How Traveling Structures Work In Leveraged Finance

Law360, New York (January 04, 2013, 5:02 PM ET) -- Aggressive structures not seen since the leveraged finance bull market of 2006 have re-entered the market. Driven largely by best efforts deals, certain private equity sponsors have sought, and obtained in limited cases, so-called "traveling structures."

These structures carve out a permitted change of control, i.e. a pre-baked approval for a post-closing sale of equity to eligible permitted purchasers, subject to satisfaction of certain conditions. This structure displaces the usual expectation of the lender syndicate that the credit facilities will be refinanced upon a change of control or, on the downside case, a change of control will cause an event of default.

The key variables when structuring a permitted change of control are:

1. What type of transaction is permitted?

A permitted change of control typically comprises any transaction or series of related transactions consummated on or prior to the outside date in which greater than 50 percent of the aggregate ordinary voting power represented by the issued and outstanding equity interests of the parent of the borrower (which is typically a holding company guarantor and pledgor) is acquired, directly or indirectly, by one or more eligible purchasers.

2. Is there an outside date?

Most traveling structures impose an outside date that reflects a pre-identified timetable of the existing sponsor to sell-down its equity stake. This date is usually not longer than 18 months from the closing date, but is often as short as three months.

3. Who is an eligible purchaser?

There are three categories of potential eligible purchasers: (i) a new sponsor entity; (ii) a pension fund; and (iii) a strategic operating company.

A new sponsor entity and pension fund must typically have, together with its controlled affiliated funds, committed capital and/or assets under management in excess a significant threshold amount (typically at least the size of the existing equity sponsor and its controlled affiliated equity funds). Additional lender protections are required if a strategic operating company (including a potential operating portfolio company of a sponsor entity) is the proposed eligible purchaser given that the syndicate will become part of a new corporate group (particular consideration should be given to the existing debt structure, tax matters and other potential liabilities).

4. What conditions apply?

The following conditions typically apply: (i) no default or event of default before and after giving effect to the permitted change of control; (ii) representations and warranties are true and correct in all material respects after giving effect to the permitted change of control; (iii) applicable leverage ratios (and, in certain circumstances, interest coverage or fixed charge coverage ratios) no worse than closing

date ratios (or up to 1.00x tighter than closing date ratios, depending on the credit story); (iv) minimum pro forma equity (including rollover equity and new cash equity from the eligible purchasers) (typically in the 30 percent to 40 percent range as a percentage of debt and equity capitalization); (v) no ratings downgrade; and (vi) PATRIOT Act and OFAC compliance and delivery of information related to "know your customer" and other applicable laws.

5. Affiliate debt cap limits, how do they work?

The affiliate/sponsor debt purchase caps must be drafted to pick up the eligible purchaser and its affiliates. The aggregate caps should roll up both the existing sponsors and its affiliates and the eligible purchaser and its affiliates to protect lenders from the scenario of these equity holders acting in concert; this, of course, reflects the market standard that would have applied if the eligible purchaser and its affiliates had been part of an equity sponsor "club" syndicate on the closing date.

6. Contemporaneous right-sizing of the debt structure?

Consideration is often given to allowing for the right-sizing of the debt structure at the same time as the consummation of the permitted change of control. Specifically, to the extent that new money is coming into the credit, permitting the earlier prepayment of junior debt is often, subject to customary conditions, permitted. This gives the eligible purchaser the option to take out relatively expensive junior capital. Typically, for short-dated permitted changes of control, a carve-back to hard and soft call provisions is often obtained.

In conclusion, the traveling structure is a top-of-the-market structural development that permits sponsors a narrow path by which they can both sell their equity stake in the business while also allowing the incoming eligible purchaser to obtain the benefits of the existing debt capital structure at a time when capital markets may not offer as favorable terms.

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