



Deal Maker's Boot Camp: Acquisition Finance

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Learning Objectives

- Committed Financing vs. Best Efforts
- Bank Execution vs. Bond Execution
- Anatomy of Committed Debt Financing Letters
- Types of Covenants
- Who is Subject to Covenants
- Negative Covenants
- Financial Covenants
- Covenants: Consequences of Breaching
- Other Default Terms: Remedies and Acceleration
- Amendments and Waivers

Bankruptcy and Distressed M&A



Committed Financing vs.
Best Efforts



Bank Execution vs. Bond
Execution



Acquisition Finance
Timelines



Anatomy of Committed
Debt Financing Letters



Types of Covenants



Who is Subject to
Covenants



Negative Covenants



Financial Covenants



Covenants: Consequences
of Breaching



Other Default Terms:
Remedies and
Acceleration



Amendments and
Waivers

Committed Financing vs. Best Efforts

Commitment Letter

Commitment Letters vs. Engagement Letter

	Committed Deal	Best Efforts Deal
Type / Purpose	<ul style="list-style-type: none"> Separate sign-and-close transaction with no financing out. Bind financing sources to provide financing on the terms and (<i>only the</i>) conditions set forth therein. 	<ul style="list-style-type: none"> Simultaneous sign-and-close deal or deal with a financing out. Engage financing sources to use best efforts to arrange a financing (but no commitment to provide).
Key Documents	<ul style="list-style-type: none"> <u>Commitment Letter and Fee Letter(s)</u>. 	<ul style="list-style-type: none"> <u>Engagement Letter</u> (and potentially <u>Fee Letter(s)</u>).
Length of Commitment / Engagement	<ul style="list-style-type: none"> Tie to termination date of acquisition agreement (typically three to four months). Longer dated commitments pose unique challenges. <ul style="list-style-type: none"> Additional fees (e.g, ticking fees), forced allocations, escrow demands and incremental pricing flex (e.g., 25 bps if the deal closes more than [120-180] days after signing). 	<ul style="list-style-type: none"> Try for ability to terminate at any time, sometimes have a period before termination is permitted (e.g., 30 days).
Expense Reimbursement	<ul style="list-style-type: none"> Condition the payment of expenses on the closing of the transaction (and legal expenses should be limited to one outside counsel). Direct lenders may require expense reimbursement whether or not closing occurs. 	<ul style="list-style-type: none"> Often have payment of expenses regardless of whether closing occurs, often try for a cap on legal and/or all fees.
Signatory	<ul style="list-style-type: none"> Should be shell acquisition vehicle, sponsor should never sign the letter (or side letters) directly. 	<ul style="list-style-type: none"> Should be the borrower, sponsor should never sign the letter (or side letters) directly.

Bank Execution vs. Bond Execution



Financing Considerations



Bank Loans

- Flexibility
 - Borrower can draw down funds and prepay loans as and when needed.
 - Less expensive (lower interest rates) and faster.
 - May contain a multi-currency option.
 - Easier to negotiate waivers or amendments with bank lenders after closing.
 - Borrower may have consent rights over future lenders.
- Typically senior in ranking to debt securities.
- More likely to be secured and guaranteed.
- Contain more restrictive covenants than debt securities.



Bond and Notes

- Issuers generally must be long-standing companies with a good credit rating:
 - Otherwise may only be able to issue high-yield “junk” bonds
- Less flexible repayment:
 - Non-callable period
 - Prepayment penalties
- More flexible and often higher interest rate options than bank loans (due to placement in capital structure and increased risk):
 - Fixed
 - Floating
 - PIK
 - S-X compliant financials.
- Looser covenants than bank loans.
- Often subordinated to bank loans.
- Often unsecured; could be guaranteed.

