TRAVERS SMITH

An Introduction to Stapled Financing

Pre-arranged acquisition finance in an illiquid market

What is it?

- In the context of funding the acquisition of a company, stapled financing refers to a financing package arranged by the seller and its financial advisers which is offered to potential purchasers, usually as part of an auction process. It is so-called because the proposed terms of the financing package are usually distributed with (or "stapled to") the information memorandum.
- During the boom years, when potential purchasers could utilise their own relationships and shop around to find better terms, stapled financing was rarely taken up. However, in more recent times where debt has been in short supply, purchasers have been far more likely to take advantage of a stapled debt package if offered and sellers have been keener to offer a stapled debt package to minimise execution risk for the prospective purchaser. Consequently, stapled financings are becoming increasingly common, especially on larger transactions.
- The stapled debt package itself will have been negotiated by the seller, its lawyers and financial advisers and can take different forms – from a two-page term sheet plus a reasonably advanced draft of the definitive facilities agreement to a long-form term sheet. Whatever the form of the stapled package, the banks will have been given access to the vendor due diligence and will be expected to have obtained the requisite credit approvals, subject to final documentation and potentially other caveats (such as the identity of the purchaser).

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Why have it?

- To maximise the sale price – the stapled debt package is available to all potential purchasers, which means that a potential bidder has access to debt which it may not otherwise have been able to raise. From the seller's perspective, the greater the number of fully-funded potential bidders, the greater the competition and therefore the higher the potential sale price.
- To facilitate a prompt sale – it should streamline the banking process if the potential purchasers are presented with a well-negotiated term sheet or facilities agreement, especially where they would otherwise have had to start from scratch with a club of several banks.

Process

- Where the stapled debt is being provided by a club of banks to multiple potential purchasers, the banks will be expected, at least in relation to senior debt, to "tree" (i.e. establish separate teams within the bank, each dedicated to finalising the terms of the debt package with a particular bidder and separated from all other competing teams by an information barrier). Separate trees may not, however, be practicable in relation to mezzanine debt where the mezzanine funds may not have sufficient personnel resources.

Issues for the Seller

- Whilst the overall package needs to be credible from both a commercial and legal perspective, the seller will primarily be concerned with issues which affect value and timing.
- Issues which go to credibility, value and/or timing are as follows:
  - Quantum – a greater quantum of debt could increase the price a purchaser is prepared to pay, which goes to value. If the amount of debt on offer is not enough, this goes to credibility and could affect timing.

- Pricing – goes to credibility and value.
- Other Key Commercial Issues – such as the operation of the margin ratchet, cash sweep and equity cure rights – go to credibility, value and timing.
- Certainty of Funds – if there is a split exchange and completion, the robustness of the financing is obviously key to the seller. In particular, a well-advised seller will expect its preferred bidder to have certainty of funds by the time the SPA is signed, with minimal "outs" for both the banks under the banking documents and the preferred bidder under the SPA. A seller should resist strongly any attempt by the banks to include any event or circumstance (for example, target group insolvency) as a ground for the banks to decline to fund which the seller would not accept as a condition to completion under the SPA. Any well-advised purchaser will insist upon symmetry between the terms of its financing and its obligations under the SPA.
- Conditions Precedent – goes to timing. Clearly, the more conditions precedent which can be pushed to become conditions subsequent – especially in a split exchange and completion scenario, where all CPs will need to be satisfied or in agreed form by signing in order to achieve certainty of funding – the shorter the delay between the final bid being accepted and signing.
- Key Legal Points – such as MAE definition, what constitutes a "continuing" event of default and the extent to which the representations and warranties, covenants and events of default have been deleted / qualified – these go to credibility and timing. Whilst the seller will ordinarily have no interest in the terms of the facilities post-completion, a well-advised purchaser will expect a sensible position to have been reached on these points if the documentation is presented as having been heavily-negotiated.
- Management Input – goes to credibility and timing. Management input on the documentation should be sought at the earliest opportunity.

- Issues which the seller will be less concerned about are as follows:
  - Equity / Acquisition Structure – this will vary from purchaser to purchaser and consequently should be left for the relevant purchaser to agree with the banks.
  - "Permitted" Items – whilst management input should be sought (and the usual carve-outs should be requested) in relation to the representations and general positive and negative undertakings found in the facilities agreement, different purchasers will have their own plans for the business going forward and will need to negotiate any bespoke permissions / carve-outs themselves.
  - Financial Covenants – whilst every effort should be made to try and agree the range of covenants and a sensible level of headroom and (where possible) advance the covenant definitions, ultimately the financial covenant ratios themselves (and, to some extent, the definitions) will be driven by the relevant purchaser's financial model.
  - Transferability – restrictions on transfers will almost certainly be a major issue for the banks. Different purchasers will have different requirements as to transfers (borrower's consent required; white-list or black-list of permitted / prohibited transferees; consultation with the borrower etc), and it is therefore best left to the individual purchaser to fight for its preferred formulation.

Issues for the Purchaser

- The purchasers are obviously not obliged to accept the stapled financing and are free to source their own bank funding. Indeed, where the financing is being provided by a club of several banks, many purchasers will view the commercial terms as representing the "lowest common denominator" (as, for example, the debt is likely to be priced at the lowest acceptable level for the most expensive funder) and will prefer to shop around to find a better deal.

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- However, a purchaser's ability to do so in recent times – particularly on larger deals where it may need to put together a syndicate of six or seven banks by signing – is likely to be very limited, particularly if the seller has prohibited potential purchasers from disclosing the vendor due diligence to any financiers other than the staple banks. A purchaser may instead choose to supplement the staple banks with one or more of its own relationship banks, which means it can afford to lose a bank – either because it drops out at the last minute or because it is "bounced" for refusing to concede key points. If all banks are then able to agree final documentation, each could participate on a scaled-back basis.
- If a purchaser plans to take advantage of the stapled financing on offer, it must decide what approach it is going to take to documentation – is it essentially going to accept the terms presented to it and only negotiate a handful of transaction-specific requirements? Is it going to take a more aggressive approach and seek to improve upon the (what may already have been heavily-negotiated) terms? Or somewhere in between? In practice, its approach is likely to be driven by the seller's expectations and the time available to it – when final bids are submitted, is the purchaser expected to have signed banking documents? Or an agreed form facilities agreement with progress having been made on ancillary documentation? Or a reasonably advanced draft facilities agreement with a "highly confident" letter from each of the banks? If the purchaser is unable to meet the seller's requirements, it is likely to be at a competitive disadvantage and a purchaser must therefore balance its desire to have the most robust banking documentation possible against the need to submit as competitive a bid as possible, always bearing in mind the time available. Tactically, a purchaser may choose to focus on the large points before final bids are submitted and then use the period between being granted exclusivity and signing to try and agree any secondary points.

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Other Issues

- Will there be a mezzanine facility? If so, has the seller negotiated the terms of the intercreditor agreement? The LMA form of intercreditor agreement has brought a number of difficult issues between senior and mezzanine lenders to a head, issues which could threaten timing and, ultimately, the robustness of the overall financing package.
- Have the staple banks agreed that they will not provide debt to purchasers outside of the staple? If so, this will reduce competitive tension between potential purchasers and restrict the ability of potential purchasers to source debt elsewhere, especially where the staple syndicate comprises several banks.

How we can help

We can assist you on both the sell-side and buy-side in structuring or reviewing a stapled debt package, to ensure that it is robust, credible and deliverable within the requisite timescales.

If you would like to discuss any of the issues covered by this note, please contact any of the following members of our Banking Department:

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