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Liability Management Transactions, Episode 2: Drop-Downs

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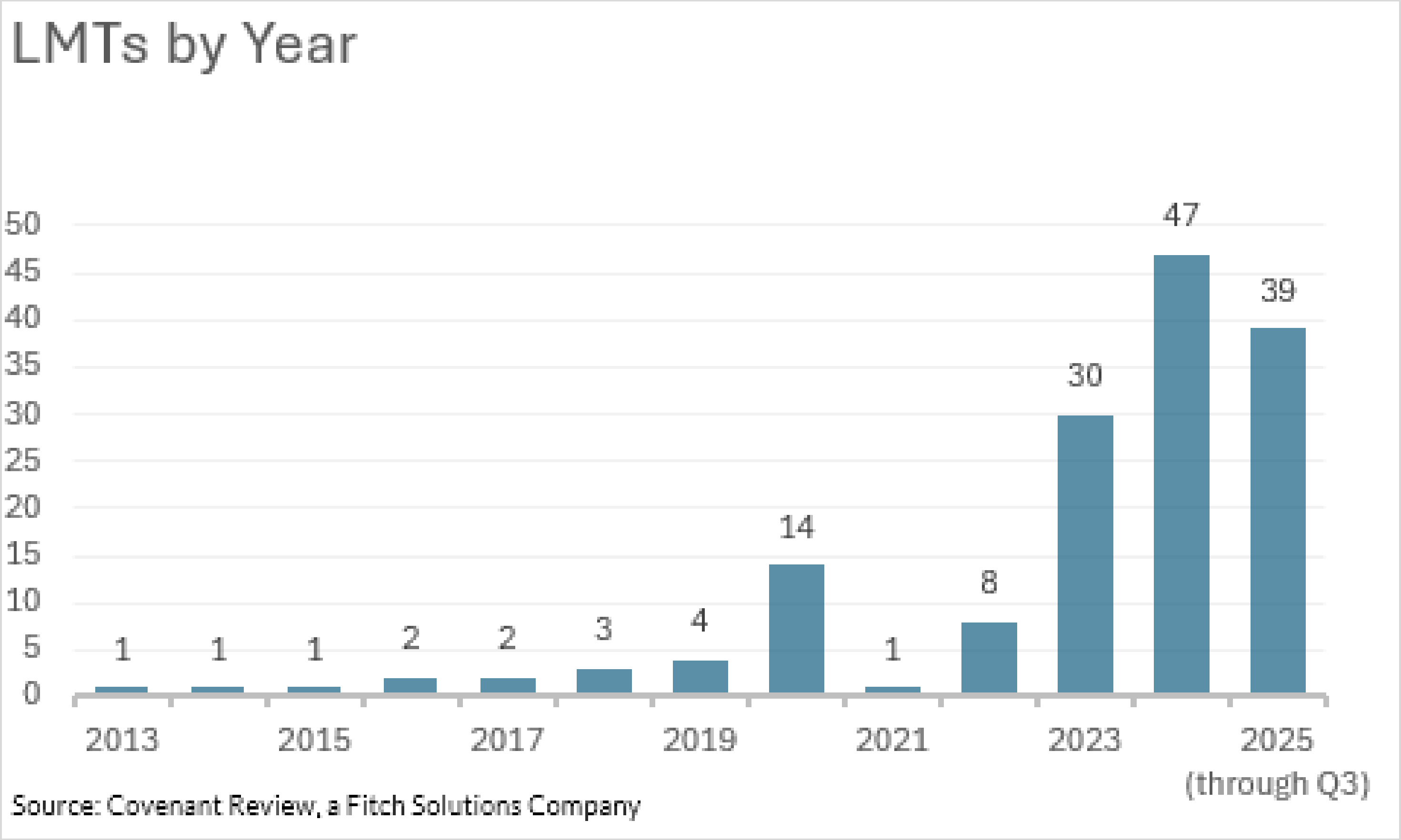
What is a Liability Management Transaction (LMT)?

