KIRKLAND & ELLIS

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U.S. Liability Management Overview

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Market Overview and Types of Liability Management Transactions

Liability Management Overview

Increasingly, companies are pursuing out-of-court liability management transactions to address their capital structure goals.

- These transactions tend to be bespoke and require detailed legal and financial diligence to address the company's goals while adhering to restrictions in applicable debt documents. In all scenarios, compliance with governing debt documents is key to mitigating risk while deploying strategies and pursuing transactions.

Potential Capital Structure Goals

- Extend maturity runway
- Reduce cash debt service requirements (i.e., interest, amortization)
- Capture trading discount and deleverage
- Augment liquidity
- Relax financial covenants

Considerations

- Debt document flexibility/restrictions
- Stakeholder motivations and
- Cross-holder dynamics
- Tax
- Litigation risk / appetite
- Credit default swap dynamics
- Ratings Impact

Analysis of Key Debt Document Provisions

- Permitted Investments
- Permitted Debt / Liens
- Sale-Leaseback
- Asset Sales / Prepayments
- Pro Rata Sharing / Lien Subordination
- Unrestricted / Non-Guarantor Subsidiaries

Potential Liability Management Transactions

- Uptier Exchanges
- Drop-Down Exchanges
- Amend & Extends
- Discounted Debt Buybacks

Uptiering Exchanges

The most common type of uptiering exchange is when a company offers to exchange unsecured bonds for a lower principal amount of secured bonds that are either pari passu with or subordinated to the company's existing secured debt (*i.e.*, "1.5 lien" or second lien).

- More generally, an uptier exchange can be any transaction in which a debtholder betters their position, either by (i) gaining liens on collateral or improving their position with respect to such collateral (*i.e.*, moving from second to first lien) or (ii) improves their payment priority.

ILLUSTRATIVE UPTIERING EXCHANGE

1. **Company exchanges $600mm of Unsecured Notes for $400mm of New Second Lien Notes (66.67% offer price)**
   - Exchange at discount to par provides $200mm of deleveraging
   - Exchange typically conducted at a premium to market prices
2. **Participating Unsecured Noteholders receive improved position by gaining second lien on collateral in exchange for discount capture provided to company / residual stakeholders**
   - Creditors de-risk downside exposure while capping upside
   - Participating noteholders improve position relative to non-participating noteholders

Capital Structure

	FACE VALUE	ADJ.	PF VALUE	CURRENT LEVERAGE	PF LEVERAGE
ABL Facility	$ —	$ —	$ —	0.0x	0.0x
Term Loan	1,200	—	1,200	6.0x	6.0x
New Second Lien Notes	—	1 400	400	0.0x	2.0x
Total Secured Debt	**$1,200**	**$400**	**$1,600**	**6.0x**	2 **8.0x**
Unsecured Notes	1,000	(600)	400	5.0x	2.0x
Total Debt	**$2,200**	**($200)**	**$2,000**	**11.0x**	**10.0x**

Discount to company / residual stakeholders

Memo: Illustrative LTM EBITDA of $200 million

BENEFITS / CONSIDERATIONS

Benefits to Borrowers

- **Delevers through discount capture**
- **Can be used to address maturities, reduce cash interest expense, relax covenants, etc.**
- **Can provide liquidity injection to company by requiring exchange participants to also provide new money (*i.e.*, a "pay-to-play" exchange)**
- **Exit consents to strip covenants can be used to incentivize participation**
- **Not the "last" transaction**
  - Thoughtful structuring can create opportunities for future exchange transactions

