SBIA Lunch & Learn Webinar Series

Evolving Debt Financing Terms

October 6, 2020

US Middle Market Trends/Current Statistics

- According to a recent study by William Blair of middle market lenders, Q2 2020 looked like this:
  - 94% increased pricing for primary debt offerings
  - 92% tightened transaction terms and pricing
  - 80% wanted at a minimum equity contribution from the sponsor of 35% or more
  - 94% of lenders did not make borrower-friendly concessions to win deals
  - New term sheets issued for companies not significantly affected by COVID-19
- According to Moody's:
  - Ratings downgrades have been a feature of the market as well, with 452 recorded in Q2 alone.
  - Institutional leveraged loan defaults in the US climbed 3.9% in June on a trailing 12-month basis, according to *Debtwire Par*.

Increase in Default Rates & Lender Responses

- How are lenders responding?
- Tighter credit standards
- Interest rate floors
- Increased spreads

Liquidity is a Key Issue

- Preservation of liquidity by borrowers
- Consideration of collateral stripping strategies
- Anti-hoarding provisions

Effect on Terms Where the Pandemic Affects Performance

- MAE definitions
- Financial covenant holidays
- Information delivery
- Exceptions to mandatory prepayments
- EBITDA add backs for COVID-related events
- Carving PPP obligations out of leverage

Treatment of PPP loans

- Specific category of permitted debt
- Representations regarding eligibility for PPP loans, compliance with CARES Act
- EBITDA Add-Backs
- Covenants and notice to lender regarding application for loan forgiveness
- Exclude from mandatory prepayments
- Cross default provisions

Treatment of PPP loans

- Considerations for the future
  - Borrowers need the ability to amend given changing SBA guidance, delayed timing for forgiveness, etc.
  - SBA has not provided PPP guidance if borrower files for bankruptcy.
  - New guidance on SBA consent requirements for change of control of PPP borrowers

Concerns About Loan Agreements That Allow for Collateral Stripping (aka "Trap Doors") and Expansive EBITDA Add-Backs

- Borrowers have utilized permissive provisions in credit agreements to access additional liquidity at the expense of senior secured creditors

- JCrew, Serta and others

- As new debt is issued in coming months, lenders will give careful consideration to the interplay of unrestricted subsidiaries, permitted investment baskets, and permitted assignments

Other Issues in This WFH World

- Electronic signatures/electronic communications
- Enforcement issues (foreclosure moratoria, court closures and the like)
- Valuation issues (difficulty in liquidating collateral, vulnerability to cram down and lien stripping in Chapter 11 proceedings)
- Timing of transactions
  - Due diligence/difficulty of on-site visits for sponsors
  - Credit approvals
  - Delays with third party deliveries
  - Again, PPP timing issues

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