

Index

- ABA model inter-creditor agreement 418
 - definitions and usages 469–76
 - enforcement 439–43
 - insolvency proceedings 452–63
 - lien priorities 419–35
 - miscellaneous 463–8
 - modification of obligations 435–9
 - payments 443–7
 - purchase obligations 447–52
- abuse of law provision 7
- accounting rules 295–311
- acquisitions
 - and RP covenants 317
 - Kratos case study 67–76, 489–91
 - Lyondell Chemical 344, 346
 - Terra Firma by Citigroup 31
 - see also* leveraged buy-outs (LBOs)
- ACSMs (alternative coupon satisfaction mechanisms) 267, 275
 - effect on hybrid ratings and touching 276–7
 - settlement requirements 279, 281, 288, 294
- Additional Tier 1 Capital *see* Tier 1 Capital, Basel III
- adjustable-rate preferred stock (ARPS) 60–1
- affirmative covenants 313, 338
- alternative settlement mechanisms (ASMs) *see* ACSMs
- amortization 230
 - cost 302, 304, 305, 306, 307–8
 - negative 31–2
- anti-layering provision, second lien 235, 319
- Asian options 44
- asset substitution covenants 314–15
- auction rate and remarketed preferred stock 61
- Australia, mezzanine products 364–5
- Autostrada Wielkopolska S.A. 196
- bad covenants 320
- balanced converts 58
- bank debt/loans 2, 3, 243, 250
- bank hybrids, rating of 274, 292–3
- bank lending, reduction in 11–14
- banking sector rules *see* Basel I; Basel II; Basel III
- Bank of Cyprus, contingent convertible bonds 172
- bankruptcy
 - automatic stay 457
 - Chapter 11 (USP financing) 340, 341, 342–4, 424, 452–3, 503, 504
 - Events of Default covenant 318, 375–6, 386
 - inter-creditor agreements 323, 324, 325, 327, 331
 - legislation, reorganization of 359–60
 - right to veto 216
- Basel Committee 140, 144, 162, 173–4, 289
- Basel I 140–1
- Basel II 141
 - capital definitions 142–4
 - ‘three pillars’ concept 141–2
- Basel III 144–5
 - 7th criterion 271
 - and Solvency II capital limits 289–90
 - and Tier 1 regulated capital credit phase out 285–6
 - capital definitions 145–62
 - central theme 163
 - specific features 178–81
 - summary 177
- basket warrants 49
- baskets, Moody’s classification of hybrids 278, 279, 280, 281, 286, 287–8, 293–4
- Belgium
 - JJ Bars & Restaurants 126
 - ‘notional interest deduction.’ 7
- Berkshire Hathaway 59, 226
- ‘best-efforts’ syndications 237
- beta of a firm, three implicit drivers 33–4
- beta of an asset, CAPM 84, 85, 86
- bifurcation requirements, IAS 39 305, 307
- binomial distribution 117
- Binomial Option Pricing Model (BOPM) 116–19
- Black–Scholes Model 49–50
 - alternatives to 116–19
 - extension of 116
 - formula 119

