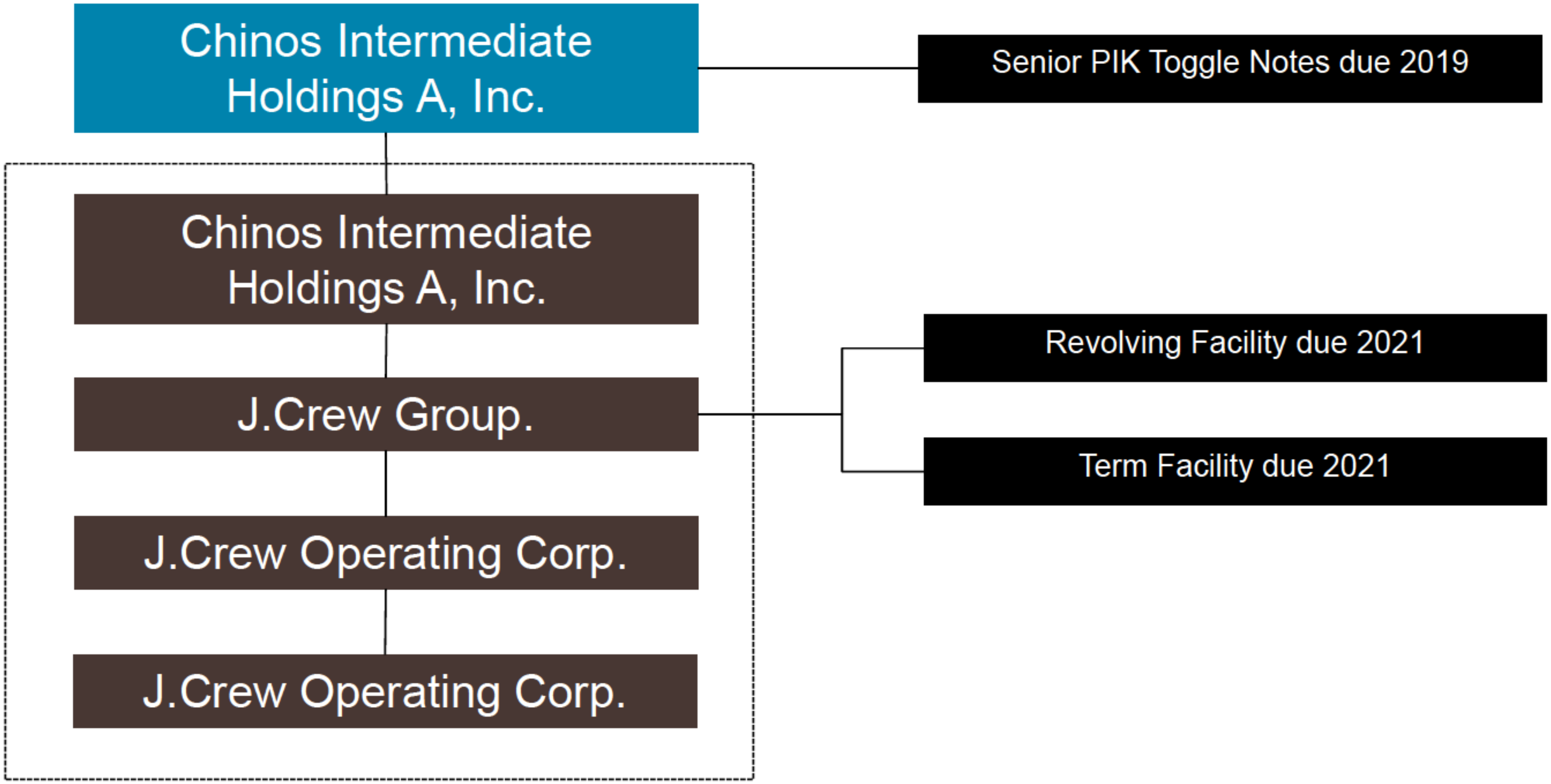
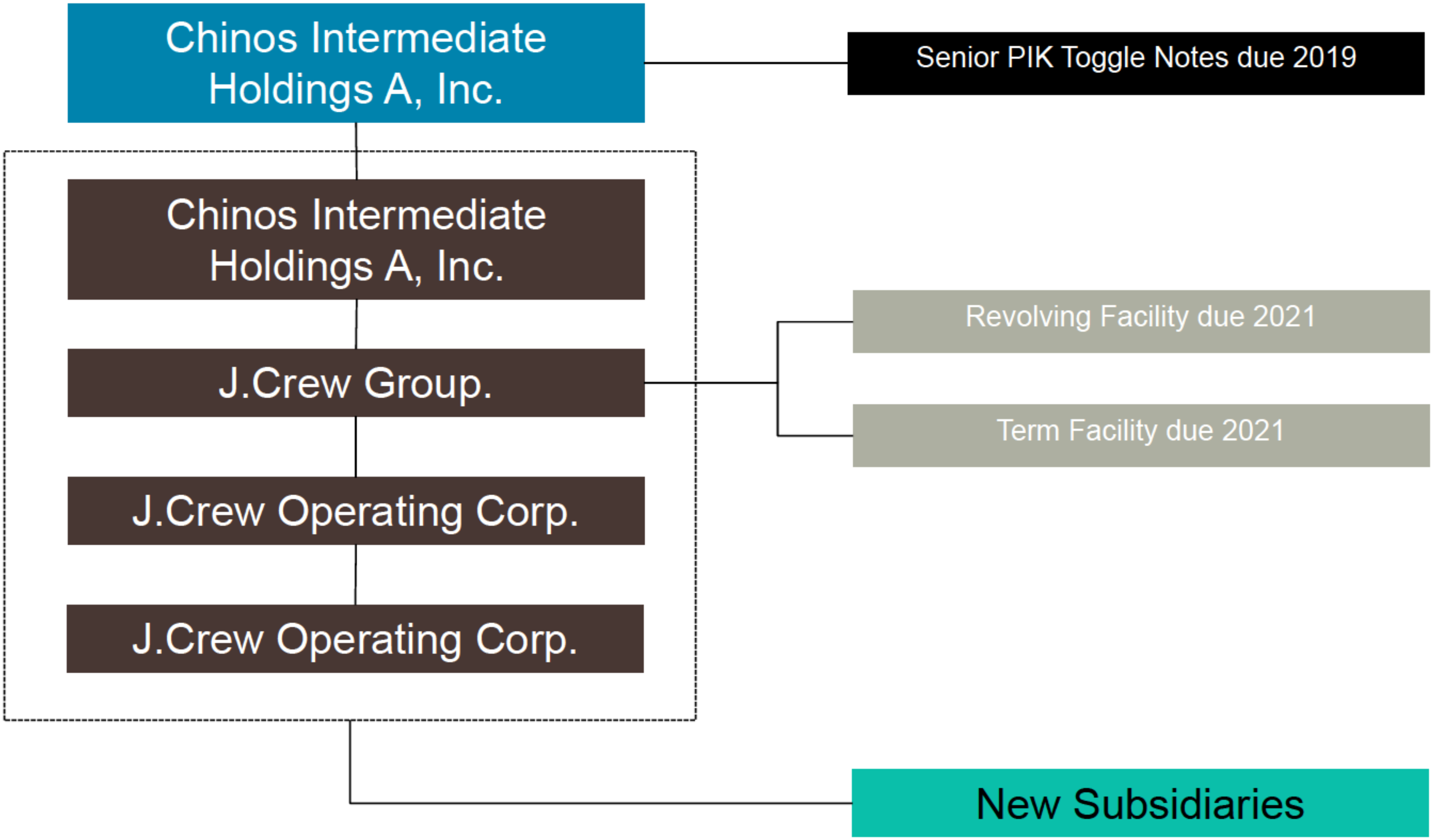
Lessons Learned From the J. Crew Credit Agreement

