Beard Group
30th Annual Distressed Investing Conference

November 29, 2023

What are liability management transactions (“LMTs”)?

LMTs are **proactive** actions that a company can take to manage—either opportunistically or in response to distress—its debt capital structure, typically to achieve one or more of the following goals:

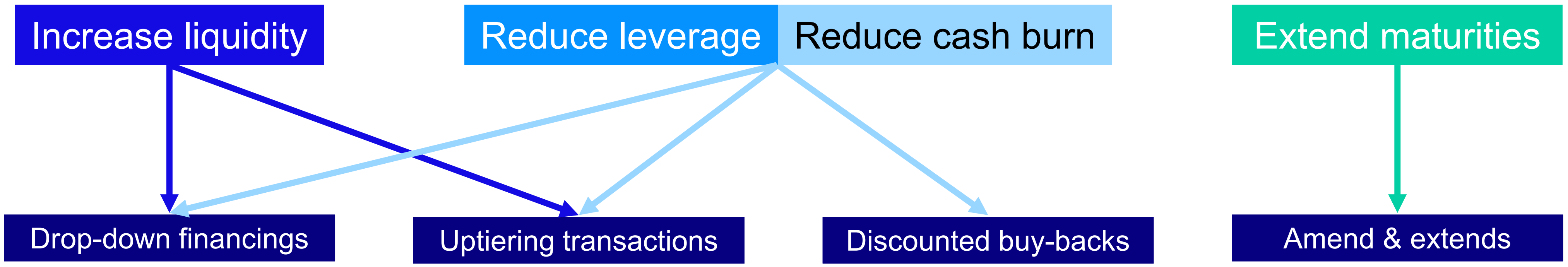
- Increase liquidity
- Reduce leverage
- Reduce cash burn
- Extend maturities

How are LMTs typically implemented?

- Drop-down financings
- Uptiering transactions (with or without new money)
- Discounted debt buy-backs
- Amend & extends

What should be considered when evaluating a potential LMT?

- Debt documentation
- Litigation risk
- Tax impact
- Ratings impact
- Stakeholder relationships