- Black–Scholes Model (*continued*)
 history 110–11
 inputs 111–12
 known problems 115–16
 underlying assumptions 112
- Blackstone Group (BG) 252–3, 256
- Brazilian bank growth, case study 184–6
- bridge finance 15, 18, 234
- Buffett, Warren 49–50, 59, 84–5, 86
- business model test 302, 304
- busted converts 58
- Cadbury Schweppes 252, 253, 254, 255
- callability/callable securities 56
 convertible bonds 99–100
 hybrids 279–80, 288
 preferred stock 62
 syndicated leverage loans 237
 warrants 47
- Call Option Enhanced Reversible Convertibles (COERCs) 173
- call options 36, 38
 and replacement language 270
 and stock price, Binomial Model 117, 118
 and warrant valuation 113–15
 convertible loan feature 57
 covenants 321–2
 embedded in warrant contract 46, 108
 exercise of 51, 149, 151
 IRR 43–5
 valuation 109–10
- capacity limits, hybrid capital 280–1, 289
- capital adequacy ratio (CAR) 142
- capital asset pricing model (CAPM) 82–6
- capital base
 deductions from 144
 limits and restrictions 144
 three tiers 142–3
- capital definitions under Basel III 145–62
- capital protection 64, 66–7
- capital ratio 142
- capital requirements, Solvency II 165–70
- capital structure covenants 314
- capital to risk-weighted assets ratio (CRAR) 142
- CAPM (capital asset pricing model) 82–6
- cash flow from operations (CFO) 230, 231
- cash flow hedge reserve 154–5
- cash flow measures, definitions of 231
- cash flow waterfall 29, 211, 212, 324, 364, 497–8
 project finance case studies 203, 204, 206, 207
 provision in Model Agreement 444, 445
- cash sweep clause/provision 45
- Castor global holdings 67, 69–70
- CD (convertible debt) *see* convertible bonds/loans;
 convertible preferred shares/stock
- CDOs (collateralized debt obligations) 33, 238
- CEE region
 real estate company finance 220–4, 498–500
 toll road case study 196–203, 494–7
- CFO (cash flow from operations) 230, 231
- change of control (CoC) covenant 317–18
- Chapter 11 bankruptcy
 DIP financing 342–4
 Lyondell case study 340, 341, 344–52, 502, 503, 504
- clawback clauses, inter-creditor agreements 325
- CLOs (collateralized loan obligations) 238, 358
- club deals 237–8
- CoCo bonds *see* contingent convertible (CoCo) bonds
- COERCs (call option enhanced reversible convertibles) 173
- collateral 470
 inter-creditor agreements 332–3
- collateralized loan obligations (CLOs) 238, 358
- collateral value of assets 13–14
- commercial paper 3–4
- Common Collateral 327–9, 330–1
- Common Equity Tier 1 Capital *see* Tier 1 Capital, Basel III
- compensation scheme 5–6
- compensation structure 23
- competition risk 29
- consent, modifications requiring 436–8
- contingent capital 171
 comparing to equity 173
- contingent convertible (CoCo) bonds 171–6, 285
see also convertible bonds/loans
- contingent settlement provisions 300
- contingent value rights 4
- contractual obligation to deliver cash or other financial asset, financial liability feature 298, 309
- contractual subordination 239
- conversion triggers 172, 175, 176, 274
- conversion value (CV)
 and convertible preferred stock 107
 convertible bonds 54, 55, 100–1
- convertible bonds/loans 51–2, 99–100
 alternative forms 56–7
 application 106–7
 categorization of 53–4
 contemporary reasons for using 55–6
 evaluation 57–8
 features of 52–3, 57
 four market areas 53
 motives for issuance of 54–5
 term sheet 390–6
 valuation aspects 58, 100
 conversion value 100–1
 fixed-income value (FIV) 101–4
 hybrid security 104–6
 vs. straight corporate bonds 52
- Convertible Enhanced Capital Securities (CECS), Bank of Cyprus 172
- convertible exchangeable preferred stock 107–8

- convertible preferred shares/stock (CPS) 54, 62, 107–8, 246
 embedded call and put options 108–10
 term sheet for potential investment 396–407
- cost of capital
 mezzanine finance reducing 10
 WACC 90–1
- cost of debt 90, 91
 cost of equity 88, 90, 91
 country risk 94
- covariance of an asset 83–4
- covenant-light loans 236, 241
- covenants 313–14
 anchor concepts 314–15
 and seniority of a bond 315
 case studies, benefits and risks 319–21
 comparison of mezzanine products to investment-grade products 321, 322
 definition and fine print 316
 early redemption features 316
 exit strategies 321–2
 in leveraged syndicated loans and HY bonds 243–5
 in real estate deals 338
 key high-yield 316–18
 maintenance and incurrence tests 315–16
 used less frequently 318–19
- covered warrants 48
- Cox–Rubinstein, binomial option pricing model 116–17
- CPS *see* convertible preferred shares/stock
- credit ratings 261, 265–6
see also rating agencies
- credit risk
 Basel rules 141, 143, 151–2, 155
 convertible financing 56
 fair value measurement, financial liabilities 308–9
- Credit Suisse, contingent convertible bonds 172
- cross-acceleration clause 314, 449, 499, 500
- cross-discipline treatment of securities 297
- cross-holding default clause/provision 28, 238, 314, 499
- cumulative preferred stock 60, 61
- death spiral convertible bonds 174
- debt capacity analysis, LBOs 229–33
 Orangina case study 255, 259, 500–2
- ‘debtor-in-possession’ (DIP) loan facility 340–6
- debt restructuring, DIP financing 340, 342–6
- debt service coverage ratio (DSCR) 194, 200, 205, 208, 233, 332, 495
- debt service reserve account (DSRA) 205, 207, 208
- debt subordination vs. lien subordination 235–6
- debt-to-equity swaps 322, 499, 500
- debt vs. equity 1–2, 6
 tax treatment 6–7
- DECS (dividend-enhanced convertible stock) 65
- deemed dividends 7, 37
- default
 inter-creditor agreements 334–5
 risk, drivers behind 87–8
- default spread 88, 243
- deferability 263, 266
 and payment risk 266–7
 implications and consequences of 269–70
 main characteristics 271
 ongoing payments 279, 287–8
- deferred tax assets (DTAs) 154, 158
- deferred tax liabilities (DTLs) 154, 155
- detachable warrants 42, 49, 63, 384
- developmental mezzanine investment 217
- development banks 18, 362–3
- Diamond, Stuart 17
- DIP (‘debtor-in-possession’) financing 340, 342–3
 attractions for lenders 344
 Lyondell case study 344–6
- disclosure requirements, Basel III 160
- distressed converts 58
- diversification
 and reduction of firm-specific risk 81
 Buffett’s views on 84–5
 by investors and market risk 81–3
- dividend/coupon discretion requirements, Additional Tier 1 capital 271
- dividend-enhanced convertible stock (DECS) 65
- dividend pushers 149, 270, 281, 294
- dividend recapitalization 248–9
- dividend stoppers 270, 271, 281, 294
- documentation
 modification rights 334, 335
 real estate deals 336–7
see also covenants
- drag/tag-along rights 39, 42, 322, 438, 500
- DSRA (debt service reserve account-opening position) 205, 207, 208
- due diligence 388, 409, 413
- early redemption, covenants 316
- EBITDA formula 230
- EBIT Variability Measure 34
- economic vs. financial distress 28
- effective maturity 292
- ELKS (equity-linked securities) 65
- embedded derivatives 305–6, 309
- embedded options 99
 convertible bonds/loans 57, 99–107
 convertible preferred stock 107–10
 valuation and pricing 110
 Binomial Option Pricing Model 116–19
 Black–Scholes Model 110–16, 119–21
- emerging markets (EMs) 14–16
 Basel rules 182
 governmental organizations 362–3
 PE industry 227
 use of warrants 51
- employee stock option plans (ESOPs) 42, 47, 51
- enforcement, inter-creditor agreements 330–1, 439–43

