FOLEY

FOLEY & LARDNER LLP

Top 10 Financing Issues for Manufacturing Companies

Presenters

Heidi Furlong
Partner | Milwaukee

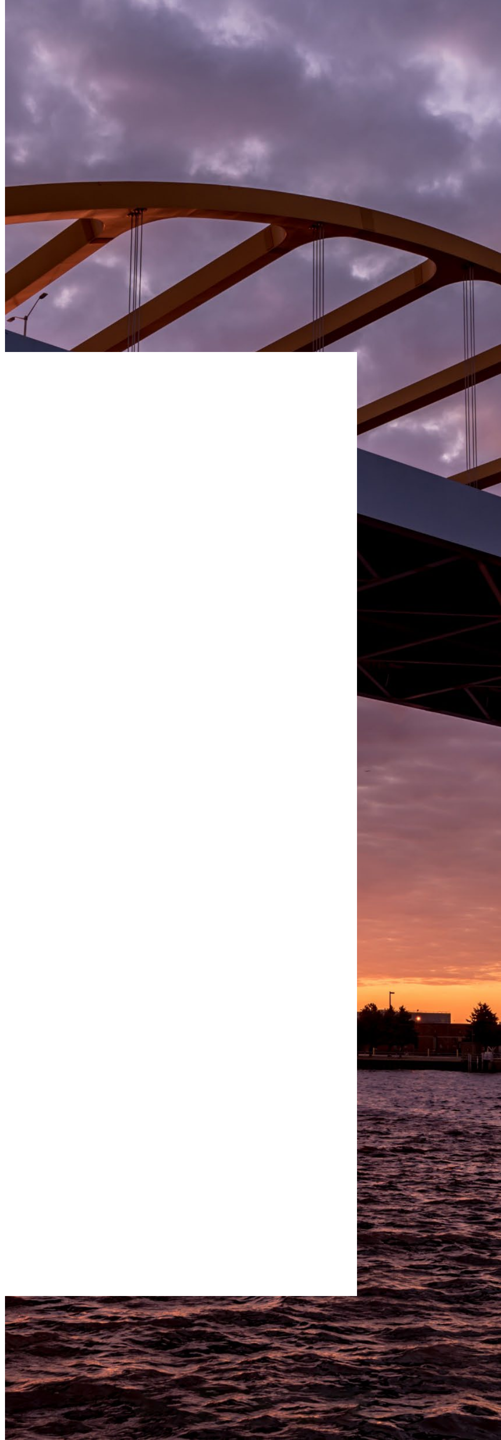
T: 414.297.5620
E: hfurlong@foley.com

Sarah Null
Partner | Chicago

T: 312.832.4555
E: snull@foley.com

Louis Wahl
Partner | Milwaukee

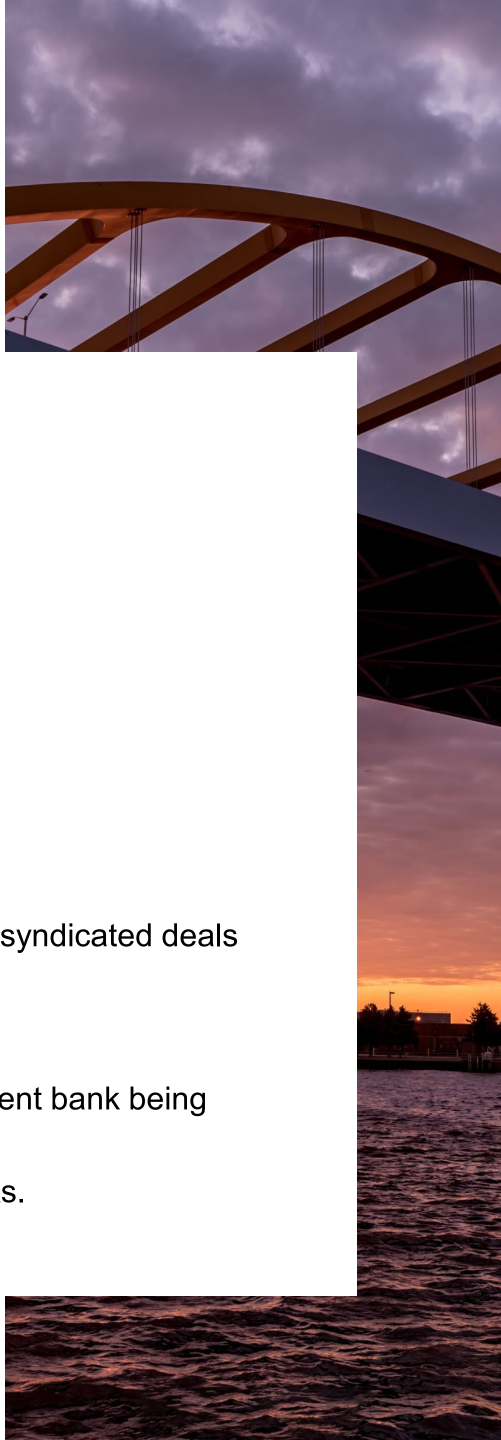
T: 414.297.5054
E: lwahl@foley.com



1. Know Your Lenders

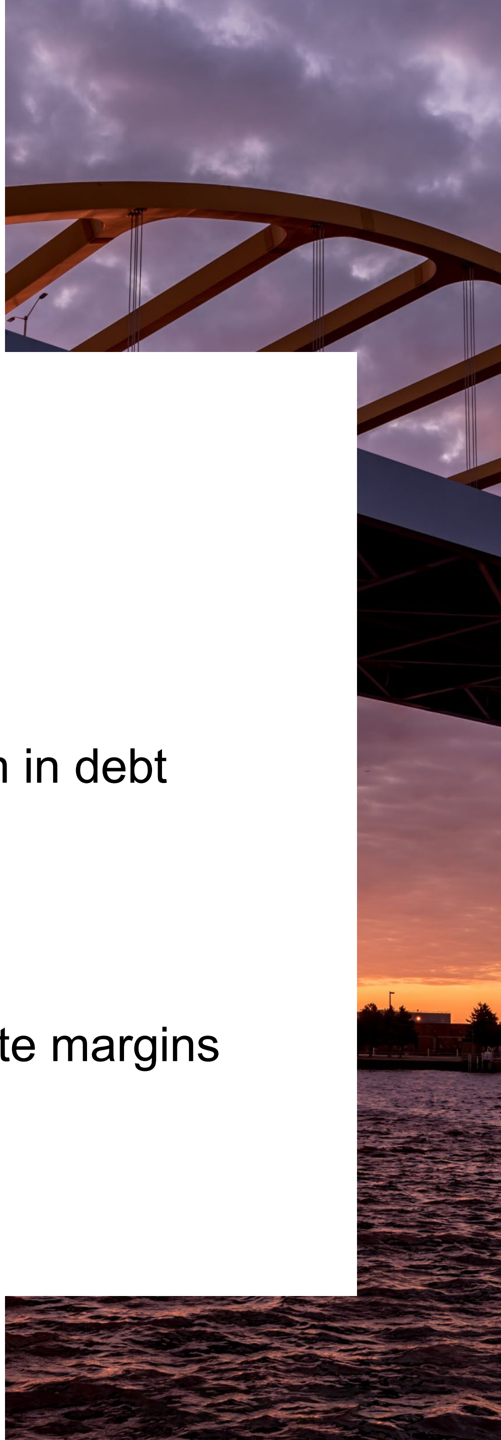
Can you get a commitment?	Can you get the terms you want?	Can you get the services you need?

