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High-Yield Bonds

An Issuer's Guide (Asia Edition)

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This Mayer Brown publication provides information and comments on legal issues and developments of interest to our clients and friends. The foregoing is intended to provide a general guide to the subject matter and is not intended to provide legal advice or be a substitute for specific advice concerning individual situations. Readers should seek legal advice before taking any action with respect to the matters discussed herein.

With a vibrancy and diversity consistent with its many constituent countries and cultures, the Asian high-yield debt capital markets have expanded dramatically since the Asian financial crisis of the late 1990s. Credit investors in search of yield have gravitated toward the Asian high-yield market and issuance volumes have surged to record levels. In addition to the deeper investor interest, increased stability of after-issuance trading markets and the emergence of numerous repeat issuers, we have observed expansion into new business sectors, and even countries, as the markets have matured and continue to deepen.

Since 2013, when we published the last edition of our Guide to High Yield Bonds, the high-yield market in Asia has evolved as changes naturally have emerged with respect to structures and covenant packages designed to suit these new issuers and developing markets, and to address the challenges faced by global macroeconomic factors. In addition, recent cross-border debt defaults from China may well reshape investor expectations (and crystallise some of the structural risks discussed in this publication). Despite this changing landscape, there are core high-yield principals and structures that remain constant.

This Guide addresses the core elements of high-yield debt as encountered by Asia-based issuers. It aims to provide existing and new issuers with a reference tool to help understand and navigate high-yield covenant packages, structures and deal execution in Asia and better equip issuers to manage their day-to-day business through the lifetime of the instrument.

Thank you for your interest in this new edition of the Guide to High-Yield Bonds. We trust that it will be a key resource for new and existing issuers in the Asian high-yield markets, and we hope that you will find it useful for your business.

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High-Yield Notes Compared to Traditional Bank Financing

High-yield notes provide issuers with the benefits associated with long-term debt financing but with covenants that are typically less onerous than standard credit facility covenants, and can be self-administered rather than requiring an ongoing dialogue with creditors. The high-yield note covenant package largely does not include traditional bank financing maintenance covenants, which require the issuer to maintain a certain financial health or the lenders can call or accelerate the loans. Instead, the high-yield covenant package includes incurrence covenants, which require the issuer (and its restricted subsidiaries) to take some action, such as incur indebtedness or make a payment or investment, in order to be triggered. Moreover, such covenants are designed to scale with the issuer's business as it grows in size over the lifetime of the notes.

As a whole, the high-yield covenant package has been designed to (i) prevent the credit group from becoming over-leveraged by either borrowing too much or decreasing its cash-generating assets without concurrently decreasing its debt, (ii) protect the position of noteholders in the credit group's capital structure by limiting the ability of the credit group to effectively subordinate the notes through structural or lien subordination and (iii) preserve the assets of the credit group and the issuer's access to such assets. High-yield covenants place restrictions (with numerous carve outs that will be discussed later) on the ability of the credit group to:

- Incur additional debt;
- Pay dividends, invest outside the credit group or make certain other restricted payments that would result in value leakage out of the credit group;
- Grant security interests on its assets (securing indebtedness other than the notes);
- Sell assets and subsidiary stock;
- Enter into affiliate transactions;
- Issue guarantees of debt incurred by others;
- Engage in mergers or consolidations or sell substantially all of the issuer's or a guarantor's assets;
- Enter into transactions that would fundamentally alter the ownership structure of the credit group; and
- Agree to restrictions on distributions and transfers of assets within the credit group.

The following table highlights the major distinctions between traditional bank financing and high-yield notes:

Traditional Bank Financing	High-Yield Notes
Maintenance and incurrence covenants	Incurrence covenants only
Typical term of three to five years	Typical term of five to ten years
Interim principal payments	Bullet maturity
Repayable at any time	Non-call period of three to five years and thereafter decreasing prepayment/call premium Typical call features: 5nc2, 7nc3, 8nc4 and 10nc5 During the "non-call period," issuers are often permitted to call the notes, but with a make-whole premium (essentially the present value of all remaining interest and principal payments based on a discount rate of US treasuries plus a spread (typically 50 bps))

Traditional Bank Financing	High-Yield Notes
Amendments relatively common and uncomplicated, except in syndicated context in which there may be numerous lenders	Amendments require consent solicitation from noteholders, which can be costly and time-consuming
Senior and typically secured and guaranteed	Potentially more flexibility; senior or subordinated and frequently unsecured
Minimal public market awareness	Awareness in public capital markets and may serve as a benchmark to facilitate further fundraisings, including an IPO or subsequent debt capital markets transactions
Rating not required	Rating required (typically by two agencies among Fitch, Moody's and S&P)
Investors are typically banks and institutional funds	Investors are typically mutual funds, hedge funds, insurance companies, pension funds and private wealth management accounts
No securities law liability, but potential ongoing records requirements and inspection rights afforded to bank lenders	Potential disclosure liability related to offering memorandum, but no inspection or access rights for holders

The Ideal High-Yield Note Candidate

High-yield note issuers are typically (i) established companies without investment-grade ratings looking to offer debt, (ii) private companies looking to reorganise their capital structures or (iii) companies which are the target of a leveraged buyout financing. High-yield issuers exhibit some or all of the following characteristics:

- Stable and resilient business model;
- Strong financial track record;
- Growth or recovery story;
- Market-leading positions in their industry or geography;
- Favourable industry trends;
- Experienced management team with proven track record;
- Solid cash generation and future deleveraging potential; and
- Financing needs of at least US$100 million.

PRACTICE TIP

The typical Asian high-yield covenant package is, in many ways, stronger than the customary U.S. and European covenant packages, thereby addressing enforcement challenges in many Asian jurisdictions post-default.

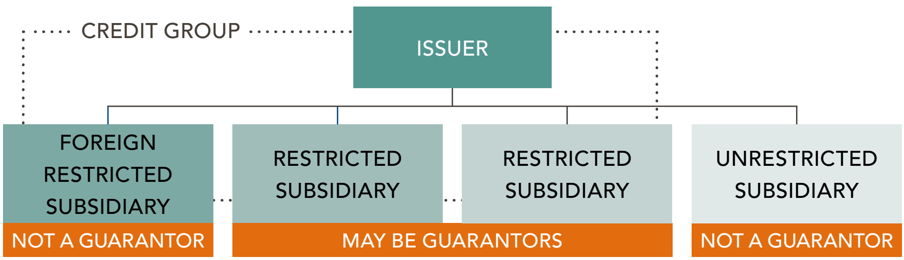
Objective and Process for Negotiating a High-Yield Covenant Package

The high-yield covenant package seeks to ensure adequate protections for noteholders while preserving the necessary operating and financial flexibility to allow the issuer to execute its business plan. It is critical that all parties involved in the drafting process analyse and be fully familiar with the issuer's existing organisation, capital structure and business plan. In particular, it will often save a significant amount of time and resources if the working group takes sufficient time at the outset of the transaction to consider and explore all reasonably foreseeable transactions and activities that the issuer may engage in during the lifetime of the notes and that may be restricted under the covenants. These transactions and activities can include (i) future acquisitions, joint ventures or other investments, (ii) future financing plans and requirements such as equipment financing, sale and leaseback transactions, receivable financings or other secured debt transactions, (iii) debt or debt-like arrangements incurred in the ordinary course of business, (iv) plans for potential geographic expansion and/or new lines of business, (v) the need for letters of credit or other credit enhancements, particularly if required to conduct its business at the time the notes are issued, (vi) expected intra-group funds flows and (vii) potential related party transactions.

As a practical matter, the underwriters' counsel typically takes the lead in drafting the terms of the notes (referred to as the "description of the notes" in the offering memorandum), which will closely track, largely verbatim, the relevant contractual provisions that will later be included in the indenture. Although the issuer's counsel will provide comments to the initial draft, it is essential that issuer's senior management and financing and accounting staff are closely involved in the process as outside counsel cannot be expected to anticipate all of the flexibility the issuer may need during the term of the notes.

The Credit Group and Building the Credit Story

The issuer, any guarantors and all restricted subsidiaries constitute the credit group and fall within what is referred to as "the box." Only the entities comprising the credit group (or those within the box) are subject to the covenant package, and the covenants aim to protect the credit group from deterioration during the lifetime of the notes. The strength and quality of the credit group forms the basis of the credit story presented to investors and ratings agencies, and ultimately impacts the marketability and pricing of the notes. Set forth below is an illustration of a typical credit group:



The Issuer

The selection of the entity to act as the issuer of the notes depends on a variety of factors such as the capital structure of the company and any existing senior debt permitted under its current obligations. The issuer could be either the ultimate parent holding company, an intermediate operating holding company or a lower-level operating company. See *Subordination* for a discussion regarding how the choice of entity impacts investors' analysis of the credit story.

Subsidiaries: Restricted and Unrestricted

Unless expressly designated as unrestricted subsidiaries, all issuer subsidiaries are restricted subsidiaries, meaning that their activities are subject to and limited by the covenant package.

Unrestricted subsidiaries are, by definition, not part of the credit group and are not subject to the covenant package. This means that the financial results of unrestricted subsidiaries are not included in the calculation of financial ratios under the covenants and therefore do not affect (positively or negatively) covenant compliance for the credit group. In addition, intercompany transactions between unrestricted subsidiaries and restricted subsidiaries are more difficult than those solely between and among restricted subsidiaries and the issuer as the high-yield covenant package seeks to limit activities by the credit group where value may be transferred outside the box.

The issuer may grow new businesses outside the constraints of the note covenants by forming unrestricted subsidiaries or re-designating restricted subsidiaries as unrestricted subsidiaries. See *The High-Yield Note Covenant Package – Other covenants – Limitation on designation of restricted or unrestricted subsidiaries – Designating a restricted subsidiary as an unrestricted subsidiary* and *The High-Yield Note Covenant Package – Other covenants – Limitation on designation of restricted or unrestricted subsidiaries – Re-designating an unrestricted subsidiary as a restricted subsidiary* for a discussion regarding the process of designating restricted subsidiaries as unrestricted subsidiaries (and vice-versa).