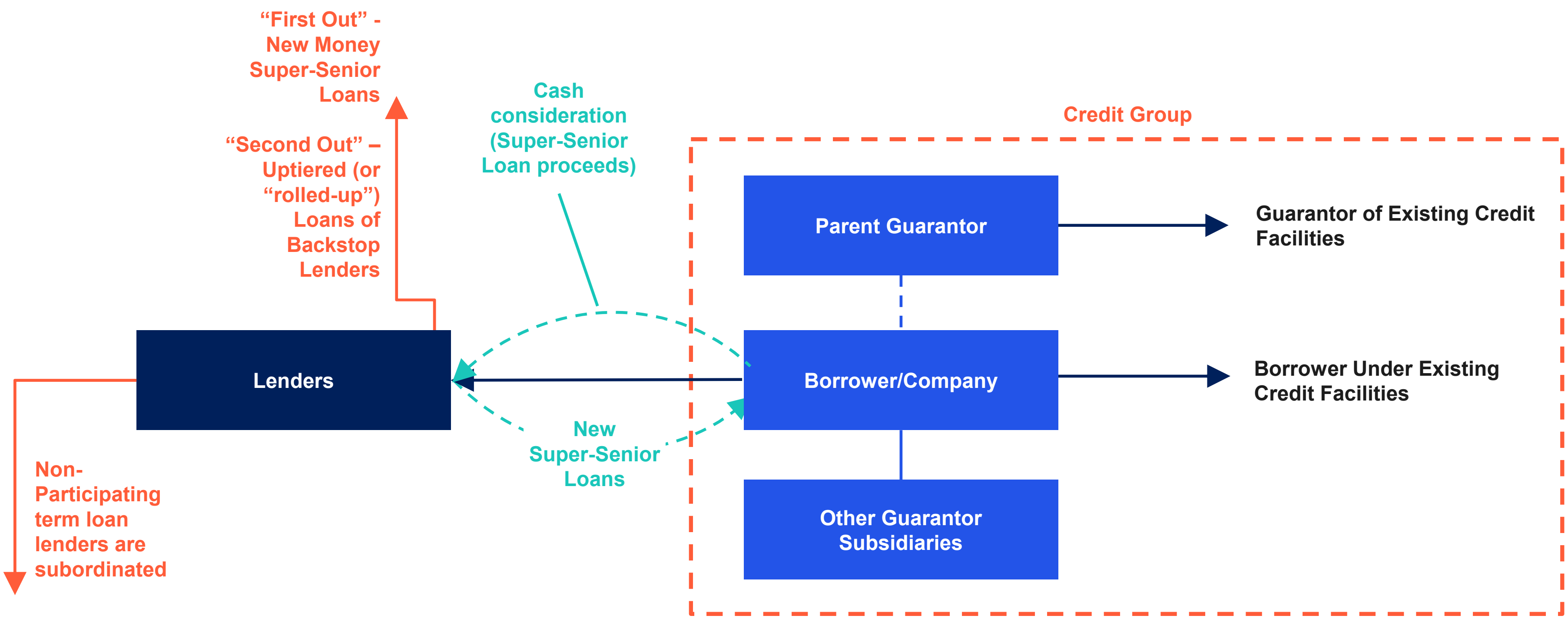
Considerations

- **Often requires scarcity value to incentivize participation**
  - At conflict with hold-out problem; limits uptier exchanges ability to provide for a comprehensive capital structure solution
- **Can give rise to substantial cancellation of debt income**
- **Agents (particularly commercial banks) may not be willing to participate and will need to be replaced**
- **Maintaining Confidentiality and avoiding the "Serta Mistake"**

The "New" Way – Uptiers in Credit Agreements

Illustrative Loan Buyback with Exit Consent

- This creates up-tier opportunity in first lien only capital structures where none existed previously. Here's how it works:
  - Certain lenders (the "Backstop Lenders") constituting a majority under the Loan Agreement (or new lenders acquiring term loans in contemplation of this transaction) agree to provide a new loan that will rank senior in lien and/or payment priority to the existing loans (the "Super-Senior Loans").
  - The Backstop Lenders utilize the open market purchase provisions to uptier, sometimes at par, their existing loans into the facility evidencing the Super-Senior Loans.
- Prior to consummating the open market purchase, the Backstop Lenders also amend the existing Loan Agreement to (i) permit the incurrence and senior priority of the Super-Senior Loans, (ii) direct the agent to enter into an intercreditor agreement and (iii) strip covenants (similar to an exit consent in the bond context) leaving the non-consenting lenders with subordinated loans without covenant protections.
- These transactions only require majority consent under the Loan Agreement on its plan terms and subordinate all non-consenting lenders and strip their covenant protections.



* Note, the old loans are purchased by the Borrower with the new "second out" loans. This can be done on a cashless basis.

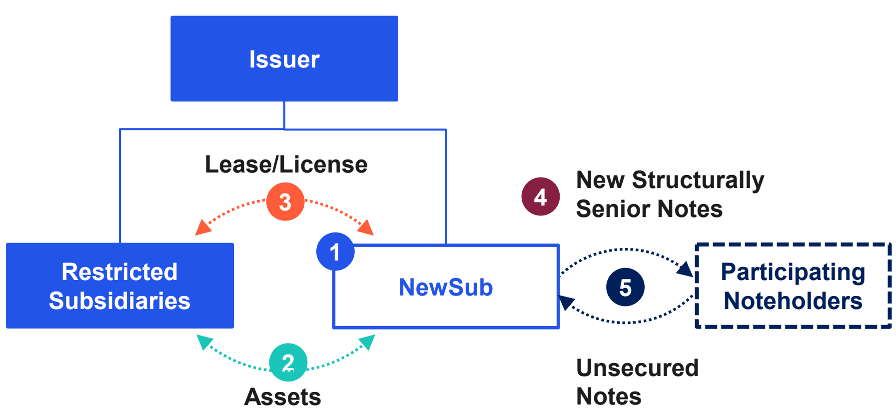
“Drop-Down” Exchanges

In a “drop-down” exchange, a company places certain assets into an unrestricted subsidiary or designates a restricted subsidiary as unrestricted, and then uses such assets as negotiating leverage or collateral for new financing or new debt securities which are offered in an exchange.

- Unrestricted subsidiaries are not subject to debt document covenants, including debt incurrence and lien restrictions.

ILLUSTRATIVE “DROP-DOWN” EXCHANGE

1. **Form an unrestricted subsidiary (“NewSub”)**
   - Unrestricted subsidiaries are not subject to covenants under debt documents
2. **Company contributes assets to the NewSub**
   - Requires Permitted Investments and/or Asset Sale basket capacity
3. **Company enters into intercompany agreements (*e.g.*, leases, licenses) so that the transferred assets can be utilized by the Restricted Subsidiaries**
4. **NewSub issues and guarantees new debt, the “New Structurally Senior Notes”**
   - Notes have structural seniority with respect to the assets in NewSub
5. **The Company exchanges current debt for the New Structurally Senior Notes, at a discount**



BENEFITS / CONSIDERATIONS

Benefits to Borrowers

- **Delevers through discount capture**
- **Can be used to address maturities, reduce interest expense, relax covenants, etc.**
- **In certain situations, noteholder appetite may be even greater than a secured debt exchange**
  - If secured debt is trading below par, structural seniority to the transferred assets is often viewed more favorably
  - Appetite will be materially influenced by the type of assets contributed to the Unrestricted Subsidiary
- **Exit consents to strip covenants can be used to incentivize participation**

Considerations

- **Should be structured to mitigate fraudulent conveyance and fiduciary duty challenges by creditors**
- **Gives rise to substantial cancellation of debt income**
- **Unconventional structure may invite litigation from creditors**
- **Practical difficulty in identifying assets that could be contributed to the Unrestricted Subsidiary**
- **Ability to obtain and/or evidence lien releases by agent**
- **Impact on underlying business**

“Amend & Extend” Transactions

An Amend & Extend (“A&E”) transaction provides companies with a maturity extension in exchange for certain credit enhancements.

