Article 5 of 6 of The Race to Recapitalise
Preparing for the First Listed Bond

Bart Capeci (Xtract Research) and Julian Macedo (The Deal Team)

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Bart Capeci is a Senior Covenant Analyst at Xtract Research. A New York qualified lawyer, he has more than 30 years' experience in corporate finance transactions. He was previously a partner at Allen & Overy, Sidley Austin and King & Woods Mallesons. We are grateful to Bart for co-authoring this article.

The Race to Recapitalise has started, and companies are determining what new forms of financing may be necessary to anticipate the long-term changes of the crisis. In our series of articles on the "Race to Recapitalise" we are illustrating some of the key issues to consider to win the Race.

Preparing for a maiden bond issue is a major decision for a company. It will often be the first form of marketed instrument they sell. Compared to an M&A sale, this process involves a prospectus instead of an information memorandum, a bookbuilding instead of a negotiation, and a listing instead of an investor agreement. For most companies this will be a high yield bond with certain covenants embedded, which creates the need to consider how the company's current and future operations, strategy and financing could be impacted.

1. Consider what you've got to work with - the current financing structure and company disclosure

Be clear what need the bond is fulfilling. In Article 2 of the Race to Recapitalise, we set out the suggested steps to identify the Bridge to Liquidity that a company may be facing as a result of the crisis. The new bond may not be a standalone financing decision, but the result of a complex forecasting and modelling exercise. In particular, the relationship between the bond and any existing bank facilities will need to be considered. Will lender consent be required to issue the new bond? Will the bond sit at the same level in the corporate structure as the bank facility? Will the two share security?

Review the company's existing public disclosure, particularly if this bond is the first listed capital markets instrument for the group. For some, this prospectus could be the first time the company description, key factors, and risks have been written down and tested. The company's marketing materials, website, PR campaigns, may not have considered the implications of this process – yet your disclosure to both the general public and the capital markets should be consistent. Importantly, you need to manage your public disclosure to instil confidence among investors and analysts, and not just to manage liability.

2. Management time to write the prospectus

A prospectus is a legal document. However, it cannot just be handed over to the lawyers - it tells the company's story and ultimately the company has liability for any errors in it. This bond may be the first time a company has written an offering document, which has to balance the company's credit story, strategy and financial disclosure with the same due diligence standards which apply to an IPO. The bond will generally be listed on a stock exchange, which will have its own disclosure requirements. What's more, most high yield bonds will be offered to US investors on a private placement basis, and therefore need to satisfy US securities law disclosure standards.

As a result, senior management should expect to be heavily involved in key parts of the preparation process. Depending on the company, this could involve IPO levels of work on their part. To make the preparation process easier to manage, we set out our key recommendations for running data rooms and due diligence processes in Article 4 of the Race to Recapitalise.

3. Developing the credit story

A key part of preparing the bond prospectus and marketing the deal will be developing your credit story – that is, how the company will be able to pay interest and repay the bond. This explains where the business has been and where it is going, by pulling together the common threads in both the three year financial history that will be included in the prospectus, and in your short to medium term business plan,. You'll develop it with your lawyers and bankers and use it in the prospectus, in the rating agency presentation, in the roadshow presentation and in tailoring the covenants in the bond to your business. These disclosures will have to take into account what the peers have disclosed, what does the company feel comfortable saying, and is the level of guidance appropriate, verifiable and does not constitute a profit forecast.

The rating agency presentation will also require a full company model with sensitivities and scenarios, to understand the company's headroom and ability to pay. This could be more detailed than the company has done before and will take time to prepare alongside the rating agency presentation. Even once it is delivered, the rating process can take several weeks. Typically these can be run alongside the prospectus preparation, but we'd caution not to underestimate the time this will take.

4. Tailoring the Covenant Package

The high yield bond covenant package has become relatively standardised over the years, but you need to make sure that the covenants in your bonds will work for your business. The starting point will be the business plan used in developing the credit story for the prospectus, then you'll need to consider how things are likely to deviate from that during the lifetime of the bonds.

