GUIDE TO SYNDICATED LEVERAGED FINANCE

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1. INTRODUCTION

Readers of this guide are assumed to have previously read the "Guide to Syndicated Loans" as explanations of the basic concepts will not be repeated in this paper. Furthermore the guide will largely focus on the senior level of debt in a typical leveraged buy-out transaction, which normally is provided through a syndicated loan facility.

Borrowing by way of a syndicated loan facility provides the core element of the senior debt structure in a leveraged finance transaction. Typically a leveraged buy-out of a company will involve various categories of funding in the capital structure, from senior debt through various subordinated categories of debt to a final element of equity.

The purpose of this note is to provide guidance on various aspects of a leveraged finance transaction, focusing on the following:

(i) the types of structures and borrowing facilities commonly seen in a senior syndicated leveraged finance agreement;

(ii) a description of the parties to the finance agreements and an explanation of their roles and legal positioning within the debt structure;

(iii) a brief explanation of the documentation entered into by the parties;

(iv) the time line for a typical syndicated leveraged finance transaction; and

(v) a brief description of transfer arrangements in a senior syndicated leveraged finance transaction.

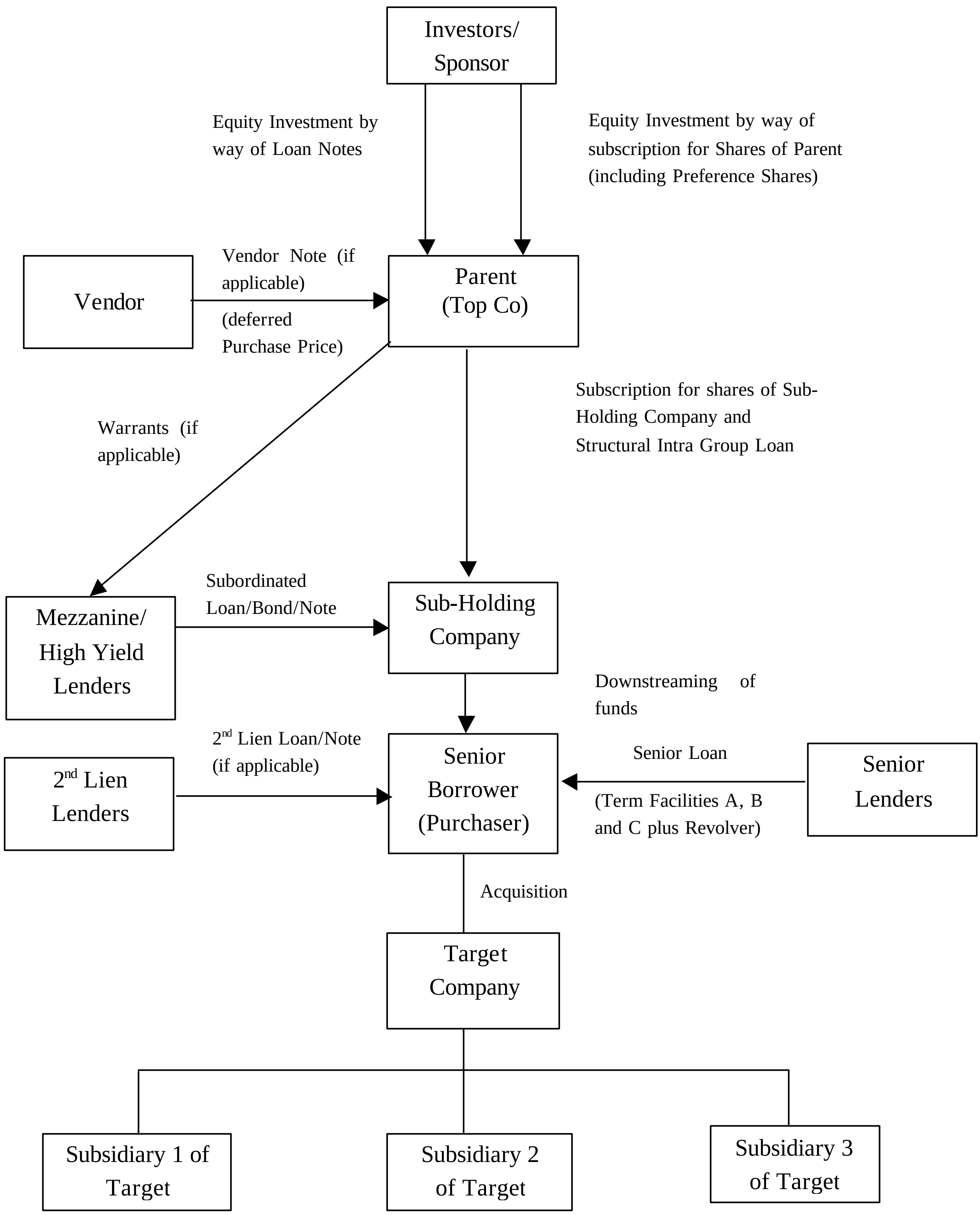
The guidance in this note is given on the basis of a typical syndicated leveraged finance transaction undertaken in the European loan market as envisaged in the LMA Primary Leveraged Loan documents and governed by the laws of England. This note is not intended to provide a detailed explanation of the provisions of the LMA Primary Leveraged Loan Agreements - guidance on this is set out in the "Users Guide to the Recommended Form of Facility Agreement for Leveraged Finance Transactions" published by the LMA and available to LMA members on the LMA website.