Most Common Form of Acquisition Financing

Term Loan B (“TLB”)

Term Loan B vs. High Yield Bond

TLB	HYB
Firm underwriting amount, pricing and closing date commitment.	Amounts, pricing and closing dependent on market conditions.
Secured.	Unsecured or secured (U.S.), Secured (Europe).
Minimum deal size varies.	Issuance must be at least \$100-150 million.
Six to seven year tenor.	Seven to 10 year tenor.
Generally lower pricing (floating rate) and fees (particularly if secured).	Generally higher pricing (fixed rate) and fees (particularly if subordinated).
Senior/secured.	Generally unsecured/subordinated.
Call protection is more limited; soft calls are common.	Call protection is higher and more fixed; "make-whole" is common.
Limitations on sponsor ability to buy debt.	Debt is freely tradeable.
Amendments and modifications are easier to manage - require lender voting.	Amendments and modifications are difficult and expensive - require consent solicitations.
No public reporting or securities law risk.	Public reporting and securities law compliance is required.

Most Common Form of Acquisition Financing

Term Loan B (“TLB”)

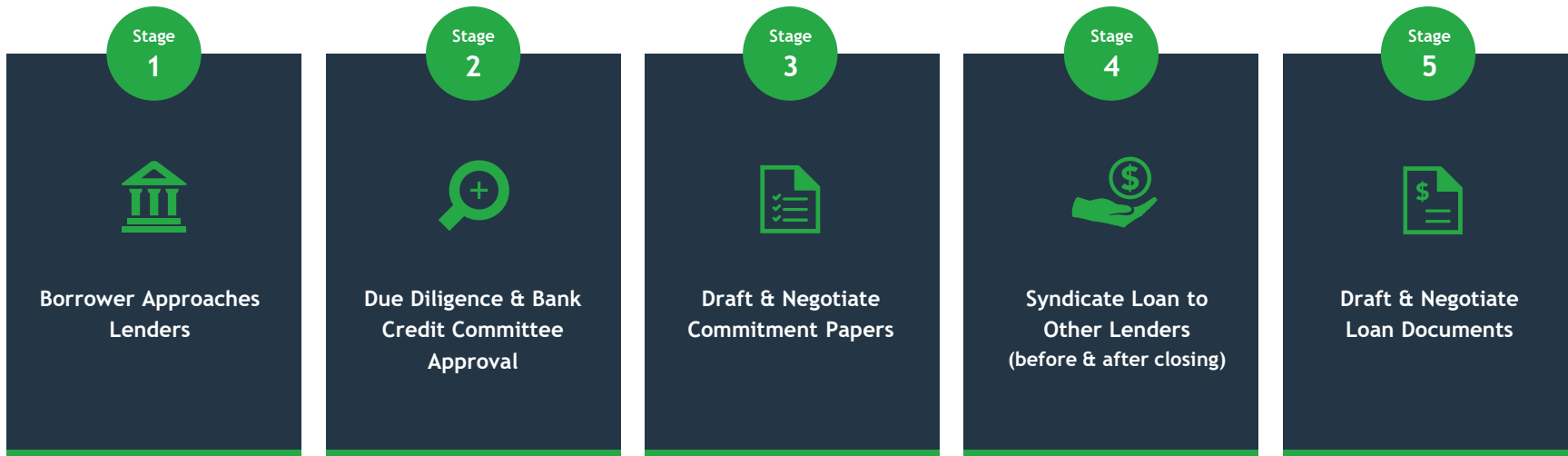


HYB Features that TLB Borrowers and Sponsors Want

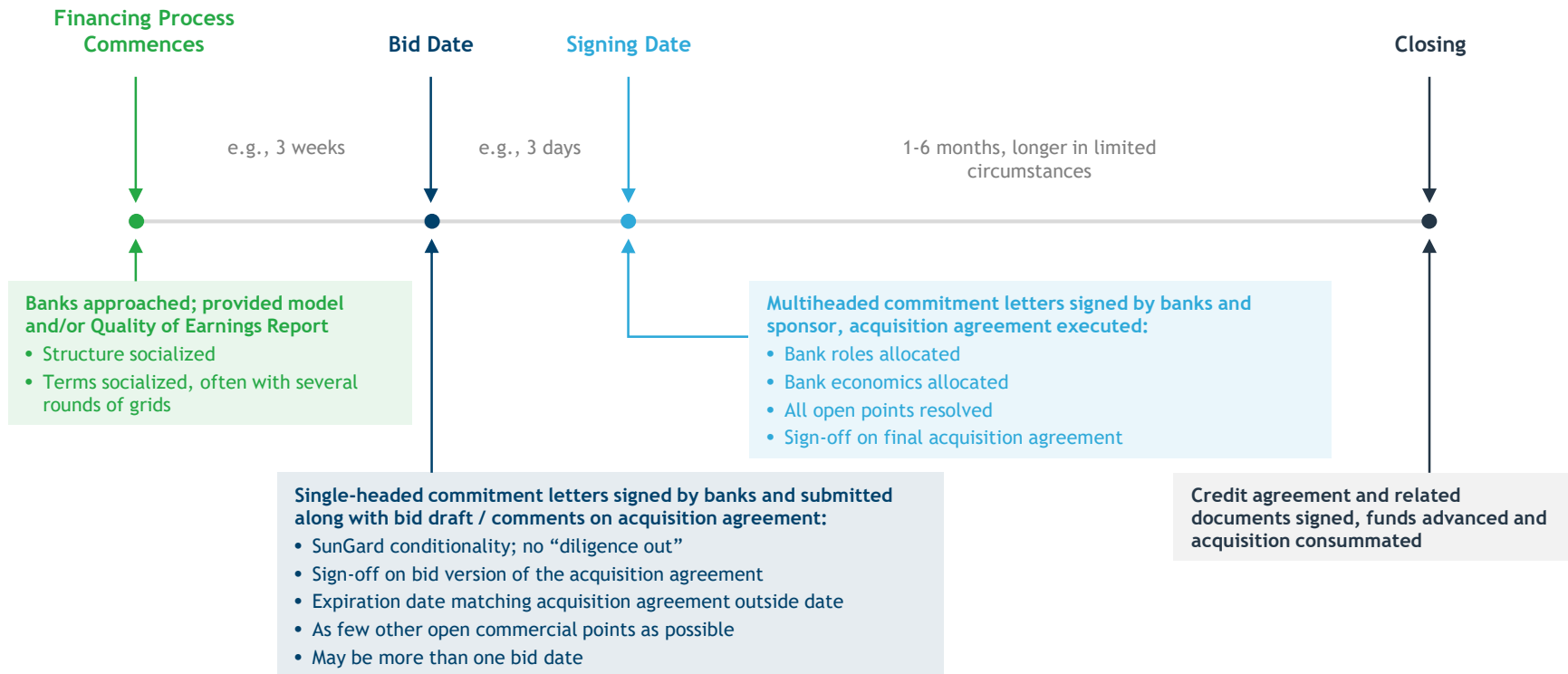
- No or minimal amortization, limited mandatory prepayment events.
- More flexible covenants.
- Relaxed defaults.
- Ability to retire debt at market price (rather than at par).
- Ability to make significant corporate and capital changes without amendment - acquisitions, dispositions, additional debt, Initial Public Offerings (IPOs), etc.
- Consistency of terms across financings (and, for sponsors, across portfolio companies).

Acquisition Finance Timelines

Basic Stages of a Debt Finance Transaction



Basic Stages of an LBO – Detailed Steps



Timeline



Acquisition financings can run from a **few weeks to several months**. This timeline will vary depending upon whether it is a broadly syndicated deal or a “club deal”.

Initiation (Weeks 1-3)

Sponsor approaches potential financial institutions to fund an acquisition and requests indicative terms. (Standard grid used?)

Sponsor provides financial information and due diligence material to financial institutions after signing a non-disclosure agreement.

Sponsor chooses Lender(s) to provide commitments/best efforts term sheet [and to conduct the syndication process].

Administrative Agent and its counsel sign off on the diligence.

Timeline



Acquisition documents and commitment paper documentation (weeks 2-4)

Lenders' counsel and Sponsor's counsel negotiate commitment papers/term sheets concurrently with the negotiation of the acquisition agreement.