The Guarantors

High-yield notes are frequently guaranteed by most, if not all, of the issuer's restricted subsidiaries ("upstream guarantees"), and in secured offerings such guarantors also typically provide asset security for the notes. This arrangement gives noteholders a direct claim against the relevant guarantor subsidiaries, and brings the obligations under the notes closer to the physical assets of the issuer, which in turn overcomes some structural subordination issues. See *Subordination – Structural subordination*. If the issuer is an entity other than the ultimate parent company, there may also be a parent guarantee ("downstream guarantee").

PRACTICE TIP

For investors in typical PRC high-yield structures, noteholders only receive subsidiary guarantees (and related share pledges) from non-PRC subsidiaries. In a default scenario, such structural subordination significantly limits noteholder access to onshore assets and potentially places offshore creditors at a disadvantage to onshore lenders.

In some jurisdictions, guarantees by foreign subsidiaries can have negative tax consequences and it is therefore necessary to consult tax specialists early in the structuring process. For example, foreign subsidiaries of US issuers usually do not act as guarantors because, under US tax law a guarantee by a foreign subsidiary of a US parent company's debt is deemed a dividend, subject to certain exemptions. Additionally, in some jurisdictions, foreign subsidiaries simply cannot serve as guarantors due to regulatory hurdles or prohibitions related to such foreign subsidiary guaranteeing offshore debt.

As a general matter, the issuer and the underwriters should consult local law experts as to any requirements for, and the validity of, subsidiary-parent guarantees under applicable fraudulent conveyance, insolvency or similar laws.

The High-Yield Note Covenant Package

This section provides a high-level overview of some of the general principles and key covenants of a high-yield covenant package. Issuers should carefully review and analyse with legal counsel the full contractual terms of any high-yield notes as set out in the indenture to ensure that the covenant package is tailored for the specific operational needs of the issuer.

The ability of entities within the credit group to engage in the types of transactions that are restricted by a particular covenant depends on the available capacity under baskets and carve outs. For example, as a series of exemptions from the general limitation on incurring additional indebtedness, the limitation on indebtedness covenant may include several specified baskets denominated in the note currency, including possibly a basket for local currency debt issued by foreign subsidiaries (for working capital purposes) and, most importantly, a basket for indebtedness issued under the issuer's senior credit facilities.

There are several types of baskets. During the lifetime of the notes, baskets may be set only at an aggregate cap which may be used and reused based on availability ("refillable baskets") or deplete as they are used ("one-time only baskets"). The issuer naturally prefers refillable baskets. While baskets are traditionally expressed as specified fixed amounts in the currency of the notes, transactions are increasingly using soft-capped baskets that are expressed as the greater of a fixed amount and a percentage of a financial reference point, such as total assets ("grower baskets"). These grower baskets reward issuers for strong financial performance and provide them with flexibility for growth over the lifetime of the notes.

In addition to baskets for specific categories of transactions, covenants may also contain general baskets ("hell or high water baskets"), which may, for example, permit a limited amount of indebtedness to be incurred for any purpose. As a general matter, it will always be more advantageous to the issuer to rely on a general exemption (i.e., a non-basket exemption) to a covenant for a particular transaction or a basket designed for a specific category than on a general basket.

Limitation on Indebtedness

The purpose of the limitation on indebtedness covenant is to (i) limit the amount of additional debt that may be incurred by the credit group unless cash flow is sufficient to service all debt and (ii) control structural subordination by specifying where additional debt can be incurred. See *Subordination – Structural subordination*. The covenant includes a general prohibition on the incurrence of indebtedness unless a ratio test is satisfied[1] and exceptions to such general prohibition ("permitted debt"). Indebtedness is generally broadly defined to include guarantees, letters of credit, capital lease obligations, hedging obligations, disqualified stock of the issuer or any preferred stock of restricted subsidiaries. Debt that is incurred in accordance with the ratio test is commonly referred to as ratio debt.

[1] The ratio test is satisfied if the resulting ratio is at least the negotiated multiple. See the limitation on indebtedness covenant discussion within *Global Comparison of High-Yield Note Covenant Packages* for a discussion regarding the typical ranges of such multiple.

Ratio Tests

There are two alternative types of ratio tests that are used in conjunction with the limitation on indebtedness covenant: the fixed charge coverage ratio and the leverage ratio. The fixed charge coverage ratio is a ratio of earnings before interest, taxes, depreciation and amortisation ("EBITDA") to fixed charges.[2] Fixed charges primarily include (i) interest expense (cash and non-cash), (ii) amortisation of debt issuance costs and original interest discount, (iii) interest component of capital leases, (iv) dividends on preferred stock and (iv) net payments under hedging obligations. It may also include, for certain types of businesses, other charges or expenses (e.g., for retail and real estate based issuers, fixed charges could also include rental expenses). The leverage ratio is a ratio of debt to EBITDA and is typically used only for issuers in capital-intensive industries such as telecommunications, cable and media.

PRACTICE TIP

Careful attention must be paid to the EBITDA definition, which should be tailored by industry and issuer.

Ratio tests are calculated based on the operating results of the credit group for the immediately preceding four quarters for which financial statements are available and give *pro forma* effect to the incurrence of debt proposed to be incurred, incurrence and retirement of other debt from the beginning of the four quarter period until calculation date and acquisitions and dispositions during the same period.

[2] The calculation for EBITDA is customarily adjusted net income *plus* interest *plus* taxes *plus* deprecation and amortisation *plus* non-cash charges decreasing net income minus non-cash items increasing net income; *provided, however,* the calculation for adjusted net income is as follows: GAAP net income (or loss) of the credit group, adjusted by excluding: (i) any gain (but not loss) on any asset sale, (ii) any extraordinary gain (but not loss), (iii) net income (but not loss) of an entity that is not a restricted subsidiary, except to the extent distributed to the issuer or a restricted subsidiary, (iv) net income of a restricted subsidiary to the extent restricted from being distributed to the issuer or a restricted subsidiary and (v) the cumulative effect of a change in accounting principles.

Permitted Debt

Permitted debt typically includes:

- Debt under credit facilities; provided, however, it is (i) typically permitted only up to a fixed amount, although sometimes the limitation is defined as the greater of a fixed amount and a borrowing base or other "grower" component and (ii) sometimes reduced to the extent permanently paid down with net proceeds of asset sales;
- Ordinary course debt, such as letters of credit supporting workers' compensation claims, self insurance obligations, performance, surety, appeal or similar bonds;
- Existing debt;
- Debt represented by the notes and any related guarantees;
- Refinancing debt (i.e., debt incurred to refinance ratio debt or other permitted debt);
- Capitalised leases, mortgage financings and purchase money obligations, all subject to a cap;
- Intercompany borrowings between and among the credit group;
- Hedging obligations incurred for non-speculative purposes (and it should be noted that such allowance may differ from transactions receiving hedging treatment under applicable accounting standards);
- Negotiated basket (typically a fixed amount) for any purpose; and
- Other specific carve outs (e.g., foreign subsidiary debt under local lines of credit).

Limitation on Restricted Payments

The limitation on restricted payments prevents cash and assets from being transferred outside the credit group (also referred to as "leakage") by limiting the outflows of payments in situations where the credit group's positive financial performance has not justified its ability to make such payments. This protection is important to noteholders because it preserves the issuer's ability to repay its indebtedness as well as preserving assets in the credit group in the event of insolvency or bankruptcy.

The covenant is structured in three parts: (i) definition of restricted payment, (ii) conditions under which a restricted payment may be made under the general restricted payments basket and (iii) exceptions to the limitation on restricted payments (i.e., instances when restricted payments may be made even if the conditions under the general restricted payment basket are not met).

PRACTICE TIP

Attention to the timing of the first post-offering dividend date is critical, because there may be a need to allow for one-time flexibility with respect to such dividend payment in the restricted payments definition.

Definition of Restricted Payments

Restricted payments are typically defined as including any of the following actions by the credit group:

- Paying cash dividends or making other distributions of assets to stockholders; provided, however, dividends paid in stock (other than disqualifying stock) and dividends paid to the issuer or another restricted subsidiary are excluded (i.e., are not restricted payments);
- Repurchasing capital stock of the issuer;
- Repaying subordinated debt prior to scheduled maturity; and
- Making investments (other than permitted investments, which are discussed below).

Conditions to Use of Restricted Payments Basket

Restricted payments cannot be made unless:

- The amount of the restricted payment plus all prior restricted payments since the original issue date of the notes does not exceed the amount of the restricted payments basket (discussed below);
- The issuer can incur US$1.00 of ratio debt under the limitation on indebtedness covenant (after giving *pro forma* effect to the restricted payment); and

- No default exists or would exist under the indenture after giving effect to the restricted payment (i.e., the issuer must give *pro forma* effect of the restricted payments when calculating the restricted payments covenant compliance).

Restricted Payments Basket

The restricted payments basket is calculated as follows:

- 50% cumulative adjusted net income (*minus* 100% of any loss), with cumulative meaning the period from the beginning of the quarter (or six-month period if the issuer does not prepare audited or reviewed quarterly financial statements) immediately prior to or after the date the notes are originally issued until the end of the most recent quarter for which financial statements are available; plus
- Cash proceeds from (i) capital contributions to the issuer, (ii) issuances of equity by the issuer (other than disqualified stock) and (iii) issuances of debt subsequently converted into issuer equity (other than disqualified stock); plus
- Net reductions in restricted investments; plus
- A negotiated dollar amount (in some cases).

Exceptions to the Limitation on Restricted Payments

Certain restricted payments can usually be made without regard to the restricted payments basket or the conditions to using the restricted payments basket ("permitted restricted payments") and they include:

- Repurchase of equity out of proceeds of a concurrent issuance of new equity;
- Repurchase of subordinated debt out of proceeds of concurrent issuance of new equity or new subordinated debt;
- Pro-rata dividends of restricted subsidiaries paid to third parties; and
- Other negotiated exceptions (e.g., limited investments, limited repurchase of management stock or specific exceptions necessitated by the issuer's capital structure).

PRACTICE TIP

When determining permitted investments, practical consideration must be given to how the issuer conducts its business and if it has a history of making the permitted investments being proposed.

Permitted Investments

Permitted investments generally include:

- Investments in the issuer, restricted subsidiary or any entity that becomes a restricted subsidiary;
- Certain enumerated hedging transactions;
- Loans or advances to officers or directors, subject to a cap;
- Joint ventures, subject to a cap; and
- Other investments, subject to a cap.