- A transaction by a distressed borrower or issuer which utilizes existing or amended contract terms to manage long-term corporate debt liabilities with creative out-of-court solutions.
- Can significantly affect creditor rights, collateral pools, and recovery values.
- No formal definition.



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Common Types of Liability Management Techniques

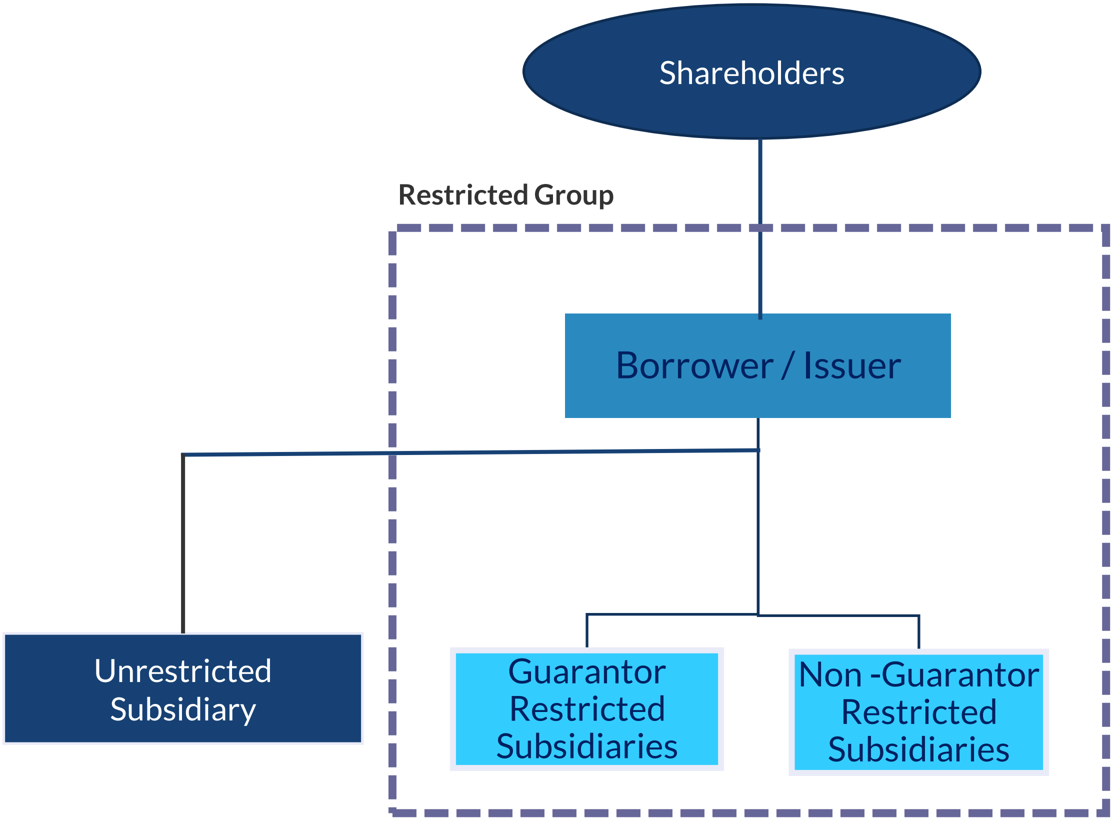
- Uptier Transactions (“Serta”)
- Drop-down Transactions (“J. Crew”)
- Double-Dip / Pari Plus Transactions (“At Home”)
- Miscellaneous: Combination of the above, as well as other structures

Drop-Down Transactions - Overview

- **Overview:** Value transfer to non-credit parties, often followed by structurally senior debt issued out of those subsidiaries

- **Impact on recoveries / waterfall:** Could lead to lower-than-expected recoveries due to value leakage to entities not providing credit support

- **Enabling provisions:**
  - Broad Investment carveouts
  - Potential "free-flow-of-value" weaknesses
  - Debt and/or liens carveouts if the transferee is a non-guarantor restricted subsidiary.
  - Non-pro rata buyback flexibility (in the case of exchanges)
  - Broad securitization flexibility



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DROP-DOWN TRANSACTIONS – WHITHER THE TRAP DOOR?