Syndication Process (Weeks 4-8)*

Sponsor and target provide information so that the Arranger can prepare an information offering memorandum.

Arranger prepares information memorandum.

Arranger goes on "road show" and/or holds lender meetings to discuss information memorandum with potential Lenders.

Timeline



Loan documents and satisfying the conditions to fund and for the acquisition (weeks 4-8)

Conditions

Lenders' counsel and Sponsor's counsel negotiate the loan documents.

Administrative Agent posts documents for syndicate Lenders (if applicable).

[Lenders provide any comments].

Loan documents are finalized and the conditions to fund and for consummation of the acquisition are satisfied except for execution and delivery of the final documents.

Timeline



Closing (Week 8)

Closing (8 weeks)

The loan documents are executed and delivered and all conditions to the funding and acquisition are satisfied (or waived).

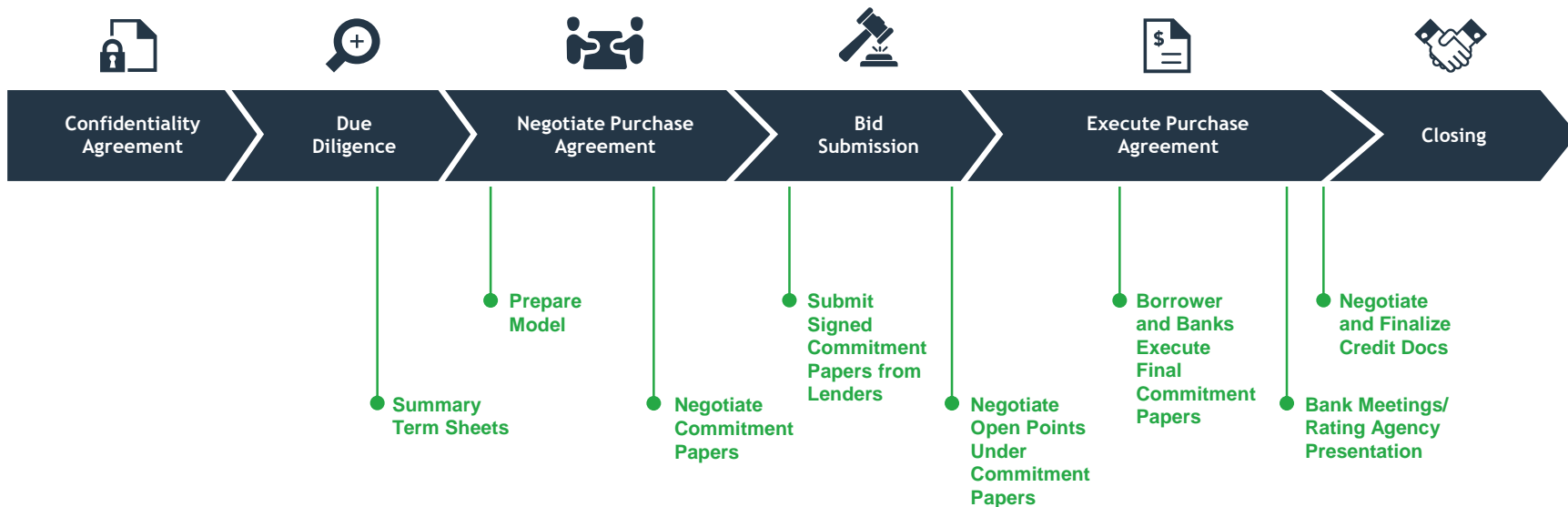
Funding occurs and the acquisition is consummated.

Post Closing

Borrower and Administrative Agent work collaboratively to satisfy any post-closing conditions.

Arranger continues to syndicate loans (if not fully syndicated at close).