It is imperative to pay attention to which restricted payment exceptions count against the basket. The paragraph generally following the list of exceptions will specify which have been negotiated to count and not count. Permitted investments are similar to restricted payment exceptions, but are distinctly different. Permitted investments are specifically excluded from the definition of restricted payments. As such, because they are not restricted payments, they do not count against the restricted payments basket.

Limitation on Restrictions on Distributions from Restricted Subsidiaries

The purpose of this covenant (often called the "Limitation on dividend stoppers covenant") is to prevent cash flow needed to service debt from being trapped at a subsidiary level (i.e., noteholders want all cash generated by restricted subsidiaries to be able to freely flow up to the issuer so that it may be used to satisfy its obligations under the notes). As such, the covenant is a general prohibition on the existence of any restriction on restricted subsidiaries to pay dividends, repay indebtedness, make loans or otherwise transfer assets to the issuer or any other restricted subsidiary. This covenant is important to investors because they look to the credit quality and financial condition of the issuer and its restricted subsidiaries as a whole for the repayment of the notes, not just the issuer.

The common exceptions to the limitation on restrictions on distributions from restricted subsidiaries include:

- Existing indebtedness;
- Restrictions already in place when a subsidiary is acquired;
- Applicable law;
- Customary lease provisions; and
- Refinancing of existing debt if the limitations are not more restrictive than those being refinanced.

Joint ventures entered into by the issuer or its restricted subsidiaries may present obstacles in the context of the limitation on restrictions on distributions from restricted subsidiaries, because the partner in such joint venture will typically have veto rights over dividend payments. One possible solution is the formation of a joint venture that is less than 50% issuer owned, because such a joint venture would not be a consolidated subsidiary and would be unrestricted (and not subject to the indenture covenants). However, any investment in the joint venture would then count as a restricted payment that would be subject to the requirements of the limitation on restricted payments covenant.

Limitation on Liens

The limitation on liens covenant limits the issuer's ability to effectively subordinate the notes through lien subordination.[3] The covenant restricts liens on assets unless the notes are equally and rateably secured, subject to certain exceptions ("permitted liens"). It is important to match the definition of permitted liens with the same definition in the issuer's senior credit facility. There should not be liens permitted under the issuer's senior credit facility that would not be permitted under the terms of the notes, although the terms of the notes may permit additional liens.

Permitted liens typically include:

- Liens securing debt under credit facilities (generally tied to the amount permitted under the clause for debt credit facilities under the debt covenant);
- Purchase money liens;

[3] The limitation on liens covenant is the only high-yield maintenance covenant, as it begins with "Issuer shall not incur or suffer to exist any liens...".

- Liens on acquired property that were not incurred in contemplation of the acquisition;
- Liens on refinanced secured debt; and
- Existing liens.

Limitation on Sales of Assets and Subsidiary Stock

Because sales of assets and subsidiary stock may result in income-producing assets being transferred outside the credit group, they are a concern to potential noteholders. As such, the limitation on sales of assets and subsidiary stock covenant governs the type of proceeds that may be received as consideration. Under the covenant, a minimum percentage (typically between 75% and 85%) of the consideration from the sale must be cash or "deemed cash." Sometimes this percentage is based on the aggregate consideration received on all asset sales since the date of the indenture. While the definition of "deemed cash" is negotiated, it often includes (i) unsubordinated debt assumed by the buyer, so long as the credit group is unconditionally released, (ii) replacement assets and (iii) securities and other non-cash consideration that is converted into cash within a specified period of time (generally 90 to 180 days). The restrictions imposed by this covenant are not meant to limit the issuer's ability to sell assets; rather the restrictions define appropriate uses for the proceeds from such sales.

Under the indenture, the definition of "asset sales" is typically broadly defined and will generally include traditional asset disposals and any direct and indirect sales of interests in restricted subsidiaries, including any issue of new shares of a restricted subsidiary or any disposition by means of a merger, consolidation or similar transaction. Moreover, the definition will include numerous categories of asset disposals that do not need to satisfy the asset sale test, including ordinary course transactions and a carve-out for transactions below a specified minimum fair market value.

The asset sale test requires:

- The issuer or its restricted subsidiaries receive consideration equal to the fair market value of the assets sold;
- At least a minimum percentage (typically between 75% and 85%) of the consideration from the sale is in the form of cash or "deemed cash"; and
- The issuer or the relevant restricted subsidiary applies the net available cash proceeds from the asset sale within a specified period of time (usually between 270 and 365 days) to acquire assets or stock of another entity in the same business line, make capital expenditures or acquire assets used in the business or to pay off senior debt (sometimes also requires a permanent commitment reduction).

To the extent the net available cash proceeds from an asset sale are not applied in accordance with the specified uses within the specified period of time and such unused proceeds exceed a specified dollar amount, the issuer must use those unused proceeds to offer to repurchase notes at their face value plus accrued interest.

However, cash is fungible and as long as the issuer or the relevant restricted subsidiary budgets capital expenditures within the relevant timeframe following an asset sale, compliance with the limitation on sales of assets and subsidiary stock should normally not be difficult.

Limitation on Affiliate Transactions

The purpose of the limitation on affiliate transactions covenant is to avoid leakage from the credit group to controlling stockholders and other affiliates. An affiliate is typically defined to include any person which controls, or is under common control with, the issuer and usually includes any shareholder above a specified percentage (usually between 5% and 10%).

The covenant prohibits the credit group from entering into transactions with any affiliate unless:

- The transaction is on an arms-length basis;
- If the transaction value exceeds a threshold amount (usually US$1 million to US$5 million, depending on the issuer's size at the time the notes are issued), the transaction is approved by a majority of the issuer's board of directors, including a majority of disinterested directors (although sometimes this approval is required only from an officer); and

- If the transaction value exceeds a higher threshold amount, the issuer obtains a fairness opinion from an independent investment bank, accounting or appraisal firm (although sometimes this approval is required only from the issuer's board of directors).

Typical exemptions to the limitation on affiliate transactions covenant include: (i) transactions between and among the issuer and its restricted subsidiaries, (ii) payment of reasonable and customary fees to directors, (iii) restricted payments made in accordance with the limitation on restricted payments covenant and sometimes permitted investments and (iv) payment of management fees to leveraged buyout sponsors.

Other Covenants

Limitation on Designation of Restricted and Unrestricted Subsidiaries

The limitation on designation of restricted and unrestricted subsidiaries ensures the various other covenants are not thwarted through the designation and re-designation of restricted and unrestricted subsidiaries.

As a general rule, all subsidiaries of the issuer are restricted subsidiaries unless a subsidiary is listed as an unrestricted subsidiary in the indenture or the issuer subsequently expressly designated a restricted subsidiary as an unrestricted subsidiary in accordance with the requirements of the indenture. The issuer may designate and re-designate its subsidiaries as either restricted or unrestricted at any time. However, because the covenants will not apply to unrestricted subsidiaries, noteholders may view the issuer's designations and re-designations as a way to potentially circumvent the otherwise applicable restrictions on investments, on incurring indebtedness or on engaging in acquisitions and dispositions.

By designating a subsidiary as unrestricted, the issuer is deemed to have made an investment in the subsidiary in an amount equal to the fair market value of the issuer's or its restricted subsidiary's interest in the subsidiary at the time of the designation.

In order to designate a restricted subsidiary as an unrestricted subsidiary, the following conditions must be met:

- The issuer must comply with the limitation on restricted payments covenant (i.e., the fair market value of the issuer's deemed investment in the relevant subsidiary at the time of designation must be permitted under the restricted payments covenant or as a permitted investment);[4]
- The issuer must comply with the limitation on indebtedness covenant (i.e., any guarantee by the issuer or the remaining restricted subsidiaries of any indebtedness of the unrestricted subsidiary will be deemed to be an incurrence of additional indebtedness);[5]
- The relevant subsidiary must not hold capital stock or indebtedness of, or hold any liens on the assets of, or have any investment in, the issuer and its remaining restricted subsidiaries;
- The issuer must comply with the limitation on affiliate transactions covenant (i.e., any agreement, transaction or arrangement between the issuer, the newly unrestricted subsidiary and the issuer's remaining restricted subsidiaries must comply with the limitation on affiliate transactions covenant);
- The issuer and its remaining restricted subsidiaries must not have any obligation to (i) subscribe for additional equity in the newly unrestricted subsidiary or (ii) maintain or preserve the financial condition of the newly unrestricted subsidiary (whether by guarantee or extension of credit); and
- Designation will not result in default or an event of default.

In order to designate an unrestricted subsidiary as a restricted subsidiary, the following conditions must be met:

- Any investment held by the newly restricted subsidiary must be able to be made in accordance with the limitation on restricted payments covenant or as a permitted investment;
- Any debt by the newly restricted subsidiary must be able to be made in accordance with the limitation on indebtedness covenant;
- Any liens on the newly restricted subsidiary's assets must be in compliance with the limitation on liens covenant; and
- The designation will not result in default or an event of default.

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[4] See The *High-Yield Note Covenant Package – Limitation on restricted payments – Restricted payments basket* for the restricted payments basket calculation formula.

[5] See The *High-Yield Note Covenant Package – Limitation on indebtedness – Ratio tests* for the ratio tests calculation formulas.

Limitation on Merger, Consolidation and Sale of Substantially all Assets

The goal of the covenant limiting mergers, consolidations and sales of substantially all assets is to prevent a business combination in which the resulting entity is not financially healthy, as measured by the fixed charge coverage ratio and the consolidated net worth test. The covenant prohibits the issuer from merging with or consolidating into another entity, or transferring all or substantially all of the credit group's assets, as a whole, to another entity, unless the following general conditions are satisfied:

- Either the issuer is the surviving entity or the surviving entity is an entity organised under the laws of a specified jurisdiction (e.g., the jurisdiction under which the issuer is organised) and expressly assumes the issuer's obligations under the notes and the indenture;
- The issuer or the surviving entity is able to incur at least US$1.00 of ratio debt under the limitation on indebtedness covenant on a pro forma basis (although sometimes this condition is required to provide only that the issuer's compliance with the fixed charge coverage ratio is no worse even if it still could not incur US$1.00);
- The issuer's or the successor entity's consolidated net worth is at least equal to the issuer's consolidated net worth prior to the transaction (although this condition is sometimes not required);
- The absence of default, either before or as a result of the transaction; and
- There is no credit ratings downgrade as a result of the transaction (although this condition is often not required).