- Regional Banks are under stress lately because of regulatory concerns:
  - More uncertainty for commitments
  - More attention to deal terms
  - More likely to reject financing deals
- Direct Lenders:
  - Generally a larger presence, heavily involved in non-investment grade financings and PE deals, and are getting more involved in syndicated deals
  - Are potentially more flexible because of less regulation
- Agent banks:
  - Recently, it is more likely that deal terms will change based on lender input, rather than the deal a borrower negotiates with its Agent bank being the final deal.
- Consider what treasury/banking services are available from your lenders: this has become more of a focus when selecting lead banks.
  - Relationships still matter



2. The Crowning of Term SOFR

- BSBY:
  - The BSBY cessation date was November 15, 2024
  - Other alternatives have also fallen away or taken a back seat to Term SOFR
- Term SOFR:
  - This is the benchmark that is most analogous to LIBOR and has become fairly uniform in debt agreements.
- SOFR Credit Spread Adjustment:
  - The market has been 10 basis points, but there may be some flexibility here.
  - Even when a spread adjustment seems absent, it may have been incorporated into rate margins or other fees.

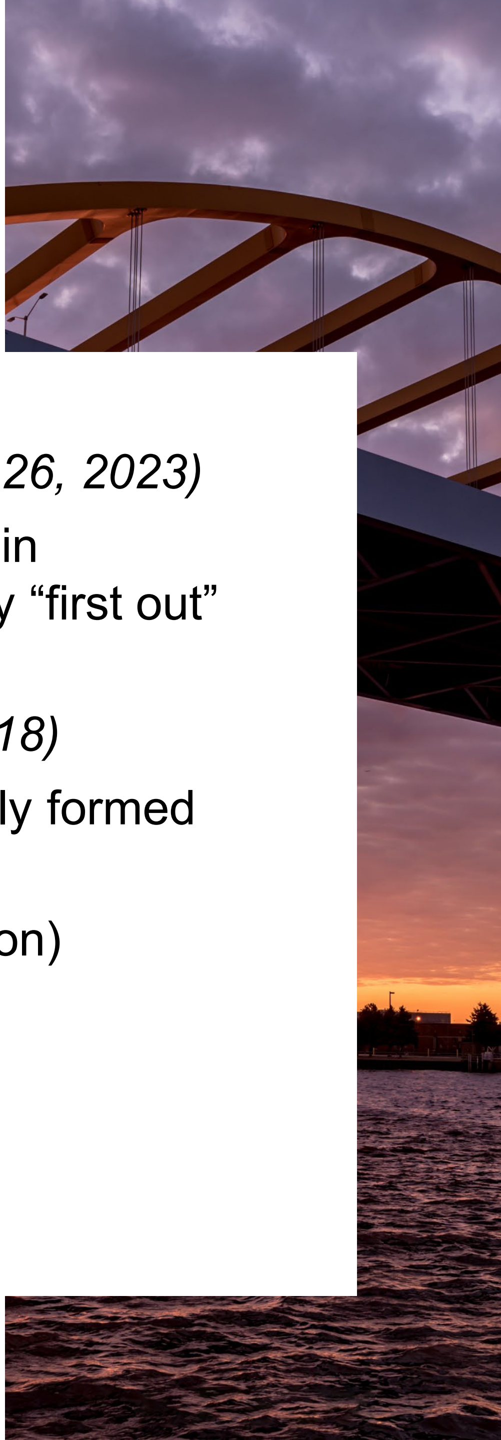


3. Liability Management Transactions

- Syndicated loan documents have become more flexible, leaving “loopholes” that some see as beneficial to managing troubling times, and others see as an unnecessary risk to lenders. Notable examples:
  - J. Crew “trap door”: *J. Crew Grp. v. Wilmington Sav. Fund Soc’y, No. 0650574/2017 (N.Y. Sup. Ct. 2017)*
    - $250 million of IP transferred to a restricted subsidiary, which then transferred to an unrestricted subsidiary that licensed the IP back to the loan parties
    - Unrestricted subsidiary secured additional loans with the transferred IP

3. Liability Management Transactions

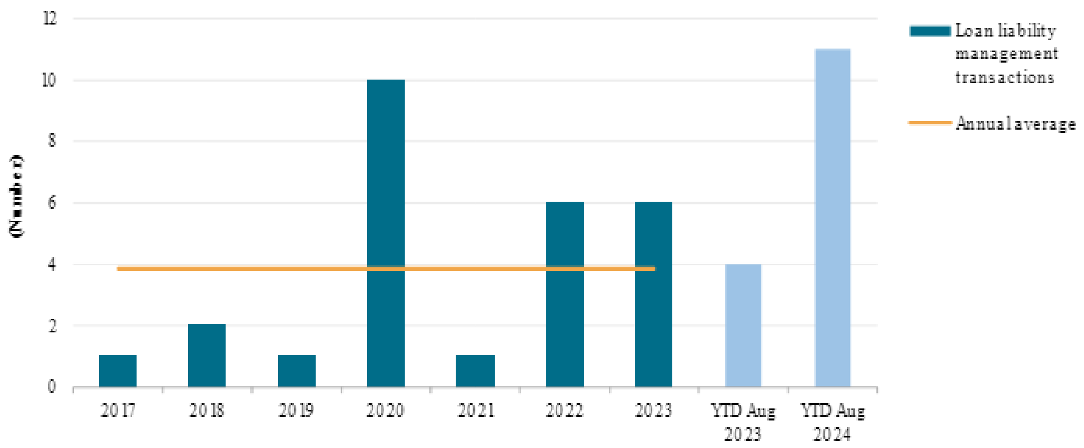
- Serta: *Excluded Lenders v. Serta Simmons Bedding, L.L.C., No. 23-90012 (5th Cir. Apr. 26, 2023)*
  - In compliance with the voting requirements of its credit facility, Serta agreed with certain consenting lenders to amend its credit facility to permit a new facility with super-priority “first out” and “second out” debt, which facility was only available to consenting lenders.
- Chewy: *Argos Holdings Inc. v. Citibank NA, Case No. 18-cv-5773 (S.D.N.Y. June 26, 2018)*
  - PetSmart spun off newly acquired Chewy to its Sponsor, with a portion going to a newly formed Unrestricted Subsidiary of PetSmart.
  - Since Chewy was no longer a wholly-owned subsidiary, it was (eventually, after litigation) released from the lien and guarantee obligations under PetSmart’s loan documents.