The Parallel Path: Acquisition and Financing Process



● M&A Process ● Debt Finance Process

Anatomy of Committed Debt Financing Letters

Conditions Precedent in Debt Financing Letters



Conditions precedent must be met or waived by banks prior to funding

- | | | |
|---|--|--|
| <ul style="list-style-type: none">• No Mae• Market MAC• Diligence Out | <ul style="list-style-type: none">• Clear Market• Financial Metric Conditions• Ratings | <ul style="list-style-type: none">• Transactional Conditions• Capital Structure Conditions• Syndication Assistance |
|---|--|--|

Commitment Letter



Negotiating General Terms


Sungard

- Designed to assure buyers and sellers that so long as the conditions to closing under the acquisition agreement are satisfied, Lenders will not have any additional “out” beyond a narrow list of enumerated conditions.
- Limits actions required to be taken on or before the closing date to perfect security interests in the collateral.
 - Lenders will typically agree to limit to filing of UCC-1 financing statements, delivery of stock certificates of domestic subsidiaries and filing of IP security agreements.
- Solvency condition satisfied by mere delivery of a solvency certificate (which should be attached as an exhibit to the commitment letter).

Conditionality

- Relationship to acquisition agreement: closing of acquisition and satisfaction with acquisition agreement.
- Diligence conditions: **NO** diligence conditions should be included (business or legal) and no information outs.
- Equity documents: no Lender right of approval over equity documents, other than acquisition agreement amendments materially adverse to Lenders.
- Material Adverse Effect:
 - Definition and lookback date to match condition precedent in acquisition agreement.
 - No “market MAC”.
- Minimum equity contribution (22.5% - 40%) tied to closing date fundings (with limited exceptions to fund market flex OID/upfront fees and other items).
- Syndication, Ratings, Financial Covenants: should **NOT** be conditions to closing (including leverage tests, min EBITDA, liquidity, etc.).

Fee Letter — Fees Generally

 Fees	Fees only payable if both acquisition and financing close	
	Underwriting / Arrangement	Fees payable to bank lead arrangers.
	OID / Upfront Fee	Fees paid to the market.
	Administrative Agent Fee	Annual fee paid to admin agent, usually payable quarterly and try for rebates for partial periods.
	Ticking Fees	In the case of a longer commitment or DDTL, fees that are tied to the applicable margin and increase over time.
	Breakup Fees	Fee paid to arrangers out of any break-up fee received under the acquisition agreement, typically limited to reimbursement of expenses after sponsor's fees are covered.


Fee Letter — Market Flex



Market Flex

- In syndicated deals, language allowing bank to change certain terms of the committed financing in order to “successfully syndicate” the deal.
- Require “successful syndication” to be expressly defined. Have the definition tied to the earlier to occur of (i) the passing of a certain period of time (i.e., 45 days or the closing date) and (ii) the loans having been syndicated down to an amount that the Lender commitment parties agree to hold (e.g., \$0 in broadly syndicated facilities).
- Flex provisions should be closed-ended.
 - i.e., provide a finite list of terms that can be changed to successfully syndicate the loans.