PRACTICE TIP

High-yield notes for Asia-based issuers typically also require the issuer or surviving entity to have a consolidated net worth equal to or greater than the consolidated net worth of the issuer prior to the transaction.

As the limitation on merger, consolidation and sale of substantially all assets covenant restricts certain transactions that may also constitute a change of control giving noteholders the option to put their notes back to the issuer, this covenant should be negotiated in conjunction with the change of control covenant.

Change of Control

The change of control covenant protects noteholders from fundamental changes in the issuer's ownership structure. Investors have traditionally insisted on a change of control put option, because the identity, track record and financial and business strategies of the issuer's ultimate owners can be a significant factor in investors' overall investment decisions. This can be particularly true for portfolio companies of private equity sponsors that are repeat players in the high-yield markets.

Upon the occurrence of any of a series of specified change of control events, the issuer is required to make an offer (i.e., a change of control offer) to repurchase the notes at a specific percentage (usually 101%) of their principal amount. Specific change of control events can be heavily negotiated between the issuer and the underwriters (especially where an initial public offering ("IPO") or partial sale of the issuer within the terms of the notes are realistic scenarios), but will ordinarily include:

- The acquisition by a person or group of people (other than defined permitted equity holders) of more than a specific percentage (generally between 30% and 50%[6]) of the issuer's voting capital;
- A contested change in the issuer's board of directors (e.g., from a proxy fight); and
- Certain dispositions of all or substantially all of the credit group's assets.

Reporting Requirements

The purpose of the reporting covenant is to ensure the continuous availability of current information on the issuer's financial performance. While it may appear to be a boilerplate covenant, potential investors can be very sensitive about the content of this covenant and generally require the issuer to provide full public disclosure for as long as the notes are outstanding, whether or not the issuer is subject to SEC or other reporting requirements. Public availability of current information on the issuer's financial performance is important not only for the development of a liquid market in the notes, but it also protects noteholders that may wish to sell

[6] If the issuer is a public company, noteholders will typically insist that this figure be on the lower end of the range because a small minority interest may possess effective control of a public company due to the diverse holdings of public shares.

their notes from potential liability for market abuse. Additionally, the availability of current information on the issuer's financial performance is necessary to permit US investors to on-sell their notes within the United States in reliance on Rule 144A. See *Legal Considerations – Transaction structure and US federal securities law – Rule 144A*.

Limitation on Business Activities

The aim of the limitation on business activities covenant is to restrict the issuer from entering into new lines of business that were not contemplated by investors at the time of issuance. For example, the covenant prohibits the issuer from entering a business line that is (i) not the same type of business conducted by the issuer and its subsidiaries as of the time of issuance (or reasonably related thereto) or (ii) not otherwise disclosed in the offering memorandum. Therefore, prior to negotiating the limitation on business activities covenant, the issuer must carefully consider its potential business lines over the life of the notes, while balancing such considerations against the investors' desire to limit the issuer to lines of business and geographies where it has a proven track record.

Limitation on Issuances of Guarantees of Indebtedness

The covenant limiting issuances of guarantees of indebtedness prevents the issuer from structurally subordinating the notes to other issuer debt. The covenant does so by restricting non-guarantor restricted subsidiaries from guaranteeing, directly or indirectly, any indebtedness of the issuer or any other subsidiary guarantors unless it also guarantees the notes on at least a pari passu basis with any such other indebtedness.

Use of Proceeds

The use of proceeds covenant is structured such that the issuance proceeds are to be used in the manner contemplated in the offering memorandum.

Payments for Consent

The payments for consent covenant requires that all offers of consideration in exchange for consents and waivers to indenture provisions must be made equally to all holders and the consideration offered must be paid to all holders who consent.

Duration of Covenant Restrictions

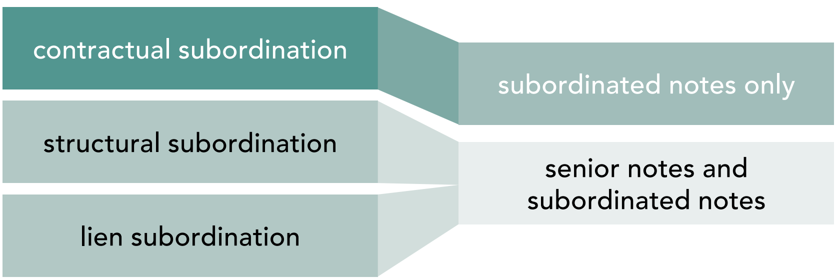
Generally, the covenants will apply as long as the notes are outstanding. While waivers and amendments under traditional senior credit facilities are relatively common and uncomplicated, waivers and amendments to high-yield notes typically require the issuer to solicit consents from a qualified majority, or possibly all, noteholders, which can be costly and time-consuming.

For high-yield debt issuers that are on the cusp of investment-grade, it is, however, possible to negotiate fall away covenants or suspension covenants. Under fall away covenants, if the issuer's long-term debt receives an investment-grade rating from two out of three rating agencies, most of the high-yield covenants are automatically deemed eliminated (i.e., they fall away forever) and only investment-grade covenants will remain. In a typical fall-away scenario, the remaining investment-grade covenants are: limitation on liens; limitation on merger, consolidation, and sale of substantially all assets; change of control covenant; and reporting covenant. Suspension covenants, however, are only in place while the issuer is rated sub- investment guide. If the issuer gains an investment-grade rating, such covenants are suspended. However, if the issuer's investment-grade rating is lost, then the high-yield covenants will resume (meaning that the covenant package "springs" back into existence).

Subordination

High-yield notes are sometimes structured to be junior to bank debt (i.e., are subordinated), because subordination allows the issuer to incur more debt cost effectively than it could if all of its debt was senior. High-yield notes can be subordinated either (i) expressly and referred to as subordinated notes or (ii) effectively and still referred to as senior notes.

The methods of subordination are contractual subordination, structural subordination and lien subordination. Only subordinated notes have express contractual subordination provisions, while structural and lien subordination may be a feature of both senior notes and subordinated notes.



Contractual Subordination

High-yield notes are contractually subordinated when the debt is expressly subordinated by its own terms. Under such a structure, the high-yield noteholders agree that:

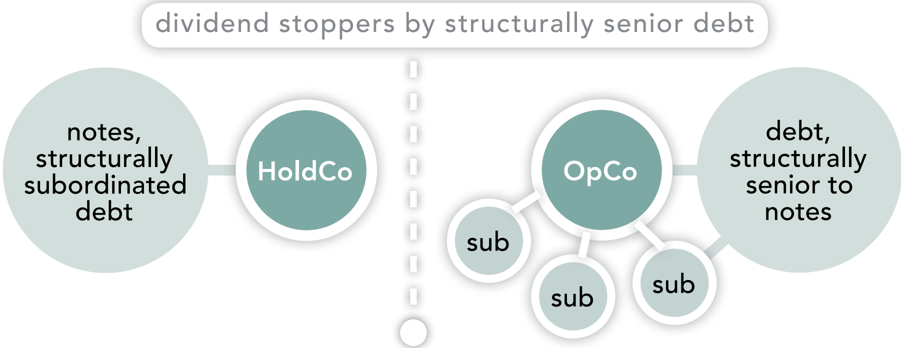
- Upon the issuer's bankruptcy or liquidation, they will not be paid until the senior debt is paid in full; and
- Any amounts received will be allocated to any senior debt holders until the senior debt is paid in full.

One way to achieve this result is by including payment blockage provisions in the indenture, whereby upon a default under the senior debt, no payments are permitted to be made on subordinated debt for a specified period of time. Additionally, the indenture will include standstill provisions, whereby the high-yield noteholders are required to give the senior lenders notice and wait for a certain period of time before accelerating the subordinated debt.

Under contractual subordination, high-yield notes need not be subordinated to all other debt. As such, it is possible to specify exactly to which debt the notes are subordinated, often referred to as "senior subordinated notes".

Structural Subordination

In the most common form of structural subordination, high-yield notes are issued by a holding company without the benefit of any upstream guarantees while the structurally senior debt is issued by the operating company or subsidiaries where the operations and assets of the issuer reside. The structurally senior debt may have restrictions on the ability of the operating company to make dividends and other payments to the issuer holding company ("dividend stoppers").



In the structural subordination structure, the subordinated debt is effectively junior in right of payment to the other debt because there are no upstream guaranties by OpCo or its subsidiaries, and, therefore, OpCo and its subsidiaries are not obligated to make payments on the notes. As a result, noteholders and other creditors of HoldCo have no direct access to the assets or cash of OpCo and its subsidiaries. The only claim the HoldCo creditors have on the assets of OpCo and its subsidiaries is through the stock of OpCo held by HoldCo (i.e., an equity holder claim). In a bankruptcy or liquidation of OpCo, the claims of HoldCo's creditors, including structurally subordinated debt holders, would be junior to the claims of all creditors of OpCo and its subsidiaries, including the claims of unsecured creditors, such as subordinated debt holders and trade creditors.

Lien Subordination

For most non-investment grade issuers, senior bank debt will often be secured by a first-priority lien on all or substantially all of the issuer's and its subsidiaries' assets. High-yield notes may be secured or unsecured. If secured, it can be either first-lien secured debt (in which case it is not subordinated) or second-lien secured debt. First-lien secured debt shares pari passu with the senior debt in the proceeds from collateral, while second-lien secured debt receives proceeds from collateral only after senior debt has been paid in full. However, in either case, the security interest of the high-yield notes is generally silent, meaning the bank debt determines enforcement remedies with respect to the collateral. If the high-yield notes are secured, the intercreditor agreement spells out the rights and limitations as between the secured creditors with respect to the collateral.