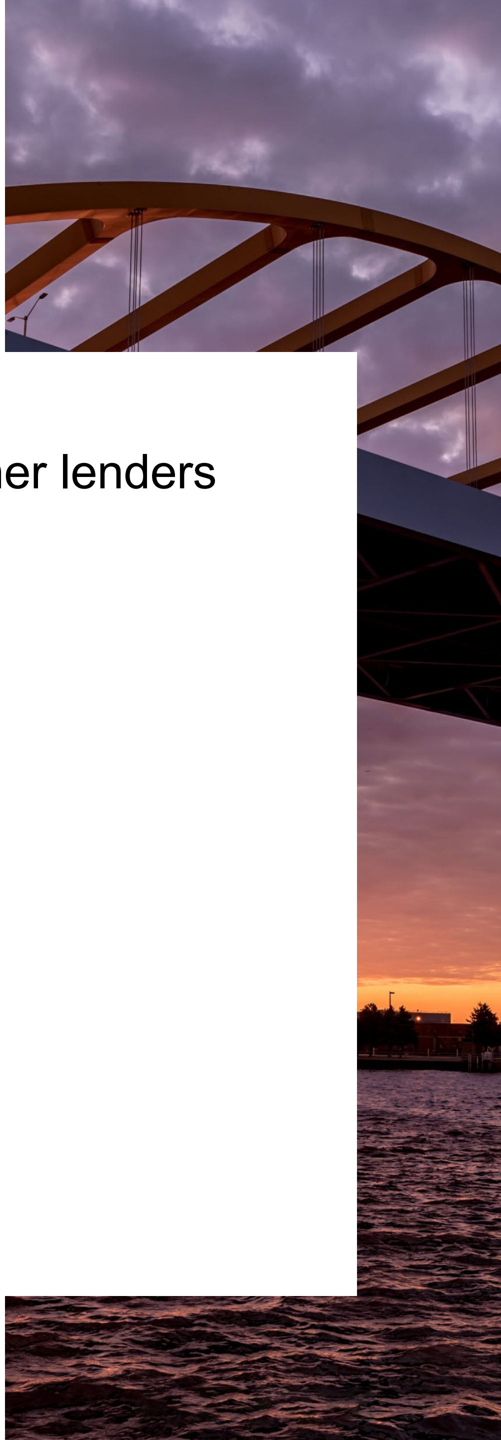
3. Liability Management Transactions

- These out-of-court restructurings, often benefitting existing lenders at the expense of other lenders in the same loan (lender-on-lender violence) are up in the last few years:

Surge in loan LMTs that subordinate existing lenders

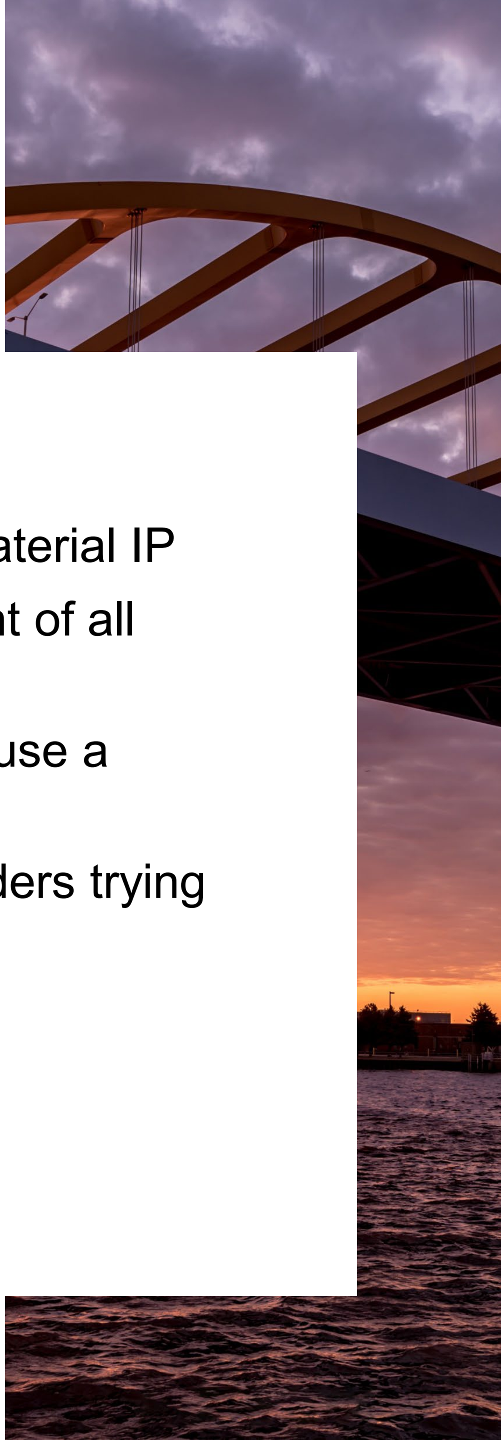


We don't include pro rata restructurings in which lenders were offered the same terms. Source: S&P Global Ratings.



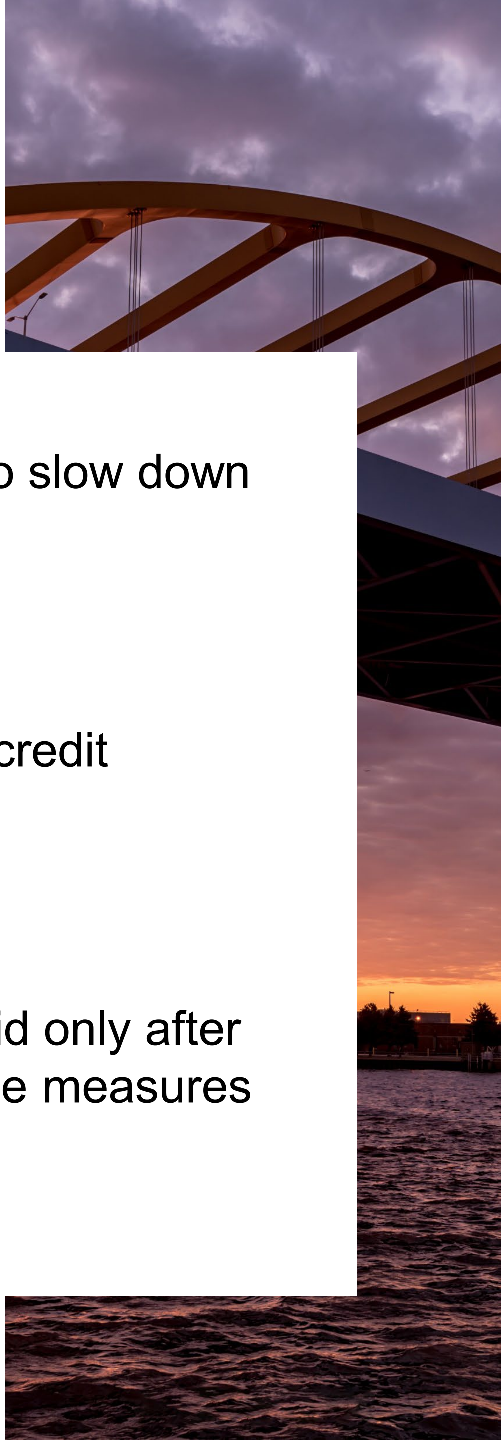
3. Liability Management Transactions

- Lenders are now asking for:
  - J. Crew blockers: Restricting transfers of assets outside of the Obligor group, often material IP
  - Serta protection: Fine-tuning lender consent provisions, including requiring the consent of all affected lenders to any subordination of their debt or liens
  - Chewy blockers: Providing that guarantees and security are not released simply because a subsidiary is no longer wholly owned
- This is an ongoing cat-and-mouse game, with borrowers still exploring flexibility and lenders trying to keep up.

