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9Questions — Karan Chopra and Sindhoo Vinod Sabharwal, Paul Hastings — Private and public docs deep dive (9fin)

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The battle between direct and syndicated lenders has spilled over into documentation this year, as liquid markets bite back and direct lenders concede some protections to keep deals in their market.

Karan Chopra and Sindhoo Vinod Sabharwal are partners in the London global finance practice at Paul Hastings, who advise private credit and investment bank clients on a range of cross-border leveraged finance transactions at all levels of the capital structure including senior, super senior, second lien and PIK and across private credit and syndicated financings.

They talked to *9fin* about some of the trends they are seeing in certain private credit deals, as well as the recent increase in holdco PIK financings and areas of investor focus across private credit and syndicated transactions.

1. In certain private credit deals, there has been increasing crossover on terms with the syndicated markets. What terms from the syndicated market have crept into the private market in those deals?

We think the crossover has been particularly prevalent in large cap private credit deals where the restrictive covenants are closer to what you would traditionally expect to see in the syndicated than private credit market.

Outside of those large cap private credit deals, however, there is much less crossover between private credit and the syndicated market as the restrictive covenants (and terms more generally) are broadly in line with what we'd typically expect in private credit. There is the inevitable crossover of certain negotiated terms in sponsor-backed upper mid-market private credit deals but not to the extent seen in large cap private credit deals. So while there is increasing crossover in certain deals, there hasn't been convergence across the board.

2. You mention that there has not been the same crossover in mid-market private credit. What are the

standout documentary terms that separate the syndicated and private credit markets?

The European syndicated market largely moved away from “loan style” covenants in favour of “bond style” covenants a while ago. We do see similar covenants in large cap private credit deals but outside of that, “loan style” covenants are very much the norm.

In addition to tighter regimes around debt incurrence and permitted payments, this also applies to disposals, loans and joint ventures in particular and we rarely see inclusion of the unrestricted subsidiaries construct in private credit transactions. Prepayment fees also stand out as being more favourable to lenders, with call protection being provided for as opposed to the more typical six months soft call on re-pricings in syndicated markets. There may also be the ability to “PIK” certain interest payments subject to pre-agreed parameters in the private credit market, which wouldn’t be seen in the syndicated market.

Another feature of the syndicated market is that such financings are typically “cov-lite”, meaning that only the revolving facility benefits from the springing financial covenant and not the term facility. While this has become more common in the private credit market, mid-market private credit deals typically include a financial covenant for the benefit of the term loan lenders and a separate financial covenant for the benefit of the revolving facility lenders, which is set with 10% headroom to the financial covenant that the term loan lenders benefit from. In addition to this, the EBITDA adjustments in private credit transactions are more conservative as they are narrower in scope and include lower caps.

3. How would the capital structure for a private credit deal and a syndicated deal differ?

In terms of the initial capital structure, private credit deals often include a capex/acquisition facility which is rarely seen in syndicated deals. Where this is included in syndicated deals, it is an amortising facility, unlike in private credit deals, where it’s repaid in full at maturity. Private credit deals also typically permit super senior revolving debt and hedging which is similar to a bond deal, whereas in a syndicated loan deal, these have the same ranking as the term facility.

Then in terms of the capital structure going forward, a private credit deal usually would not permit sidecar or junior debt and requires debt acquired pursuant to an acquisition to be refinanced within a certain time period. This is unlike the syndicated market where junior and sidecar debt is permitted and the capital structures are more complicated given they have more flexibility. In both capital structures, we see holdco PIK debt being provided in certain transactions.

4. What documentary terms do you see as attracting the most focus from investors in syndicated deals and in private credit transactions?

We are seeing common areas of focus across both syndicated and private credit documentation, with

investors predominantly focused on debt incurrence, value leakage and EBITDA adjustments.

We see a lot more discussions around:

(i) debt incurrence conditions (including the leverage ratio tests, MFN, amortisation and inside maturity protections, right of first offer/refusal, sidecar debt and debt capacity at non-guarantors);

(ii) scope of restricted payments and risk of leakage (including starter baskets and Available Amount definition, extent of permitted payments, conditions for allowing payments such as compliance with leverage ratios and no Event of Default and relevance of and risk of leakage to Unrestricted Subsidiaries, if any);

(iii) EBITDA adjustments, which remains a key issue for investors (including look forward periods, extent of synergies and caps (and what falls outside the caps)) and;

(iv) asset sale step downs and conditions (including restrictions on disposing core assets and the extent of carve-outs).

Guarantee and security packages also remain an area of focus for investors, including the basis of guarantor coverage test (whether a pre-agreed exhaustive list of jurisdictions or all jurisdictions other than a pre-agreed excluded list of jurisdictions). Investors want to make sure that they are not blindsided by J Crew trapdoors and priming of debt. Fall out from liability management transactions in the US has led investors to expect J Crew, Serta and Chewy protection language in European documents as well.