One important point to remember is that the bonds generally contain incurrence covenants, not maintenance covenants. Accordingly, if you fall outside of a specified financial ratio, you won't be in breach of the covenant, you just won't be able to do the things that it regulates, like incur additional debt or pay dividends. The principal covenants will include:

- *Limitation on Indebtedness* – Any future incurrence of debt will generally be subject to a fixed charge coverage ratio test (the ratio of EBITDA to interest expense) of 2x;
- *Limitation on Liens* – Securing other debt will be tightly controlled, restricting both the amount and type of debt that can be secured and the assets that can serve as collateral;
- *Restricted Payments* – Restricted payments (dividends on equity, repurchases of equity, prepayments of subordinated debt and minority investments outside the group) will typically be limited to 50% of group consolidated net income since the issue date of the bonds and only permitted while the 2x FCCR test for incurring debt is satisfied;
- *Limitation on Asset Sales* – If material assets are sold, the sale will need to be at fair market value and the net sale proceeds will need to be used within a year to repay indebtedness or reinvested in the business.

All of these limitations will be subject to a number of exceptions (the categories of permitted debt, permitted liens, permitted payments, etc.) and the exceptions are generally where you will tailor the covenants to work for your business. It may be that the standard covenant package gives you all the flexibility you need to run your business and with a bit of headroom, just in case. If you need somewhat unusual exceptions to meet a particular situation (an acquisition or a joint venture that won't fit within the normal covenants, for example), you should be able to get them.

However, you'll need to explain clearly (in the prospectus and in the roadshow) what you need flexibility to do and why, and then draft the exceptions tightly. One big difference between a bond offering and, say, an M&A transaction is that with a bond you only get one bite at the apple; there is no back-and-forth of negotiation over the terms. If investors don't like what you're offering, they'll either decline to buy or insist on a higher interest rate to compensate for their perceived higher risk.

5. The company now has issued securities – what needs to change?

The company has now agreed to a set of reporting requirements and covenants. Quarterly reporting to deadlines is the norm, so consider whether reporting systems need to be upgraded. And to identify possible issues, build covenant testing into the regular management reporting systems and forecasting. Among other things, the company will need to track headroom under the various covenants to ensure that it can respond quickly to corporate opportunities as they develop.

The management team now also need to consider access to information. The precise regulatory regime that applies post-offering will depend on where the company is located and where the bonds are listed. But regardless of the legal requirements, be conscious of who has access to **material non-public information** and who has ongoing press/external relationships. As a general rule, you don't want to disclose information to anyone outside the organisation if you wouldn't want to disclose it to everyone.

Finally, become a good corporate citizen for your new stakeholders. Identify who will be the primary investor relations liaison. Although the covenants typically don't require it, a quarterly conference call with bondholders to discuss the most recent results will go a long way in building investor goodwill. The company will benefit long term from being more than just a technically compliant reporting issuer – by creating a reputation for appropriate disclosure and investor engagement, future conversations with investors, requests for waivers, or new bond issues, are likely to be significantly easier.

Watch the video accompanying this article here

About The Deal Team and the Race to Recapitalise series

The Deal Team is the first professional transaction manager for public equity and debt capital markets transactions and M&A, providing dedicated Deal Captains to project manage transactions within existing management teams. Based in London and working across Europe, we know how to maximise the speed and efficiency of execution for deals such as rights issues, high yield bonds, and M&A disposals, among others.

Through April and May 2020, we will publish weekly articles on the internal execution steps a company should consider in order to win the Race to Recapitalise. This is the fith in the series – which will continue as follows:

1. The key lessons of crisis management
2. Getting to an answer fast: Financials and Forecasting
3. Tapping your shareholders: Rights issues best practice
4. Managing the details: best practices for due diligence and data room management
5. *Preparing for the first listed bond*

6. Disposals – how to take control and avoid the fire sale

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