2. TYPES OF SENIOR LEVERAGED FACILITIES COMMONLY SYNDICATED

The capital structures of leveraged finance transactions vary from deal to deal, although the senior loan facilities are commonly syndicated incorporating both term loan facilities and a revolving loan facility, which are made available to an acquisition vehicle (and its designated subsidiaries) (hereafter collectively referred to as the "Senior Borrower"), which has been formed to acquire the target company. A schematic diagram of a (simplified) leveraged structure is produced below. It can be noted that the positioning of the Senior Borrower within the group helps to preserve structural seniority for the senior lenders against most subordinated classes of debt.

Furthermore legal priority is contractually obtained through an Intercreditor Agreement (refer to section 4.6).

Typical (Simplified) Debt Structure Chart



2.1 **General**: Syndicated leveraged finance agreements contain both a combination of multiple term loans and revolving facilities with different optional currencies and with different maturity profiles (commonly an A, B and C facility together with a revolving credit facility). Typically maturities for these facilities are: A - 7 years, B - 8 years, C - 9 years with the margin on the C being the highest followed by the B and then the A. There would also typically be a margin ratchet on the A, B and the revolver linked to one or more of debt, interest and cashflow coverage. The margin and maturity for the revolving facility is typically the same as the A facility.

There can be one borrower or more typically a group of borrowers, with provision for the accession of new subsidiary borrowers under certain circumstances from time to time. The facility agreement and security documentation will include a cross-guarantee structure and security arrangements and will allow for additional guarantors to accede and additional security to be taken.

2.2 **Term Loan Facilities:** Typically, the Senior Borrower is allowed a short period after executing the loan (the "certain funds" or "availability" or "commitment" period), during which time it can draw loans up to a specified maximum facility limit in order to complete the acquisition of a leveraged buy-out, refinance existing debt and meet certain costs through a number of term facilities (usually A, B and C facilities). A further initial D facility is sometimes included to permit term drawings for defined capital expenditure, restructuring or supplementary acquisitions. Repayment may be in instalments ("amortising") for the A, and, if applicable, D facilities while the B and C facilities usually have "bullet" repayment terms. Once a term loan has been repaid by the Senior Borrower, it cannot be re-drawn.

2.3 **Revolving Loan Facility**: A revolving loan facility provides the Senior Borrower with a maximum aggregate amount of funds, available (over a specified period of time) to meet the general working capital needs of operational companies within the acquisition group. The revolving loan facility allows the Senior Borrower to draw down, repay and re-draw loans advanced to it, as well as to request the issue of letters of credit, during the term of the facility, subject to the available commitments and to remaining in compliance with agreed financial covenants and undertakings. Furthermore, a revolving loan facility for a leveraged transaction will often require a "clean down period" for a certain number of days each year, during which time the revolving loan facility must not be drawn or alternatively is required to be reduced to a pre-agreed level.

A revolving loan facility for a leveraged finance transaction often incorporates different types of financial accommodation within it called the "Ancillary Facilities" - for example an overdraft facility; a guarantee, bonding, documentary or stand-by letter of credit facility; a short term loan facility; a derivatives facility; or a foreign exchange facility - provided on a bilateral basis by a Lender in place of all or part of that Lender's unutilised revolving facility commitment.

