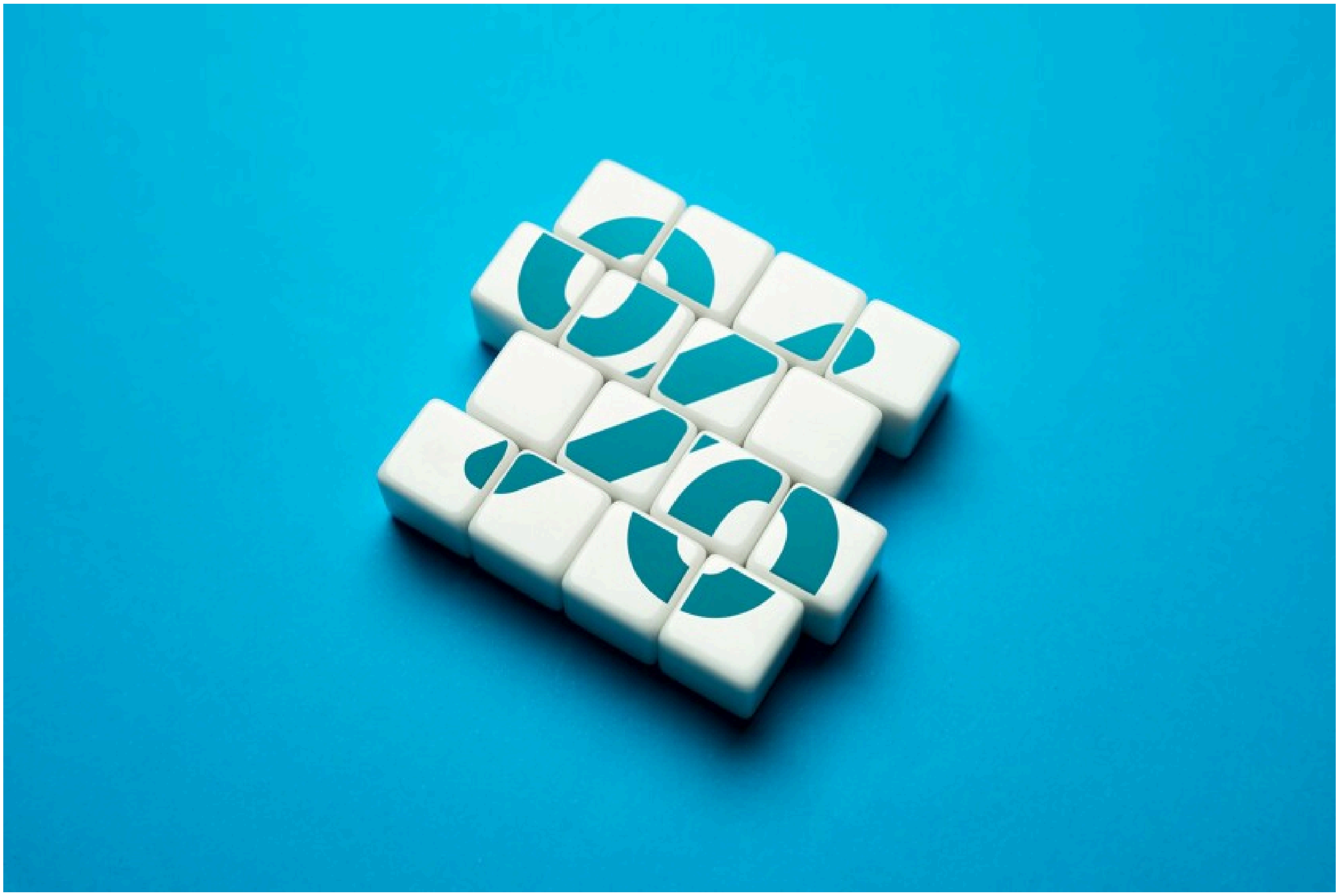
Uncertainty Drives Continued Liability Management Momentum



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With uncertainty driving credit issues as the first half of 2025 draws to a close, clues have emerged about the next wave of liability management exercises.

By Conner Searfoss

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While the rise to prominence of liability management exercises was always expected to continue, uncertainty has accelerated that process.

"I expect to see even more LMEs moving forward," said Shai Schmidt, a partner at Glenn Agre Bergman & Fuentes LLP. "In the face of disruption to businesses, tariff-related uncertainty and general market volatility, many sponsors will continue to perceive an LME as a better alternative than bankruptcy with all its attendant costs."

Distressed exchanges in April totaled $3.5 billion, according to JPMorgan Chase & Co., up from $2.2 billion in March and $1.6 billion in February. Accordingly, on April 30, Fitch Ratings Inc. revised its forecast for leveraged loan and high-yield default rates from 3.5%-4% to 5.5%-6% and from 2.5%-3% to 4%-4.5%, respectively.

"Issuers will face challenges accessing the public capital markets to address near-term debt, leading to increased distressed debt exchange activity," wrote the agency.