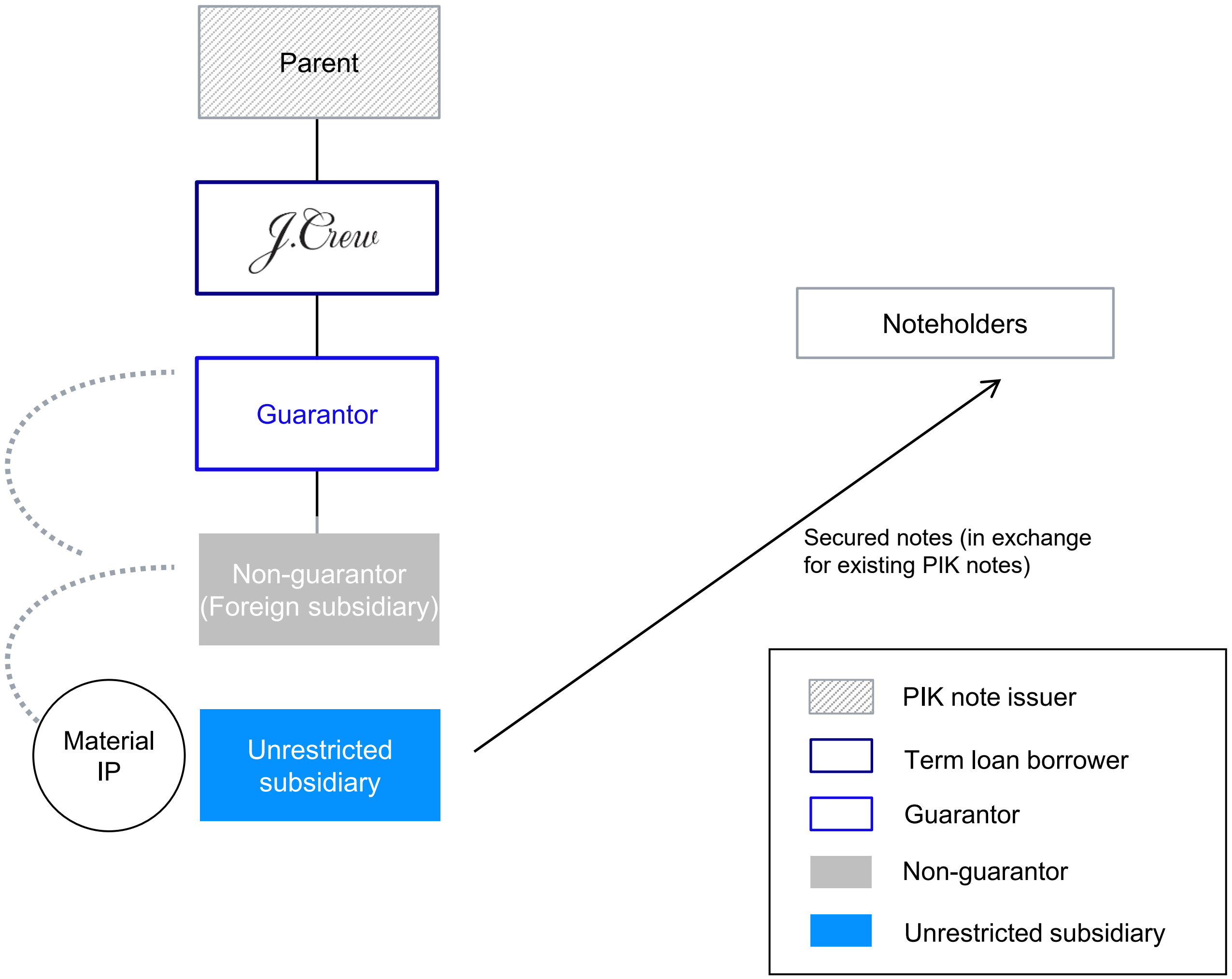


Market overview

- Proliferation of LMTs in the last 5 years because of loose credit documents combined with robust private credit market
- LMTs have gone mainstream; formerly sponsor-led exercise has become a free-for-all
- Public companies are following LMT playbook from sponsor-owned companies
- Many private and public companies are seeking to extend runway and buttress liquidity in the face of near-term maturity walls, high interest rates and continued supply chain issues and consumer uncertainty
- Increase in complex guarantee structures (double DIP and pari plus transactions)
- Decreased interest from sponsors in non-pro rata deals
- Threat of non-pro rata deals has also changed party dynamics and deal structuring, with an increased appetite for pro-rata or private credit deals