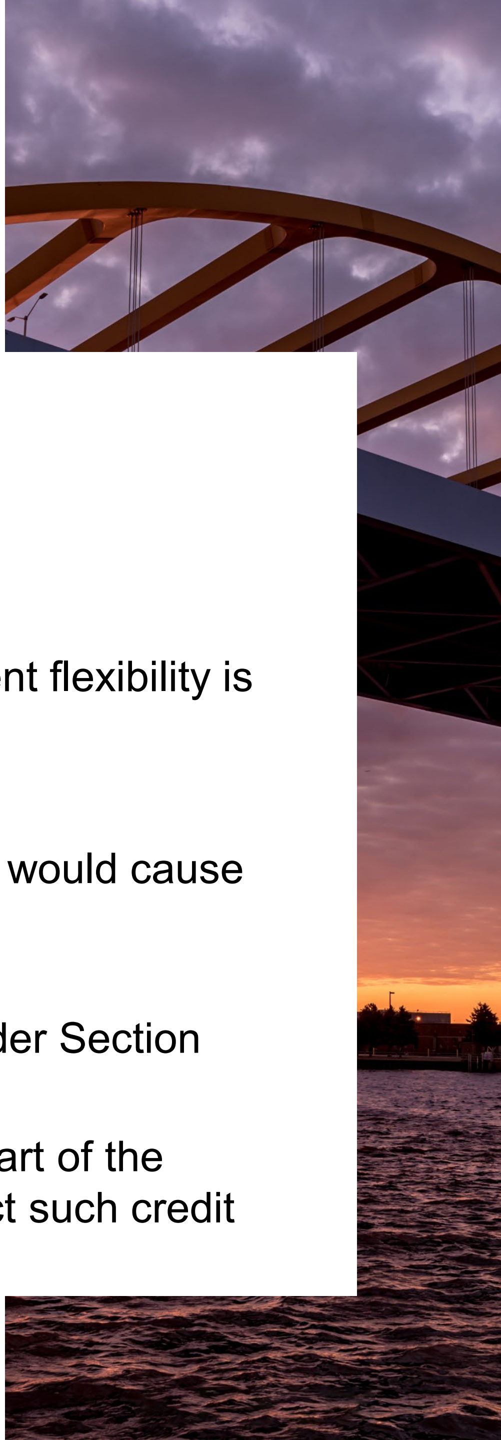


4. Acquisition Financings

- In our experience, this year has seen an uptick in M&A activity that doesn't seem likely to slow down soon
- Acquisition financing structure
  - Limited conditionality in commitment letters
    - Limited conditionality also comes into play with respect to incremental increases to credit facilities
  - Certain funds/SunGard provisions
  - EU certain funds requirements
    - The U.K. City Code on Takeovers and Mergers requires that a bidder announce a bid only after ensuring that it can fulfill in full any cash consideration and after taking all reasonable measures to secure any other type of consideration
  - Ticking Fees and interaction with purchase agreement



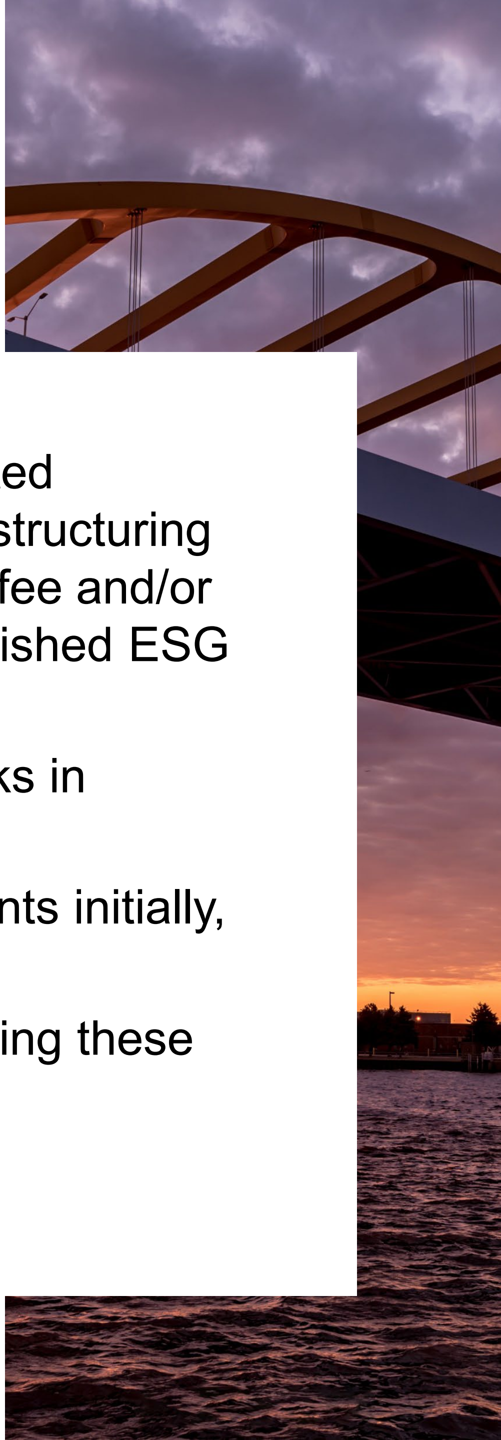
5. International Credit Support (Guarantors and Collateral)



- Considerations for borrowers with assets or business outside of the U.S.:
  - There is an increased focus on this from a lender’s perspective
  - Setting requirements for when foreign guarantors or assets need to support the credit facility
  - To finance international subsidiaries outside of the credit group, restricted payment and investment flexibility is important
- Changes to the “deemed dividend” issue:
  - Previously, a controlled foreign corporation (CFC) providing credit support to a U.S. parent entity would cause the U.S. parent to be deemed to have received a dividend from the CFC, which has adverse tax consequences.
  - Now, generally, a U.S. corporation can reduce the amount of a deemed dividend from a CFC under Section 956 of the Internal Revenue Code to the same extent it would if it were an actual dividend.
  - As a result, lenders are becoming more comfortable requesting international subsidiaries to be part of the financing structure, though this can still be an issue under U.S. and foreign law which may restrict such credit support.