- A variety of “carrots” and “sticks” can be used to incentivize holders to participate in the transaction and reduce the risk of “holdouts.”
  - Key “carrots” can include improved rate, enhanced covenants, par paydown, and greater collateral coverage.
  - Key “sticks” include exit consents provided by transaction participants to subordinate liens and strip covenants.

BENEFITS TO BORROWERS

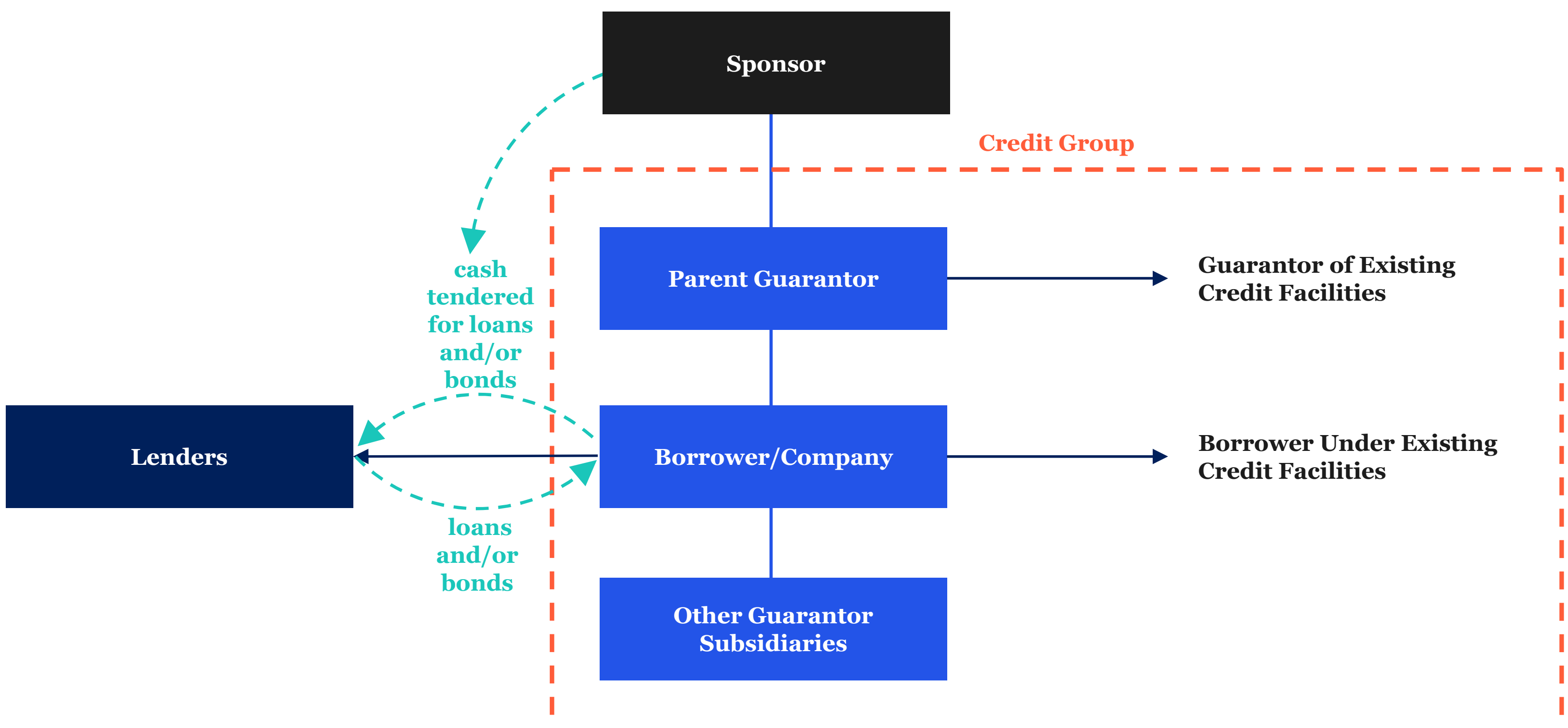
- Provides management time to execute on its business plan and “grow” back into its capital structure
- Generally cheaper form of capital relative to raising new primary issuance
- Not mutually exclusive from other exchange alternatives that a company may need to pursue
  - A&E transactions, via amendments to more restrictive senior debt, can provide for additional flexibility in crafting exchanges targeting junior creditors

CONSIDERATIONS

- Fees and enhanced rate detrimental to liquidity over time
- May limit future flexibility to pursue other capital structure alternatives
- Often conducted at par as opposed to a discount to par
- In distressed scenarios, typically relies on operational turnaround rather than comprehensive capital structure solution

Discounted Debt Repurchases

- The Company (or a Subsidiary) would repurchase existing loans and/or bonds at discounted prices, including through (1) open market purchases and/or (2) Dutch Auctions. Bonds may also be purchased in privately negotiated transactions or tender offers.
- The repurchased loans and/or bonds will be cancelled if purchased by the Parent Guarantor, Borrower, or any Restricted Subsidiary.
- This transaction does not require consent from lenders or bondholders other than those selling.
- **Alternatively, the Sponsor could acquire loans and/or bonds in the secondary market and either hold them to use as currency in a future liability management transaction or resell them later at a profit.**



Recent Liability Management Transactions in the Market

Lycra Case Study

Lycra Case Study

1 Existing Indenture

Lycra had a single secured indenture (the "Existing Indenture") that had two different note issuances issued under it: (1) a €250mm senior secured note issuance maturing in May 2023 (the "2023 SSNs") and (2) a $705mm senior secured note issuance maturing in May 2025 ("2025 SSNs")

2 Negotiating with Noteholders

After a failed regular way refinancing transaction, Lycra entered into negotiations with two separate ad hoc groups of noteholders regarding an amend and extend transaction, with a majority group (the "Majority AHG") holding ~55% of the 2023 SSNs and a minority group (the "Minority AHG") holding ~40% of the 2023 SSNs

