Linklaters

An in-depth study into liability management transactions: Session 3 - Exchange Offers

May 2020

Our five part liability management webinar series – your questions answered

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

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

> How do we locate bondholders?

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

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

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

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

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

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

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

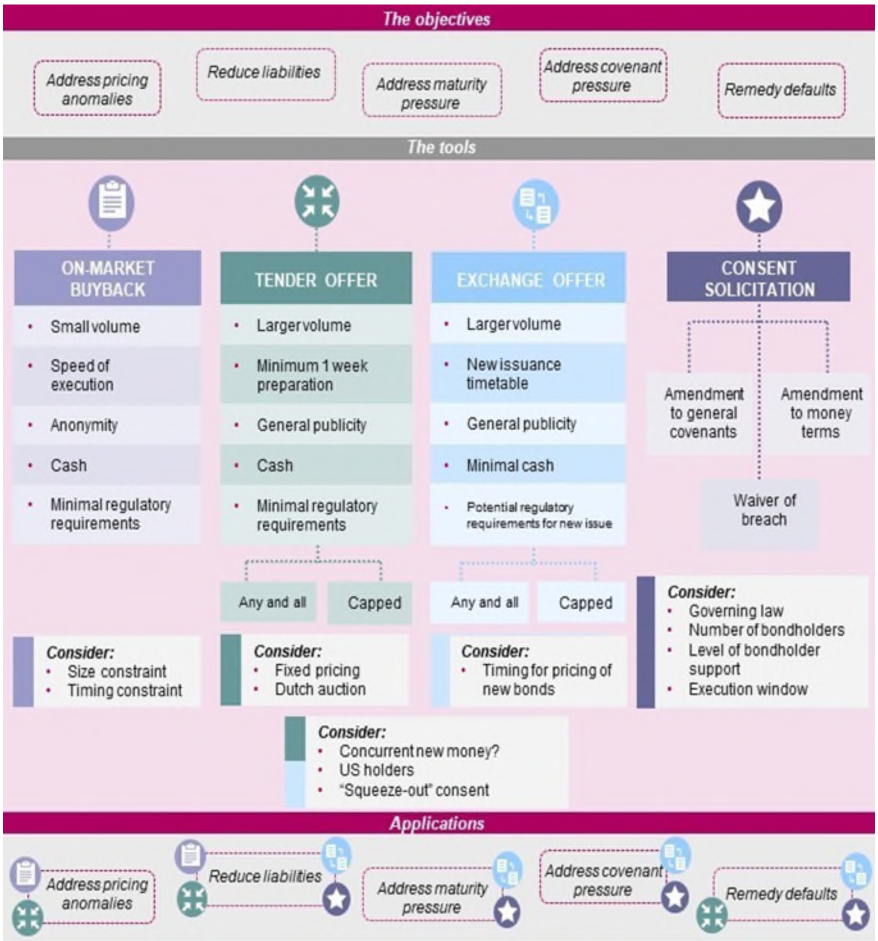
> **What happens if the issuer's financials will be published during the offer period?**

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

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

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

The road map below illustrates some of the key areas which we will be exploring in our five part webinar series.



This client note is a follow-up to Session 3 that was held on 12 May 2020 for our debt capital markets clients.

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

Introduction

In this Session 3, we provide an in-depth discussion on exchange offers, including:

> Reasons for conducting exchange offers;

> Pricing and structural considerations when undertaking an exchange offer;

> Practical and commercial issues to consider where a new money tranche is being undertaken concurrently with the exchange offer; and

- Other interesting issues from case studies including third party exchange offers and securing anchor bondholder support.

In this series, we have focussed primarily on liability management conducted outside of the United States although our fifth and final webinar and client note will examine U.S. issues on liability management transactions.

Exchange offers

An exchange offer is an approach by an issuer to exchange its existing bonds for an issue of new bonds. The time required to structure and prepare the relevant documentation for an exchange offer will typically be more than an on-market buyback or tender offer. Generally speaking, the timing will be similar to a standard new issuance timetable and will vary depending on whether the new bonds under the exchange offer are being issued pursuant to a standalone issuance or off a medium term note programme.