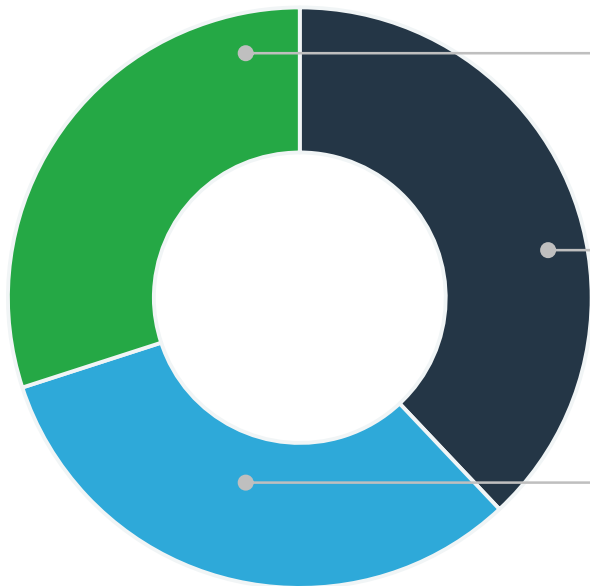
Fee Letter — Market Flex*

*Exercise of flex should require adjustments to financial covenant(s) and incurrence ratios	
 Market Flex	Pricing <ul style="list-style-type: none"> • Increase the interest rate on the loans (try to cap amount that can be OID), ability to be funded through revolver draw and/or additional term loan.
	Structure / Amort / Tenor <ul style="list-style-type: none"> • Reallocate portions of the loans between first/second lien - should be resisted. • Increase amortization amounts - should be resisted. • Reduce maturity of loans - should be resisted.
	Incremental / Incurrence Tests <ul style="list-style-type: none"> • Decrease “freebie” basket (and/or eliminate “grower”). • Reduce leverage ratio(s) for incremental and other ratio-based incurrence tests. • Lengthen/remove MFN sunset.
	Call Protection <ul style="list-style-type: none"> • Impose, extend or increase prepayment premiums.
	Financial Covenant <ul style="list-style-type: none"> • Add a financial covenant to a covenant-lite loan or add a financial covenant. • Decrease step-back % for financial covenant (if any). • Change trigger for covenant-lite loan.
	Financial Definitions <ul style="list-style-type: none"> • Decrease amount of cash that may be netted from leverage ratio. • Reduce cost/savings synergies percentage addback and time to realize synergies.
	Negative Covenants <ul style="list-style-type: none"> • Reduce or remove “growers” or specific baskets.
	Prepayments <ul style="list-style-type: none"> • Increase the Excess Cash Flow percentage sweep to a maximum of 75% (up from 50%). • Remove step downs on asset sale mandatory prepayments.
	Available Amount <ul style="list-style-type: none"> • Reduce the “starter” basket (and/or eliminate “grower”). • Reduce leverage ratio governing utilization.

Types of Covenants



Covenants: Types of Covenants



Affirmative Covenants

- Stipulate what the company must do.
- Cover things such as delivering financial statements, providing notice of certain events, complying with law, paying taxes, maintaining insurance, etc.

Negative Covenants

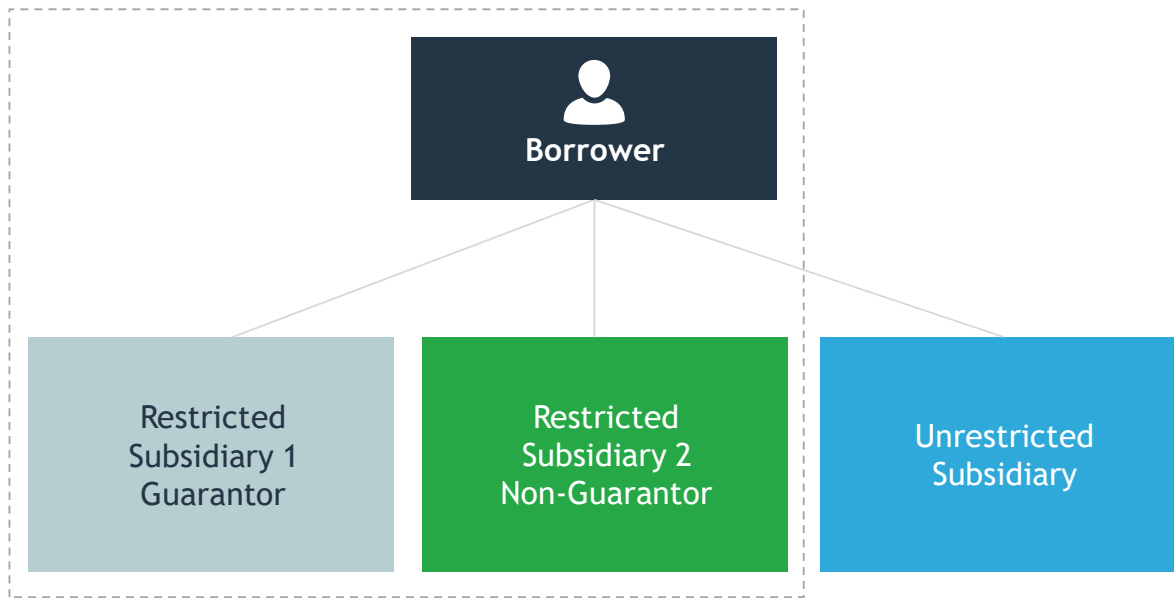
- Contain what the company cannot do.
- Often regulate incurrence of debt and liens, making of investments, making of dividends, selling meaningful assets and other important business decision, the making of which cannot be done without satisfying certain conditions.