- “J. Crew Trapdoor” basket is generally viewed as a specific basket and not a “LME” mechanism

- Section 7.02(t): “Investments **made by any Restricted Subsidiary that is not a Loan Party** to the extent such Investments are financed with the proceeds received by such Restricted Subsidiary from an Investment in such Restricted Subsidiary made pursuant to **Sections 7.02(c)(iv),** (i)(B) or (n)”

- Section 7.02(c)(iv): “Investments … (iv) by any Loan Party in any Non-Loan Party that is a Restricted Subsidiary; *provided* that … the aggregate amount of Investments made pursuant to this clause (iv) shall not exceed at any time outstanding the sum of (x) the greater of **$150,000,000 and 4.00% of Total Assets** and (y) the Available Amount (if positive) at such time”

J. Crew basket effectively extinct (and a red herring). What really matters is the capacity to invest assets in an Unrestricted Subsidiary under the applicable credit agreement and/or the indenture; not a particular carveout.

FREE-FLOW-OF-VALUE AND THE "BLACK HOLE"

- **Free-flow-of-value:** Allows uncapped investments among the company and its restricted subsidiaries, including investments in non-guarantor restricted subsidiaries

> "Permitted Investments" means:
>
> (1) any Investment in the Company or any of its Restricted Subsidiaries;

- **J. Crew trapdoor:** Allows investments made by non-loan party restricted subsidiaries if funded by other permitted investments

> (25) Investments made by a non-Guarantor Restricted Subsidiary to the extent such Investments are financed with the proceeds received by such Restricted Subsidiary from an Investment in such Restricted Subsidiary by the Issuer or a Guarantor permitted under this covenant;

Combined, the baskets allow for potentially unlimited investments capacity in unrestricted subsidiaries

Drop-Down Transactions: Market Responses

Response	Description	Weaknesses
"J. Crew" blocker	Limit transfer of specified assets to unrestricted subsidiaries	Often prohibits only certain assets (e.g., only material IP) Only prohibits transfers by or to a limited subset of parties Often applies only upon "designation"
"Pluralsight blocker"	Same as J. Crew blocker but applicable to non-guarantor restricted subsidiaries	Often prohibits only certain assets (e.g., only material IP)
Remove unrestricted subsidiary flexibility	Prohibit creation of unrestricted subsidiaries	Low uptake in BSL / HY market Does not address risk of leakage to non-guarantor subsidiaries
Limit unrestricted subsidiary leakage	Limit capacity to invest in unrestricted subsidiaries via global cap or limited baskets	Low uptake in BSL / HY market (more common in private credit)

Drop-Down Transactions: Additional Examples

Ivanti (2025): Ivanti structured a drop-down LMT for its leveraged loans as part of a comprehensive maturity extension that also included an uptier element.

Anastasia Beverly Hills (2025): Anastasia Beverly Hills disclosed in May 2025 that it had moved assets (including IP) to an Unrestricted Subsidiary in a drop-down transaction.

Trinseo (2025): Trinseo completed refinancing LMT that included certain existing unsecured bondholders exchanging their debt for new secured debt of an entity resulting from a drop-down transaction with double-dip / pari plus elements.

iHeart (2024): iHeart threatened to complete a drop-down transaction involving Unrestricted Subsidiaries if it didn't receive enough support from its outstanding leveraged loans and bonds for a comprehensive uptiering LMT transaction. Ultimately, iHeart did not proceed with the drop-down after being threatened with litigation.

Michaels (2023): Michaels moved its e-commerce segment to an Unrestricted Subsidiary as part of a distribution to its sponsor.

Bausch Health (2022): Bausch Health completed a refinancing LMT involving multiple series of BHC's unsecured bondholders exchanging into a package of first lien BHC bonds, second lien BHC bonds, and new bonds of an Unrestricted Subsidiary.

Envision (2022): Envision designated subsidiaries holding 83% of the equity in its Amsurg business as Unrestricted Subsidiaries as part of a drop-down transaction to raise new structurally senior debt at those entities.

Q&A

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