

December 20, 2016

## Cumulus Media's Proposed Debt Exchange: Replay of The Pass Through Structure

Radio broadcaster Cumulus Media ("Cumulus" or the "Company") has a simple capital structure but a complicated problem, namely how to refinance \$610mm of 7.75% Senior Notes which mature May 1, 2019 (the "Senior Notes").

### Background

[Back on March 23, 2016](#), we wrote about Cumulus' public disclosure that it was considering a distressed exchange: its Senior Notes would be exchanged for certificates representing interests in a trust that would hold revolving loans, along with common stock, and potentially additional capital. While that deal went nowhere, presumably for economic reasons, it will sound familiar to many, as the fundamental structure (the pass through nature of it) is reminiscent of the deal [Arch Coal attempted in the summer of 2015](#). Fast forward to December, and such a deal is back on the Cumulus play list.

Beyond the Senior Notes, Cumulus has outstanding \$1.839B of Term Loans which mature December 23, 2020 (springing to January 30, 2019 unless the Senior Note balance is less than \$200mm on that date) and an undrawn \$200mm Revolver which terminates December 23, 2018. The Revolver, however, is currently inaccessible as any draw on it would cause the springing financial covenant to become operative, and Cumulus cannot currently meet that test (more on that below). In addition, Cumulus has incremental facilities available: a \$200mm basket and an unlimited amount subject to a pro forma 4.75x Senior Secured Leverage Ratio.

Earlier this month, on December 12, 2016, Cumulus announced the launch of a private Exchange Offer for the Senior Notes, which comes on the heels of a Refinancing Support Agreement pursuant to which holders of approximately \$349.7mm (57.3%) of the note balance

agreed to tender their Senior Notes in the Exchange Offer. Based on public filings, tendering holders will receive a combination of equity in Cumulus and certificates issued by a trust which will represent undivided ownership interests in the assets of the trust: Revolving Loans and payments thereon<sup>1</sup> (think of the trust as the Revolving Lender). If all Noteholders tender, \$610mm of Senior Notes will be exchanged into \$305mm of trust certificates due 2020 which represent Revolving Loans that are secured equally with the Term Loans; certificateholders would receive distributions on their certificates from payments received in respect of the Revolving Loans.

### Complaint

Cumulus' nascent transaction is already taking a different route than that of Arch Coal, as Cumulus, instead of waiting to be sued, has preemptively run to court. On December 12, 2016 Cumulus filed a complaint against the Credit Agreement's Administrative Agent, J.P. Morgan Chase Bank, N.A. (the "Agent") in the SDNY for declaratory judgment that, among other things the refinancing transactions do not constitute a Default or Event of Default under the Credit Agreement; and an order of specific performance requiring the Agent to provide consent and execute required documentation.

While Arch Coal's proposed exchange was challenged by its first lien lenders who would have been diluted by the transaction (just as the Term Loan Lenders here would be diluted), and it ultimately failed, we believe now as we did then that such a creative structure can be successfully employed in a distressed exchange in other circumstances – as we do not believe that the **form** of the transaction – unusual as it may be for leveraged finance – was its downfall.

<sup>1</sup> See the [December 12, 2016 Press Release](#) for details with respect to the mechanics of the exchange and the non loan/certificate consideration.

For Cumulus that means that the transaction must work within the applicable terms of the Credit Agreement. In this report we focus on the following substantive elements: (1) accessible Revolving capacity; (2) the ability to effect an incremental increase; (3) satisfaction of conditions precedent to a Revolver draw including permissible use of proceeds; (4) the ability to incur debt to refinance the Senior Notes under the Debt covenant; and (5) the ability to refinance the Senior Notes under the debt prepayment restrictions (which, in this Credit Agreement with respect to the Senior Notes, are included within the definition of Restricted Payments). We leave aside a discussion as to whether or not the Agent has acted unreasonably.

Part and parcel of these basic matters is the springing financial covenant, as in order to borrow even \$1 of first lien debt, Cumulus will need relief under its First Lien Net Leverage Ratio springing financial covenant.<sup>2</sup> The covenant level is currently set at 5.0x and will step down to 4.5x for the first quarter of 2017, with further stepdowns through March 31, 2018; actual covenant first lien net leverage as of 9/30/2016 is 8.2x and would increase to 9.6x pro forma for the Exchange. Because this covenant is only for the benefit of the Revolver, waivers and amendments thereto are subject to approval by a majority of the Revolving Commitments with no say from Term Loan Lenders (however, when used as an incurrence test, amendments or waivers of such a test, or any other incurrence test, would require the vote of the Required Lenders). We examine these matters and the related provisions in the Credit Agreement below.