3. PARTIES TO A SENIOR SYNDICATED LEVERAGED FACILITY

The syndication process is initiated by the Sponsor (the provider of private equity) seeking to make the leveraged acquisition on behalf of a group of Investors. The Sponsor on behalf of the Senior Borrower appoints a senior lender through the grant of a mandate to act as the *Arranger* (also often called a *Mandated Lead Arranger)* on the deal for the Senior Facilities. There is often more than one Arranger on any transaction but for the purposes of this note we will refer to this role in the singular. The leveraged buy out will also incorporate syndication arrangements for various types of subordinated debt such as 2nd lien, mezzanine or high yield bonds or notes, however this paper is not intended to provide a description of these subordinated product groups.

The Arranger is responsible for advising the Senior Borrower as to the type of facilities it requires and then negotiating the terms of those facilities. The Arranger is also responsible for syndicating the senior facilities to a wider group of senior lenders. The Arranger will be a lender and is likely to have an established relationship with the Sponsor, although this is not always the case.

Syndication is often done in stages, with an initial group of lenders providing a share of the facility in order to fund the senior element of the buy-out, refinancing of existing debt in the target group, fees and expenses and for working capital requirements. This group of lenders is often referred to as *Underwriters or Co-Arrangers,* although other titles may be used - however, we shall continue to refer to this group of lenders as Co-Arrangers for the purposes of this note. The Bookrunner (the Arranger which manages the process of inviting other institutions) then finds more lenders (usually post completion of the acquisition) to participate in the facility, who agree to take a share of the Arranger and Co-Arrangers' commitment.

In leveraged transactions institutional investors often invest in a percentage of the B and C facilities, as these facilities are particularly favoured by such institutions for their bullet repayment characteristics and higher yielding interest margins compared to the amortising and slightly lower yielding A tranche.

To facilitate the process of administering the facilities on a daily basis, one bank from the syndicate is appointed as *Facility Agent*. The Facility Agent acts as the agent of the lenders, not of the Senior Borrower, and has a number of important functions (as explained in the Guide to Syndicated Loans).

The leveraged syndicated facility documentation includes security and a lender from the syndicate is appointed to act as *Security Agent* to hold the security for the benefit of all the lenders. The duties imposed upon the Security Trustee are typically more extensive than those of a Facility Agent.

Typically some decision making power is delegated to the majority (or a super-majority) of the lenders from time to time (often referred to as the 'majority or super-majority lenders' or 'instructing or super-instructing group'). This group usually consists of members of the syndicate at the relevant time who hold a specified percentage (typically two-thirds by commitment) of the total commitments under the facility. Super-majority voting might be included into an agreement where a higher hurdle percentage of approvals is deemed appropriate for particularly contentious issues such as for proposed changes in the security structure.

4. **DOCUMENTATION FOR A SYNDICATED LEVERAGED FINANCE AGREEMENT**

4.1 **Mandate Letter**: The Senior Borrower appoints the Arranger via a Mandate Letter (sometimes called a Commitment Letter) usually to "underwrite" the required facility. The provisions commonly covered in a Mandate Letter include:

(i) an agreement to "underwrite";

(ii) appointment of the arranger, underwriter, bookrunner, facility agent, security agent, commitment amounts, exclusivity provisions for senior debt;

(iii) conditions to lenders' obligations;

(iv) syndication issues (including preparation of an information memorandum, presentations to potential lenders, clear market provisions, market flex provisions and syndication strategy); and

(v) costs cover and indemnity clauses.

4.2 **Term Sheet**: The Mandate Letter will be signed by the Senior Borrower and the Arranger/Co-Arrangers with a Term Sheet attached to it. The Term Sheet is used to set out the terms of the proposed financing prior to full documentation. It sets out the parties involved, their expected roles and the main commercial terms (for example, the type of facilities, the facility amounts, the pricing, the term of the loans, the security and guarantee structures to be provided and the covenant package that will be put in place).

4.3 **Information Memorandum**: Typically prepared by the Arranger with the assistance of the Sponsor and sent out by the Arranger (following approval by the Sponsor) to potential syndicate members. The Sponsor assists the Arranger in writing the information memorandum on the basis of information provided by the Sponsor during the due diligence process. It contains a commercial description of the Senior Borrower's business, management and accounts, as well as the details of the proposed loan facilities.