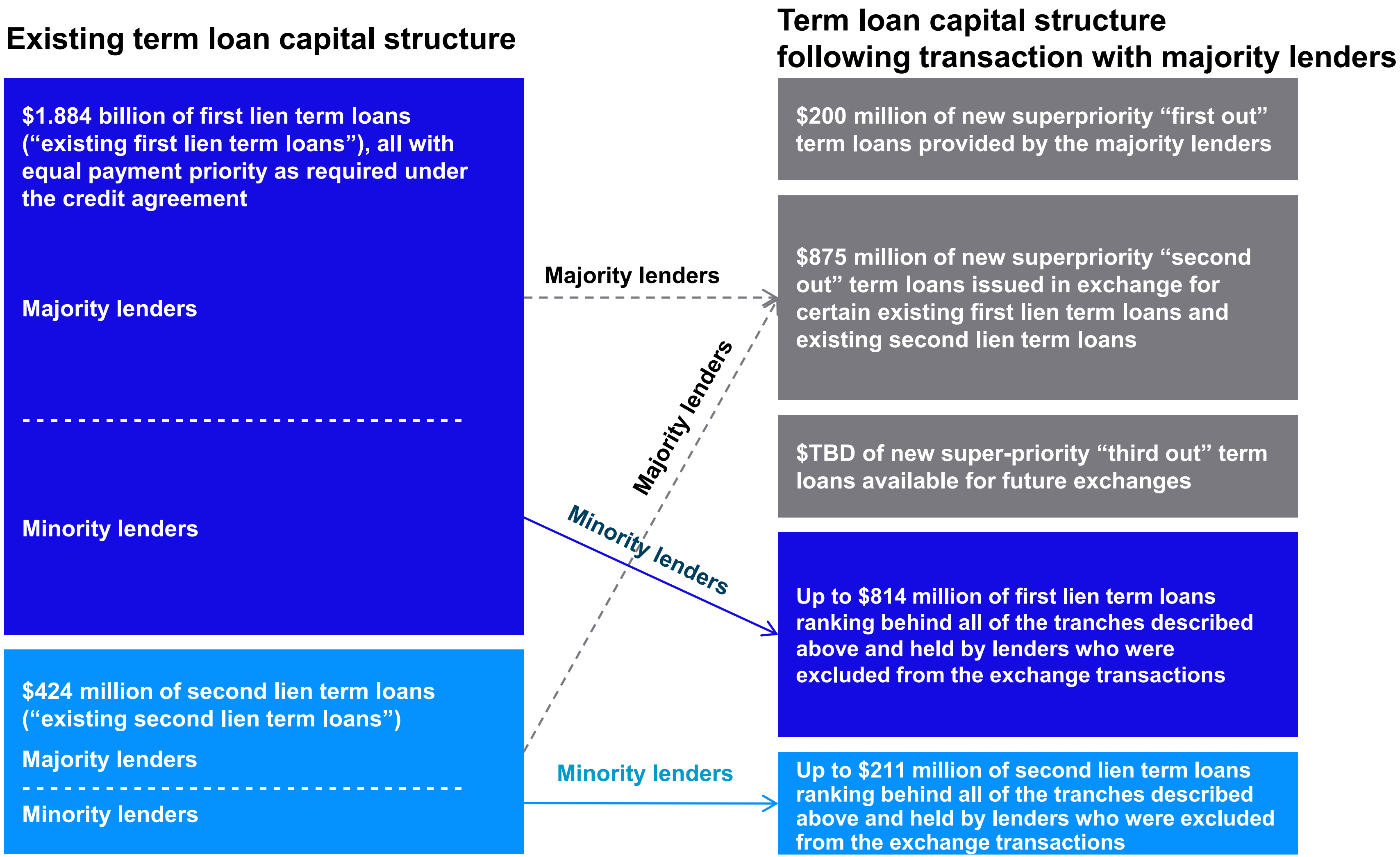
LMTs in the loan market

J.Crew drop-down transaction