### Assignment: Where the Exchange Starts (and Could End)

Assignment of the existing Revolving Commitments to the exchanging Noteholders is the starting point for the process: this is necessary in order to modify, waive or

eliminate the springing financial covenant so that funds can be borrowed under the original committed amount, the Incremental increase can be effected/borrowed and that the Company will not breach the covenant on a go forward basis. We do not know exactly to what Cumulus and holders have agreed under the RSA, but the form of the agreement is less important than the substance: relief is an absolute necessity. With respect to assignments, a Revolving Lender can assign its Commitment with Borrower's consent, and Agent's consent, which may not be unreasonably withheld or delayed. Per the Complaint, the Agent has not confirmed to Cumulus that it will consent. Without this consent, the Exchange would be stopped in its tracks.

### The Refinancing

**Debt Covenant, Use of Proceeds and Conditions Precedent to Revolver Draws:** Under the Debt covenant, the Senior Notes and any Permitted Refinancing thereof are permitted under a dedicated exception. However, even though "Permitted Refinancings" do not block a refinancing of unsecured debt into secured debt, the Exchange cannot meet two of the typical conditions, namely an equal or later maturity date and equal or greater WAL. That is why there is no mention in the Complaint of reliance on "*Permitted Refinancing*" for the Exchange but rather a *permitted refinancing* of the Senior Notes. There is nothing in the Credit Agreement that blocks Cumulus from relying on another debt exception, other than a Permitted Refinancing, in connection with the refinancing of the Senior Notes so long as there is sufficient capacity thereunder and all related conditions can be met.<sup>3</sup>

Cumulus relies on the exception for debt of the Loan Parties under the Credit Agreement – which comprises the initial Term Loans, the initial Revolving Commitments and any permitted Incremental Facilities. If the springing financial covenant can be amended, waived or eliminated,

---

<sup>2</sup> This test: (1) measures first lien debt; (2) permits netting of \$100mm of unrestricted cash (for covenant purposes, otherwise \$75mm); and (3) is tested at any time there are Revolving outstandings.

<sup>3</sup> Some of our readers may remember the SDNY decision this past March related to a failed exchange by *Norske Skog* in which, in *dicta*, the Court distinguished between a "financing" (which it reads as being confined to the raising of real new cash) and a "refinancing" and suggests that if a refinancing does not comport with the Permitted Refinancing exception it should not be permitted under another exception as that would permit an "end-run around" the requirements of Permitted Refinancings. Needless to say, we disagree with that analysis.

the Incremental increase can be effected and all of the Revolving Commitments could be drawn. With respect to whether proceeds of Revolving Loans may be used to refinance debt such as the Senior Note, here the use of proceeds provisions are as broad as they get: “The proceeds of the Revolving Credit Loans made after the Restatement Effective Date...shall be used for working capital and general corporate purposes...” and “[t]he proceeds of any Incremental Facility will be used only for general corporate purposes...”

With respect to conditions precedent, Cumulus must be able to satisfy all conditions precedent to the extension of credit found in Section 6.2, which include the absence of a Default/Event of Default, a bring down of its representations and warranties, and pro forma compliance with the springing financial covenant. To the extent that any of the conditions cannot be made on the funding date (or have not been waived), the Company will have failed to meet the conditions precedent for the relevant Lender to make the requested Loan.<sup>4</sup> We are not aware of any existing Default or Events of Default or anything which would cause it to be unable to make its reps.