3 Securing Financing

After Lycra and the Majority AHG failed to reach agreement on the terms of a transaction, Lycra successfully negotiated a financing with the Minority AHG pursuant to which:

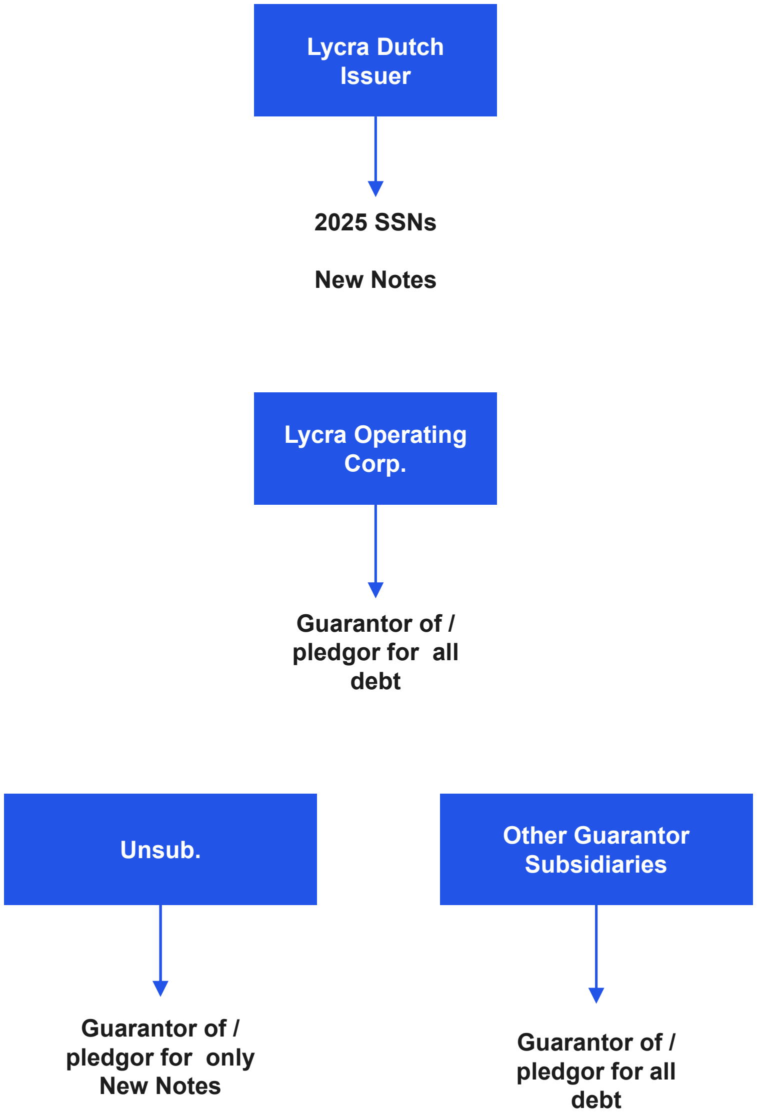
- The Majority AHG agreed to exchange their existing 2023 SSNs for newly-issued pari senior secured notes maturing in 2025 (the "New Notes")
- The Majority AHG and certain other investors agreed to purchase additional New Notes in sufficient amount (along with Company balance sheet cash and the upsizing of an existing super senior term loan) to permit the Company to use the proceeds to redeem the remaining 2023 SSNs at par at maturity

4 Post-Closing IP Dropdown

To incentivize participation in the transaction, the Company further agreed to use commercially reasonable efforts on a post-closing basis to contribute up to $75mm of identified intellectual property to a newly-formed unrestricted subsidiary (the "Unsub")

- Upon the contribution of this intellectual property to the Unsub, the liens encumbering this intellectual property will be released under the Existing Indenture and the New Notes
- Immediately after the release, the Unsub will enter into a new separate guarantee and security agreement solely in favor of the New Notes, resulting in the New Notes having this exclusive collateral
- In the event that the follow-on Unsub transaction is not timely consummated after closing, the Company will suffer certain financial penalties in favor of the holders of the New Notes

Lycra Transaction Structure (Post-Closing Unsub)



> "The 'Lycra variant' of the drop-down is relatively novel, and is something for both creditors and issuers to think more about going forward.
>
> In the typical drop-down it would probably be hard to raise enough debt to refinance a significant amount of debt because the company is only able to provide the new debt with limited security and guarantees (limited to however many assets you managed to get outside the group). But because in Lycra's case the new debt gets the same benefits as the existing, plus some, they were likely able to raise significantly more than they would have otherwise."
>
> — 9fin, May 2023

> "An innovative funding structure … that enabled a refi and denied [certain non-participating investors] from taking the keys."
>
> — Debtwire, May 2023

At Home Case Study

At Home Case Study

COMPANY OVERVIEW

- At Home (or the "Company") is a leading operator of home décor superstores, with 262 locations in 40 states, offering up to 45,000 on-trend home products, including furniture, mirrors, rugs, art and housewares, tabletop, patio and seasonal décor
- The Company was acquired by private equity firm Hellman & Friedman ("H&F") in a take-private transaction that valued the Company at approximately $2.8 billion in July 2021

SITUATION OVERVIEW

- In May 2023, At Home completed a $200mm new money raise and $447mm Senior Notes exchange with the support of 89% of its Senior Noteholders
- Key Benefits:
    - Temporary conversion of cash interest to PIK on exchanging Senior Notes, enhancing liquidity
    - $47 million of discount capture
    - New money cost of capital inside the yield on existing secured debt through the Double Dip structure
    - Rapid execution (7 weeks from NDA execution to closing) in turbulent retail capital markets

DOCUMENT LEVERS USED

Private uptier exchanges

Pari debt capacity

"Double Dip" secured debt

At Home Case Study – Double Dip Structure Overview

To minimize the cost of capital on the $200 million New Money raise, the Company structured a "Double Dip" Senior Secured Note