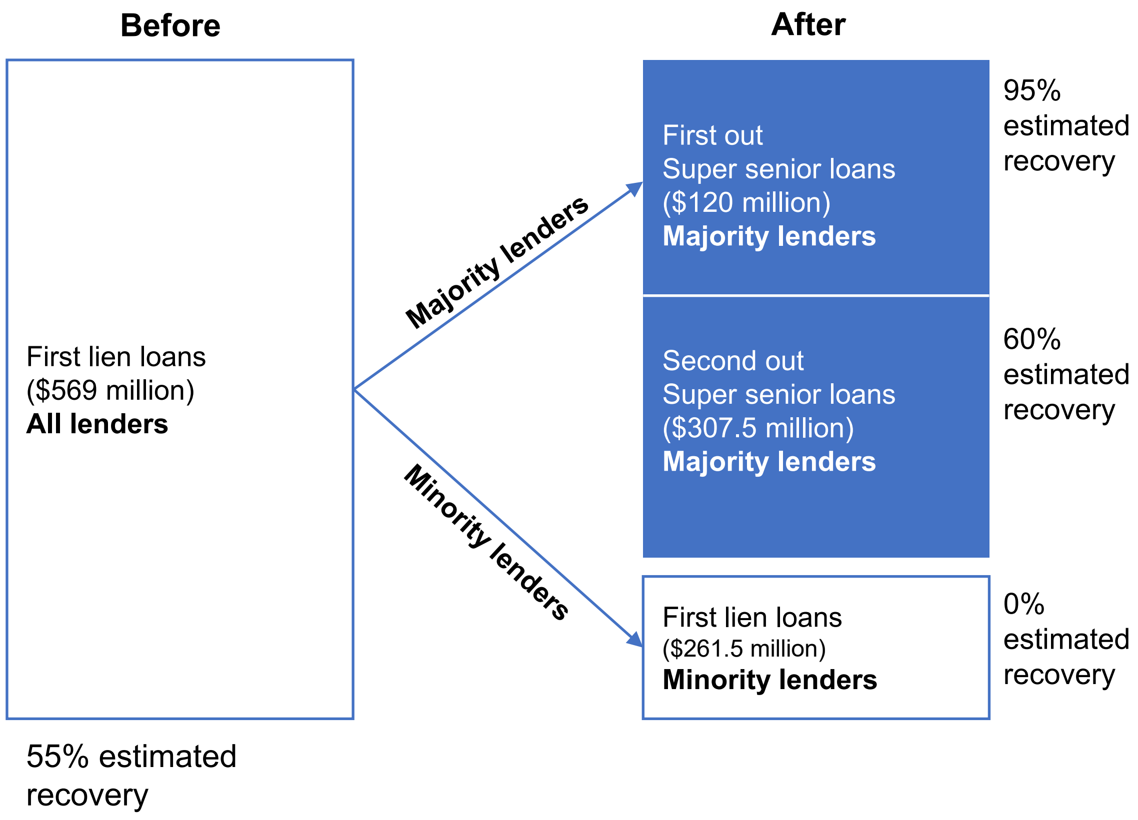
LMTs in the loan market (cont.)

