Linklaters

An in-depth study into liability management transactions: Introduction to our webinar series and overview of market trends

April 2020

Our five part liability management webinar series – your questions answered

With the recent increase in liability management activity in Asia, we are pleased to present our five part webinar series which will aim to provide you with an in-depth study into liability management transactions. In this series, we will cover a range of topics including a number of commercial and legal questions frequently asked by bankers and issuers on liability management transactions – for example:

> Can we undertake a third party tender offer or exchange offer?

> How do we locate bondholders?

> Can we speak to bondholders prior to launch and undertake pre-sounding? What can and can't we say?

> Can the issuer continue to buy back bonds in the open market ahead of launch of a tender offer?

> When and why would an issuer want to undertake (a) a tender and exchange, (b) a tender and consent or (c) an exchange and consent?

> Can we secure "anchor" bondholder support ahead of launching a tender offer, exchange offer or consent solicitation?

> Can we exclude U.S. bondholders even where the existing bonds are cleared through DTC?

> What happens when a disgruntled bondholder challenges the tender offer, exchange offer or consent solicitation shortly after launch?

> What is the difference between an exchange offer and extending the maturity date of existing bonds?

> What happens if the issuer's financials will be published during the offer period?

Ranked No. 1 for Managers' Legal Counsel (*Debtwire 2019 APAC (ex-Japan) USD High Yield Bonds League Table*)

Ranked No. 1 for Issuer's Legal Counsel (*Bloomberg 2019 Asia (ex-Japan) Issuer G3 Currency Bonds League Table*)

Ranked No. 1 for Managers' Legal Counsel (*Bloomberg 2019 Asia (ex-Japan) Issuer G3 Currency Bonds League Table*)

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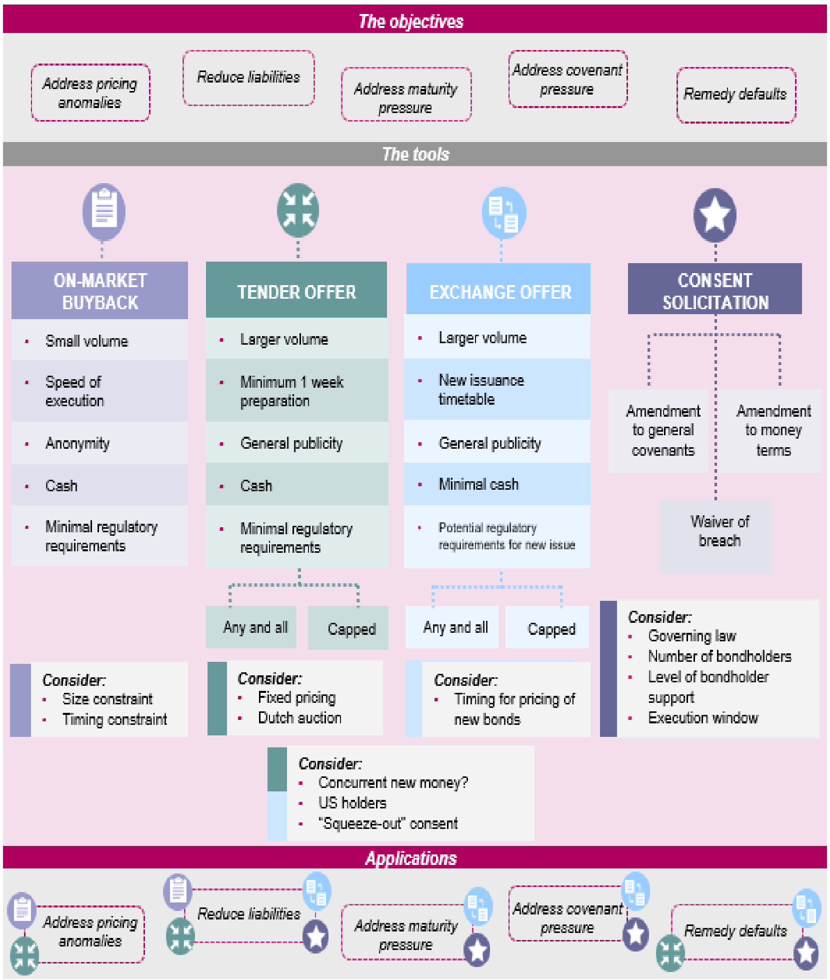
The road map below illustrates some of the key areas which we will be exploring over the next five weeks.