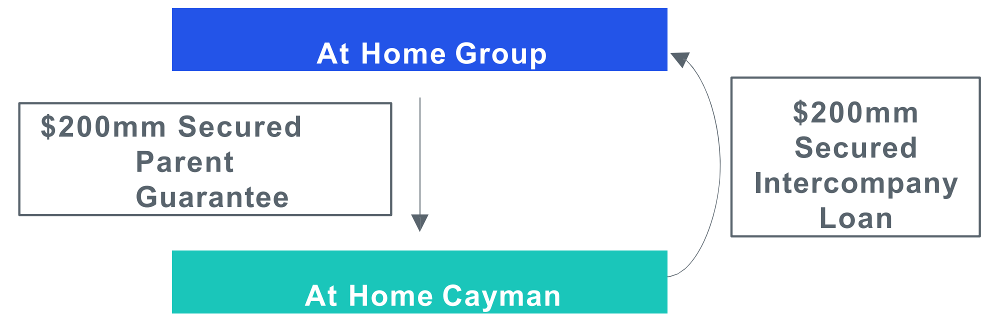
- The Double Dip Notes were issued by At Home Cayman, a non- guarantor restricted subsidiary of At Home Group
- At Home Cayman then on-lent the new money proceeds to the borrowers and guarantors with respect to the Company's existing first lien indebtedness on a first lien basis
- The Double Dip Notes benefitted from two parent claims
    - $200mm Secured Intercompany Loan from At Home Cayman to At Home Group
    - $200mm Pari Secured guarantee from At Home Group

Concurrently with the new money raise, the Company also exchanged approximately $447 million of its existing 7.125% Senior Notes due 2029 into approximately $413 million of new 7.125%/8.625% Cash/PIK toggle Senior Secured Notes due 2028 (the "Exchange Notes")

- The Exchange Notes rank pari passu with the Company's existing first lien indebtedness
- Exchange consummated at 10% discount to par
- PIK toggle on Exchange Notes results in significant liquidity enhancement

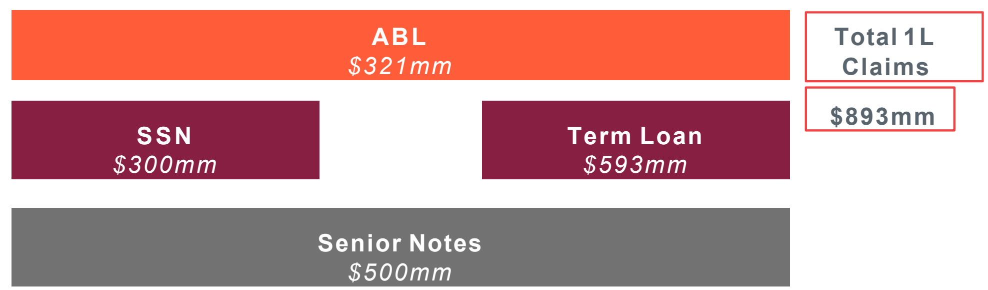
Double Dip Notes priced to a ~13% yield, significantly tighter than the Senior Secured Notes after the transaction was announced