Financial Covenants

- Financial ratios that require the company to maintain certain target levels of performance in bank credit agreements.

Who is Subject to Covenants

Who is Subject to Covenants



- Subsidiary definition is critical
- Unrestricted Subs are not subject to the covenants, but generally do not count towards financial covenants.

Negative Covenants

Negative Covenants

Limitations on



Additional Debt and Liens

Restriction on ability to incur first lien debt, junior lien debt, unsecured debt, etc.



Investments

Restriction on ability to buy debt or equity.



Restricted Payments

Restriction on dividends, share repurchases and prepayments of debt junior in the capital structure.



Asset Sales

Restriction on ability to sell assets above a de minimis threshold.



Affiliate Transactions

Restriction on ability to transact with affiliates under common control.



Negative Covenants



Limitations on Additional Debt and Liens

Restriction on ability to incur first lien debt, junior lien debt, unsecured debt, etc.

- Key Carve Outs
 - Ratio Debt
 - General Debt
 - Non-Guarantor Debt
 - Acquisition/Acquired Debt
 - Capital Leases
 - Ratio Liens and General Liens
- Points to Negotiate
 - Incremental Facility
 - Setting Ratios and Baskets Relative to Out of the Box Metrics



Restricted Payments / Investments

Restriction on ability to make dividends, investments, prepayments of debt junior in the capital structure

- Key Carve Outs
 - Cumulative Credit
 - General Basket
 - Permitted Acquisitions
 - Investments in Non-Guarantors
- Points to Negotiate
 - Definition of Cumulative Credit
 - Governors to Access Cumulative Credit
 - Definition of Junior Financing
 - Sizing of Baskets



Other

Asset sales covenant restricts ability to sell assets

- Aggregate or annual caps
- Prepayment of debt with net proceeds
- Reinvestment rights

Affiliate transactions covenant restricts ability to transact with affiliates

- Arms' length transaction
- Fairness opinion safe harbor
- Sponsor fees

Financial Covenants

Types of Financial Covenants



Maintenance vs. Incurrence



Leverage Ratios (Debt/EBITDA)



Coverage Ratios (EBITDA/Interest Expense or Fixed Charges)



Minimum EBITDA



Minimum Liquidity



CapEx

Maintenance vs. Incurrence

Maintenance Covenants

Maintenance tests that need to be maintained at regular intervals (or at all times).

Incurrence Based Covenants

Negative covenants (such as an Indebtedness covenant or a Restricted Payments covenant) that prohibit a Borrower from engaging in voluntary actions unless certain financial tests are satisfied.

Leverage Ratio

Indebtedness/EBITDA

- Gross leverage vs. net leverage
- First lien secured leverage ratio
- Secured leverage ratio
- Total leverage ratio.

Coverage Ratios

- EBITDA to Fixed Charges (interest expense, amortization and capital leases)
- EBITDA to Interest Expense
- $(\text{EBITDA} - \text{Capex} - \text{Tax}) / \text{Fixed Charges}$
- $(\text{EBITDA} - \text{Capex} - \text{Tax} - \text{Management Fee}) / \text{Fixed Charges}$
- $(\text{EBITDA} - \text{Capex} - \text{Investments}) / (\text{Fixed Charges} + \text{Tax} + \text{Restricted Payments})$
- $(\text{EBITDA} - \text{Tax} - \text{Restricted Payments}) / \text{Fixed Charges}$.