Why undertake an exchange offer?

Reasons for undertaking an exchange offer

There are various reasons why an issuer may choose to undertake an exchange offer – for example:

- An issuer's bonds may be nearing maturity and it may wish to refinance by extending the maturity date;
- An issuer who is conducting a new money issuance may look to issue further new bonds under an exchange offer at the same time in order to build the new issuance to a benchmark size;
- A third party offeror may wish to use its credit to exchange the existing bonds of another issuer for new bonds issued by itself in order to offer investors of the existing bonds (which may be distressed) a way to exit their investment and improve the investors' prospects of recovery in the long term; and
- Reasons specific to a particular product type such as:
  - Where an existing convertible bond is deeply "out of the money", an issuer may look to offer holders the opportunity to swap the existing convertible bond for a new convertible bond with a lower conversion price, particularly in circumstances where there is an upcoming maturity date or put date for the existing convertible bond; and
  - In the regulatory capital space, certain existing regulatory capital instruments may represent an expensive source of funding for the issuer, and the issuer may be keen to exchange such existing instruments for newer regulatory capital instruments. This may be particularly so if the regulatory capital recognition of the existing instruments is being amortised under the relevant transitional capital rules and further de-recognition is expected over the remaining life of such instruments.

To tender OR to exchange?

In deciding whether to undertake an exchange offer or a tender offer, an issuer would consider various factors including:

> the amount of cash available;

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

> the nature of the existing bonds and overall bondholder sentiment (for example, holders may generally want to stay in the credit, likewise a holder of a perpetual instrument may prefer being offered a new bond as opposed to receiving cash); and

> the nature of any regulatory approvals required (for example, registration with the National Development and Reform Commission in Mainland China).

To tender AND exchange?

An issuer may choose to structure its transaction as a tender and exchange offer if it is looking to maximise take up, by offering investors the option to receive either cash or new bonds. If the issuer only has a limited amount of cash available but still wishes to encourage holders to exit the existing bond, it can choose to set a cap on the tender offer piece and introduce an exchange offer piece to maximise overall participation.

Pricing and Structure

Some initial considerations when structuring an exchange offer include:

> Are you targeting “any and all” or a capped amount of the existing bonds?

> Will interest and/or rounding amounts be paid out, either in cash or capitalised into new bonds?

> Will you impose a minimum issue size for the new bonds as a condition to the exchange offer?

An issuer should also consider how and when the new bonds will be priced in an exchange offer context. There are various ways in which pricing can be structured but three common approaches are examined below:

> **At launch**: by fixing the full pricing terms (other than the issue size) of the new bonds at launch, this approach provides the issuer with more certainty around the new issuance terms, but has the slight disadvantage of exposing the issuer to a longer window of market risk

> **During the offer period**: the pricing terms (other than the issue size) of the new bonds are announced during the offer period, ideally at least two to three business days prior to expiration to ensure this information is disseminated to holders in time.

> **After the expiration deadline**: investors are provided with the key pricing parameters of the new bonds (such as a minimum yield) either at

launch or during the offer period in order to allow them to make an investment decision. The full pricing terms (including the issue size) of the new bonds is then determined shortly following the expiration deadline. This option is particularly common where there is a concurrent new money tranche being undertaken.

Issues to consider in an exchange offer and concurrent new money tranche structure

- **How should the exchange offer timetable interact with the timing of the concurrent new money tranche?** From a marketing perspective, will the exchange offer and the concurrent new money tranche launch at the same time? Will they settle on the same date? When will you price the new bonds given there will be a book-building process for the new money tranche? For example, an issuer may wish to publish the results of the exchange offer (or in some cases, indicative non-binding results of the exchange offer) prior to pricing of the new bonds, as the results of the exchange offer may provide a positive signal to the market as part of the book-building and pricing of the new money tranche.
- **Should the exchange offer be conditional on the completion of the new money tranche?** An issuer may impose such a condition to the exchange offer if it wants to ensure that the total issue size of the new bonds is of a substantial size, which it may not be able to achieve if there is no new money tranche.
- **What pricing should be offered to investors in the new money tranche?** For example, if the terms of the new bonds under the new money tranche (such as the issue price) were more favourable than the terms of the new bonds under the exchange offer, would investors in the exchange offer be unfairly prejudiced?