- enhanced capital notes (ECNs), Lloyds Banking Group 171
- equity clawbacks 316
- equity content 262, 263–5, 269–70
and capacity limits 289
categories, S&P 290–1
continuum 272
maximization and structuring criteria at Moody's 293
Moody and S&P frameworks 277–82
- equity credit cap 280–1, 289
- equity exposure 26, 41, 58, 67
- equity instruments 298–9
examples of 301–7
substance over form 299–300
- equity interest 472
- equity kicker 6, 14, 25, 26, 51, 95, 364
- equity-linked notes (ELN) 66
- equity-linked securities (ELKS) 65
- equity options pricing 110–16
- equity provided by a PE firm 246–7
- equity strength 262, 272
- equity structured as debt 214
- equity substitute converts 58
- equity-to-debt swap 322
- equity vs. contingent capital (CoCo) 173
- equity vs. debt 1–5
- equity vs. liability 310–11
- equity vs. mezzanine 216
- equity warrants 47–8
- escrow account 204–5
- ESOPs (Employee Stock Option Plans) 42, 47, 51
- Europe
insolvency laws 359–60
mezzanine products 364–5
- European Investment Bank (EIB) 496–7
- Europewide Capital Partners (ECP) 121, 122, 123, 124–5, 126–7, 138
- event risk covenants 315
- events of default 238, 335–6, 339, 375–6, 394
Events of Default covenant 318
- exchangeable bonds 56
- exit liquidity 57
covenants relating to 321–2
- exotic convertible models 56–7
- expected returns 77–9
and default risk 87
calculation of 84
risk-free rate 88–9
- fair value 298
cash flow hedge reserve 154–5
IAS 39 306–7
IASB model 308–9
IFRS 9 296, 305, 307–8
- FAQ document, Basel Committee 162
- FCF (free cash flow) 13–14, 27, 92, 227, 230–1, 259, 493
- FC/TC (fixed cost/total cost) ratio 33, 34
- financial assets
contractual obligation to deliver 309–11
IAS 32 definition 297–8
IASB classification approach 308
IFRS 9 requirements 296–7
business model test 302, 304
fair value option 305, 307–8
gains/losses 306
instrument test 302, 304–5
non-recourse 306
- financial covenants 245, 313, 357, 412, 483
- Financial Darwinism 366
- financial distress 28, 92, 241, 324
- financial industry and FIs 139–40
Basel rules 140–63
case study positions 182
Brazilian bank 184–6
South African conglomerate 186–7
South-East Asian bank 182–3
changes to criteria for assessing hybrids 291–2
CoCo bonds 171–6
insurance sector regulation 163–9
- financial leases 23
- financial leverage of a firm 34
- financial liabilities 298–9, 300
IAS 32 definition 298
preferred shares 309
requirements for 296, 306, 308–9
- financial risk 94
- firms/companies
financing options 4–5
firm-specific risks 31, 80
life stages, financing 8–9
risk exposure 93–4
- first lien/second lien inter-creditor agreement 418
definitions and usages 469–77
enforcement 439–47
insolvency proceedings 452–63
lien priorities 419–35
miscellaneous 463–9
modification of obligations 435–9
purchases 447–51
- first pillar, Basel rules 141
- Fitch credit rating for hybrid securities 272–7
example analysis and calculation 283–4
new criteria, key aspects of 268
- FIV (fixed-income value), convertible bonds 101–4
- fixed-cost burden 90
- foreclosure 215, 325, 332–3, 335, 336, 337
- free cash flows (FCFs) 13–14, 27, 92, 227, 230–1, 259, 493
- geographical diversification 364–5
- going-concern capital *see* Tier 1 Capital, Basel III
- going-concern loss absorption 272–5
- Goldman Sachs 19, 59, 254
- gone-concern capital *see* Tier 2 Capital
- good covenants 319–20