Global Comparison of High-Yield Note Covenant Packages

There is a general global structure for high-yield note covenant packages, which manages for the major risks of cash leakage, risky investments, increased leverage, subordination and corporate governance changes. However, the globally-structured high-yield covenant package is slightly tailored in each of the three major high-yield note markets: the United States, Europe and Asia. The following table summarises the important differences of typical high-yield note covenant packages globally:

	Provision	Guarantors
	NOTEHOLDER PROTECTION LEVEL	Strongest protection in the United States and Europe
DISTINGUISHING CHARACTERISTICS	UNITED STATES	Notes are often guaranteed by all restricted subsidiaries, other than foreign subsidiaries (due largely to tax reasons) and immaterial subsidiaries. Often only restricted subsidiaries that guarantee other debt of the issuer and/or incur debt are required to become guarantors.
	EUROPE	As a starting position, comprehensive guarantor coverage (at least 80%+/ as close as possible to 100% of EBITDA, revenue and assets) for "senior notes" is common and desirable. Guarantor coverage would ideally include all (material) domestic and foreign subsidiaries. In practice, however, the corporate and insolvency laws of many European jurisdictions significantly limit the usefulness and enforceability of upstream guarantees, unless there is a clear and direct corporate benefit to the relevant subsidiary guarantor.
	ASIA	Asian high-yield notes issued by non-PRC-based issuers follow the US or European guarantor models. For high-yield notes issued by People's Republic of China ("PRC")[7]-based issuers, noteholders outside of the PRC only receive subsidiary guarantees from non-PRC subsidiaries, which typically account for only a nominal proportion of the issuer's assets.

[7] For the purposes of this analysis, references to the PRC exclude the Hong Kong Special Administrative Region, the Macau Special Administrative Region and Taiwan.

	Provision	Limitation on Indebtedness
	NOTEHOLDER PROTECTION LEVEL	Strongest protection in Asia and weaker similar protection in the United States and Europe
DISTINGUISHING CHARACTERISTICS	UNITED STATES	Fixed charge coverage ratio is typically 2.0, but can range from 2.0 to 2.5. Typically, non-guarantor restricted subsidiaries are not permitted to incur ratio debt, thereby reducing structural subordination. Trend is to define credit facility exception to include debt securities offerings as well as commercial bank credit facilities. Trend is for other dollar baskets such as purchase money debt or the general debt basket to be capped at the greater of a fixed dollar amount or a growth component (e.g. % of CNTA). Issuers prefer to include ability to later reclassify debt incurred under a basket as ratio debt if fixed charge coverage ratio condition could be met, allowing the basket to be "refreshed."
	EUROPE	Fixed charge coverage ratio is typically 2.0, but can range from 2.0 to 2.5. Typically, non-guarantor restricted subsidiaries are not permitted to incur ratio debt, thereby reducing structural subordination. Common to include additional "consolidated secured debt ratio" test (consolidated total debt/consolidated EBITDA) for incurrence of additional ratio debt that is secured by liens to get rating agencies and investors comfortable that issuer will not lever up excessively. Especially for cyclical businesses with currently high EBITDA, consolidated secured debt ratio (rather than fixed charge coverage ratio) can become principal limitation on ability to incur additional ratio debt. Credit facility exception typically includes debt securities offerings as well as commercial bank credit facilities. Issuers prefer to include ability to later reclassify debt incurred under a basket as ratio debt if ratio test could be met, allowing the relevant baskets to be "refreshed."
	ASIA	Fixed charge coverage ratio is between 2.0 and 3.5.[8]

[8] Under high-yield notes by PRC-based issuers, the fixed charge coverage ratio typically is between 2.5 and 3.5. Under high-yield notes by Indonesia-based issuers, the fixed charge coverage ratio typically is between 2.0 and 3.5.

Provision		Limitation on Indebtedness
	NOTEHOLDER PROTECTION LEVEL	Strongest protection in Asia and weaker similar protection in the United States and Europe
DISTINGUISHING CHARACTERISTICS	ASIA (CON'T)	For high-yield notes issued by PRC-based issuers, non-guarantor restricted subsidiaries are not allowed to incur debt under the fixed charge coverage ratio. It is also common, under high-yield notes issued by PRC-based issuers, to limit the incurrence of debt by restricted subsidiaries to 10% to 15% of total assets, although this may exclude any debt issued in a public or private offering to institutional investors. Most high-yield note offerings by PRC-based issuers do not have a credit facility carve-out. With respect to permitted debt, high-yield notes issued by PRC-based issuers limit the general debt basket (and other baskets) to a fixed dollar amount or percentage of total assets, although weaker notes typically use the greater of a fixed dollar amount and a percentage of total assets, which include certain intangible assets. High-yield notes issued by Indonesia-based issuers sometimes include the concept of permitted priority indebtedness, in which structurally subordinated debt can be incurred by non-guarantors if (i) structurally and contractually subordinated debt is less than 15% of total assets and (ii) the applicable ratio test is satisfied.

Provision		Limitation on Restricted Payments
	NOTEHOLDER PROTECTION LEVEL	Strongest protection in Asia and weaker similar protection in the United States and Europe
DISTINGUISHING CHARACTERISTICS	UNITED STATES	Typical negotiated items: • In the context of calculating the build-up of the general restricted payments basket, whether equity contributions and offering proceeds can be the fair market value of non-cash consideration, or only cash. • Whether equity that is issued to make an "equity claw" redemption of the notes during the no-call period can also be counted toward the build-up of the general restricted payments basket. • Whether the "return on investments" component of the general restricted payments basket is calculated on each separate investment (whereby the basket cannot increase by more than the amount of the individual investment) or whether it is calculated on an aggregate basis among all investments (which is more issuer friendly)

	Provision	Limitation on Restricted Payments
	NOTEHOLDER PROTECTION LEVEL	Strongest protection in Asia and weaker similar protection in the United States and Europe
DISTINGUISHING CHARACTERISTICS	UNITED STATES (CON'T)	• Whether an issuer can later reclassify a restricted payment made under a specific basket (due to the inability to meet the fixed charge coverage ratio condition at the time of the investment) as a restricted payment made under the general basket (once the issuer is able to meet the fixed charge coverage ratio condition). • Buyback of management stock subject to an annual cap with a roll-over for unused amounts. • Dividends on disqualified stock incurred under the debt covenant as long as the dividend are included as fixed charges. • Unlike some European sponsor deals, US deals typically do not permit unlimited restricted payments subject only to leverage test.
	EUROPE	Typical negotiated items: • In the context of calculating the build-up of the general restricted payments basket, whether equity contributions and offering proceeds can be the fair market value of non-cash consideration, or only cash. • Whether equity that is issued to make an "equity claw" redemption of the notes during the no-call period can also be counted toward the build-up of the general restricted payments basket. • Size of general restricted payment basket, joint venture permitted investment basket and general permitted investment basket.
	ASIA	High-yield notes issued by PRC-based issuers often include the restricted payment basket as a component of the build-up basket rather than as a separate carve-out, which forces the issuer to comply with the fixed charge coverage ratio test in order to use the general restricted payment basket. In high-yield notes issued by Indonesia-based issuers, intercompany subordinated debt may be permitted to be prepaid and there may be up to a US$5 million general basket for restricted payments.

	Provision	Limitation on Liens
	NOTEHOLDER PROTECTION LEVEL	Strongest similar protection in the United States and Europe and weaker protection in Asia
DISTINGUISHING CHARACTERISTICS	UNITED STATES	Attention should be given to whether all permitted debt under "credit facilities" may be secured by a permitted lien (including ratio debt) or only debt under the specific credit facility basket. Covenant generally triggered by liens securing debt, as opposed to the incurrence of liens for other purposes.
	EUROPE	Attention should be given to whether all permitted ratio debt and "credit facilities" debt may be secured by a permitted lien or, if a secured deal, permitted collateral lien, or only debt under the specific credit facility basket. Covenant generally triggered by liens securing debt, as opposed to the incurrence of liens for other purposes.
	ASIA	Debt permitted under the debt covenant is typically permitted to be secured. Many high-yield notes issued by PRC-based issuers do not have a credit facility debt basket and thus no corresponding lien basket. Secured notes issued by PRC-based issuers often allow permitted pari passu debt with no ratio test, which effectively allows for unlimited dilution of the collateral.

	Provision	Limitation on Sales of Assets and Subsidiary Stock
	NOTEHOLDER PROTECTION LEVEL	Strongest protection in Asia and weaker similar protection in the United States and Europe
DISTINGUISHING CHARACTERISTICS	UNITED STATES	Covenant has become progressively weaker in the current market. Negotiated items typically include: • Types of consideration that will constitute "deemed cash" toward the 75% cash consideration requirement. Recently, some deals permit the designation of certain proceeds up to a cap as "deemed cash." • Type of debt that can be repaid with asset sale proceeds as a permitted use of proceeds (debt structurally senior to the notes or any non-subordinated debt). • Transactions that are excluded from the definition of "Asset Sale." • Asset sale proceeds generally don't have to be spent within 365 days (or other specified time period) as long as a binding contract is in place within such time period, and the proceeds are in fact spent during a subsequent 180-day period.

<table>
<tr><th></th><th>Provision</th><th>Limitation on Sales of Assets and Subsidiary Stock</th></tr>
<tr><td></td><td>NOTEHOLDER PROTECTION LEVEL</td><td>Strongest protection in Asia and weaker similar protection in the United States and Europe</td></tr>
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• Types of consideration that will constitute “deemed cash” toward the 75% cash consideration requirement.
• Type of debt that can be repaid with asset sale proceeds as a permitted use of proceeds (debt structurally senior to the notes or any non-subordinated debt).
• Transactions that are excluded from the definition of “Asset Sale.”
• Asset sale proceeds generally don’t have to be spent within 365 days (or other specified time period) as long as a binding contract is in place within such time period, and the proceeds are in fact spent during a subsequent 180-day period.</td></tr>
<tr><td>ASIA</td><td>Under high-yield notes issued by PRC-based issuers, the asset sale test often includes an additional requirement that the issuer meet the fixed charge coverage ratio in connection with any sale of a restricted subsidiary, division or line of business. High-yield notes issued by PRC-based issuers often restrict restricted subsidiaries from entering into any sale-leasebacks.

Some high-yield notes issued by Indonesia-based issuers also prevent restricted subsidiaries from entering into sale-leasebacks, but allow the parent to enter into sale-leasebacks in certain circumstances. Many high-yield notes issued by Indonesia-based issuers include an additional requirement that the issuer be able to incur ratio debt for an asset disposition or sale of a restricted subsidiary, division or line of business.</td></tr>
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	Provision	Limitation on Affiliate Transactions
	NOTEHOLDER PROTECTION LEVEL	Strongest protection in Asia and weaker similar protection in the United States and Europe
DISTINGUISHING CHARACTERISTICS	UNITED STATES	Trend to not require independent fairness opinions, relying instead on decision of independent directors. Broad exceptions to covenant, including permitted restricted payments and permitted investments.
	EUROPE	Negotiation items typically include appropriate threshold for fairness opinion. Broad exceptions to covenant, including permitted restricted payments (other than permitted investments).
	ASIA	Under high-yield notes issued by PRC- wand Indonesia-based issuers, the covenant is often extended to apply to 5% to 10% stockholders.

