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The "Magnificent Seven" Lender Protections

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Summary:

- Recent examples of "lender-on-lender violence" have created both issues and opportunities for credit investors as credit documentation is increasingly in focus
- OHA negotiates key lender protections in its credit agreements to enhance protection for investors. We refer to the protections colloquially as the "Magnificent Seven"
- OHA has specialized in credit for 30+ years and has deep experience evaluating and negotiating key credit terms to seek downside protection for our investors

As certain companies face pressures in the current environment with elevated base rates and/or leverage, they may attempt to employ tactics to optimize value for equity holders by inducing lenders to work against each other or otherwise force their hands. These transactions are known broadly as liability management exercises or "LMEs," which in turn can induce "lender-on-lender violence" as creditors are often pitted against one another or else fall victim to a prisoner's dilemma created by the borrower. LMEs typically are new financings that involve collateral stripping maneuvers such as dropping valuable assets out of the credit group so they may be financed by other creditors, and sometimes preferential treatment to larger, favored members of the lender group while forcing other lenders to accept lower paydowns or other impairment of their lien or payment priority.

While recently structured leverage finance transactions often include documentation that limits some or most LME transactions, the syndicated loan and high yield markets are populated by many borrower capital structures that have "loose" documentation and contain many risks for existing lenders / investors. As the prevalence of LMEs has increased, being aware of these covenant and documentation loopholes is essential to understanding downside risk in these investments and managers that are focused and knowledgeable of the risks may have an advantage versus other investors.

Fortunately, the private credit market has seen very few LMEs. Further, private credit typically has financed simpler capital structures without multiple classes of creditors and lender groups are much smaller. As a result, borrowers and their private equity sponsors are considerably more relationship-oriented with their key lenders. The partnership nature, rather than transactional nature of many of the relationships in broadly syndicated loans, make LMEs less common but not impossible. While we believe a judicious underwriting process and careful credit selection will be paramount in protecting against losses, documentation and structuring are critical if and when a borrower becomes troubled. OHA views every commitment letter and credit agreement we negotiate through a lens of potential distress for this reason.

The "Magnificent Seven" Lender Protections

While there are dozens of terms that must be negotiated properly in commitment letters and credit agreements, the following seven protections are OHA's thematic areas of focus for protecting investor capital. Several are commonly known by the names of the first highly visible credits in which the targeted threat was employed. Taken together, the "Magnificent Seven" intend to fortify OHA's credit investments against priority impairment and value leakage—broadly speaking, they aim to keep our secured deals as secured as possible by seeking the following three benefits:

1. **Protect the collateral and guarantees of our lender group**
2. **Maintain lender lien and payment priority**
3. **Limit value leakage from our credit group**

The "Magnificent Seven":

Protection	Description	Benefit
"J. Crew"	J. Crew and the related Envision and Pluralsight protections guard against the transfer of material intellectual property and sometimes other valuable assets to parties not in our credit group	Protect the collateral and guarantees of our lender group
"Chewy"	Chewy blocks the stripping of subsidiary guarantees via bad faith partial stock sales or transfers	Protect the collateral and guarantees of our lender group
Non-Guarantor Investment Cap	Caps investments that may be made to entities affiliated with the borrower but which are not members of our credit group	Protect the collateral and guarantees of our lender group
"Serta"	Serta limits the ability of sponsors / borrowers to make sweetheart deals with majority lenders to the detriment or exclusion of minority lenders	Maintain lender lien and payment priority
Pro Rata Sharing	Requires a 100% vote for changes to the credit agreement to ensure fair treatment among lenders with respect to the payment of principal, interest and fees	Maintain lender lien and payment priority
Non-Guarantor Debt Cap	Preserves access to the value in certain third parties by limiting the amount of debt that can be placed ahead of our loan	Limit value leakage from our credit group
Definitions of EBITDA & Leverage[1]	Imposes reasonable and objective limits on EBITDA addbacks and seeks to base the secured leverage definition on debt secured by any assets versus only those assets covered by a more limited definition of "Collateral"	Limit value leakage from our credit group

1 EBITDA is defined as earnings before interest, taxes, depreciation and amortization. EBITDA is a commonly used proxy for cash flow.

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