"For many sponsors, the decision to do an LME is not necessarily a tough one," Schmidt added. "From the sponsor's perspective, you roll the dice hoping that the business will perform better, while preserving your optionality and without giving up your equity."

With the wave set to continue, the biggest questions are how LMEs will further evolve. Some signals have emerged thus far this year.

Signs from Serta

Among 2024's most significant LME moments came on New Year's Eve, when the U.S. Court of Appeals for the Fifth Circuit ruled that a June 2020 up-tier LME executed by Serta Simmons Bedding LLC wasn't permissible under a 2016 credit agreement.

Immediate concerns largely surrounded using the aggressive non-pro-rata mechanism by Serta to subordinate minority creditors. In January, Kinderhook Industries LLC portfolio holding Better Health Inc., a Tampa, Fla.-based primary care physician group created a new up-tier mechanism out of concerns about the impact of Serta. Better Health reportedly agreed with a majority group to extend existing loans in a de-facto amend-and-extend, a new class was created under the credit agreement, sufficiently insulating the group from Serta-obligated pro-rata sharing requirements.

The mechanism, dubbed an extend-and-exchange, was followed in use by Portland-based Oregon Tool Inc., a Platinum Equity LLP backed manufacturer of forestry and other equipment in February. Extend-and-exchange is yet to undergo legal scrutiny, sources stressed, but offers a solution for issuers looking to do an up-tier.

Aggressive LMEs haven't been confined to Better Health and Oregon Tool of late. On May 9, Chicago-based juice maker Tropicana Brands Group Inc. executed an LME that limited the first-lien, first-out $519 million of its roughly $2.56 billion in debt to a small group, according to S&P Global.

But the deal speaks more to the nature of Tropicana's sponsors, sources said. The company is majority owned by PAI Partners SAS and PepsiCo Inc., who are less concerned about the reputational risk that can come with too much LME aggression, as they're not frequently involved in the space.

For those that are, reputational risk isn't the only headache that can come with an aggressive approach.

"I think a lot of lenders and CLO/BSL funds have concluded that the race to get into the 51% can leave them well-positioned should they get in the circle, but can have the exact same ramification on the other side when they don't, and over the course of twenty deals, that's probably going to even out," said Douglas S. Mintz, a partner at Cadwalader, Wickersham & Taft LLP. "When you add in the litigation cost of fighting with your fellow lenders, it turns out not to be a very positive experience."

This and other factors, Mintz added, have generally resulted in a shift away from truly combative lender-versus-lender liability management transactions.

"Those have pushed towards more collaborative and cooperative efforts, though certainly the larger holders continue to take up a larger share of those transactions," he added. "They're less typically going out of their way to smack around the 49% [of]

lenders, and I think companies are happy with that. They want their deals done and their capital structures improved, and turning it into a three year litigation [battle] doesn't help with that."

All-Inhibiting

Sources agreed that co-op agreements among lenders have continued to gain steam, but several pointed to another earlier-stage development to watch: using the omni-blocker.

It's a provision that prohibits any non pro-rata transaction whatsoever, and while it's yet to see widespread use just yet, lenders in a position to use it have increasingly begun to explore its the possibility, sources said.

One recent high-profile deal did see the mechanism adopted: the bankruptcy plan of Spirit Airlines Inc. Spirit's lenders took control of the Dania Beach, Fla.-based low-cost airline through a prenegotiated plan implemented via the company's November Chapter 11 proceedings. The company emerged from bankruptcy in March.

While Spirit's emergence was of relevance to the LME space, another company's possible entry could have even deeper ramifications.

As the double-dip LME grew in prominence last year, practitioners stressed it was yet to be tested in bankruptcy court. That could change with the looming filing of Plano, Texas-based home décor retailer At Home Group Inc., a Hellman & Friedman LLC holding.

Should At Home be unable to secure widespread lender support for any restructuring plan obligated by its declining performance and reliance on tariff-affected imports, excluded lenders could challenge the May 2023 double-dip LME, the first such clash in bankruptcy. A ruling in either direction would have significant ramifications for the mechanism's use.

TAGS RESTRUCTURING BANKRUPTCY LAW $ 1-10 BILLION $ 500 MILLION TO 1 BILLION TEXAS PRIVATE EQUITY DEBT FINANCING FEATURES AND COMMENTARY EDITOR'S PICK

COMPANIES

At Home Group Inc. | At Home Stores LLC | Better Health Inc. | Cadwalader, Wickersham & Taft LLP | Fitch Ratings Inc. | Glenn Agre Bergman & Fuentes LLP | Hellman & Friedman LLC | JPMorgan Chase & Co. | Kinderhook Industries LLC | Oregon Tool Inc. | PAI Partners SAS | PepsiCo Inc. | Platinum Equity LLC | S&P Global Mobility | Serta International | Serta Simmons Bedding LLC | Spirit Airlines Inc. | Spirit Super | Tropicana Brands Group Inc. | Tropicana Enterprises | U.S. Court Of Appeals

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