- goodwill 154
- governmental organizations 362–3
- grace period 27
- guarantees as additional collateral, inter-creditor agreements 333
- hard protection 64
- hedge accounting 297–9
- Hedge Agreement, defined 474
- high-yield (HY) bonds/loans 4, 15, 19–20
- comparison with other securities 251
 - covenant comparisons 322
 - Euro and global volume 21
 - light covenants 236, 238–9
 - Limitation on Indebtedness covenant 316–17
 - maturity wall 22
 - vs. leveraged syndicated loans 242–6
- holding company (HoldCo)
- PIK notes 246
 - PPLs 38–9
 - subdebt with step-up rates 28
 - subdebt with warrants 45
 - subordination levels 247
- “Hollywood accounting” 35
- house purchase, financing of 13, 31–2, 41
- hybrid capital instruments 64–7
- accounting classification 310–11
 - convertible bonds as 104–6
 - financial liabilities 308–9
 - IFRS 9 requirements 295–305, 307–8
 - rating/rating agencies 261–72
 - Basel III, impact of 285–6
 - capacity limits/equity credit caps 289
 - changes in assessment criteria 291–3
 - Fitch 267–8, 272–7, 283–4
 - five core documents 282
 - S&P and Moody 277–82, 286–8, 293–5
 - Solvency II 289–91
- IAS 32 terminology 297–8
- IAS 39 requirements 296, 297, 305–9
- IASB (International Accounting Standards Board) 295, 296, 308–9
- IDR (issuer default rating) 268, 273, 274–5
- IFRS 9 Financial Instruments (IASB/FASB) 296
- classification and measurement 296–7
 - hedge accounting 297–9
 - impairment methodology 297
- IFRS 9 requirements
- business model test 302, 304
 - classification and measurement 296–7, 302–3
 - embedded derivatives 305–6
 - fair value option 305
 - gains/losses on the instrument 306
 - hybrid instruments 307–8
 - initial and subsequent measurement 306
 - instrument test 302, 304–5
 - non-recourse financial assets 306
 - impairment methodology 297
 - implied equity premium model 89–90
 - implied volatility 48, 49, 111
 - incurrence covenants 241
 - incurrence tests 315–16
 - indebtedness covenants 244, 316–17, 319
 - index-linked notes (ILN) 66
 - industry-specific risk 80, 94
 - innovative Tier 1 instruments 143
 - insolvency laws in Europe, reorganization of 359–60
 - insolvency proceedings 452–63
 - instrument test 302, 304–5
 - insurance sector regulation 163
 - Solvency II 164–5
 - capital requirements 165–70 - intangibles 144, 154
 - intent-based replacement covenants 269
 - inter-company transfer pricing 38
 - inter-creditor agreements 318–19
 - and lien subordination 240–1, 326, 327–31
 - and mezzanine products 323–6
 - see also* ABA model - interest coverage (IC) ratio 27, 92–3, 97–8, 200
 - interest forfeiture provision (screw clause) 64
 - interim loans 214–15
 - International Accounting Standards Board (IASB) 295, 296, 308–9
 - intrinsic value, warrants 112
 - investment-grade bonds/loans 238, 243, 320–1, 322
 - investment-grade issuer rating 275, 281, 294
 - investors, diversified 81–2
 - IRB (Internal Rating-Based) approach 141
 - IRR (internal rate of return) 127
 - and share buy-back 43–5
 - financial risk 232–3
 - real estate sector 211, 218 - Islamic finance 360–1
 - issue ratings 265–6
 - issuer credit rating (ICR) 265, 266, 267, 293
 - issuer default rating (IDR) 268, 273, 274–5
- JJ Bars & Restaurants, case study 121–2
- company information 123–4
 - Cornelis and his team 125
 - cost structure 124
 - datasets 128–38
 - Europewide Capital Partners (ECP) 122
 - geographical distribution of locations 126
 - growth strategy 125–6, 127
 - guidance/solution 492–3
 - investment committee and its decision 127
 - maintenance and remodeling (M&R) costs 124–5
 - majority equity owner 125
 - questions 138
 - restaurant industry 122–3
 - junior debt 4, 6, 15, 30–1, 337, 358, 364
 - junk bonds *see* high-yield (HY) bonds