Points to Negotiate



Springing Testing vs. Constant Testing



Definitions of Consolidated Net Income and EBITDA



Cushions to Model



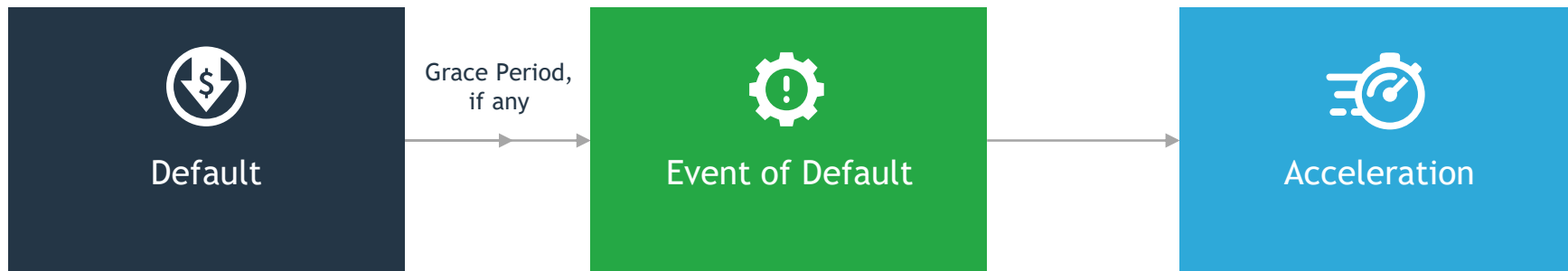
Pro Forma Treatment



Equity Cures

Covenants: Consequences of Breaching

Stages of Trouble



Consequences of Breaching Financial Covenants



Frequently
constitute an
automatic event of
default with no
grace period

Consequences for the borrower:

- Loss of liquidity (i.e. loss of access to the revolving credit facility)
- Requirement to pay a default interest rate on loans
- Potential to trigger a cross-default under other indebtedness
- Lenders have the right to accelerate the loans and demand repayment.

Averting a breach:

- Equity cures
- Waivers and amendments.

Consequences of Breaching an Affirmative Covenant



Generally has a period of time to cure its breach before it triggers an event of default, which is commonly between 10 and 30 days in credit agreements. Consequences for the borrower that apply during the cure period:

Importantly, the borrower is not entitled to obtain additional loans or letters of credit.



If the borrower fails to remedy a breach of an affirmative covenant within the cure period, the default matures into an event of default.

Consequences of Breaching a Negative Covenant



Generally, a breach causes an immediate event of default without notice or grace period to cure the breach in credit agreements



Upon the occurrence and during the continuation of an event of default, the lenders have the right to exercise all remedies which typically include:

- Terminating their commitments to make further loans to the borrower
- Calling the loans immediately due and payable
- Requiring default interest (typically an additional 2%) to be paid
- Requiring cash collateralization of any outstanding letters of credit
- Foreclosing on the collateral, if any
- Demanding payment by the guarantors, if any.

Other Default Terms: Remedies and Acceleration



Other Default Terms

Certain Events of Default



- Defaults in payment of principal: immediate event of default in both instruments.
- Defaults in payment of interest: three to five days to cure in credit agreements but 30 days to cure in indentures.
- Bankruptcy or insolvency: immediate event of default.

Cross default v. Cross-acceleration



Cross-defaults occur when the borrower/issuer defaults under any other debt obligation. Often (but not always) subject to a materiality threshold. Found more often in credit agreements than indentures.

Cross-acceleration requires that the default in respect of the other outstanding debt obligation must have, in fact, been accelerated. Borrowers/Issuers prefer cross-acceleration provisions over cross-defaults.

Amendments and Waivers

Amendments and Waivers

- If the amendment affects principal, interest rate, payment terms, maturity or other fundamental economic terms, every lender/holder must consent to the amendment.
- Amendments not falling within these categories require consent from a specified subset of lenders/holders, typically a majority in both credit agreements and indentures, but in some cases two-thirds, of the aggregate principal amount of the debt in question.
- To the extent that the company does seek the consent and offers to pay for consent, many documents require the company to offer to pay a consent fee to every lender/holder that is willing to provide its consent.

Questions?



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Thank You!
