KING & SPALDING

Private Credit & Special Situations Investing

WHAT IS IT?

"No worse than" prong

Summary

Lenders prefer not to include a "no worse off" test because it provides the Borrower with flexibility to incur additional debt even if the leverage of the company is very high. For example, if the company is not doing well financially and EBITDA has dropped causing leverage to rise to 10x, the Borrower could still go out at this leverage level and make an acquisition with new incremental debt, so long as on a pro forma basis, the leverage of the combined entity does not exceed 10x. These are particularly egregious in covenant lite deals where there is not leverage Financial Covenant and leverage at the time of acquisition could theoretically be any number. A Borrower may argue that the new debt and acquisition does not hurt the Lenders because leverage is no worse. However, many lender positions will be that at leverage levels above the ones already set forth in the Credit Agreement, the Borrower should be focused on repaying debt rather than incurring additional debt for an acquisition that may or may not benefit the company in the long run.

Examples

- Pro forma compliance with a Total Net Leverage Ratio (to be defined but to not include a cap on cash netting) that is no greater than 6.00:1.00 **(or, if such incurrence is in connection with an acquisition or similar investment, a pro forma Total Leverage Ratio that is no worse than the Total Leverage Ratio prior to such acquisition or similar investment)**.
- The First Lien Net Leverage Ratio (as determined on a Pro Forma Basis) shall not exceed the greater of (x) 5.25x) and **(y) the First Lien Net Leverage Ratio immediately prior to the incurrence of such Indebtedness**.