- Overview of the J. Crew Transactions
- Investment Baskets
- Unrestricted Subsidiaries
- EBITDA Add-Backs
- Pro-Rata Sharing Provisions
- Lessons Learned

Structuring the Stitch-Up



Structuring the Stitch-Up



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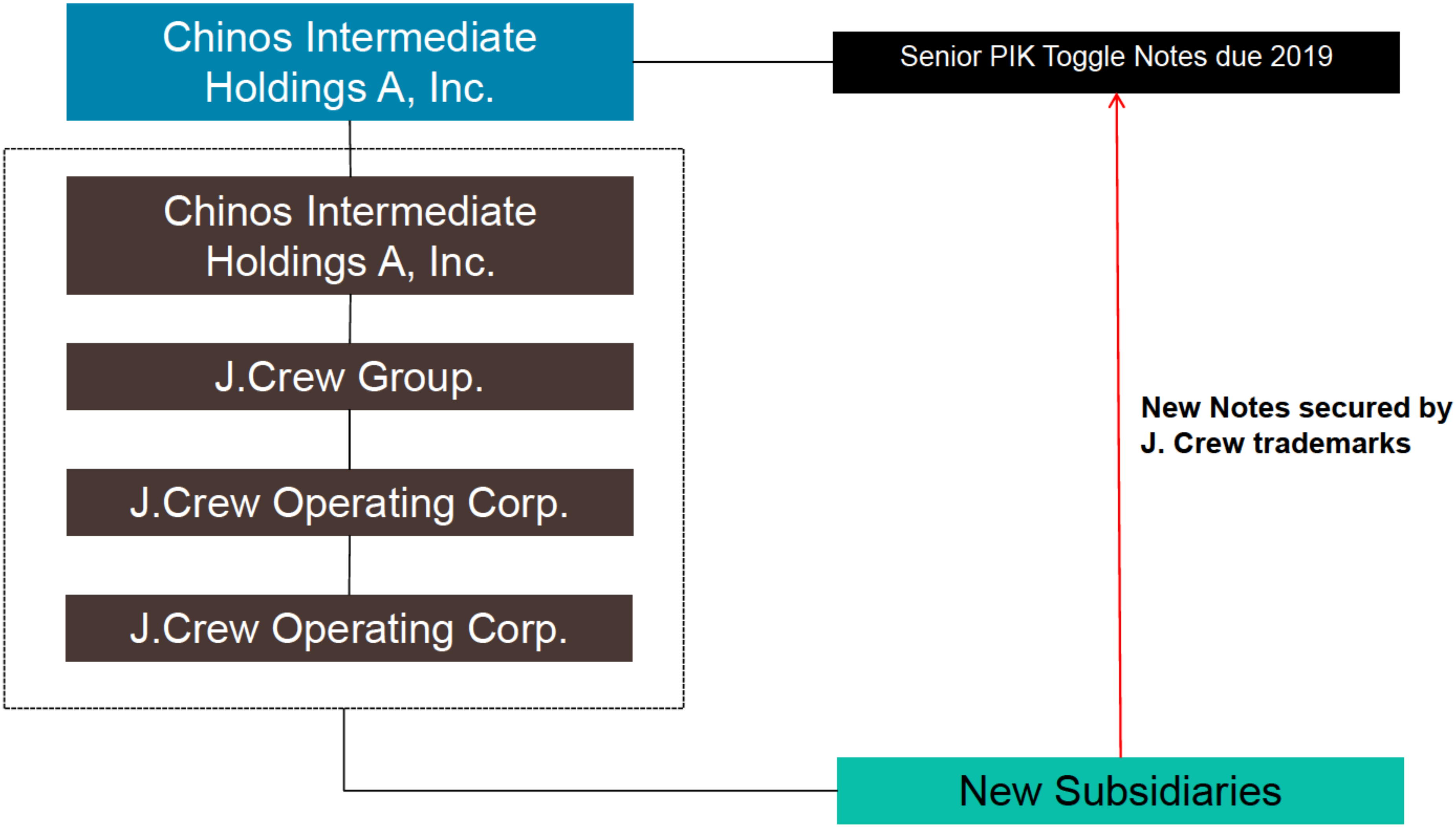

