.** Consider early on the applicable insolvency/creditors' rights regime and withholding tax implications in the jurisdictions in which the expected borrowers and guarantors are located. In addition, if the primary borrower is not expected to be a US entity, a US domiciled co-borrower may be required for marketing and syndication purposes.
- **Documentation Considerations.** European loan documentation/LMA standard form varies significantly from a typical NY law governed credit agreement, including with respect to covenant packages, the provision of ancillary facilities, treatment of hedges, transfer provisions (e.g., "white list" vs "disqualified institutions") and intercreditor arrangements.
- **Currency Considerations.** There may be a mismatch between the company's revenues and the currency of the financing (US$, often with a portion of the term loan available in €, £ or other agreed currencies). As a result, hedging needs should be addressed up front and in addition, the impact of FX fluctuation on financial covenants and other incurrence based baskets should be considered and appropriately addressed.
- **Conditionality.** European style certain funds provisions are becoming increasingly common in US financings for the acquisition of European public and private targets where sellers would expect such limited conditionality. Otherwise, standard US style conditionality (including "SunGard" provisions) would apply.

Q2 Market Trend: Issuer-friendly High Yield Terms

Through May, the second quarter saw a continuation of a number of issuer-friendly trends in high yield terms that began to appear in the fourth quarter of 2012 as high yield demand grew. The market softened in June and volume declined dramatically following wider pricing with a number of deals being pulled by issuers. It remains to be seen whether these terms will continue when market conditions become robust again, however, there was at least one sponsor-backed issuance in July that contained a number of these terms.

These trends include the following terms:

- **Unlimited restricted payments basket subject to compliance with a leverage ratio.** The leverage ratio, which is either based on total or net debt, is typically set inside the closing date ratio, but may also be set outside of closing date leverage for low leveraged issuers. The issuer may also be permitted to later reclassify restricted payments in the same way that it can reclassify debt issuances in order to replenish previously used general baskets once ratio compliance is achieved.

- **Inclusion of incremental facilities in credit facility basket.** An increasing number of deals have included in the credit facility basket for the bonds both the fixed dollar component of the incremental facility in the credit agreement and the unlimited component of the incremental facility subject to compliance with a specified senior secured leverage ratio.
- **Double trigger change of control or change of control covenant suspension.** With a double trigger change of control, the issuer is only required to make the customary 101% change of control offer if there has been both a change of control and a ratings decline as a result of the change of control transaction. While more common in the investment grade market, this concept had not traditionally been seen in high yield issuances. A number of deals alternatively included the change of control covenant among the covenants that would be suspended upon achieving investment grade ratings. This would allow an issuer to avoid the requirement to make a change of control offer if the notes had an investment grade rating following the change of control (either as a result of the issuer achieving investment grade status or the issuer being acquired by an investment grade company).
- **Change of control call and/or change of control cleanup.** A number of deals allowed the issuer to redeem the notes at 110% in connection with a change of control during a specified period following the issue date (typically between 12 and 18 months). Irrespective of whether a change of control call was included, a number of deals allowed the issuer to call the remaining notes at the change of control offer price if at least 90% of the holders accepted the change of control offer.
- **Permanent covenant "fall away" versus "suspension."** The ability to suspend most of the restrictive covenants during the period when the notes have investment grade ratings has become increasingly common. A number of deals, however, provided that these covenants terminate once the notes are rated investment grade even if there is a subsequent loss of investment grade status. In some cases, the terminated covenants included the requirement to provide guarantees and the change of control covenant.
- **Larger equity claw baskets.** An increasing number of deals contained a 40% equity claw basket (rather than 35%) and a number of deals required that only 50% of the bonds must remain outstanding (rather than 60% or 65%).

Ratings Alert: Moody's Potential New Treatment of Shareholder Loans

On July 31, 2013, Moody's issued definitive guidance regarding its new proposed framework for assessing the debt and equity characteristics of hybrid instruments (including Shareholder Loans (as defined below)) issued by speculative-grade non-financial companies with a corporate family rating (CFR) or senior unsecured rating of Ba1 and below. The full article describing the new methodology is available on Moody's website. This late breaking development is in response to Moody's request for comment issued in May on this topic. The treatment of Shareholder Loans as debt or equity may impact the ultimate CFR and facility ratings received by borrowers in connection with financings.