	Provision	Limitation on Merger, Consolidation and Sale of Substantially All Assets
	NOTEHOLDER PROTECTION LEVEL	Strongest protection in Asia and weaker similar protection in the United States and Europe
DISTINGUISHING CHARACTERISTICS	UNITED STATES	Trend is to require that either the issuer could incur $1.00 under the fixed charge coverage ratio on a *pro forma* basis, or the *pro forma* fixed charge coverage ratio is not worse or is better than prior to the transaction. Requirement for leverage ratio condition is becoming less common.
	EUROPE	Frequently negotiated item includes whether issuer must be able to incur $1.00 under the fixed charge coverage ratio on a *pro forma* basis, or the *pro forma* fixed charge coverage ratio must be not worse or is better than prior to the transaction. Typical requirement that successor company be incorporated in "pre-expansion" (i.e., pre-2003) EU country, Switzerland or United States (i.e., assuming issuer is not organised in post-expansion EU country).

	Provision	Limitation on Merger, Consolidation and Sale of Substantially All Assets
	NOTEHOLDER PROTECTION LEVEL	Strongest protection in Asia and weaker similar protection in the United States and Europe
DISTINGUISHING CHARACTERISTICS	ASIA	In addition to the typical US and European market requirements, high-yield notes issued by PRC-based issuers require that (i) the issuer or the surviving entity have a consolidated net worth equal to or greater than the consolidated net worth of the issuer prior to the transaction and (ii) no rating decline has occurred. Many high-yield notes issued by Indonesia-based issuers also require the issuer or the surviving entity to have a consolidated net worth equal to or greater than the consolidated net worth of the issuer prior to the transaction. Certain high-yield notes issued by Indonesia-based issuers also require the surviving entity to be incorporated in Indonesia, Singapore or the United States.

	Provision	Change of Control
	NOTEHOLDER PROTECTION LEVEL	Strongest protection in the United States and weaker similar protection in Europe and Asia
DISTINGUISHING CHARACTERISTICS	UNITED STATES	Ratings trigger is typical only in stronger credit issuances and sponsor deals. Portability less common than in non-US jurisdictions. Recently, some deals trigger a change of control only if a leverage test is not met. Recent concern that dead hand proxy puts may be unenforceable and/or create director liability.
	EUROPE	Portability with double triggers (i.e., change of control plus ratings downgrade or leverage test) is typical only in stronger credit issuances and sponsor deals.
	ASIA	Under high-yield notes issued by PRC-based issuers, double triggers are common (with the requirement that the rating downgrade event occur within six months of the change of control event). High-yield notes issued by Indonesia-based issuers may have single or double triggers.

	Provision	Reporting Requirements
	NOTEHOLDER PROTECTION LEVEL	Equal protection in Europe and Asia
DISTINGUISHING CHARACTERISTICS	UNITED STATES	The issuer is required to furnish all quarterly, annual or certain reports that would be required on Forms 10-Q, 10-K and 8-K, respectively. Trend to give extended cure periods to reporting defaults, sometimes with an increase in interest rate. Also trend to exclude reporting defaults from "no-default" condition to other actions such as restricted payments and debt incurrence. Another trend is for the issuer to agree to hold quarterly conference calls with investors to discuss financial results.
	EUROPE	The issuer is required to deliver annual reports 120 days after year-end, quarterly reports 60 days after each of the first three fiscal quarters, and descriptions of certain material events promptly after they occur. First-time issuers typically have 90 days for first quarterly report. Frequently negotiated and increasing focus of investors is access to and required quality/scope of reports, in particular whether reports must be substantially similar in scope and content to (Rule 144A) offering memorandum or if lower standard applies. Certain privately-held (e.g., family-owned) issuers only make reports available on password-protected investor relations website.
	ASIA	High-yield notes by Asia-based issuers typically adopt the European requirements, although there is some case-by-case variation.

	Provision	Fall-Away Covenants
	NOTEHOLDER PROTECTION LEVEL	Equal protection in the United States, Europe and Asia
DISTINGUISHING CHARACTERISTICS	UNITED STATES	"Suspension" more typical than permanent "fall-away." The change of control and limitation on liens covenants are not fall-away covenants for the same reasons as in other regions.
	EUROPE	"Suspension" more typical than permanent "fall-away." The change of control and limitation on liens covenants are not fall-away covenants, as neither change of control or creation of lien for the benefit of other creditors can be later undone. "Negative pledge" also feature of (investment-grade) Eurobonds in Europe, so investment-grade status not a reason for limitation on liens covenant to fall away or be suspended.
	ASIA	"Suspension" more typical than permanent "fall-away." The change of control and limitation on liens covenants are not fall-away covenants for the same reasons as in other regions.

Closer Look at High-Yield Notes by Asia-Based Issuers

The preparation of high-yield note offerings by Asia-based issuers requires attention to distinctively Asian and country-specific concerns. The offering structures and covenant packages of such offerings, consequently, vary from their US and European counterparts in fundamental ways.

General Considerations for Asia-Based Issuers

Currency

The default currency for high-yield notes offered by Asia-based issuers continues to be the US dollar. However, other currency arrangements (e.g., dim sum notes and offerings in local denominations such as the Singapore dollar) are gaining traction.[9]

Rating Enhancements

In structuring an offer by an Asia-based issuer, it is important to attend to ways in which the structure can enhance the offering's ratings. The following are strategies to improve the ratings of high-yield notes offered by Asia-based issuers: (i) pledge of collateral, (ii) offshore escrow of proceeds, (iii) third-party guarantee, (iv) debt service reserve account, (v) amortisation schedule, (vi) equity sweetener such as warrants and (vii) pledge of offshore assets and revenues.

[9] Dim sum notes are denominated in renminbi but are issued outside of the PRC.

Offering Type

The choice between a Rule 144A offering and a Regulation S offering is not solely dictated by the offering size. For example, the target investor base is an important factor to consider. Offerings by higher-rated PRC property companies can be sold exclusively to Asian private banking clients, while lower-rated issuers are targeted to a more specialised investor base in the United States. Additionally, attention should be given to the necessary lead time. Rule 144A offerings take longer than Regulations S offerings to come to the market, because Rule 144A offerings are subject to more extensive due diligence procedures and disclosure requirements. See *Legal Considerations – Transaction structure and US federal securities law – Rule 144A*.

Key Considerations for Offerings by PRC Issuers

Credit Support and Structural Subordination

Under the PRC's regulatory scheme, it is virtually impossible for an operating company that is not a state-owned enterprise (i.e., an offshore holding company) to obtain the PRC approvals necessary to guarantee securities offered to non-PRC investors. As a result, high-yield notes issued by PRC-based issuers are deeply structurally subordinated, because the high-yield noteholders rank junior to creditors of the issuer's PRC subsidiaries. The usual remedy for structural subordination is to require upstream guarantees from operating subsidiaries. See *Subordination – Structural subordination*. In the PRC that necessitates upstream guarantees from all of the issuer's existing and future non-PRC subsidiaries.

However, the effectiveness of such upstream guarantees may be limited for the following reasons:

- Guarantees may be challenged by other creditors on the grounds of fraudulent conveyance if the subsidiary guarantor did not receive reasonably equivalent value for the guarantee;

- Existing lenders or minority shareholders may be prohibited from providing guarantees pursuant to existing agreements;
- If a subsidiary has significant minority shareholders, such minority shareholders may object to a guarantee by such subsidiary; and
- Subsidiaries cannot guarantee the notes if they are deemed to be investment companies pursuant to the US Investment Company Act of 1940, as amended.

Security

Due to Asian dynamics, the preferred method of using hard asset collateral to pledge as collateral for the notes is not available. PRC regulatory restrictions prohibit shares and assets of PRC operating companies from being pledged as security for offshore debt. While the shares of offshore intermediate holding companies are instead pledged in PRC deals, a foreclosure on such shares does not allow the noteholders to control the onshore PRC operating companies where the assets and revenues sit. As such, some high-yield note offerings by PRC-based issuers have omitted share pledges.

Covenant Package

Because high-yield notes issued by PRC-based issuers are deeply structurally subordinated, the covenant packages are designed to minimise the incurrence of onshore debt that is structurally senior to the offshore high-yield notes. See *A Closer Look at High-Yield Notes by Asia-based Issuers – General considerations for Asia-based issuers – Keyconsiderations by PRC issuers – Credit support and structural subordination*. However, due to the business reality in the PRC, many high-yield issuers require substantial flexibility – even when they are already highly leveraged. Accordingly, the covenant packages are designed to permit such issuers to incur substantial additional onshore debt through purchase money and other exceptions tied to a percentage of total assets that grows with the business.

Key Considerations for Offerings by Indonesian Issuers

Withholding Tax

Withholding tax is a key component in the structuring of high-yield notes issued by Indonesia-based issuers. Under Indonesian laws, payments of principal under high-yield notes are not subject to withholding tax, but interest income sourced from Indonesia is subject to withholding tax. Because withholding tax rates can be as high as 20% in Indonesia, issuers are incentivised to minimise withholding taxes or gross up payments.

On January 1, 2004, a tax treaty between Indonesia and the Netherlands became effective whereby the withholding tax rate of interest payments became 0% (as opposed to the previously prevailing rate of 10%) if:

- The interest income recipient is not permanently established in Indonesia;
- The interest was paid on loans with a term greater than two years; and
- The interest income recipient is the beneficial owner of the interest.