Where a leveraged transaction includes the issuance of public securities (such as a high yield bond) then it is typical for the Arranger and Sponsor to prepare two different Information Memoranda. One will be a public document incorporating only information which is available in the public domain and which will be used by potential lenders who also want to be able to freely trade in the public securities. The other will be a private document, to receive which, potential lenders seeking more detailed information, including due diligence reports, will be required to sign a confidentiality undertaking.

4.4 **Senior Syndicated Facility Agreement**: The Senior Facility Agreement sets out the detailed terms and conditions on which the Facilities are made available to the Senior Borrower. The Agreement incorporates many provisions including, where required, the obligation on senior lenders to provide "Certain Funds". This clause obliges the senior lenders to provide funding (unless a major event of default or major misrepresentation has occurred) to the Senior Borrower in order to complete the cash element of an acquisition. It is a precondition of the City Code on Takeovers and Mergers for the purchase of a public company in the UK that a buyer has certain funds (so as to protect accepting shareholders of the target company). The Certain Funds period is time limited (typically 4 to 6 months from date of the facility agreement).

The Senior Borrower generally has the ability to rectify minor or technical breaches of the representations, undertakings or events of default caused exclusively by the Target Group within a defined period from the closing of the acquisition. This is known as the "Clean-Up Period". The rectification rights are further subject to the Senior Borrower having the capability of remedying and reasonable steps being taken to remedy the breach; the circumstances giving rise to the breach not having been procured by or approved by the Senior Borrower and the breach not being reasonably likely to have a Material Adverse Effect.

The guarantee structure is usually incorporated within the Facility Agreement and will require that, subject to any legal restrictions, up-stream and cross-guarantees from the Senior Borrower and certain subsidiaries ("Obligors"), equal to at least a certain proportion of the assets, income and/or operating cashflow of the Senior Borrower and its subsidiaries, are provided to the Senior Lenders. Subject to any legal restrictions on giving guarantees, the up-stream and cross-guarantees provide Senior Lenders with the ability to call upon (after an event of default) the assets and cashflow generation of the major operating companies of the group.

4.5 **Transaction Security Documents**: Any document entered into by any Obligor creating or expressed to create any Security over all or any part of its assets in respect of the obligations of any of the Obligors under any of the Finance Documents or the Mezzanine Finance Documents.

The security is held by a Security Trustee on behalf of the Senior Lenders, the 2^{nd} Lien lenders, the mezzanine lenders and the hedge counterparties and is usually documented in the form of a debenture. The security trustee provisions are typically contained in an intercreditor agreement between (amongst others) the senior lenders, 2^{nd} Lien lenders, mezzanine lenders and hedge counterparties.

4.6 **Intercreditor Agreement**: The Intercreditor Agreement (also sometimes known as the subordination or priority deed) is a document which contractually provides that the senior bank debt and the security ranks in priority to the 2^{nd} Lien and other subordinated debt as well as to the shareholder debt.

4.7 **Structural Intra-Group Loan Agreement**: This agreement contains Topco and its subsidiaries' structural shareholder debt subscription mechanics, rights, obligations and restrictions.

4.8 **2nd Lien and/or Mezzanine Facility Agreement**: These agreements set out the detailed terms and conditions on which the subordinated facilities are made available to certain companies within the acquisition group.

4.9 **Hedging Letter:** The Senior Borrower will be required to confirm in a letter to the Arranger that interest rate hedging will be obtained (within a certain period of time after completion of the acquisition) for a pre-determined percentage of the funded debt and for a pre-determined period of time in order to create a greater degree of certainty over the funding costs.

4.10 **Fee Letters**: In addition to paying interest on the Loans and any related bank expenses, the Senior Borrower must pay fees to those banks in the syndicate which have performed additional work or taken on greater responsibility in the loan process, primarily the Arranger, the Facility Agent and the Security Trustee. Details of these fees are usually put in separate side letters to ensure confidentiality. The Senior Facility Agreement should refer to the Fee Letters and when such fees are payable to ensure that any non-payment by the Senior Borrower carries the remedies of default set out in the Senior Facility Agreement.

4.11 **Other Documents**: A complex web of documents is created when a leveraged buy-out occurs and it would not be practical to explain every document in a briefing paper such as this. In brief, some of the other transaction and financing documents include: the acquisition documents and contracts with the vendors; subscription and shareholders/investment agreement; articles of association of topco; warrant instrument; insurance letter; group structure chart; budget and funds flow statement; auditors' report; various legal opinions.