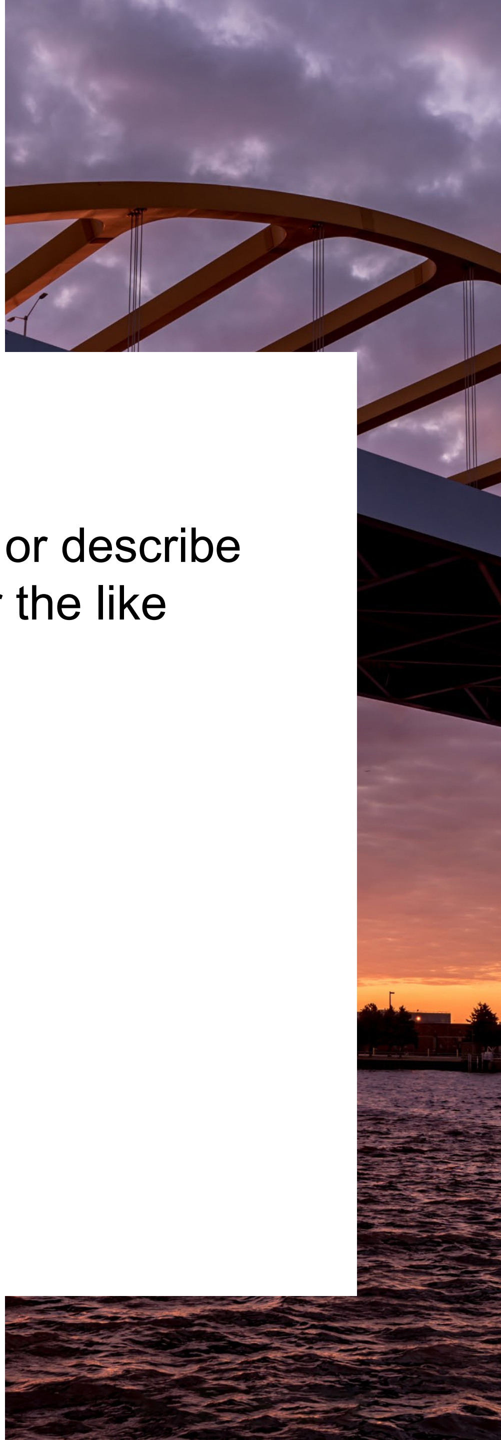
6. Green and ESG provisions

- In the last several years there have been several credit agreements that have incorporated frameworks for borrowers to implement, in consultation with an appointed sustainability structuring agent, certain ESG targets that provide for an adjustment to the applicable commitment fee and/or applicable interest rate margin depending on the borrower’s performance with the established ESG targets
  - LSTA developed model market language and guidelines to assist companies and banks in implementing ESG frameworks in credit agreements
- While a lot of focus was given to these sustainability/ESG frameworks in credit agreements initially, we have seen a noticeable drop off in borrower interest as of recently
  - Potential benefits outweighed by the administrative burden and expense of implementing these frameworks



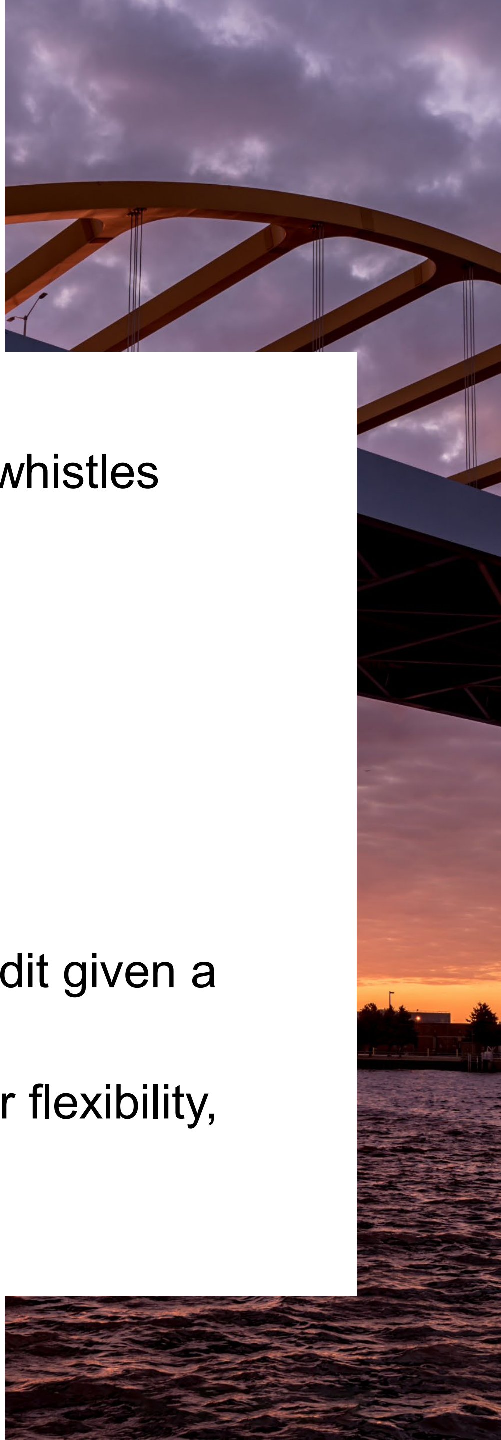
6. Green and ESG provisions

- "Greenwashing" concerns?
  - More frequently lenders are imposing limitations on the ability of a borrower to market or describe financings with sustainability/ESG frameworks as "green bonds", "green financings" or the like