Serta Simmons uptiering transaction



LMTs in the loan market (cont.)

TriMark uptiering transaction



Recent developments

Some of the more recent LMTs have included one or more of the following mechanisms:

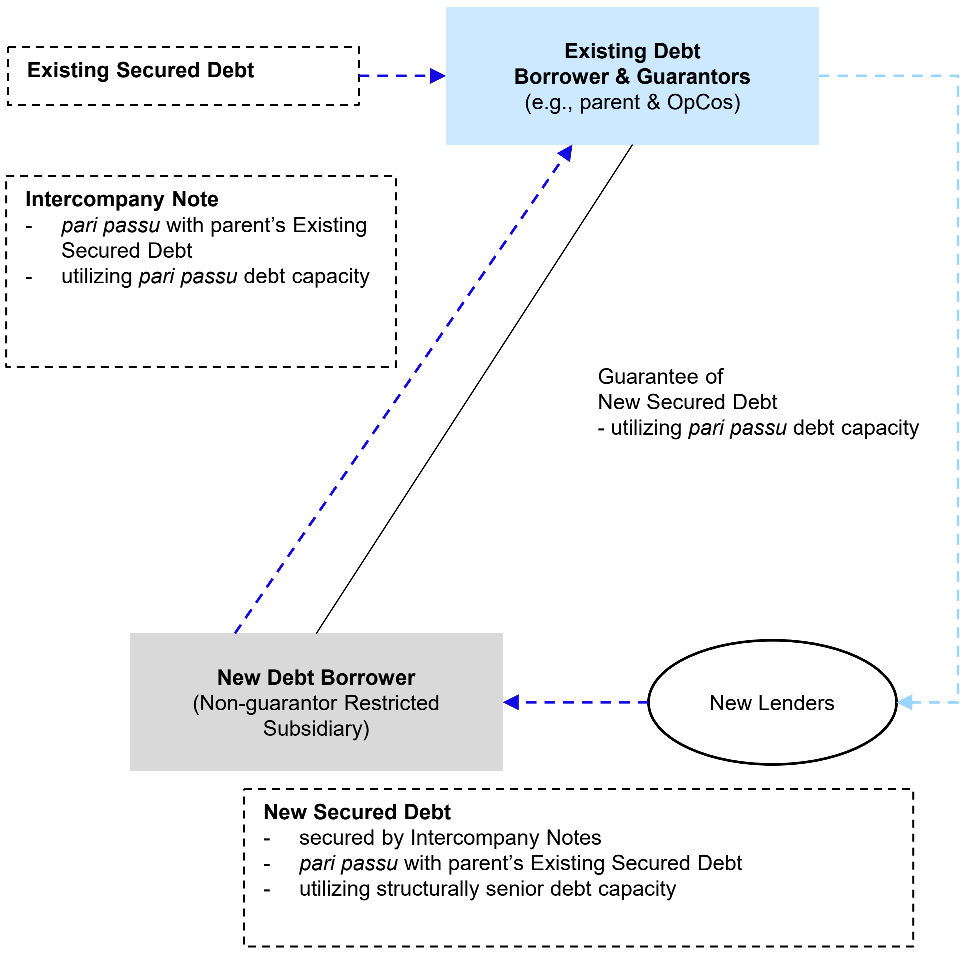
- ***"Double dip" transactions*** – effectively giving participating creditors two claims against the same collateral securing the company's first lien debt through the use of an intercompany claim (e.g., *At Home*, *Wheel Pros*)
- ***"Pari plus" transactions*** – creditors benefit from a pari claim against the existing loan parties—which may be indirect, through an intercompany loan—plus a new-money guarantee claim against assets outside of the existing credit group (e.g., *Trinseo, Sabre*)
- ***Grace period extensions*** – extending the grace period for interest payment defaults without the consent of each affected bondholder or lender
- ***Entrance consents*** – issuing additional debt to consenting creditors in order to obtain the requisite vote