5. Has there been a reset in documentary terms across syndicated and private credit terms in the last year or two compared to deals done in more borrower-friendly conditions back in 2021?

There has been a steady stream of investor pushback on certain aggressive provisions and a consequential tightening of some of those terms over the last 24 months or so, but it stopped short of being a reset of documentary terms in both markets. Documents therefore remain relatively borrower-friendly, even if not as borrower-friendly as certain deals in 2021.

Having said that, investors have taken advantage of the market over the last 24 months to tighten some of the more aggressive terms that were underwritten at the height of the market, particularly around the areas we mentioned above, such as debt incurrence, value leakage and EBITDA adjustments. They have also pushed to include provisions around J Crew blockers (restrictions on payments to, investments in and disposals to unrestricted subsidiaries), Serta protections (to protect against priming, including via a requirement to seek consent of senior term lenders to increase the super senior debt basket) and Chewy protections (to ensure that there are tighter protections around non-wholly owned subsidiaries not being

required to grant guarantees and security).

6. Why has there been so much focus on J Crew and Serta and are they as relevant in European financings as US financings?

There has been a lot of focus in recent years on liability management transactions, with investors understandably concerned about potential creditor-on-creditor violence seen in such transactions. While these are more prevalent in the US, with the LSTA also producing an investor checklist for liability management transactions, it has made investors more focused on closing any potential loopholes in European documents that can prime their debt or reduce the effectiveness of their collateral package.

J Crew is relevant in structures that include an unrestricted subsidiaries construct and would be addressed via restrictions on designating unrestricted subsidiaries as well as restrictions on transfers, investments/disposals and payments to those unrestricted subsidiaries. Chewy is relevant where collateral is limited to assets of wholly-owned subsidiaries and investors will require confirmation / controls around that entity becoming non-wholly owned for the sole purpose of circumventing the requirement to grant guarantees and security or releasing it from the collateral package. LMA-style European loan documents include protections against Serta-style priming via an all lender consent requirement to change priority and ranking as well as potentially having a higher consent threshold to amend the super senior debt basket than Majority Lenders. In short, even though Europe hasn't seen these types of liability management transactions play out in our documents to the same extent as seen in the US, the focus has been to review and tighten European documents in light of these developments.

7. The number of holdco PIKs in the market have increased more recently. What developments are you seeing as PIKs make their return?

The expected structural points remain the focus for holdco PIKs, given their position in the capital structure. These include (i) anti-short circuit provisions (which ensures that new investments or debt into the senior group as well as permitted payments being made to investors flow through the PIK borrower), and (ii) anti-layering protections (including preserving the closing date group structure and preventing the incurrence of more structurally senior debt to the PIK debt above the senior group).

But restrictions on debt incurrence and permitted payments both at the PIK group level and the senior group level are heavily negotiated and can vary from deal to deal. They often depend on what the senior debt instrument that the holdco PIK sits above is — we've seen holdco PIKs sit above private credit financings, syndicated loan financings and high yield bonds in recent transactions, all of which require different considerations given the different nature of those senior financings and the flexibility within the senior debt documents.

8. What else of note are you seeing recently on recent European financings?

There has been a lot of interest in UK (and European) public assets from US-based private equity sponsors and private credit lenders. Quite of few of these have been NY law-governed financings, with European-style certain funds conditionality including an interim facility agreement.

Not all US investors are familiar with European certain funding terms and interim facility agreements. The US market does not require fundable documents at the offer stage; offers are based on commitment papers that refer to a term sheet and a precedent, with an agreement to negotiate fundable documents in good faith, relying on the NY law obligation to negotiate in good faith (there is no equivalent English law duty to negotiate in good faith).

The European approach to certainty of funding is derived from the rules of the City Code on Takeovers, which imposes an obligation on the buyer in a public acquisition to provide cash confirmation at the time of announcing the offer. The requirements of the City Code coupled with market concerns around perception of documentation risk, has given rise to the European practice of parties signing a fundable interim facility agreement at the time of making an offer — and this practice is now entrenched in private acquisitions as well as public acquisitions, even though it isn't technically a legal requirement for these private transactions.

We are also seeing increase in recurring revenue financings in private credit where, prior to a conversion date (where there will be both mandatory and voluntary conversion date mechanics), the traditional EBITDA metric in the documentation is replaced with an annualised recurring revenue metric. For such transactions the documentation is similar to that which would be used for mid-market private credit transactions but, in addition to having the conversion date mechanics, would typically be more conservative in nature prior to the conversion date.

9. With the summer finally upon us, what are you looking forward to?

It looks set to be a great summer of sport with the cricket T20 world cup, the football Euros and the Olympics among other events. Plus, holidays (obviously!).