POST-TRANSACTION SIMPLIFIED ORG STRUCTURE

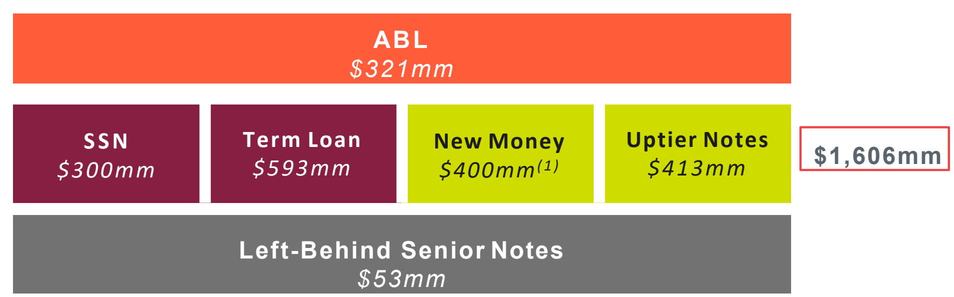


WATERFALL

PRE-TRANSACTION



POST-TRANSACTION



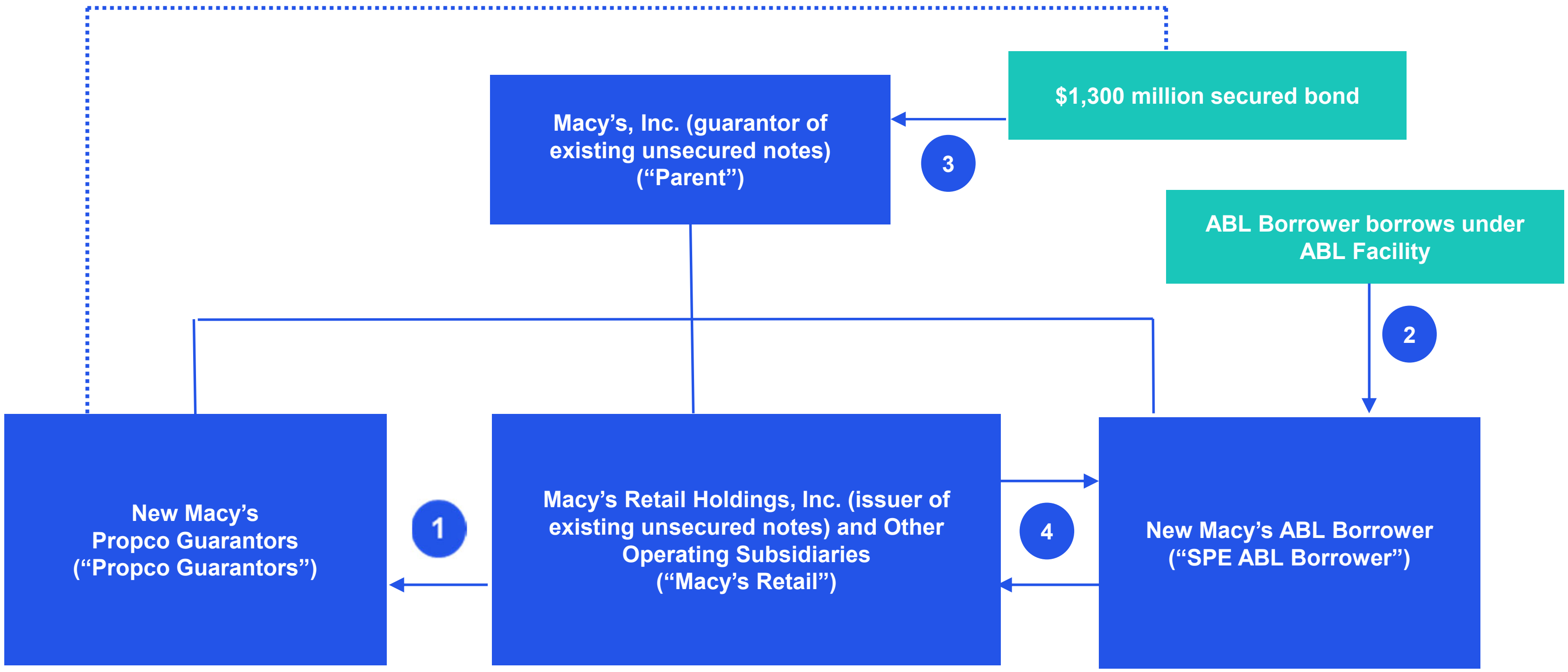
(1) $400mm maximum claim size, maximum recovery of $200mm.

Macy's Case Study

Macy's Case Study

- **Response to COVID-19 Pandemic and Liquidity Needs**
  - Due to the effects of COVID-19, Macy's decided to seek additional liquidity in spring of 2020.
  - To do so, the company needed to navigate restrictions within its existing indentures and preserve flexibility for additional secured financing.
- **ABL Financing**
  - Due to restrictions in the company's existing indentures on creating liens on inventory, Macy's sold all of its owned inventory to a new special purpose entity serving as the borrower under a new asset-based revolving facility (the "SPE ABL Borrower"). Going forward the SPE ABL Borrower will be the purchaser and owner of all Macy's inventory, which it will then consign to the Macy's operating companies for sale to customers.
  - The asset-based revolving facility is secured by inventory and accounts receivables. The SPE ABL Borrower and its holding company parent are the only security providers on the asset-based revolving facility.
  - We believe this is the first asset-based loan structured in this manner.
- **Secured Real Estate Financing**
  - Macy's transferred certain real estate assets to new real estate SPVs which are not restricted by the company's existing indentures.
  - This real estate was used as collateral for a new issuance of secured notes.
  - The use of this real estate collateral allowed the company to obtain favorable financing terms, not available under more traditional structures, including a shorter "make-whole call" period and limited restrictive covenants on the rest of the Macy's group, giving Macy's significant flexibility to operate its business and to refinance the notes without significant breakage costs.

Macy's Case Study



1. Macy's Retail moved real estate assets into Propco Guarantors.
2. SPE ABL Borrower will draw under new ABL Facility, to be secured by inventory and accounts receivables.
3. Parent issues new bonds, secured by the real estate assets of the Propco Guarantors.
4. SPE ABL Borrower purchases inventory from Macy's Retail, which inventory will serve as collateral for ABL Facility and will be consigned back to Macy's Retail for sale to customers.