### Payments on the Senior Notes – Restricted Payments

**Covenant:** Any optional payment or prepayment of the Senior Notes or any redemption or other acquisition for value, purchase of defeasance of the Senior Notes constitutes a Restricted Payment under the Credit Agreement and, as a result, may only be made if there is a useable carveout to the Restricted Payments covenant. Cumulus focuses on a dedicated exception covering the Senior Notes which allows any **[lowercase]** “refinancing” permitted by the terms of the Credit Agreement (or any payment if the pro forma First Lien Net Leverage Ratio does not exceed 4.0x (clearly not available and its waiver or amendment would require the consent of the Required Lenders)). Note that the exception is **NOT** tied to a “Permitted Refinancing” of the Senior Notes but a generic “refinancing” that is

permissible. Beyond this exception, though, Cumulus is stuck, as even if capacity existed under the Available Amount, the Company would have to meet a 6.25x Total Net Leverage Ratio test, which is way beyond reach considering that it is nearly 11x levered.<sup>5</sup>

### Is This Structure a Circumvention of the Debt and Liens Covenants?

We discussed this same issue in connection with the Arch Coal exchange, whether this type of transaction, when viewed as a whole, is effectively the equivalent to the issuance of first lien bonds even though the terms of the Credit Agreement would not allow their incurrence (a 4.0x First Lien Net Leverage Ratio test would have to be met). In other words, can one argue that by utilizing a pass through vehicle, Cumulus is simply making an end run around the Debt and Liens covenants? In our view, that is not a winning argument. We repeat here what we said with respect to the Arch deal. Pass through structures are commonly used in other asset classes (securitization and other structured finance financings), and such structures are respected and not collapsed. While we would expect the basic economic terms of the Revolving Loans and certificates to be the same (tenor, maximum amount, etc.), in many respects trust certificates are nothing like debt instruments and possess basic characteristics that are fundamentally different. Most importantly, based on the description of the structure, we do not see how a certificateholder would have any recourse to the Company, its Subsidiaries or their assets, as a secured bondholder would, but rather may look only to the assets of the trust for distributions.

### Why Not Use an Unrestricted Subsidiary?

Some may be wondering if another play is available to Cumulus if the Agent remains intractable and Cumulus is forced to retreat (or if its arguments prove to be unpersuasive to the Court), perhaps taking a page from the play book of iHeart: use an Unrestricted Subsidiary to

---

<sup>4</sup> Note that there is no prohibition on the trust or exchanging Noteholders becoming Assignees and/or Incremental Lenders as both “Eligible Assignees” and “Additional Lenders” allow, respectively, “any Person” and “person” that elects to extend loans or commitments under an Incremental Facility.

<sup>5</sup> Declined Asset Sale proceeds, if any, may also be used to make payments in respect of the Senior Notes.

buy back or exchange for the Senior Notes. Careful readers of the Credit Agreement know that, even assuming sufficient investment capacity, this would not work due to a single clause added at the end of Section 7.14 (“Designation of Subsidiaries”). This bespoke provision expressly precludes the use of an Unrestricted Subsidiary to engage in any transaction with respect to the Senior Notes under the Restricted Payment covenant or subordinated debt under the debt prepayment covenant, if, in either case Cumulus could not do so thereunder. In other words, Cumulus cannot make an end run around the Restricted Payments covenant and use an Unrestricted Subsidiary to do what it cannot.

### **Conclusion**

In our view, absent an existing Default or Event of Default, the proposed structure works within terms of the Credit Agreement. While Term Loan Lenders are not happy to be diluted, because the springing financial covenant was always subject to amendment – or elimination – without their consent, any reliance by them on that covenant to provide protection is misplaced. We also believe that Cumulus really has no other options than this structure to issue secured debt and were it to lose in court, it will have to go back to the drawing board.

### Conditions of Use and Legal Disclaimer

Xtract Research Special Reports is a product of Xtract Research. All Information contained herein is protected by copyright law and may not be copied, reproduced, transferred or resold in any manner or by any means whatsoever, by any person without written consent from Xtract Research.

This report should not be relied upon to make investment decisions. Furthermore, this report is not intended and should not be construed as legal advice. Xtract Research does not provide any legal advice and clients should consult with their own legal counsel for matters requiring legal advice.

All information is sourced from either the public domain or is provided to us by our clients, and Xtract Research cannot and does not verify or guarantee the adequacy, accuracy or completeness of any source document. No representation is made that it is current, complete or accurate. The information herein is not intended to be used as a basis for investing and does not constitute an offer to buy or sell any securities or investment strategy. The information herein is for informational purposes only and Xtract Research accepts no liability whatsoever for any direct or consequential loss arising from any use of the information contained herein.