This client note is a follow-up to the first webinar that was held on 28 April 2020 for our debt capital markets clients.

We hope you find our webinar series and corresponding client notes useful. As always, we encourage you to get in touch with us and speak to your usual Linklaters' contacts if you have any questions.

Introduction

More than ever, liability management presents a hugely valuable tool for issuers – whether it be to optimise their balance sheets and capital structures, manage relationships with investors, react to new business and market developments, respond to changes in the regulatory landscape or other commercial and legal drivers, issuers should always be thinking of how they can more effectively recalibrate their balance of debt and equity. This is particularly pertinent given the significant volume and diversity of debt issuances across Mainland China, Hong Kong and other key Asian jurisdictions in the last few years and the uptick in market volatility in more recent times.

In this first note, we consider recent market trends in Mainland China, Hong Kong and other key Asian jurisdictions. We then provide an overview of the main types of liability management, focussing on some of the key pricing and other structural issues that often come up on transactions and which will be covered in more detail in our subsequent webinars. In this series, we have focussed primarily on liability management conducted outside of the United States although our fifth and final webinar and client note will examine U.S. issues on liability management transactions.

Recent market trends

The unprecedented turmoil in global financial markets since March has tipped the public bond markets in Asia to almost a halting point and resulted in significant pricing anomalies. Stronger credits have started to plan for, and some of these issuers have already executed, on-market buybacks and tender offers in order to take advantage of such pricing anomalies.

At the same time, a large number of issuers facing covenant and upcoming maturity pressures are considering tender offers, exchange offers and consent solicitation exercises in order to actively manage their debt exposure. Given the significant widening of spreads, many potential issuers have also had to consider managing some of their existing debt at the same time as they plan to bring new money deals to the market.

For Mainland Chinese issuers, two interesting trends have emerged in recent times. Firstly, intervention by the government or their proxies in the bond market has resulted in more cases of sister companies being involved as the offerors or sponsors of tender offers and exchange offers. Secondly, we are seeing increasing cases of bondholder activism for which many Asian issuers remain relatively unprepared.

In the restructuring space in Asia, we are seeing primarily two types of opportunities – first, borrowers who were expecting a 'just in time' refinancing solution and are now struggling to finalise those arrangements, and second, existing clients who were previously involved in a restructuring and are now finding it difficult to comply with their restructured obligations, particularly where the restructured facilities were based on expected cashflows that have since been negatively impacted by market conditions.

Restructuring opportunities may be particularly relevant for those companies with upcoming maturities, companies that are close to a refinancing date and are facing very high rates of interest in order to refinance and companies that are selling assets in order to make repayments. Companies in certain sectors are also more likely to come under stress such as the leisure and hospitality sectors, the natural resources sector, and more recently, the airline and retail sectors.

Main types of liability management

On-market buybacks

Issuers will often look to undertake an on-market buyback where they are aiming to retire a small amount of bonds discreetly from the open market. Such buybacks are frequently opportunistic, with the goal being to repurchase a relatively small amount at a low premium to secondary price levels, particularly to take advantage of pricing or market anomalies. The pricing and other terms of the on-market buyback will typically be privately negotiated between the issuer (often acting through a financial intermediary) and the seller.

A frequent area of focus for issuers is whether it is under any disclosure obligation either before or after the buyback. This will be considered in more detail in our next webinar and client note. As a general observation, an on-market buyback may not require public disclosure provided that (i) the amount of bonds repurchased does not exceed the prescribed threshold under the relevant stock exchange listing rules (for example, for SEHK: 10% and every subsequent 5% interval of the original issue size; and for SGX-ST: every 5% of the total principal amount, calculated based on the principal amount at the time of initial listing) and (ii) the buyback itself would not be considered price sensitive information under the relevant stock exchange's insider dealing (or other equivalent) rules.

Tender offers

A tender offer is an approach by an issuer to buy back some or all of its bonds for cash. How the tender offer will be structured will depend on the commercial objectives of the issuer – for example:

> whether the issuer is looking to repurchase as much as possible from the market versus a capped amount; and

> whether the issuer has a clear idea of the price it is willing to offer to investors versus asking investors to submit offer prices. The latter is used where the issuer is looking to repurchase a capped amount (as a dutch auction mechanism looks to create some price tension in the tender offer) and may be particularly useful where the secondary market price is relatively volatile or if the issuer is otherwise less willing to set a fixed price at the time of launch.