Indonesia and Singapore agreed to a similar scheme, under which the withholding tax rate decreased from 20% to 10%. As a result, many Indonesia-based issuers establish special purpose vehicles ("SPVs") in the Netherlands or Singapore to avoid the Indonesian withholding tax and issue the notes through the SPVs with guarantees from the Indonesian parent and its operating subsidiaries.[10]

However, Indonesian withholding tax regulations promulgated in November 2009 stated that tax treaties do not apply to non-resident companies without real commercial operations or interests. As such, in order to qualify for the benefits under tax treaties, the issuer must show: (i) the interest income recipient is not established merely to obtain treaty benefits, (ii) the interest income recipient has independent management and its own employees, (iii) the interest income recipient has an active

[10] Issuers ought to decide on a case-by-case basis as to whether, in establishing an SPV, it should be organised under the laws of the Netherlands or Singapore. It is important to note, however, that there is a perception that Dutch structures are subject to more scrutiny by Indonesian regulatory authorities.

operation or business, (iv) the interest income recipient is subject to tax in its jurisdiction of residence on Indonesia-sourced income and (v) 50% or more of the interest income recipient's income is not used to satisfy an obligation to another party in a form of interest, royalty or other reward.

Consequently, Indonesia-based high-yield issuers tend to use one of the following structures to minimise withholding taxes while complying with Indonesian regulations:

- **Double decker structure or dual issuer structure** – Under this structure, the Indonesian parent company establishes two companies in the Netherlands or Singapore. One of the two entities is an SPV that issues the notes and contributes the proceeds of such offering to a direct, wholly-owned operating company, which, in turn, on-lends the proceeds to the parent company through an intercompany loan.
- **Singapore operating company issuer structure** – Under this structure, the Indonesian parent company establishes a Singapore operating company that issues the notes and on-lend the proceeds to the parent company through an intercompany loan. It is unclear if this structure explicitly complies with the requirement that 50% or more of the interest income recipient's income not be used to satisfy an obligation to another party in a form of interest, royalty or other reward. But advocates of this structure rely on the notion that the Singapore entity will be taxed at 10% such that tax authorities will not review the structure.

Material Transactions

On November 28, 2011, the Indonesian Capital Markets and Financial Institutions Supervisory Agency ("BAPEPAM-LK") issued the New Material Transactions Rules, which requires Indonesian-listed issuers contemplating a high-yield note offering with a principal amount representing over 50% of the issuer's equity book value to take certain actions. First, such issuers must obtain shareholder approval of the maximum pricing terms of a proposed offering.[11] And, second, if the debt securities purchasers are

[11] This requirement is in contrast to the Material Transactions Rules issued in November 2009, which required the issuer to obtain prior shareholder approval for specific pricing-related terms through a general shareholder meeting significantly in advance of the offering launch.

unknown when such issuer enters into a material transaction, then such issuer must, within two working days of the issuance, announce, in at least one national Indonesian daily newspaper, information relating to the offering size, interest rate and value of any security.[12] The issuer must also submit all supporting documents to BAPEPAM-LK.

Security

The dysfunctional court system in Indonesia results in hard asset onshore collateral being a myth. As a result, many Indonesia-based high-yield note offerings are unsecured.

[12] In contrast to the Material Transactions Rules, under the New Material Transactions Rules, the issuer does not need to announce information relating to the purchasers and the summary of the independent appraiser's valuation report.

Legal Considerations

Governing Law

High-yield notes are generally governed by New York law because there is certainty in court interpretation and investors understand how the product works under New York law. The governing law, however, should be discussed among the issuer, the underwriters and their respective counsels at the outset of the transaction and attention should be paid to marketability considerations and the target investor audience for the particular offering (i.e., depending on the particular issuer and current state of the market, US investors may be a key target investor group and such investors may favour New York law). Irrespective of the governing law, the substance and drafting of high-yield note covenants is substantially similar.

Transaction Structure and US Federal Securities Law

Section 5 of the US Securities Act of 1933, as amended ("Securities Act"), prohibits any sales or offers for sale of securities in the United States or to US person unless a registration statement (including a prospectus that meets statutory requirements) has been filed with the US Securities and Exchange Commission ("SEC") or unless an exemption from such registration is available. Substantially all high-yield note offerings are conducted as private placements through a combination of Section 4(2) of the Securities Act, and (i) in the United States exclusively to qualified institutional buyers ("QIBs") in reliance on Rule 144A under the Securities Act ("Rule 144A") and (ii) outside of the United States in reliance on Regulation S under the Securities Act ("Regulation S").

Section 4(2)

The first step in the note offering is the sale of the notes from the issuer to the initial purchasers (i.e., the underwriters). This is accomplished through a private placement of the notes under Section 4(2) of the Securities Act which exempts transactions by an issuer not involving a public offering. After the private placement from the issuer to the initial purchasers, the initial purchasers resell the notes in the United States under Rule 144A and outside the United States under Regulation S.

Rule 144(A)

Rule 144A provides a safe harbour that permits resales of securities (including resales by the underwriters in a securities offering) only to QIBs. QIBs include various enumerated categories of sophisticated institutional investors with at least US$100 million of securities of non-affiliates under management as well as SEC-registered broker-dealers owning and investing at least US$10 million in securities of non-affiliates. In addition, to be eligible for the Rule 144A safe harbour, purchasers must be notified that a proposed sale is made pursuant to Rule 144A (typically by way of appropriate legends and disclaimers in the offering memorandum) and the relevant securities must (i) not be of the same class as securities listed on a US exchange or quoted on a US automated inter-dealer quotation system (e.g., NASDAQ), (ii) not be convertible or exchangeable into listed or quoted securities with an effective premium of less than 10% and (iii) not be issued by an open-end investment company. Holders of the relevant securities and prospective purchasers designated by the holders must have the right to obtain from the issuer certain reasonably current information about the issuer. Because resales of securities pursuant to Rule 144A (like any other offers and sales of securities in the United States) are fully subject to the liability and anti-fraud provisions under the US securities laws (including Rule 10b-5 under the US Securities Exchange Act of 1934, as amended ("Exchange Act")), it is market practice to provide disclosure in connection with a Rule 144A offering that is substantially similar to the disclosure required for an SEC-registered offering, both in terms of quality and scope. This is why the due diligence exercises conducted by the working group in a Rule 144A transaction is so comprehensive and robust. See *Transaction Execution – Documentation – Legal opinions and disclosure letters*.

Regulation S

Regulation S provides a safe harbour from the registration requirements of Section 5 of the Securities Act for certain offerings outside the United States and offshore resales of securities. If the conditions of Regulation S are met, the transaction is deemed to take place outside of the United States and does not trigger the registration requirements of Section 5 of the Securities Act.

Regulation S transactions start with the same basic conditions provided by Rule 903 whereby an offer or sale of securities is deemed to occur outside the United States if (i) the offer or sale is made in offshore transactions and (ii) no directed selling efforts are made in the United States by the issuer, the underwriters, any other distributor, any of their respective affiliates or any person acting on their behalf.

An offshore transaction is defined as an offer that is not made to a person in the United States and either:

- At the time the buy order is originated, the buyer is outside the Untied States or the seller and any person on the seller's behalf reasonably believes that the buyer is outside the United States;
- The transaction is executed in, on or though the physical trading floor of an established foreign securities exchanged located outside of the United States (for issuer safe harbour); or
- The transaction is executed in, on or though the facilities of a designated offshore securities market and neither the seller nor any person on the seller's behalf knows the transaction has been prearranged with a buyer in the United States (for resale safe harbour).

PRACTICE TIPS

It is important to determine with the underwriters as early as possible whether a transaction will be structured as Regulation S only or Regulation S/Rule 144A as this will impact the due diligence and disclosure requirements, among other things, and the overall transaction timeline.

Directed selling efforts means any activity undertaken for the purpose of, or that could reasonably be expected to have the effect of, conditioning the US market for any of the securities being offered in reliance on Regulation S. It is therefore necessary for the US counsel involved in an offering to analyse any relevant activity or communication in terms of its audience, timing and content as well as in light of both the various exceptions included in the definition of directed selling efforts and the relevant SEC staff positions.

In order to qualify for a given safe harbour under Regulation S, certain additional requirements, such as the implementation of additional offering restrictions and the imposition of a distribution compliance period, may have to be met as well. These requirements vary depending principally on the status of the issuer and the likelihood of the securities flowing into the US market. The three categories of requirements are:

- **Category 1** (least restrictive) – it is unlikely that securities offered abroad will flow into the US market and no other requirements need to be met other than the Regulation S basic conditions;
- **Category 2** – adequate information about the issuer is publicly available in the United States, such that the concerns about securities flowing into the US market are reduced. Offering restrictions must be adopted, including a 40-day distribution compliance period; and
- **Category 3** (most restrictive) – adequate information about the issuer is not publicly available in the United States and existing potential US market interest is sufficient (i.e., there is substantial US market interest or "SUSMI" with respect to the relevant securities) to suggest that offerings of the issuer's securities outside the United States may not come to rest abroad). All of the category 1 and 2 restrictions must be adopted (with further distribution compliance period restrictions) and certain purchaser certifications and others restrictions must be satisfied.

Publicity Restrictions

The securities laws of many jurisdictions, in particular the United States, impose various restrictions on publicity and the release of information generally in connection the proposed offerings of securities. Publicity for this purpose can be construed very broadly and may include any form of communication, whether in written, oral or electronic form, that (i) relates to or concerns the offering, (ii) relates to the performance, assets, liabilities, financial position, revenues, profits, losses, trading record, prospects, valuation or market position of the issuer, (iii) might affect an investor's assessment of the financial position and prospects of the issuer or (iv) otherwise has the purpose, or reasonably could have the effect, of conditioning the market in a particular jurisdiction or influencing or encouraging an investor's interest in the issuer, the offering, or a decision to purchase the securities in question.

The release of information that is inaccurate, misleading or inconsistent with the offering memorandum is undesirable, as it may cast doubt on the accuracy of the offering memorandum. Failure to observe publicity requirements may result in publication, registration or similar requirements under the securities laws of various jurisdictions and imposition of a cooling off period. However, it often results in the offering dying. As such, careful attention to publicity is imperative to the successful completion of an offering. A common issuer problem is information on the issuer's website. Therefore, the issuer's website should be scrubbed before the deal to remove all information that is inaccurate, misleading or inconsistent with the offering memorandum. Additionally, the issuer should avoid posting information on its website during the course of the offering.

To ensure compliance with all applicable securities laws and regulations, the issuer's counsel prepares publicity guidelines at the outset of a proposed offering. The guidelines are reviewed by the underwriters' counsel and must be adhered to by all offering participants. While all issuer representatives and other offering participants who are likely to be approached by, or come in contact with, the press or securities analysts during the course of the offering should be familiar with the publicity guidelines, it is advisable to appoint one issuer representative to serve as the initial point of contact with the press and securities analysts and to handle publicity and other broad-based communications during the offering process.