- Kratos Company, case study 67–9
 case guidance
 questions 72
 solutions 489–91
 Castor company 69–70
 datasets 73–6
 financial strategy of Kratos 70–1
 Odin as a potential acquisition 71–2
 structure of Kratos 69
 kurtosis 78–9
- ‘laundry list’ approach 436
 leasing 2–3
 legally-binding enforceable covenants 269–70
 legally-binding replacement capital covenants 280, 288
 lenders of mezzanine finance *see* mezzanine lenders/providers
 leveraged buy-outs (LBOs) 225–8
 alternatives using a similar model 247–9
 and PIK (payment-in-kind) loans 30–1
 case study, Orangina 251–60, 500–2
 drivers of return 228–32
 structure 232–3
 equity 246–7
 mezzanine/HY loans 236–46
 PIK notes 246
 second lien 235–6
 senior debt 234
 summary 249–50
 types of security 251
 tax implications 247
 leveraged finance 16, 19–20, 251
 refinancing needs 22–3
 leveraged recapitalizations 248
 leveraged secured credit 237–8
 leveraged (syndicated) loans 236–8, 242–5
 leverage limitations 232–3
 liabilities *see* financial liabilities
 LIBOR (London inter-bank offer rate) 214–15, 241–2, 303
 lien priorities, intercreditor agreements 419–35
 lien subordination 240–1
 and inter-creditor agreements 326
 four critical themes 327–31
 vs. debt subordination 235–6
 vs. payment subordination 326–7
 light covenants (cov-lite) 31, 32–3, 236, 241
 Limitation on Asset Sales covenant 317
 Limitation on Indebtedness covenant 316–17
 Limitation on Liens covenant 317
 Limitation on Restricted Payments (RP) covenant 317
 Lion Capital 251–2, 255
 liquidation 147, 311, 359–60
 Lyondell case study 339–46, 502–4
 protective covenants 321–2
 see also inter-creditor agreements
 liquidity events, covenants 321–2
 liquid yield option notes (LYONs) 56, 66
- Lloyds Banking Group 171
 loan life coverage ratio (LLCR) 194, 200
 loan participation agreements 40
 loan-to-cost ratio 217
 loan-to-value (LTV) ratio 217, 218, 219, 223, 332
 loss absorbency 163, 181, 262, 264, 268, 275–6
 CoCo bonds 174, 175, 176
 Fitch rating approach 272–6, 286
 S&P and Moody rating approach 277–8, 279, 280, 287–8
- LyondellBasell case study 339–52
 guidance/solution 352, 502–4
 LYONs (liquid yield option notes) 56, 66
- macro-economic risk 80–1
 maintenance covenants 236, 241
 maintenance tests 241, 315–16
 mandatory convertible securities 57
 mandatory deferral 266, 269–70, 271, 279, 281
 effect of ACSM 276, 294
 market for mezzanine products 18–24
 market risk
 capital asset pricing model 82–6
 Tier 3 capital 143, 144
 maturity 2–4
 CoCos 175
 convertibles 52–4, 99–100
 covenants 319, 320, 322
 effective maturity 161–2, 292
 inter-company PPLs 37
 options contracts, Black–Scholes formula 49
 PIK notes 29, 30, 246
 reverse convertibles 64–6
 second lien 235
 Tier 2 capital 151, 178
 wall 22
 warrants 113–14
- MCR *see* minimum capital requirements
 mergers
 covenant 318
 Kratos and Castor, case study 67–76
 Lyondell and Basell 340, 341
 mezzanine debt term sheet 382–8
 mezzanine finance/products
 advantages and disadvantages 10
 characteristics/features 5–6
 compared to other financial products 14, 15
 geographical diversification 364–5
 market for 18, 24
 obstacles and requirements 24
 origination sources for 361–2
 outlook for 353–5
 performance of 363–6
 positioning and use of 7–10
 risk–return conundrum 10–17
 mezzanine lenders/providers 15, 18
 and inter-creditor agreement 323–6
 capital raised by 18–19
 cost of funding for 364

