THE LEAD
https://theleadpc.com/lead-left-interview-daniel-winick-andrew-young/

Lead Left Interview – Daniel Winick & Andrew Young

THE LEAD | November 14, 2017

This week we chat with Daniel Winick, a partner in the banking and finance group of Clifford Chance US LLP, and Andrew Young, a senior associate in the same group. Their practice includes representing sponsors, corporates, lenders and participants in multijurisdictional leveraged and other finance transactions. Clifford Chance is a multinational law firm that is one of the ten largest globally.

The Lead Left: *Daniel and Andrew, thanks for making time for us today. Give us a perspective on the big picture items that are driving credit agreements in today's leveraged loan market?*

Daniel Winick: Flexibility in terms of future financing optionality and covenant exceptions continue to be significant drivers of credit agreement terms today. Lenders (particularly in the mid-market space) have been laser focused on protecting and preserving the "ring-fence" and preventing value leakage and collateral erosion. Recent litigations, such as in J. Crew, have reminded lenders of the risks of covenant holes.

TLL: *Do you see a difference between the terms that banks are sticking with compared with non-banks?*

DW: Yes and no. Of course leveraged lending guidance remains a key governor, but otherwise bargaining leverage and credit needs are the biggest factors. At the same time, banks often have limited (to no) flexibility in modifying certain terms, for example relating to transferability and legal and regulatory compliance.

TLL: *One of the frustrations for lenders is the "big boy" terms that have made their way down market, most notably cov-lite. What's your view on this trend from the lender's perspective?*

Andrew Young: Cov-lite has become a movement against the traditional banking philosophy of providing only for the needs of the business. While middle market lenders have become desensitized to allowing for some more flexibility, they are still able to challenge the "sweeteners" that only the stronger borrowers and sponsors regularly get. Thus, while frustrating in principle, lower market lenders still retain many "strengtheners" that get them to the table quicker in a down-side scenario.

TLL: *Could you give us some examples of strengtheners?*

AY: Maintenance covenants with more robust reporting, tighter parameters on EBITDA adjustments and limited (to no) cash netting — often with requirements for any such cash to be in controlled accounts. Bolstering such oversight, lower market lenders tend to have greater control over the borrower group as well as its cash and other assets and property.

TLL: *Is there a difference in the degree of push-back you see from middle market lenders between deals that are syndicated, and the buy-and-hold variety?*

DW: Yes. The club-like, non-syndicated deals tend to be more hardwired and less flexible in terms. Without a market "check," we find middle market lenders with more non-negotiable provisions.

TLL: *For middle market lenders, are there terms that are still holding?*

AY: Yes, we continue to see middle and direct market lenders holding on to one or more financial covenants, preferential rights to participate in incrementals, greater collateral coverage and the fall-away of DQ lists upon EoDs.

TLL: *Incremental loans continue to be a hot topic in the leveraged loan market. What is your perspective on incremental facilities and recent trends?*

DW: Incremental loans continue to excite the leveraged lending community in many ways. Through 2017, borrowers have enjoyed favorable bargaining power to negotiate expansive rights to raise incremental debt along with broad exceptions to most-favored nation ("MFN") yield protections.

It's not all bad for lenders. Incremental loans provide a borrower with resources that can be utilized for value-maximizing or liability-managing purposes (such as acquisitions or refinancings) that may benefit the ultimate recoveries of lenders. In addition, an incremental facility may provide a future investment opportunity for lenders hungry for paper in a market with little net new money.

Still, we find lenders remaining sensitive to the risks of an over-levered borrower group as well as the threat of new loans carrying higher pricing. Lenders thus continue to push for sensible caps to contain debt capacity as well as MFN clauses to protect the tradability of loans in the secondary market.

TLL: *Interesting. So what are the building blocks of incremental debt capacity and how have they been changing in recent credit agreements?*

AY: Incremental debt capacity typically consists of (1) a fixed (or "freebie") dollar amount, plus (2) the amount of indebtedness voluntarily prepaid and commitments permanently reduced (i.e., "dry powder"), plus (3) an unlimited amount so long as a leverage ratio test is satisfied.

The fixed incremental basket is typically set at an amount somewhat lower than pro forma EBITDA of the borrower group. However, stronger borrowers often negotiate the ability to borrow more based on the company's growth – for example, 100% of EBITDA levels.

Debt capacity under the ratio-based basket is typically set also under opening leverage levels. However, strong borrowers often negotiate a "no worse than" alternative so that capacity would not be affected if leverage remains the same following an incurrence in connection with an acquisition or investment. Large-cap and sponsor-owned borrowers also often negotiate the right to toggle their use of incremental baskets (as their leverage permits) to recharge capacity. They also benefit from favorable building block terms, namely, the ability to add-back to EBITDA to expand overall borrowing capacity.

Contact:

Daniel Winick: Daniel.Winick@cliffordchance.com
Andrew J. Young: Andrew.Young@cliffordchance.com