Further issues to consider from case studies

Third party exchange offers

Third party exchange offers (or any form of third party liability management for that matter) present some interesting issues which should be considered at an early structuring stage. For example:

- **To what extent should the existing issuer be involved in the exchange offer?** This will impact whether the existing issuer is included as a party to the contractual documentation and how announcements relating to the exchange offer can be published. Furthermore, if the existing issuer is not involved in the exchange offer, certain events relating to the existing bonds may not be completely within the control of, or known to, the third party offeror. For example, the existing issuer could redeem the existing bonds if they fall due during the offer period or it could publish announcements during the exchange offer which could have a material impact on the price of the existing bonds.
- **What is the underlying commercial rationale for the third party exchange offer?** Will the third party continue to hold the existing bonds

following completion of the exchange offer or will the existing bonds be cancelled?

> **Is there any intention by the third party offeror to sweep up the remaining existing bonds?** If so, any squeeze out consent should ideally be undertaken concurrently with the exchange offer (rather than after consummation of the exchange offer). In addition, discussions with the trustee should be initiated early on to flush out any queries or concerns.

> **Reach out to the clearing systems at the outset.** Engage an exchange agent early on so that discussions with the clearing systems can occur well ahead of launch. The clearing systems may have specific questions or concerns around the structure of, and reasons for, the third party exchange offer. They may also require further information around the relationship between the existing issuer and the third party offeror.

> **Are there any inside information concerns, particularly in the context of pre-sounding?** The analysis will be highly fact specific and will depend on the wider context of the existing bonds (for example, whether the existing bonds are in distress or in default).

Anchor bondholder support

An issuer may wish to secure support from one or more “anchor” bondholders ahead of the launch of an exchange offer or other liability management exercise. Consideration should be given to how such bondholders can be approached prior to launch (bearing in mind some of the principles around pre-sounding discussed in our Session 2 webinar). If such support is secured, the issuer might consider if and how this might be disclosed in the offer memorandum. For example, the issuer may include “soft” language indicating that it has received informal indications from holders representing a certain percentage of the existing bonds that they intend to participate in the exchange offer.

Publication of financial statements during the offer period

If the issuer is expecting to publish financial statements during the offer period, consideration should be given to how this can be dealt with from a commercial and legal perspective. For example:

> **Delay the instruction window**: it may be possible to delay the instruction window for submitting exchange instructions so that, rather than commencing at launch, the instruction window will only commence after publication of the financial statements.

> **Grant automatic revocation rights**: it may be possible to allow investors to revoke their previously submitted instructions once the financial statements have been published. However, this option is slightly more cumbersome and may not always be acceptable from a commercial perspective.

Stay tuned: 19 May 2020 - our next webinar session on consent solicitations

We welcome you to join us for our next session on consent solicitations, bondholders holdouts and challenges where we will take an in-depth look into:

> The reasons for conducting consent solicitations;

> "Squeeze out" consents, how they work and issues to look out for;

> The challenges associated with bondholder committees and holdouts; and

> The position of the trustee in consent solicitations.

Contacts

Sherry Cui
Partner, Hong Kong SAR
Tel: (+852) 2842 4134
sherry.cui@linklaters.com

Karen Cheng
Counsel, Hong Kong SAR
Tel: (+852) 2901 5566
karen.cheng@linklaters.com

For general enquiries please contact

Linklaters
11th Floor, Alexandra House
Chater Road
Hong Kong SAR
China

Tel: (+852) 2842 4888
Fax: (+852) 2810 8133/2810 1695

linklaters.com