- development banks 362–3
- investment opportunities 354–5
- objectives 247
- participation in DIP scheme 503–4
- risk exposure 16–17, 30, 31
- mezzanine loans 332
 - collateral for 332–3
 - default under 335
 - document modifications 334, 335
 - guarantees as additional collateral 333
 - payments from borrower 333–4
 - rights to sell 336
- mezzanine product group 25
 - categorization 25–6
 - convertible loans 51–8
 - preferred shares 58–63
 - reverse convertibles 64–7
 - subdebt with PIK interest 29–33
 - subdebt with profit participation 33–40
 - subdebt with step-up rates 26–9
 - subdebt with warrants 40–51
 - Kratos company case study 67–76
- minimum capital requirements (MCR)
 - Basel II 142
 - Basel III 145–62
 - compliance with 168, 170
 - own funds
 - calculations of 169–70
 - compliance with 170
 - limits applicable to Tier 1, 2 and 3 items 168
 - under Solvency II 289–90
- minority interest (non-controlling interest), Basel III 152–4
- Model Agreement *see* ABA model inter-creditor agreement
- model contracts *see* term sheets
- modern financial theory 81–2
 - risk measurement issues 84–6
- modification of obligations, inter-creditor agreements 435–7
- Moody and S&P, hybrid capital rating 277
 - assignment of equity credit to 278
 - capacity limits in the capital structure 280–1
 - effect of ACSM on ratings and notching 276–7
 - example 283–4
 - key structuring considerations 278–9, 281, 282, 287–8, 294–5
 - motives behind issuance of 277–8
 - notching of hybrid issue ratings 278, 287
 - ongoing payments 279, 287–8
 - permanence 279–80, 288
 - phasing out 286–7
- mortgages 332–3
 - covenants 338
 - second 214, 215, 333
- Muldavin, Scott 217–18, 219, 220
- negative amortization 31–2
- negative pledge clause, covenants 314, 317, 320, 322
- negative (restrictive) covenants 313, 338
- negotiation 16, 29, 331
- Netherlands, JJ Bars & Restaurants case study 121–38
- Newco Emerging Growth, Inc., term sheet 396–407
- non-recourse financial assets 306
- non-sponsored financiers 18
- normal distribution 78, 79
- notching 266–7, 273–5
 - bank hybrids 292–3
 - effect of ACSMs 276–7
 - S&P and Moody 278, 282, 287, 288, 295
- Odin company, acquisition by Kratos 70, 71–2, 489–91
- ongoing payments 279, 287–8
- operational leases 2–3
- operational leverage 34
- operational risk 94, 141
- optional convertible notes (OCNs) 66–7
- optional deferral 266, 269–70, 271, 276, 279, 281
- options *see* call options; embedded options; put options
- Orangina LBO, case study 251–60
 - guidance/solution 500–2
- origination channels for mezzanine products 361–2
- ownership interests, real estate 215–16
- own funds 165–6
 - minimum capital requirements 169–70
 - tiering structure 166–8
- pari passu* (equal footing) 40
- participating preferred stock 61–2
- participation loans *see* profit participating loans (PPLs)
- payment blockage 235, 239, 323, 324, 325
- payments, inter-creditor agreements 333–4, 443–7
- payment subordination 326–7
- payout covenants 314
- PERCS (preferred equity redemption cumulative stock) 108
- permanence 263, 271
 - S&P and Moody 279–80, 288
- PIK (payment-in-kind) notes 246
 - cash sweep provision 45
 - subdebt 29–33
- pledged collateral 332–3, 428–9
- Poland toll road case study 196–203
 - financial peculiarities 202–3
 - financing options 495–7
 - identification and allocation of risk 494–5
- positive (affirmative) covenants 313, 338
- PPL *see* profit participating loans
- preferred equity 214
 - benefits to issuers 266–7
 - risk spectrum 11, 16
- preferred equity redemption cumulative stock (PERCS) 108
- preferred ownership of interest 215–16