Utilization of Investment Baskets

GOAL: To be able to pledge IP freely

- Max out and aggregate multiple Investments baskets
  - **Investments by Loan Parties in Non-Guarantor Loan Parties**
    - greater of $150 million or 4.00% of Total Assets
  - **General Investment Basket:**
    - greater of $100 million and 3.25% of Total Assets
- Utilize "Trap Door" Investment basket
  - **Investments in Unrestricted Subsidiaries** (not subject to covenants)
- Value intellectual property
  - **Financial advisor values trademark collateral at $347 million**
- Set percentage interest of intellectual property
  - **A 72.04% interest in $347 million of collateral is…$250 million**

"Trap Door" Investment Basket

(COULD NOT HAVE MADE THE "TRAP DOOR" INVESTMENT DIRECTLY!)

Restricted Subsidiary (Loan Party)

↓

Restricted Subsidiary (Non-Loan Party / Subject to Covenants)

↓

Unrestricted Subsidiary (Non-Loan Party / Not Subject to Covenants)

Investments by any Loan Party in any non-Loan Party that is a Restricted Subsidiary <u>provided</u> that the aggregate amount does not exceed the greater of $150,000,000 or 4.00% of Total Assets

<u>*plus*</u>

Other Investments in an amount not to exceed the greater of $100,000,000 or 3.25% of Total Assets

Investments made by any Restricted Subsidiary that is <u>not</u> 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 Section 7.02(c)(iv)…or 7.02(n)

Unrestricted Subsidiaries

Type of Subsidiary	Subject to Reps / Covenants	EBITDA Included	Guarantor / Grantor
Restricted Subsidiary (Loan Party)	Yes	Yes	Yes
Restricted Subsidiary (Non-Loan Party)	Yes	Yes	No
Unrestricted Subsidiary	No	No	No

- Not subject to reps, covenants or most defaults
- EBITDA is not counted
- Provide no guaranty or collateral
- Treated as Affiliates for covenant purposes

Designating an Unrestricted Subsidiary

…immediately after giving effect to such designation, the <u>Total Leverage Ratio </u>for the Test Period immediately preceding such designation for which financial statements have been delivered pursuant to Section 6.01 <u>is less than or equal to 6.0 to 1.0 (calculated on a Pro Forma Basis)</u> (and, as a condition precedent to the effectiveness of any such designation, the Borrower shall deliver to the Administrative Agent a certificate setting forth in reasonable detail the calculations demonstrating satisfaction of such test)…

Relaxed-Fit EBITDA Restrictions

- Future cost savings and synergies
- Run-rate EBITDA from investments/other transactions
- Business optimization expenses
- Non-recurring, extraordinary or unusual events
- Management fees

Relaxed-Fit EBITDA Restrictions

Future cost savings and synergies

(x) The amount of net cost savings and synergies projected by the Borrower in good faith to result from actions taken or expected to be taken no later than twelve (12) months after the end of such period…net of the amount of actual benefits realized during such period from such actions; provided that…the aggregate amount of cost savings and synergies added to Consolidated EBITDA shall not exceed the greater of (A) $30,000,000 and (B) 10% of Consolidated EBITDA for such Test Period (calculated prior to giving effect to any adjustment pursuant to this clause (x))

Relaxed-Fit EBITDA Restrictions

- Cost Savings and Synergies
  - **Greater of (A) $30,0000 and (B) 10% of Consolidated EBITDA**

- Pro forma effect to Specified Transactions
  - **Greater of (A) $30,0000 and (B) 10% of Consolidated EBITDA**

- Opening and closing stores / business optimization
  - **$25,000,000**

- Management Fees and Indemnities
  - **Dollar-for-dollar increase for all fees paid under management agreement (no other conditions)**

Made from Whole Cloth?