5. FINANCIAL COVENANTS

Control of cash is vitally important in leveraged transactions and various clauses in the senior syndicated facility agreement provide lenders with protection:

(i) Mandatory prepayment clause determines how net proceeds from claims under the acquisition documents, sale proceeds, insurance proceeds or excess cashflow (an agreed percentage of the annual net operational cashflow after debt servicing and investing activities) are allocated.

(ii) Financial covenants seek to create trigger points which, if one or more is breached, give lenders the opportunity to take remedial action (including accelerating the senior debt and/or enforcing the security) against the Senior Borrower. Financial covenants typically included in the agreement are detailed below:

(a) Cash cover (a ratio which typically measures cash generated by the business to debt servicing obligations and capital expenditure requirements);

(b) Senior interest cover (measures senior interest cost against earnings before interest tax, depreciation and amortisation ("EBITDA"));

(c) Total interest cover;

(d) Senior debt cover (measures senior debt against EBITDA);

(e) Total debt cover;

(f) Minimum net worth;

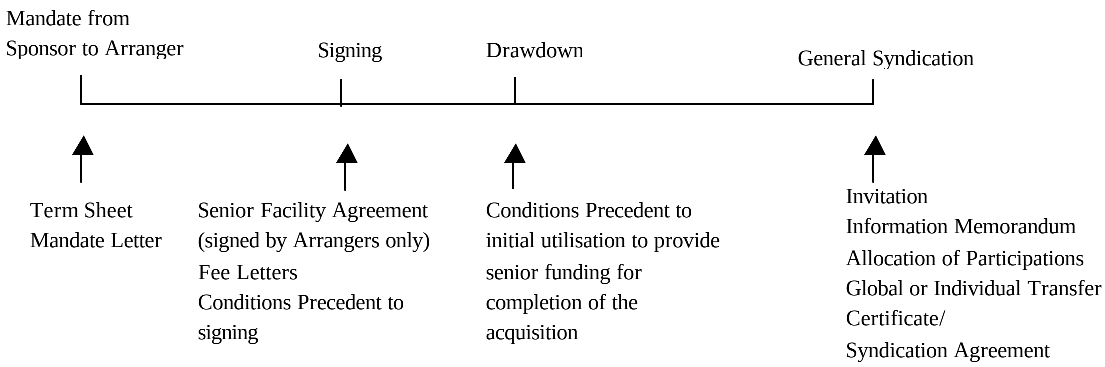
(g) Maximum annual capital expenditure limits.

6. **TIMING**

Leveraged finance transactions involve a high degree of due diligence by Vendors, Sponsors and potential lenders and therefore the time frame for this type of deal often extends over a number of months from inception to final allocation of the debt to a group of lenders.

In view of these extended time frames, as compared to primary investment grade transactions, leveraged documentation, predominantly, is signed by the Arrangers only (subject to certain conditions precedent to signing having been met). Further conditions precedents to the initial utilisation will be required to permit drawdown of the Facilities. These steps generally occur prior to the general syndication phase:

Typical Timetable of a Leveraged Finance Agreement



7. **SYNDICATED LEVERAGED FINANCE TRANSFERS**

Generally lenders joining at the general syndication phase will do so by way of novation, either through a global transfer certificate or through individual transfer certificates. In each case the Arranger and Co-Arrangers transfer a portion of their commitments to the new lenders using a similar process as that seen for a secondary transfer of commitments except no transfer fees are payable by the new lenders to the Facility Agent.

The LMA recommended form for the Senior Multicurrency Term and Revolving Facilities Agreement is drafted so as to permit secondary trading of senior debt to another bank or financial institution or to a trust, fund or other entity which is regularly engaged in or established for the purpose of making, purchasing or investing in loans, securities or other financial assets. Transferability is subject to documentation and to 'borrower consultation'. Furthermore if transfer of commitments under the Revolving Facility is sought, then, additionally, consent from the Issuing Bank (the bank which issues any Letters of Credit on behalf of the Revolving Facility lenders) is required. It should be noted that LMA recommended forms are non-binding and are intended to be a starting point for negotiation between lenders and borrowers and as such they are free to depart from these terms.

The basic forms of transfer are explained in the *"Guide to Syndicated Loans"* and will not be repeated in this paper.