An additional structural consideration for issuers is whether to undertake a "synthetic" exchange by combining a tender offer with a new money issuance, thereby offering those who are coming out of the existing bonds with the option of either investing in new bonds or cashing out. It is also worth noting that some issuers have chosen to undertake accelerated tender offers outside of the clearing systems in limited circumstances, although there would be additional risks associated with such an exercise. All of these issues will be covered in further detail in our next webinar and client note.

Exchange offers

An exchange offer is an approach by an issuer to exchange its existing bonds for an issue of new bonds. In deciding whether to undertake an exchange offer or a tender offer, an issuer would consider various factors including:

> the amount of cash available;

> the additional time and cost associated with launching an exchange offer;

- the nature of the existing bonds and overall bondholder sentiment (for example, holders may generally want to stay in the credit, likewise a holder of a perpetual instrument may prefer being offered a new bond as opposed to receiving cash);
- where there is a concurrent new money issuance, an exchange offer can look to build the new issue to a benchmark size; and
- the nature of any regulatory approvals required (for example, registration with the National Development and Reform Commission in Mainland China).

Further analysis on these issues will be considered in webinar three and the corresponding client note.

Consent solicitations

A consent solicitation is an approach by an issuer to request the consent of bondholders to amend the terms and conditions of a series of bonds. It can take various forms such as a written consent, a bondholder meeting or, in the context of New York law governed bonds, a rolling consent. Generally speaking, the relevant threshold needed to pass a consent solicitation will depend on the nature of the amendment (for example, a simple majority for a general covenant amendment or waiver and a super majority for any amendment to "money" terms, though this will be subject to any specific requirements set out in the underlying bond documentation).

A consent solicitation would be appropriate where the issuer is keen to undertake an exercise that has the potential to bind the full principal amount outstanding of the series of bonds. In fact, a consent solicitation may be combined with an exchange offer or a tender offer if the intention is to sweep up all remaining outstanding bonds not repurchased or exchanged in the concurrent tender offer or exchange offer in order to achieve 100% take-up (commonly referred to as a "squeeze out"). Generally speaking under a squeeze out, a bondholder who accepts the tender offer or exchange offer is automatically deemed to vote in favour of an extraordinary resolution to amend the terms and conditions of the existing bonds to insert a new call option which would allow the issuer to redeem all the existing bonds. However in these cases, proper consideration should be given to ensure that the squeeze out is structured so as not to give rise to concerns around oppression against the minority or any other abuse of power by the majority, particularly in circumstances which would suggest that the majority were not acting bona fide for the benefit of the class of bondholders as a whole. We consider this, together with other frequent issues associated with consent solicitations, such as the trustee angle and the challenges of bondholder holdouts, in webinar four and the corresponding client note.

Restructurings

Where it is either not possible or not desirable in the particular circumstances to proceed with a liability management exercise, certain restructuring options may be available to an issuer. Liability management may not be the most appropriate way forward for an issuer for a number of reasons – for example (i) the issuer may not be able to obtain the required consent threshold in order to implement an amendment to its bonds which is necessary to avoid a default (ii) the issuer may be facing a technical or payment default under its bonds which could trigger a covenant default under its other facilities or (iii) the issuer may want to implement a "cram down" across its various levels of creditors.

There are three main options open to an issuer where it is looking to amend the terms of its bonds but cannot or does not want to achieve this via a liability management exercise. The first option is to implement a forebearance and standstill agreement which essentially aims to create a safe space for creditors and the issuer to have discussions to agree the terms of the restructuring whilst preserving the rights of each party. The second option is to implement a consensual deal via a scheme of arrangement, which is effectively an in-court process that effects a compromise of the issuer's debt. In a scheme of arrangement, provided that the requisite consent threshold is achieved, the dissenting creditors in each scheme will be bound by the scheme and their bonds or other debt will be amended per the terms of the scheme. The third option is a U.S. Chapter 11 process. This would typically only be used in Asia for large, troubled companies and presents a more intensive and therefore expensive legal process for issuers.

Stay tuned: 5 May 2020 - our next webinar session on tender offers and on-market buybacks

Do join us for our next session on tender offers and on-market buybacks where we will cover a range of topical issues including:

> disclosure obligations pre and post on-market buybacks and inside information concerns;

> different pricing mechanisms and other structural features of tender offers;

> tender offers combined with concurrent new money issuances; and

> accelerated buybacks conducted outside of the clearing systems.

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