- Designation of Unrestricted Subsidiaries required meeting a 6.00:1.00 Total Leverage Covenant on a pro forma basis

- Leverage Ratio as derived from SEC filings: ~8.36:1.00

- Leverage Ratio calculated with $30 million cost savings and $25 million optimization add-backs: **5.78:1.00**

Pro Rata Provisions

- Most provisions of Credit Agreements can be amended with the consent of "Required Lenders"
  - **Lenders holdings more than 50% of Loans and unused Commitments (other than Affiliated Lenders)**

- "Sacred Rights" require consent of every affected Lender
  - **Increase commitments; reduce or postpone payments; release substantially all collateral; amend sacred rights provisions**

- Limitations on rights of individual Lenders to initiate enforcement actions
  - **Lender Action clause**
  - **Turnover provisions if more than pro rata share received**

Pro Rata Provisions

- “Sacred Rights” clauses may focus on voting rights and omit pro rata sharing provisions / waterfalls

- *NYDJ*:
  - **Required Lender consent to pro rata sharing amendment created a non-pro-rata super-senior term loan tranche**
  - **Proceeds of new tranche bought a portion of existing term loans of Required Lenders at a discount**
  - **Remaining existing term loans of Required Lenders were senior to term loans of non-consenting lenders**

- J.Crew credit agreement did not restrict amendments to pro rata sharing provisions

Sewing up the Transaction

- Amendment achieved by modification of pro rata sharing provisions to provide consenting lenders:
  - **Increased pricing**
  - **Increased amortization**
  - **Repurchase of up to $150 million of term loans at par**
- Grandfathered prior IP contribution and permitted contribution of remainder
- Instructed Administrative Agent to seek dismissal of litigation
- Added “gross leverage” maintenance covenant (starting at 15.0x), Events of Default tied to IP license and call right on notes secured by IP
- Eliminated “Trap Door” Investment basket
- Added majority lender consent to formation of Unrestricted Subsidiaries

Patching Up the Credit Agreement

- Cost Savings and Synergies Addback
  - **$30,000,000 (stepping down to $15,000,000) jointly with business optimization**

- Pro forma effect to Specified Transactions
  - **$30,000,000, stepping down to $15,000,000**

- Opening and closing stores / business optimization
  - **$30,000,000 (stepping down to $15,000,000) jointly with cost savings**

Patching Up the Credit Agreement

- Pro-Rata Provisions:

> [N]o such amendment, waiver or consent shall change any provision of…**Section 2.11 (in a manner that alters the pro rata sharing of payments contemplated thereby (except in connection with a transaction otherwise permitted under this Agreement))**, this Section 10.01 or the definition of “Required Lenders”, “Required Facility Lenders” or “Pro Rata Share” or any other provision specifying the number of Lenders or portion of the Loans or Commitments required to take any action under the Loan Documents, without the written consent of each Lender affected thereby.

Patching Up the Credit Agreement

- Lender Action Clause:

Each Lender agrees that it shall not**, and hereby waives any right to**, take or institute any actions or proceedings, judicial or otherwise, for any right or remedy **or assert any other Cause of Action** against any Loan Party….or institute any actions or proceedings **or any other Cause of Action**, or otherwise commence any remedial procedures, against Holdings, the Borrower and/or any of their respective Subsidiaries or parent companies with respect to any Collateral…. without the prior written consent of the Administrative Agent…**including with respect to the Specified Liability Management Transactions**…

Belts and Suspenders

- Consider the cumulative effect of additional carveouts and add-backs throughout negative covenants
- Unrestricted Subsidiaries really does mean <u>unrestricted</u>
- Keep track of collateral and guarantees
- Know your rights (and your co-lenders)
  - Affiliated Lenders and voting in bankruptcy