- preferred redeemable increased dividend equity security (PRIDES) 65
- preferred shares/stock 58–9, 309
- Basel III changes 285, 286
 - case examples 62–3
 - characteristics of 59–60
 - convertible 107–10
 - equity or liability, IAS distinction 310–11
 - rights of holders 61–2
 - types of 60–1
 - warrants attached to 42
- pricing grid for mezzanine products 97–8
- PRIDES (preferred redeemable increased dividend equity security) 65
- Prime, floating-rate option 241
- private equity (PE) firms 4, 18
- valuation of warrants issued by 119–21
 - see also* leveraged buy-outs (LBOs)
- profit participating loans (PPLs) 33
- characteristics of 34–7
 - compensation 39–40
 - dos and don'ts of 37–9
 - reasons for FIs engaging in 40
 - tax treatment 36–7
- profit participation scheme (PPS) 33, 34–5, 36
- project finance 189–91
- case studies
 - toll road development 196–203
 - wind park construction 203–9
 - financing aspects 193–4
 - securitizing project loans 195–6
 - types of project 192–3
 - vs. corporate finance 189
- providers of mezzanine finance *see* mezzanine lenders/providers
- purchase of first lien obligations by second lien claimholders 447–52
- put options
- contingent capital as kind of 171
 - convertible bonds 99–100
 - covenants 321–2
 - DECS 65
 - embedded 108–10
 - IRR 42–5
 - PPLs 36
- puttable securities/instruments 56, 298, 299, 311
- puttable warrants 47–8
- Rabobank, contingent convertible bonds 172
- rating agencies 261–2
- criteria for project loans 195
 - criteria reports 267–8
 - deferability 266–7, 269–71
 - equity content 263–4, 265
 - equity strength 262–3, 272
 - features of mezzanine products considered by 262
 - permanence 263, 271
 - rating profiles 265–6
 - regulator powers 264
 - subordination guidelines 267
- rating hybrid securities, Fitch's approach 272–3
- notching 273–5
- real estate projects 211–12
- case study 220–4
 - guidance/solution 498–500
 - other mezzanine applications 214–15
 - return issues 215–20
 - wider application of 212–14
- recapitalization 248–9
- redeemability/redemption
- and Basel III 177, 178, 289
 - callable convertibles 64
 - covenants 316
 - incentives 145, 161–2, 263
 - mezzanine debt 383–4
 - optional warrant 377
 - PERCS 108
 - preferred stock/shares 60, 62, 301, 309–10
 - PRIDES 65
 - puttable bonds 299
 - subordinated loan 380
- refinancing 475
- First Lien Obligations 435–6, 446–7
 - leveraged recapitalizations 248
 - PIK loans 30, 31
 - use of SPLs 195
- refinancing wall 20–3, 362, 363
- regulation
- and deferability 266
 - bankruptcy laws 359–60
 - Basel III 154–60, 285–6
 - criteria for assessing hybrids 291–3
 - Solvency II 163–70, 289–90
- REIT (real estate investment trust) criteria 268
- remedy standstill provisions, second lien 236, 240–1
- repayment of principal 178
- replacement capital covenants (RCCs) 280, 288, 290, 292, 295
- reports covenant 318
- restaurant industry, case study 121–38, 492–3
- restricted payments (RPs) covenant 317
- return issues 77–8, 215–20
- reverse convertibles 64–7
- revolver credit facility, bank debt 234
- Riba (bond look-alike) 360
- risk
- allocation, finance projects 192–3
 - and return 11–17, 77–8
 - real estate sector 216–20
 - compensation 79–80
 - default risk 87–8
 - identification, toll road case study 201–2, 494–5
 - in mezzanine products 92–3
 - measurement of 78–9
 - of borrowing vs. equity risk 87–90
 - reducing firm-specific 81
 - types of 80–1
- risk-free rate 88–90
- risk premium 89–90