The details and permissibility of these transactions are heavily dependent on the credit agreement/indenture provisions pursuant to which they are undertaken

“Double dip” structure in a new financing

- The company identifies, designates or creates a non-guarantor restricted subsidiary or an unrestricted subsidiary as borrower of funds from new lenders
- New lenders lend to such new subsidiary borrower, with the existing loan parties and collateral guaranteeing and securing the new debt, resulting in a direct *pari passu* claim against the existing loan parties
  - The new debt may also be supported by guarantees from non-guarantor restricted subsidiaries and/or security interests in assets that are not collateral under the existing secured debt
- The new borrower then lends the proceeds to the existing debt borrower in an intercompany loan, creating a second *pari passu* claim against the existing loan parties. The new borrower’s interest in the intercompany loan (i.e., the intercompany loan receivable) is then pledged to secure the new debt, giving new lenders the indirect benefit of the second *pari* claim

Simplified Structure

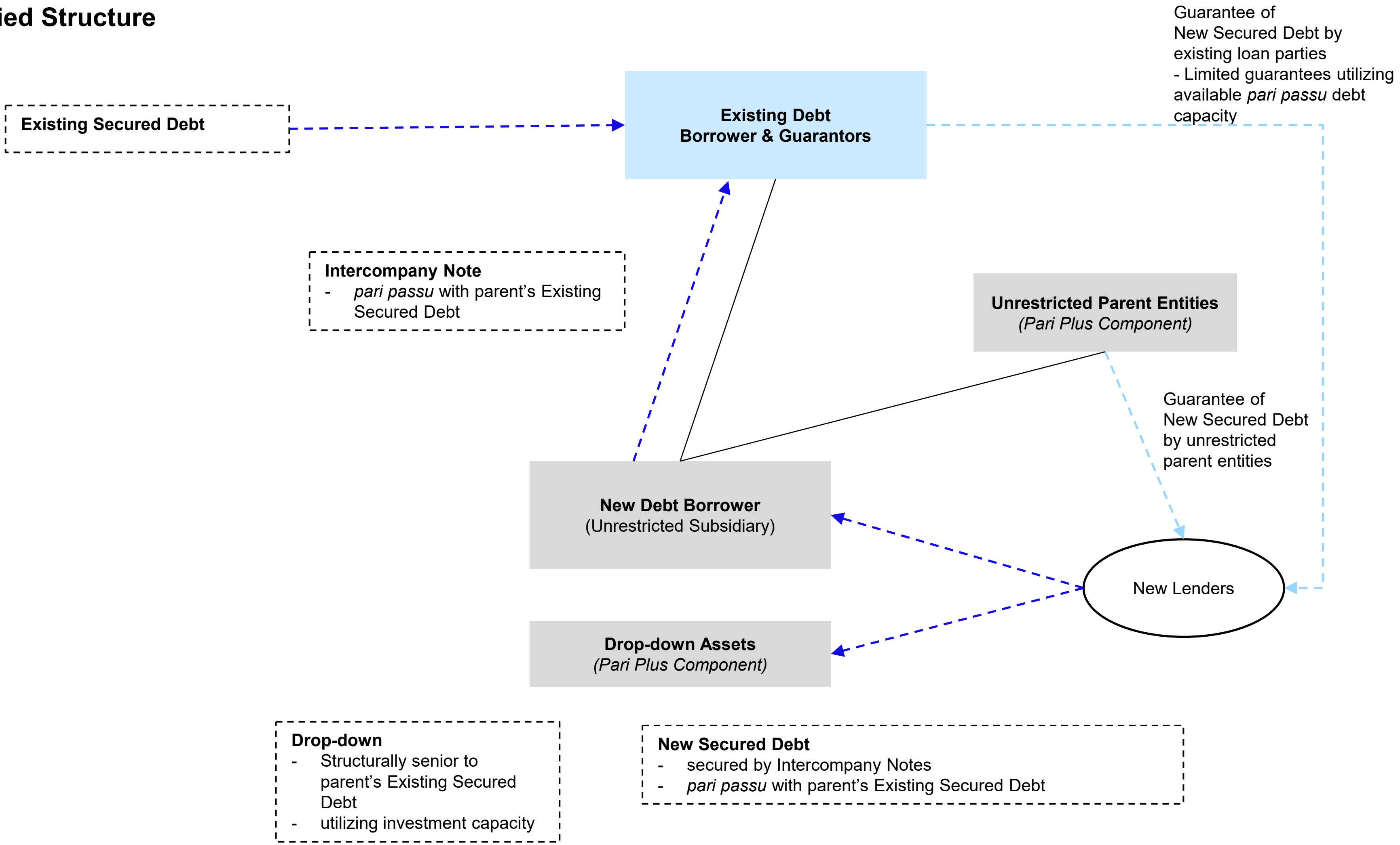


“Pari plus” structure in a new financing

- Intercompany loans have also been used in recent liability management transactions to implement “pari plus” financing structures, which allow new lenders to receive the benefit of *pari passu* claims and collateral from the existing credit group, while also receiving additional credit support not provided to others
- Similar to a double-dip financing, a pari plus transaction typically involves a new third-party secured loan to an entity (the “New Borrower”) that is an affiliate of the existing credit group, but is not, itself, a loan party under any existing debt
  - **Pari**: The New Borrower then on-lends the proceeds of the third-party loan to the existing credit group, and the existing loan parties provide guarantees and collateral to the New Borrower to secure its intercompany loan on a *pari passu* basis with existing secured debt
  - **Plus**: In addition, the New Borrower and/or subsidiaries of the New Borrower provide additional liens and guarantees to the new lenders that are not shared ratably with the existing credit group
- The intercompany loan creates a degree of separation between the *pari passu* liens and claims on the one hand, and the additional liens/guarantees, on the other hand
  - The structure is most useful for compliance with covenants that prohibit the incurrence of debt and liens that is simultaneously *pari passu* with the existing debt and the beneficiary of additional liens and guarantees
- If existing covenants permit, a pari plus financing may also benefit from a “double dip” – i.e., a direct claim and an indirect intercompany claim in respect of the same loan

“Pari plus” structure in a new financing (cont.)

Simplified Structure



Potential tax implications

- All kinds of liability management transactions implicate potential "hair-trigger" cancellation of debt income ("CODI") rules
- Payment of fees (cash, in-kind, equity kickers), changes in collateral and entity designations, maturity extensions, and modifications to other terms have to be evaluated
- If there is CODI, debt and enterprise valuation work will be needed to determine whether the "insolvency exclusion" applies—and these analyses do not always get to good answers
- Even if the insolvency exclusion applies, significant work needed to determine tax consequences, including impact on tax attributes that could lead to near-term tax liability.
- Any situation involving foreign assets implicates significant foreign tax issues