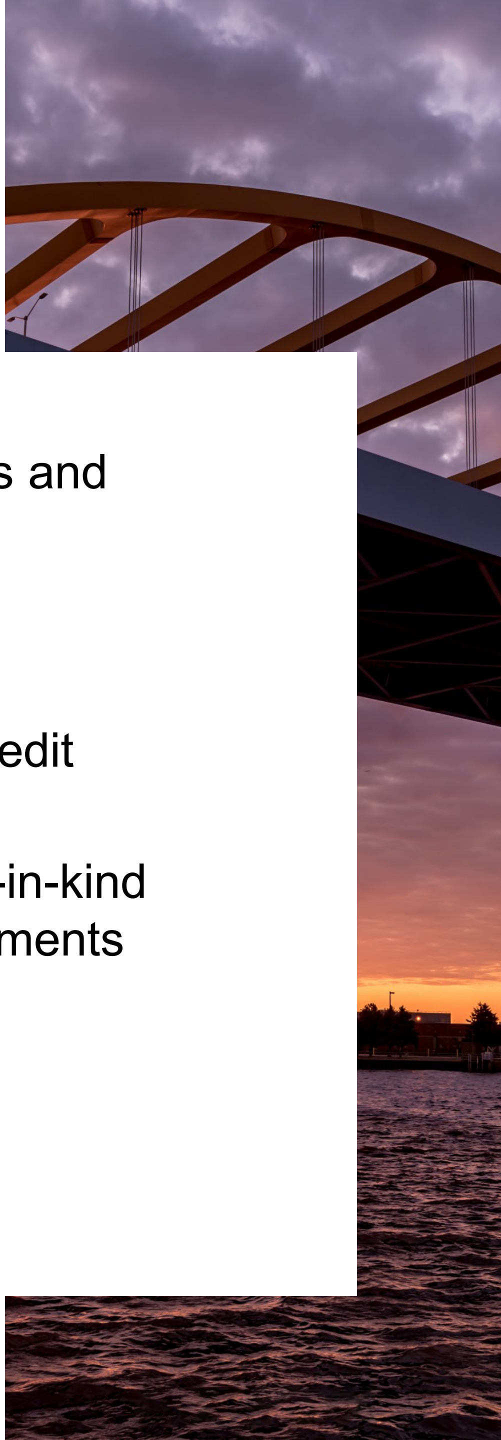


7. Points of Interest for PE Backed Companies

- A credit facility for a private equity (PE) sponsored company will contain more bells and whistles generally:
  - Robust EBITDA add-backs relative to non-PE sponsored companies
  - Equity cure rights
  - Covenant flexibility for making restricted payments / PE management fee payments
  - Change of control provisions relating to new sponsors or future IPOs
  - Highly levered companies, so more financial covenant flexibility generally
- PE-sponsored companies are increasingly being financed by direct lenders / private credit given a sponsored company's leverage/credit profile
  - Largely due to stricter regulations imposed on traditional bank lenders, which limit their flexibility, while private credit funds can offer quicker and more tailored financing solutions



7. Points of Interest for PE Backed Companies



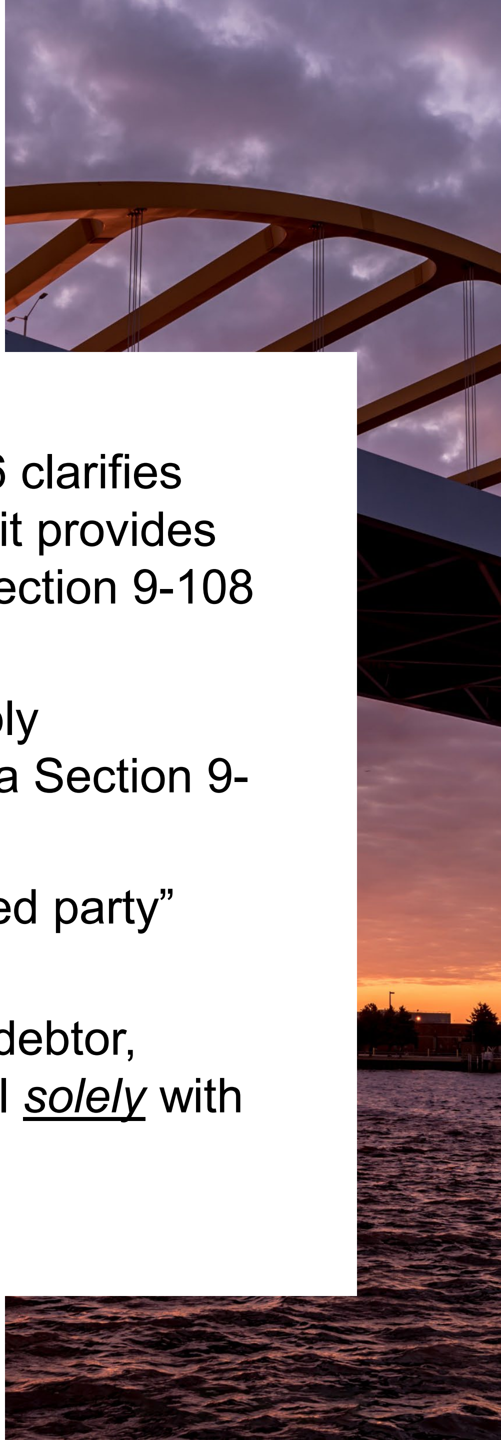
- Considerable focus recently on ensuring enough flexibility for consummating acquisitions and integrating acquired companies
  - Focus on “permitted acquisition” and “permitted investment” concepts
  - Focus on asset disposition covenant exceptions following acquisitions
  - Consideration is given to incremental facilities and limited conditionality concepts in credit agreements
  - PE firms are more frequently financing deals using a mix of preferred equity, payment-in-kind (PIK) loans, other junior capital options, and/or seller debt. Need to be sure debt documents provide enough flexibility for these different types of transactions.

8. UCC Financing Statement Sufficiency

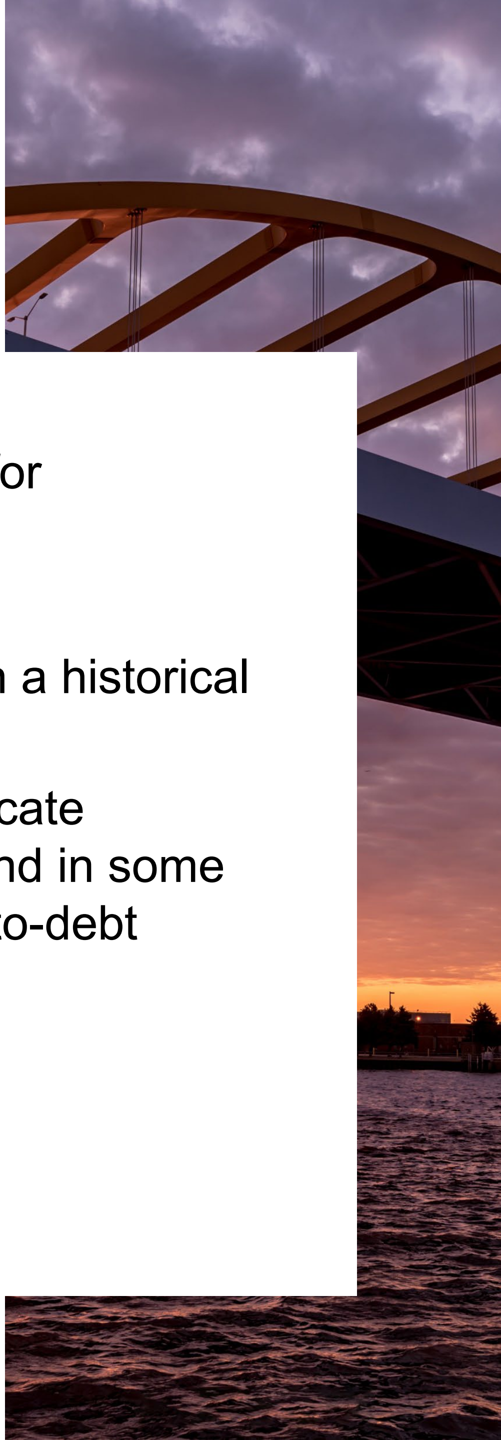
- To perfect under Article 9 of the UCC, a UCC financing statement collateral description must reasonably identify what is described to be considered sufficient
- If a UCC financing statement does not include a sufficient collateral description, such financing statement will not perfect the lender’s security interest and the security interest may be avoided in bankruptcy, and the lender left with a general unsecured claim
- Circuits are split on what constitutes sufficiency:
  - First Circuit found a financing statement describing collateral solely with reference to an external document insufficient (*In re Financial Oversight and Management Board for Puerto Rico v. Puerto Rico AAA Portfolio Bond Fund*, 914 F.3d 694 (2019)).
  - Seventh Circuit found a financing statement describing collateral solely with reference to an external agreement to be sufficient (*In re 180 Equipment LLC*, 938 F.3d 866 (7th Cir. 2019)).