- risk-weighted assets (RWAs) 160
 Rosenzweig, Dona 121, 127
- S&P (Standard and Poor's)
 credit rating agency guidelines 294
 hybrid securities' classification for FIs 265
 hybrid structuring considerations 287–8
 maximum equity content for hybrid categories 291
 rating categories and TIER results 93
- SACP (stand-alone credit profile) 291, 292, 293
- screw clauses 64
- SCR (solvency capital requirement) 165, 289–90
- second lien financing 235, 326
 and lien subordination 235–6, 327–31
 anti-layering language 319
 enforcement standstill 331
 inter-creditor provisions 323–4
 unitranche product 356–7
see also first/second lien inter-creditor agreement
- second mortgages 214, 215
- second pillar, Basel rules 142
- securitization
 credit enhancement 211–12
 of project finance loans 195–6
- securitized mortgages 218, 219
- seller's notes 245–6
- Senior Contingent Notes ('SCN'), Rabobank 172
- seniority 16, 315
- senior lenders, inter-creditor agreements 325–7, 332, 334
- senior loans 332
 default 335–6
 modification of documentation by lender 325
 right to pay off or purchase at par 336
- senior secured financing 15, 16
 leveraged syndicated loans 236–8
 summary of terms 40–13
 term sheet for 367–78
see also second lien financing
- settlement options 300
- share pledges 45
- shareholders, Buffett's (2008) letter to 49–50
- Sharia compliance 360, 361
- shark repellants 249
- sinking-fund provision/requirement 60, 99, 107
- skewness 78–9
- soft protection 64
- solvency capital requirement (SCR) 165, 289–90
- Solvency II Directive 164–5
 new regulatory limits 289–90
 regulated capital under 165–70
- South Africa, FI case study 186–7
- split collateral financing 357–8
- sponsored financiers 18
- stabilized mezzanine investment 217, 218, 219
- staged financing 194
- standard deviation and risk 81
- standstill period, inter-creditor agreements 325, 331
- step-up dividends 322
- step-up rate loans 26–9
- step-up, step-down bonds (temporary write-down bonds) 171
- strike (exercise) price, warrants 46, 48–9, 112
- structural subordination 240
- subordinated debt ('subdebt') 4
 with PIK interest 29–33
 with profit participation 33–40
 with step-up rates 26–9
 with warrants 40–51
- subordinated loans/bonds
 Brazilian bank case study 184–6
 term sheet for 378–82
- subordination 4, 239–41, 267
- subordination agreement 380
- subrogation rights 266, 325–6, 328, 329
- subsidiary guarantees 315, 319, 320, 322
- sukuks, Islamic finance 360–1
- surplus funds 166
- syndicated loans 236–8
 PPLs constructed as 40
 vs. HY bonds 242–6
- syndication pricing options 241–2
- taxation 38
 and LBOs 230, 247
 deferred tax assets and liabilities 154
- tax-deductibility 1, 2, 6–7, 30, 36–7, 297, 366
- temporary write-down bonds 171
- tenor 27
- term sheets
 convertible bonds 390–6
 convertible preferred shares 396–407
 mezzanine debt 382–8
 senior secured financing 407–13
 senior secured loan 367–78
 subordinated loan/bond 378–82
 warrant purchase agreement 388–9
- thin capitalization rules 6
- third pillar, Basel rules 142
- three-date binomial option pricing 118
- ticking fee 30
- Tier 1 bonds, criteria 290
- Tier 1 Capital, Basel II 142–3, 144
- Tier 1 Capital, Basel III 144–5
 Additional 148, 177
 and 7th Criterion 271
 criteria for inclusion in 148–50
 specific features 178–81
- Common Equity 177
 15% limit on 159
 definitions 145, 146–7
 disclosure requirements 160
 minority interest 152–3
 regulatory adjustments 154–60
 specific features 178–81
 transitional arrangements 160–2
- limits under Solvency II 289–90

- Tier 1 Perpetual Notes, Rabobank 172
- Tier 2 bonds, criteria 290
- Tier 2 Buffer Capital Notes, Credit Suisse 172
- Tier 2 Capital
 - Basel II definition 143, 144
 - Basel III definition 146, 150–2
 - components of 177
 - limits under Solvency II 289–90
 - specific features 178–81
- Tier 3 Capital, Basel II 143, 144, 145, 167, 168, 290
- time premium of an option 47, 48
- times interest earned ratio (TIER) 92–3
- time value, warrants 112
- toggle notes, PIK 30, 31, 32–3, 45, 246
- toll road construction, Poland 196–203
- Total Capital, Basel III rules 146, 153
- tranches 211–12, 345
 - LBO structure 250
 - senior debt 206, 234, 257, 258
- tranching of unitranche 358–9
- transfer pricing 38
- treasury stocks, deductions 155–6
- turbo warrants 48
- turnover clause, lien subordination 240–1
- two-date binomial option pricing 117–18

- ugly covenants 320–1
- underlying asset value (UAV) 113–14
- underwritten deals 237
- unitranche loans 206, 356–9
- US mezzanine products 364–5

- valuation of warrants 119–21
- value-added mezzanine investment 217
- value of equity 113–14
- vesting period, warrants 47, 403
- volatility
 - and risk 85–6
 - Black–Scholes Model 111–15
 - implied 48, 49, 111
 - market value of assets 13
- Volatility Skew, Black–Scholes Model 111

- WACC (weighted average cost of capital) 90–1
- waivers 324, 325–6, 327, 374, 462
- wall of maturities 20, 22
- warrants 4, 99
 - embedded in convertible bonds 51, 52, 54
 - preferred stock with 59, 62–3
 - purchase agreement, term sheet 388–9
 - subdebt with 40–50
 - valuation of 112–15
 - issued by private firms 119–21
 - vs. options 50–1
- ‘waterfall’ provision, Model Agreement 444, 445
- waterfall trigger events, unitranche loans 358
- weighted average cost of capital (WACC) 90–1
- wind park case study 203–9
 - guidance/solution 497–8
- write-down bonds 171
- write-downs, loss absorbency 149, 181, 275

- zero-coupon convertible bonds 66–7