PRACTICE TIPS

Publicity restrictions should be implemented very early in the process and in most cases are in place shortly after the transaction kick off.

Transaction Execution

Pre-Launch

Under ideal circumstances and with the full commitment of all parties involved in the offering, the preparations for a high-yield note offering for a first-time issuer can be completed within about eight weeks from the initial kick-off meeting to the offering launch (i.e., the formal external announcement of the proposed offering). Factors that cause delays include: (i) the lack of existing, high-quality, English language disclosure language for the issuer that can be tailored for purposes of the offering memorandum, (ii) the time needed by issuer's internal accounting team and external auditors to prepare the required financial information, (iii) complications and delays in any necessary negotiations with existing creditors of the issuer, (iv) complexities involved in releasing existing security interests (in favour of creditors that are being repaid) and in creating new security interests (in favour of the noteholders), (v) delays and complications in the rating process and (vi) general market conditions.

The table below details a typical pre-launch timeline:

Time	Tasks
week 1	• Issuer's counsel prepares initial offering memorandum outline and discusses it with issuer. • Issuer, underwriters and their respective counsels agree to offering structure. • Issuer and issuer's counsel discuss covenant package. • Issuer's counsel discusses covenant concerns with underwriters. • Issuer prepares data room in response to due diligence request list provided by issuer's counsel and underwriters' counsel. • Underwriters circulate management due diligence questionnaire. • Issuer's counsel circulates publicity guidelines. • Underwriters' counsel circulates research guidelines.
Week 2	• Issuer circulates management presentation to working group. • Issuer, underwriters and their respective counsels agree to approach with respect to existing lenders and security trustee. • Working group provides high-level feedback on draft offering memorandum. • Issuer and issuer's counsel revise draft offering memorandum. • Issuer's counsel and underwriters' counsel commence documentary due diligence. • Underwriters and underwriters' counsel draft description of the notes, terms and conditions and note documentation.
Week 3	• Select stock exchange for listing notes. • Select trustee and trustee's counsel. • Issuer's counsel re-circulates offering memorandum draft. • Underwriters' counsel circulates draft description of the notes. • Draft documentation for trustee accession arrangements to existing security (if applicable). • Underwriters and underwriters' counsel review draft offering memorandum and prepare consolidated mark up. • Issuer and issuer's counsel discuss description of the notes. • Drafting session on draft offering memorandum. • Draft accountant engagement and comfort letters circulated. • Underwriters and underwriters' counsel circulate draft purchase agreement. • Issuer and underwriters prepare ratings agency presentation. • Issuers, underwriters and their respective counsels further discuss approach with respect to existing lenders and security trustee, if necessary.

Time	Tasks
Week 4	• Issuer's counsel re-circulates offering memorandum to working group. • Issuer's counsel circulates mark up of description of the notes. • Underwriters and underwriters' counsel review draft offering memorandum and prepare consolidated mark up. • Underwriters, issuer and their respective counsels discuss description of the notes. • Drafting session on draft offering memorandum. • Issuer and issuer's counsel discuss purchase agreement and circulate mark up to underwriters and underwriters' counsel. • Issuer and underwriters prepare ratings agency presentation.
Week 5	• Drafting session on draft offering memorandum, if necessary. • Discussions on description of the notes (including with trustee and trustee's counsel) and trustee note accession arrangements. • Discuss purchase agreement, if necessary. • Issuer and underwriters prepare ratings agency presentation. • Work on road show presentation.
Week 6	• Issuer submits draft offering memorandum to stock exchange and sends it to printers (if it is sufficiently advanced). • Drafting session on draft offering memorandum, if necessary. • Discuss purchase agreement, if necessary. • Meetings with ratings agencies. • Work on road show presentation.
Week 7	• Issuer receives stock exchange comments to the draft offering memorandum, incorporates such comments and resubmits draft offering memorandum to exchange. • Underwriters' counsel finalises description of the notes. • Discuss purchase agreement, if necessary.
Week 8	• Issuer's counsel finalises preliminary offering memorandum, including with stock exchange • Finalise purchase agreement • Finalise road show presentation • Security trustee and any lender consents obtained • Receive preliminary feedback from rating agencies • Print preliminary offering memorandum

Post-Launch

To market and build momentum for the offering, the issuer and the underwriters go on a road show (the length of which varies from a few days up to two weeks) after launch. During this time the other members of the working group finalise the listing, note rating and contractual documentation.

Following completion of the road show, all parties participate in a bring-down due diligence call with the issuer's management, the issuer's auditors deliver the comfort letter, and the issuer and the underwriters hold the pricing meeting during which the offering terms are set. After the pricing meeting, the issuer, any guarantors and the underwriters sign the purchase agreement, at which point the issuer and the underwriters are bound to complete the offering, subject to certain closing conditions. The issuer's counsel and the underwriters' counsel then prepare the final offering memorandum and closing documents in preparation for closing. Upon closing, which usually takes place five business days after the pricing date ("T+5"), the notes are formally issued and delivered by the issuer against payment therefore by the underwriters.

Documentation

Offering Memorandum

The offering memorandum is a disclosure document intended to provide potential investors with all material information necessary to make informed investment decisions. In addition to providing potential investors with information about the proposed offering, the offering memorandum serves to protect both the issuer and the underwriters from liability under applicable securities laws for alleged material misstatements or omissions in connection with the offer and sale of the notes.

The key disclosure items in the offering memorandum are:

- **Offering summary** – markets the offering by providing (i) an issuance overview, (ii) a business description (including corporate strategies and competitive strengths), (iii) the corporate and transaction structure and (iv) a financial summary;
- **Risk factors** – specifies the risks associated with the issuer, the issuer's industry, the issuer's country and risks related to the notes;
- **Use of proceeds** – describes how the proceeds from the issuance will be applied;
- **Capitalisation** – sets forth the issuer's actual and *pro forma* capitalisation;

- **Financial statements** – the issuer's audited and reviewed financial statements (prepared in accordance with international financial reporting standards ("IFRS"), the issuer's country's generally accepted accounting principles ("GAAP") or US GAAP) including balance sheet (end of two most recent fiscal years and most recent interim period), statements of income, cash flows and stockholders' equity (three most recent fiscal years and most recent interim period and comparable prior year interim period);
- **Management's discussion and analysis ("MD&A")** – describes the issuer's financial performance through the eyes of the issuer's management team;
- **Industry** – describes the issuer's industry;
- **Business description** – describes the issuer's business;
- **Management overview** – describes each of the issuer's directors and key management members;
- **Description of other indebtedness** – describes an overview of the issuer's existing debt;
- **Description of the notes ("DoN")** – specifies the terms and conditions of the notes; and
- **Transfer restrictions, plan of distribution** – describes the selling restrictions on the distribution of the notes.

In addition, certain industries, such as oil and gas, banking and real estate may require another level of industry-specific disclosure as set out under specific SEC disclosure guides. Expert reports may also be included in the offering memorandum.

PRACTICE TIPS

Determination by the working group (i.e., auditors, underwriters, issuer and counsels) of the financial statements to be included in the offering memorandum should be made as early as possible so that the scope of due diligence and disclosure and comfort letter deliverables are clear to all parties and can be managed appropriately to meet the targeted timeline.

Indenture

The indenture is the contract entered into among the issuer, any guarantors and the trustee (an agent acting on behalf of the noteholders). It includes all of the terms of the notes including interest rate and maturity date and all of the note covenants. The terms of the indenture are summarised in the description of the notes section of the offering memorandum.

Purchase Agreement

The purchase agreement is the contract between the issuer and the initial purchasers, or underwriters, whereby the issuer agrees to issue and sell the notes to the initial purchasers and the initial purchasers agree, subject to certain conditions, to purchase the notes from the issuer at an agreed price at closing. Additionally, in the purchase agreement, the issuer makes numerous representations and warranties, including with respect to its business and the completeness and accuracy of the offering memorandum, and agrees to indemnify the initial purchasers for any losses and issues with respect to the disclosure in the offering memorandum. In certain cases, this indemnity will cover a breach of operational and other company representations contained in the purchase agreement.

Intercreditor Agreement

The intercreditor agreement governs the common terms and relationships among the creditors with respect to the issuer's obligations. The parties to the intercreditor agreement include the main secured creditors of the issuer. The agreement contains provisions limiting the ability of creditors to vary their respective rights and addresses issues such as voting rights, notifications of defaults and the order of applying proceeds of any debt recovery efforts (including from the sale of collateral). To the extent certain groups of creditors are subordinated to other groups of creditors, the intercreditor agreement sets forth the terms of subordination and other principles to apply. See *Subordination – Lien subordination*.

Legal Opinions and Disclosure Letters

At closing, both the issuer's and the initial purchasers' international and local counsels provide the underwriters with opinions with respect to certain legal matters and, for offerings into the United States under the Rule 144A resale exemption, formal disclosure letters (referred to as negative assurance letters or Rule 10b-5 letters). The Rule 10b-5 letters indicate that, in connection with counsels' work on the offering and as a result of their own investigations, nothing causes them to believe that the offering memorandum is materially incomplete, inaccurate or misleading. These letters are the culmination of counsels' comprehensive due diligence of the issuer during the course of the transaction and satisfaction that offering memorandum disclosure is in line with the US federal securities law anti-fraud provisions under Section 10b and Rule 10b-5 of the Exchange Act. The Rule 10b-5 letter is a requirement for the initial purchasers for any Rule 144A high-yield note offering.

Comfort Letters

The comfort letter is issued by the issuer's auditors at pricing and is addressed to the initial purchasers. In the comfort letter the auditors (i) reaffirm their independence, (ii) state that they stand by their audit opinion on the issuer's audited financial statements included in the offering memorandum, (iii) describe any procedures they have performed on any interim financial information included in the offering memorandum or on any internal management accounts for the period of time between the date of the issuer's latest audited or reviewed financial statements and the date of the offering memorandum ("stub period"), (iv) describe any additional agreed-upon procedures they conducted with respect to the issuer's financial information included in the offering memorandum and (v) provide negative assurance as to the absence of material changes with respect to certain specified financial line items during the stub period. The issuer's auditors will provide a bring-down comfort letter, as of the closing date, to verify that the original comfort letter is still valid.

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