COVID-19 Coronavirus Business Impact Broadcast Series

Is Your Debt Trading Below Par? Have You Thought About Buying it Back?

MAY 15, 2020

On May 15, 2020, Dechert's Private Equity group presented "Is Your Debt Trading Below Par? Have You Thought About Buying it Back?" an episode of the firm's COVID-19 Coronavirus Business Impact Broadcast Series. The episode was hosted by Anna Tomczyk (moderator), a corporate and securities associate in the firm's New York office; John Markland, a partner based in the firm's London office and co-head of the firm's leveraged finance group; and Ian Hartman, a corporate and securities partner in the firm's Philadelphia office.

The presenters discussed how the decline in the trading prices of bank loans and corporate bonds resulting from the COVID-19 pandemic may present opportunities for companies to deleverage their balance sheets by buying back their own debt and for PE sponsors to shore up the stability of their portfolio companies while maintaining their liquidity by reducing or restructuring debt within their investment portfolio.

HIGHLIGHTS FROM THE EPISODE

Debt Buyback Mechanics for Bank Loans

The specific procedures for buying back debt, if permitted, vary from credit agreement to credit agreement. Where permitted, buybacks are typically handled through one of two processes: a solicitation process, which is effectively a reverse Dutch auction, in which lenders are invited to pitch to sell their debt, stating the price and quantity at which they are willing to sell, and the borrower is obliged to accept the lowest offers first; or an open-order process, in which the borrower states a price and amount that it is interested in buying and lenders can choose to accept the offer or not. These procedures give all lenders an equal opportunity to participate in the buyback and prevents borrowers from opportunistically buying from individual sellers at attractive prices.

Debt Buyback Mechanics for Corporate Bonds

Indentures governing corporate bonds typically do not have procedures covering or restricting buybacks, though it is important to review the indenture in question for potential buyback-related covenants. In addition to standard insider trading considerations, buyers of corporate bonds need to be careful that their purchases will not unintentionally constitute a tender offer under U.S. securities rules, which may delay or add complexity into the buyback process. If a buyer does choose to proceed with a formal tender offer, there are several ways to work through the complexity and make it as efficient as possible.

Considerations for Private Equity Sponsors

PE sponsors interested in buying back portfolio-level debt using their own cash are typically free to do so under the applicable loan documents, but this type of buyback does not actually serve to deleverage the borrower group's balance sheet, unless the purchased debt is transferred into the group (which usually is not desirable). A sponsor holding repurchased debt is often disenfranchised in the lender decision-making process under the loan documents.

Tax Considerations

The major tax concern in any debt restructuring is that the reduction in the principal amount due gives rise to cancellation of debt income ("CODI"), which is taxable income unless an exception applies. Even if there is no reduction in the principal amount due, negotiated changes to debt documents (such as changes in yield or collateral or payment deferrals) can be considered deemed debt exchanges, and debt exchanges, whether deemed or intentional, can also give rise to CODI if publicly traded debt is trading below par.