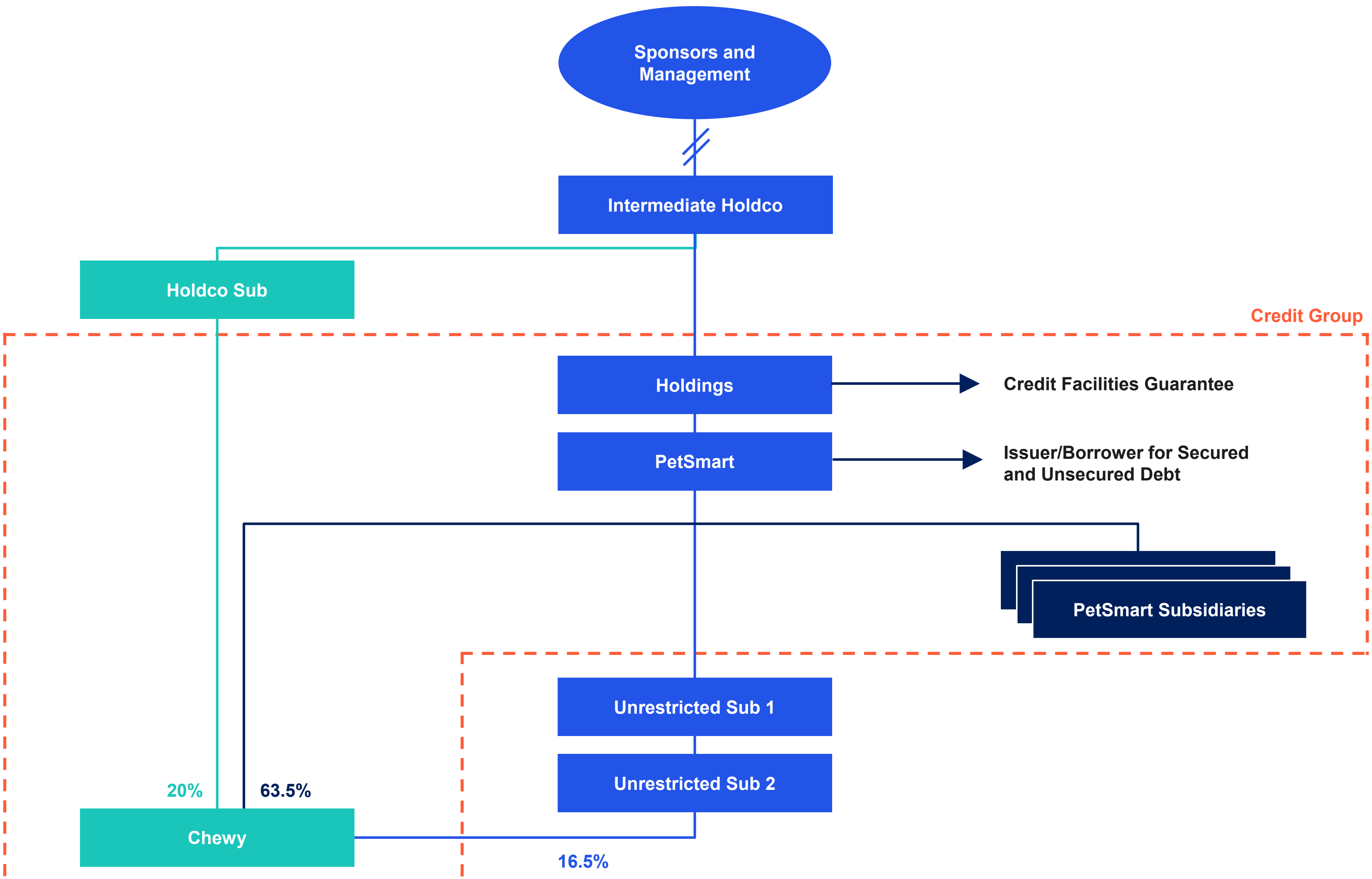
PetSmart Case Study

PetSmart / Chewy Case Study

Overview

- In June 2018, PetSmart declared and paid a dividend in the form of 20% of the common stock of its online retailer ("Chewy") to its parent company. Separately, PetSmart invested 16.5% of the common stock of Chewy in the form of a capital contribution to a wholly-owned new unrestricted subsidiary of PetSmart.
- The transactions were each approved by special committees of disinterested directors of PetSmart and Holdings, as applicable, each of which was advised by its own legal and financial advisors.
- As a result of these transactions, Chewy was no longer a wholly-owned subsidiary of PetSmart and, accordingly, its guarantee of the obligations under the Term Loan was released. The release of Chewy's guarantee of the obligations under the Term Loan caused the guarantee of PetSmart's outstanding senior notes to be released.
- Chewy remained a restricted subsidiary under PetSmart's credit agreements and the indentures governing its outstanding senior notes and a guarantor of the obligations under its ABL Facility.
- These transactions provided PetSmart with additional flexibility to address its capital structure and evaluate potential strategic opportunities.

PetSmart / Chewy Case Study



PetSmart / Chewy Case Study

Aftermath of Liability Management

- The transactions did not come without scrutiny as they were subject to litigation after lenders alleged a fraudulent transfer. However, the dispute was settled in mid-April 2019 through a loan amendment that restricted lenders' rights to pursue further litigation.
- On April 29, 2019 Chewy filed a Form S-1 Registration Statement announcing an IPO of Class A common stock.
- On June 3, 2019, Chewy filed an amended S-1, disclosing that PetSmart will offer 36 million shares at an offering price expected to be between $17.00 and $19.00 per share.
  - PetSmart's proceeds of the Chewy IPO were slated for voluntarily prepayment of certain secured debt.
  - Chewy's proceeds of the IPO were slated for general corporate purposes.
- On June 13, 2019, Chewy announced that the initial public offering of its common stock would be $22.00 per share.
- On July 18, 2019, PetSmart announced a buyback of $205 million worth of its notes due 2025 at par funded entirely by the proceeds from the Chewy initial public offering.