8. UCC Financing Statement Sufficiency

- Permanent Editorial Board for the Uniform Commercial Code (PEB) Commentary No. 26 clarifies that the collateral description may contain references to external documents, as long as it provides a description of the collateral (i) with reference to collateral categories defined in UCC Section 9-108 or (ii) that covers all assets.
  - E.g., “all inventory supplied by the secured party to the debtor under that certain supply agreement between the debtor and secured party” is sufficient because “inventory” is a Section 9-108 category.
  - E.g., “collateral described in that certain supply agreement between debtor and secured party” would *not* be sufficient.
- If a collateral description covers more particular assets than all personal property of the debtor, incorporate a collateral category from UCC Section 9-108 and avoid describing collateral *solely* with reference to an external document.



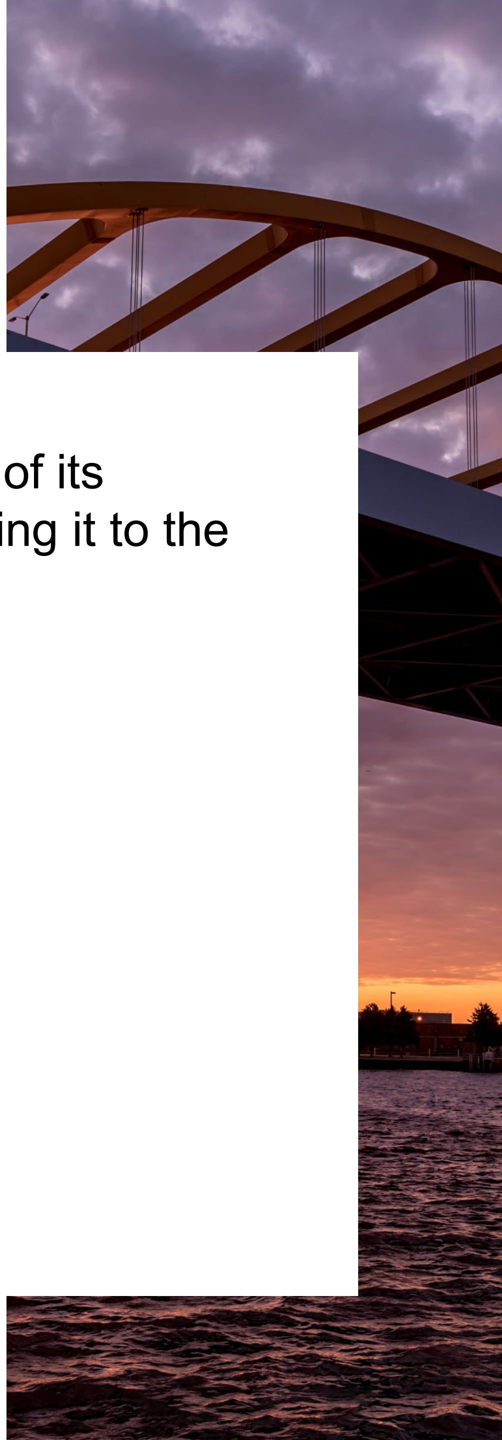
9. What’s Next in Covenant Flexibility



- In general, continued movement toward increased credit agreement covenant flexibility for borrowers
- Notable recent examples of such flexibility:
  - **“High water mark”** baskets permit a borrower to use the largest EBITDA achieved on a historical basis, in lieu of its *current* earnings, for the purpose of setting basket sizes
  - **“Pick your poison”** or **“dividend-to-debt toggle”** baskets allow a borrower to reallocate capacity available under the facility’s restricted payments basket to the debt basket, and in some facilities, to use that capacity for investments in unrestricted subsidiaries for dividend-to-debt optionality

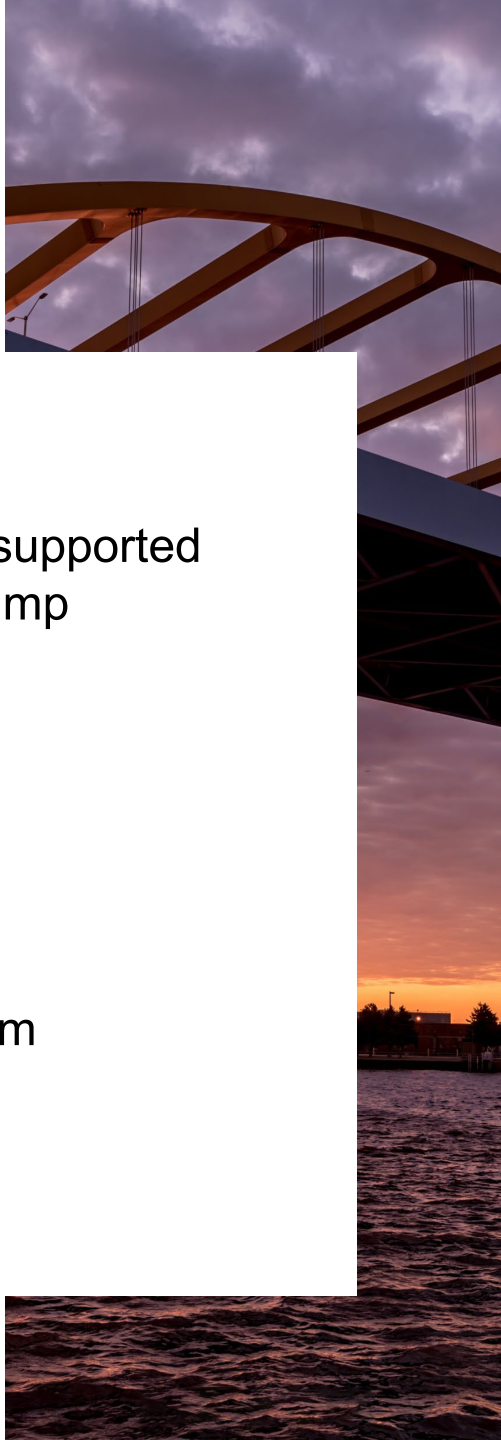
9. What's Next in Covenant Flexibility

- **PIK (payment-in-kind) optionality** permits a borrower to make a portion or the entirety of its interest payments in-kind (PIK), rather than in cash, by capitalizing that amount and adding it to the principal amount outstanding
  - More often seen in private credit deals, but no longer limited to distressed borrowers