- Moody's new methodology applies binary criteria to shareholder loans (including debt instruments and preferred equity certificates and convertible preferred equity certificates that are issued in certain European jurisdictions, collectively, "Shareholder Loans") – according Shareholder Loans either 100% or 0% equity credit, depending on whether the instrument has a debt claim in bankruptcy (other than Shareholder Loans meeting the criteria described below). This is in contrast with Moody's prior approach which assigns varying degrees of equity credit for Shareholder Loans (i.e., 0%, 25%, 50%, etc.).
- In order for a Shareholder Loan that would otherwise be treated as debt to receive 100% equity treatment under the new methodology, it must be deeply subordinated and meet each of the specific criteria set forth by Moody's to make the Shareholder Loan function equivalent to equity from a credit standpoint, including (among others) (i) contractual subordination to all liabilities (including non-financial liabilities such as trade credit, but excluding other shareholder debt), (ii) entry into an intercreditor or subordination agreement that documents among other things enforcement processes and application of recovery proceeds, (iii) maturity of any Shareholder Loan being at all times at least six months after the maturity of any other debt within the rated group, (iv) very limited permitted covenants, (v) alignment of interest with the common equity through "stapling," (vi) protections against cash leakage and (vii) protections for other creditors in the event of modifications to the Shareholder Loans (e.g., majority approval of senior lenders required to amend Shareholder Loans). Failure to comply with the prescribed criteria post issuance of a rating could result in a subsequent ratings adjustment if Moody's no longer believes the Shareholder Loans will behave like equity.

Portable Capital Structures: Recent Developments Relating to Change of Control

Change of control provisions are common to both US and European leveraged debt financings and are generally intended to ensure that creditors are protected against changes in ownership that could affect the way the borrower is managed. As a result, leveraged capital structures have not traditionally been "portable" between equity owners and acquisitions typically require the target's existing debt to be refinanced.

The European high yield bond market (and to a lesser extent, the US high yield bond market) has in recent months, however, seen an increase in "portable" bonds that carve out a "specified change of control event" from the definition of change of control, effectively eliminating the issuer's obligation to make a change of control offer, typically subject to a maximum leverage test. At the same time, some sponsors, in the US in particular, have also made their portfolio companies' credit agreements "portable" through the use of "pre-caps", which carve out changes of control that meet certain specified conditions from the change of control definition used to trigger an event of default.

These portability features enhance a portfolio company's value by facilitating acquisitions by removing the need to refinance a target's debt and provide potential buyers with access to a more attractive capital structure than would otherwise be available if markets weaken. This allows for avoiding financing uncertainties and the fees and expenses required to refinance existing debt.

In April, French caterer and Charterhouse Capital Partners' portfolio company Elior announced a refinancing package that includes a "specified change of control event" in its senior secured notes and a pre-cap in its amended term loan. This very rare structure provides Charterhouse an extraordinary level of flexibility as it looks to sell Elior, and may serve as a template for sponsors seeking ways to maximize the value of their portfolio companies by taking advantage of market conditions to secure favorable financing terms, which can then move with (and accentuate the value of) the asset.

Portability features remain highly negotiated in both Europe and the US, and the identity of the backing sponsor and company management is important to investors in both markets. For example, recent US portable bond and loan financings that have cleared the market have involved refinancings by top tier sponsors of relatively mature portfolio companies, rather than new acquisition financings.

Awards and Rankings: Weil's Finance Practice and Partners Recognized in *Chambers USA* and *Chambers Global* 2013

In May 2013, *Chambers and Partners,* publisher of the world's leading guides to the legal profession, released its *Chambers USA* 2013 rankings. Weil's Finance practice and its partners received 13 recommendations this year, and the publication notes that the firm's "key strengths include advising private equity clients in acquisition finance as well as representing financial institutions in their lending activities in the leveraged finance space. This practice is also boosted by the firm's impressive international footprint which attracts highly coveted, cross-border deals."

In April 2013, *Chambers Global* released its 2013 rankings. Weil's US and international Finance practice and its partners received 36 recommendations across 14 categories in eight regions.

Recent Weil Representations

Goldman Sachs Bright Horizons Family Solutions	Advent Cytec	Citi AMC Entertainment	Charterhouse Capital Partners Armacell	THL Partners CompuCom – The Leading IT Outsourcing Specialist	Barclays WNA
Macquarie TNS	CCMP/Milacron Mold Masters – performance delivered	Dubai International Capital Doncasters	THL Partners/ Goldman Sachs CTI Foods	UBS KSS Key Safety Systems	Advent Oxea

LevFin Quarterly provides updates on current topics and trends in leveraged finance and is published by the Finance practice of Weil, Gotshal & Manges LLP, 767 Fifth Avenue, New York, NY 10153, +1 212 310 8000. www.weil.com.

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