Trends and Lessons Learned

Liability Management — Trends

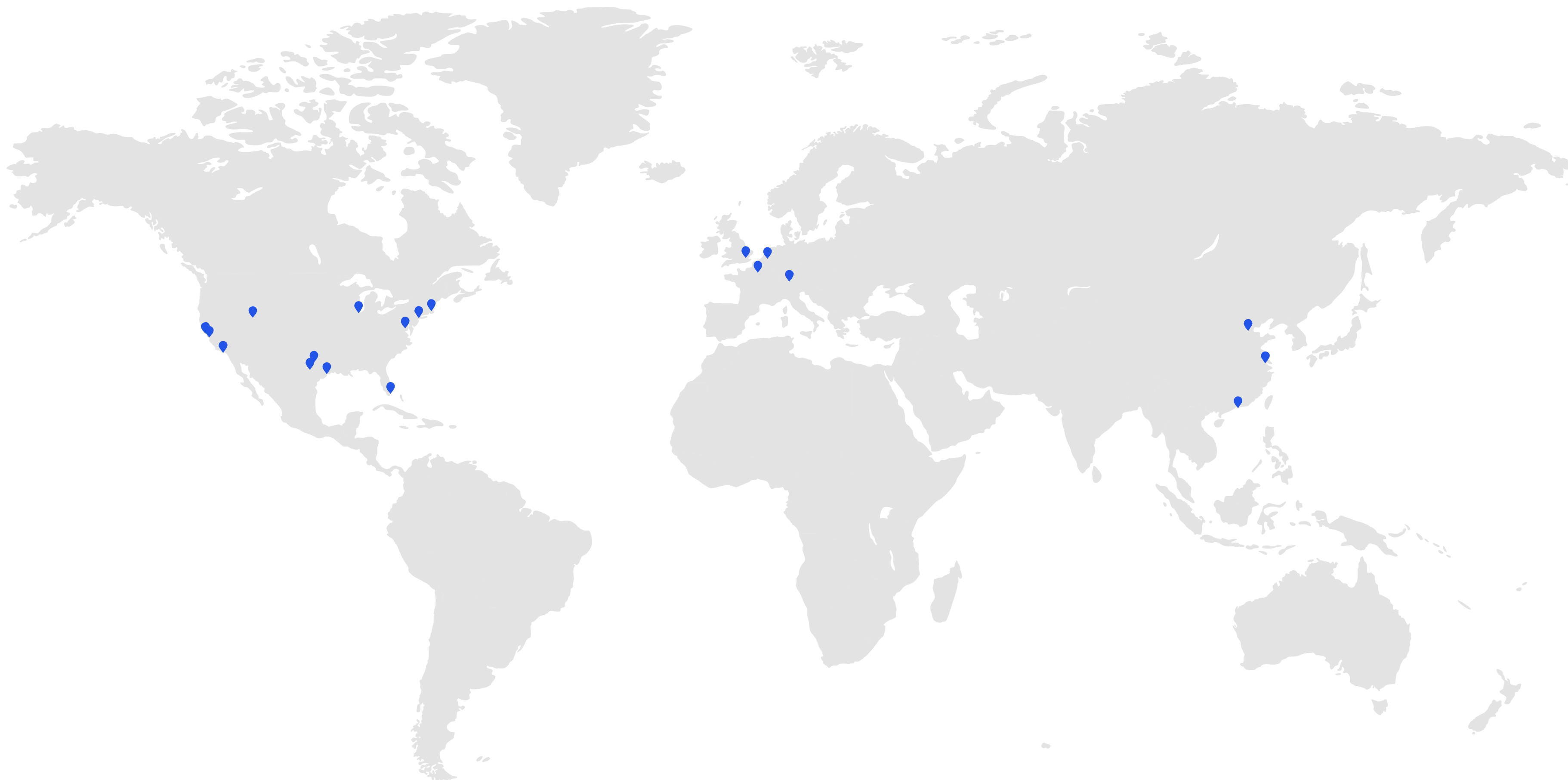
Normalization	▶ **Sponsors and public companies are more focused on liability management as a strategy than ever before** – Recent high profile transactions, including Envision, are bringing liability management techniques to the mainstream – Press coverage regarding liability management exercises increasingly focuses on the "creditor on creditor violence" angle and less on borrowers' aggressive tactics
Evolving Views	▶ **Credit agreements are being treated more like indentures** – Lenders are increasingly accepting that non-pro rata transactions are permitted under credit agreements
Creditor on Creditor Violence	▶ **Creditors are increasingly willing to cut side deals and leave similarly situated holders out of liability management transactions** – Trend towards non-pro rata transactions that benefit first movers – Lender cooperation agreements are weak and cannot be relied on – Side arrangements are often undisclosed and invisible from other participants
Thought Leadership	▶ **Creditors can play a meaningful role in shaping the direction of liability management transactions** – Creditors that participate in structuring are less likely to be left behind in non-pro rata transactions
Litigation	▶ **Litigation is a key part of the story** – Companies and creditors increasingly accept that litigation may be a cost of doing business in this context – Certain borrower strategies actually require litigation
Risk	▶ **Sponsors and public company boards have higher risk tolerance** – Less concern about reputational risk – Growing view that fiduciary duties may compel exploring liability management strategies

Liability Management — Lessons Learned

A number of important lessons can be learned from recent liability management transactions regarding debt documents, timing, creditor dynamics, and the effective structure of a proposal.

Debt Documents	▸ **Careful attention should be paid to how a company's debt documents treat the use of, *e.g.*, investment, restricted payment, and asset sale baskets, as such provisions may supply the company with attractive opportunities to maximize value for its stakeholders** – By proactively identifying and utilizing creative strategies unlocked by a company's debt documents, a company may be able to create value that can serve as consideration in a targeted exchange – Even if such baskets are not ultimately used, the identification of those baskets can be highly valuable, as an offer to "close a loophole" or otherwise tighten certain covenants has served as a material "carrot" for creditors in recent transactions (*e.g.*, Neiman Marcus)
Timing	▸ **Developing a comprehensive liability management "playbook" well in advance of any potential distress catalyst is critical to maximizing value, and companies that wait to understand their capital structure issues and formulate a game plan are often too late** – In certain instances, companies simply do not have the time—whether on account of constrained liquidity or impending debt maturities—to structure a comprehensive liability management transaction or secure rescue financing – In other instances, companies lose substantial investment or debt flexibility under their debt documents (through, *e.g.*, ratio covenant governors) that could have helped the company provide significant value to facilitate a transaction
Creditor Dynamics	▸ **Understanding the company's debtholders, and any potential cross-holdings and/or CDS exposure across a company's capital structure, is critical to being able to structure and propose an executable transaction** – Creditors who are sellers of CDS may be ready sources of new capital and/or may be willing to structure a deal on attractive terms to help facilitate a transaction that extends a company's runway ▸ **Extensive cross-holdings across a company's capital structure can work for or against a company, however, depending on whether the company is interested in pursuing a global or selective deal, respectively**
Deal Structure	▸ **Combining "carrots" and "sticks" with an aggressive timeline can help put pressure on counterparties to accept a deal they might have otherwise opposed** – Splitting creditor groups such that only creditors who consent to the transaction will receive the "carrots" offered in the deal, while those who oppose the transaction will risk the imposition of certain "sticks," can help drive high participation levels, especially under a compressed timeline – Typical "carrots" include a partial pay-down at par, increased interest rate or amortization, consent fees, and collateral, while "sticks" can include consent solicitation, layering, the stripping or subordination of liens

International Reach



Austin	Brussels	Houston	Munich	Shanghai
Bay Area	Chicago	London	New York	Washington, D.C.
Beijing	Dallas	Los Angeles	Paris	
Boston	Hong Kong	Miami	Salt Lake City	