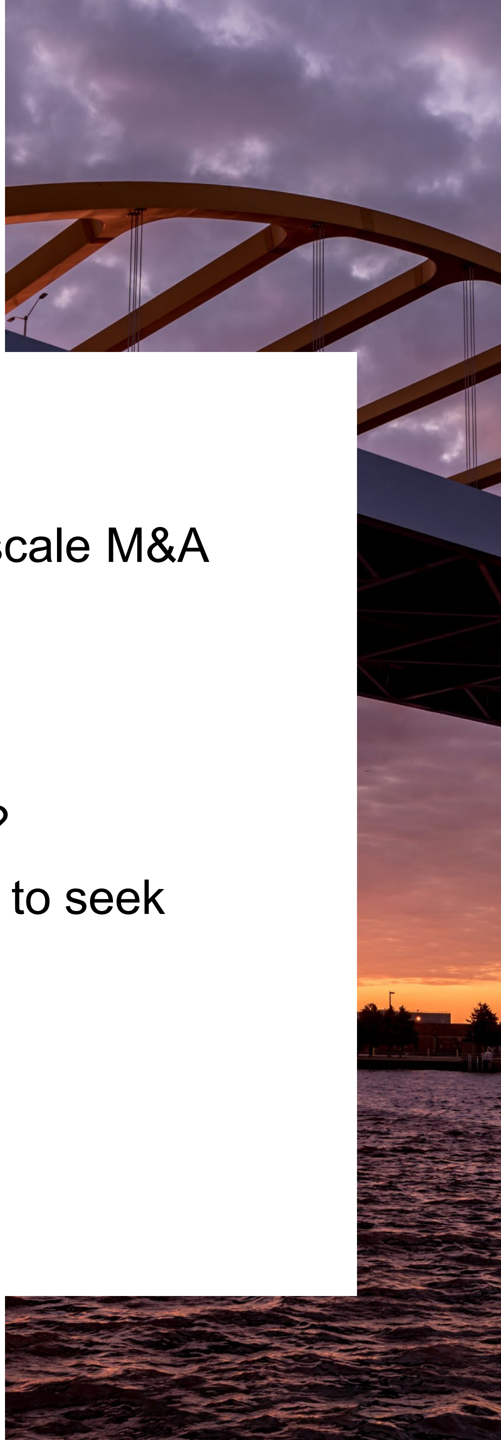
10. What’s ahead? Looking forward to 2025.

- **Increased M&A Activity?**
  - Per Fitch Ratings, M&A activity by U.S. corporates is expected to accelerate in 2025, supported by accommodative cost of capital and the possibility of looser regulation under the Trump administration
  - Many U.S. corporates have cash on hand or available debt for acquisitions
- **Increased Corporate Debt?**
  - Per Goldman Sachs, debt issuance/incurrence is expected to pick up in 2025
    - 2024 was busy; 2025 is expected to be busier
    - Due to anticipated lower interest rates and increased demand for corporate debt from investment markets (refi opportunity); increased M&A activity (need for $)

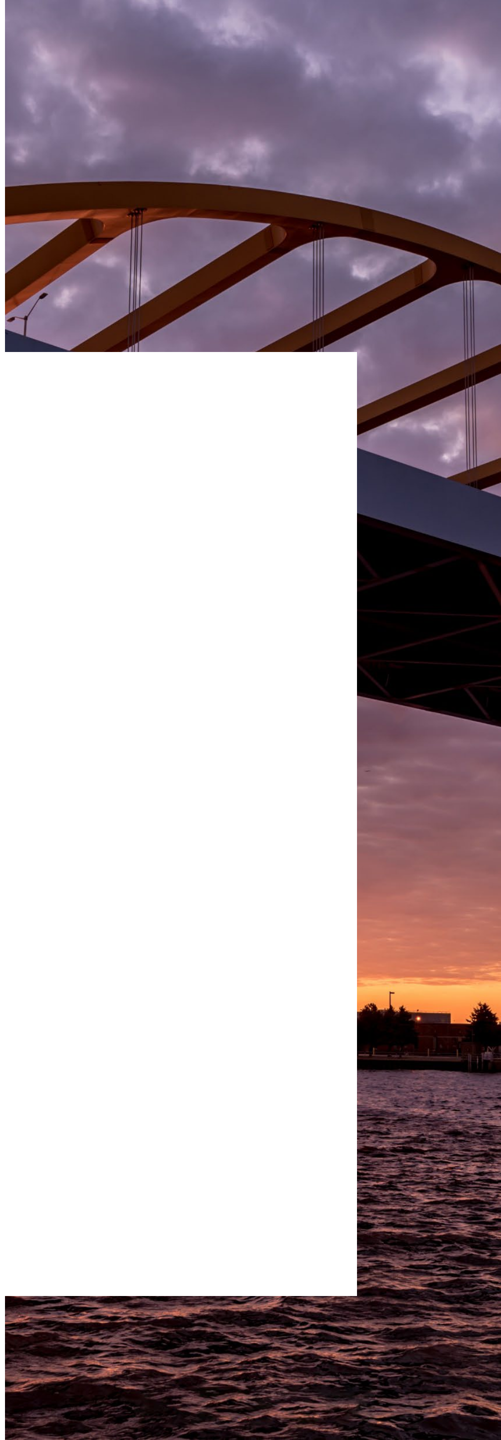


10. What's ahead? Looking forward to 2025.

- **Favorable FTC?**
  - Under the Biden administration, the FTC's hawkish approach to antitrust made large-scale M&A more difficult; that may reverse under the Trump administration
- **Tariffs?**
  - Expected to be a focus under the Trump administration
  - Implemented when? Which countries? Which products? How much? Tariff exclusions?
  - Companies that import considerable amounts of products affected by tariffs may need to seek covenant relief under debt documents



Questions?



About Foley

Foley & Lardner LLP is a preeminent law firm that stands at the nexus of the Energy, Health Care & Life Sciences, Innovative Technology, and Manufacturing Sectors. We look beyond the law to focus on the constantly evolving demands facing our clients and act as trusted business advisors to deliver creative, practical, and effective solutions. Our 1,100 lawyers across 26 offices worldwide partner on the full range of engagements from corporate counsel to intellectual property work and litigation support, providing our clients with a one-team solution to all their needs. For nearly two centuries, Foley has maintained its commitment to the highest level of innovative legal services and to the stewardship of our people, firm, clients, and the communities we serve.

FOLEY
FOLEY & LARDNER LLP

FOLEY.COM