Lead Left Interview – Wayne McKinzie (Part 2)

THE LEAD | September 16, 2015

This week we continue our conversation with Wayne McKinzie, a partner at Moore & Van Allen PLLC. Named in *Best Lawyers in America for Banking and Finance Law*, Wayne represents investors in various senior and mezzanine financing transactions and investments. Moore & Van Allen, based in Charlotte, is one of the largest law firms in the Southeast, employing nearly 300 attorneys, with approximately 80 attorneys on the Financial Services team. ***Second of two parts – View part one***

The Lead Left: Is there a distinction with middle market deals?

Wayne McKinzie: We still see set dollar amounts in lower middle market deals but are seeing leverage based components in larger middle market deals. For example, $50 million plus additional debt that would cause net leverage to be no more than closing leverage. One nuance is that you would deem any incremental RC or delayed draw term loan to be funded for purposes of the leverage ratio test. Also, the net leverage ratio would not net incremental loan proceeds from outstanding debt for purposes of the test. Finally, a borrower friendly feature is not to count debt incurred under the FAC basket when running the leverage test. For example, if net leverage is 4.5x at closing, you could add incremental debt up to closing date net leverage and then add additional debt under the FAC and still comply with the incremental facility tests.

TLL: How about other baskets?

WM: For restricted payment baskets we're seeing allowance for the greater of a set dollar amount and a percent of Ebitda. That's less common in the lower middle market. But for over $25 million Ebitda companies, it's becoming fairly common.

TLL: I've also wondered about the scope of mandatory prepayments.

WM: It's certainly getting narrower. Sometimes we see new equity proceeds coming out altogether. Certainly there are carve-outs for sponsor or LP equity coming in. On equity cures there may be an exception, and there's a distinction between middle market and the lower middle market. For the latter, equity cure proceeds need to reduce first lien debt.

TLL: Or counted as additional Ebitda?

WM: Yes but there is still the provision that the maximum amount you're allowed to count is the amount that's needed to cure the covenant default. In the real world (equity cures do matter less in practice), often the sponsor wants to put in more equity than is necessary to cure the covenant default, but they want it to *all* count to Ebitda. Usually there's a middle ground. Some will go to pay first lien debt, some stays in the company, some counts as Ebitda.

TLL: Our favorite is the watering down of excess cash flow definitions and levels.

WM: I agree. It's now typically starting at 50%, then going to 25% at a given leverage level, then zero. Even for the lower middle market. And now we see them kicking in later and later. It used to kick in for the stub period after closing, but now it's after the first fiscal year after the closing, or even longer. They can also reduce the sweeps dollar for dollar by prepayments they've made.

TLL: How about voting rights?

WM: Agreement Among Lenders (AAL) are incredibly complex. The unitranche arrangers often want to retain control. Even lenders at the same level may get dragged along, except on 100% voting issues. We often represent lenders coming into unitranche. We've found a fairly common result on covenants and baskets is using a formula. If there's a miss of 10% or less, the agent or controlling group of lenders – the first out lenders or the last out lenders – can decide on its own whether to waive. But for a miss over 10%, a vote of both groups of lenders would be required. If definitional add-backs are decided only by the agent or controlling group of lenders, the Ebitda can be susceptible to gaming. You need to be aligned with the agent and controlling group. KYC!

TLL: Speaking of which, are black lists of lenders still common?

WM: More than ever. Sometimes we see 20-30 names! We see situations where sponsors with lender affiliates try to add to the list to eliminate competitors. Sponsors have had bad experiences with some debt funds. One list that's appropriate for first lien may not be appropriate for second lien, though the sponsor wants to use the same list.

TLL: Are there distinctions for broadly syndicated transactions?

WM: In large cap you may be able to sell to anyone only in a bankruptcy or sometimes in the event of a payment default. For the lower middle market, you often get more flexibility. For example, if a covenant default is in place for a certain period of time, then you can sell to anyone. Sometimes only the agent has the list. New lenders should always ask for it so they know who's on it. Also, assignees need to represent that they are "eligible" when signing assignment agreements. You need to make sure you're not on the black list!

TLL: So Wayne, what's been your biggest surprise this year?

WM: It goes back to my opening comments – what the comps are, what lenders are willing to give. Some of these companies may not have the size to deal with business setbacks or downturns. And yet these are the ones still getting aggressive terms.

Contact: Wayne McKinzie
Email: waynemckinzie@mvalaw.com