

XAIA INVESTMENT Perspectives

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Quiet Convexity CoC Optionality in IG Credit

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A growing universe of long-dated investment-grade (IG) bonds continues to trade materially below par, largely due to the low-coupon, long-duration issuance wave during the zero-rate era. With sponsor-led take-privates and leveraged buyouts (LBOs) re-emerging, these discounted bonds can offer significant upside when a Change-of-Control (CoC) clause forces a repurchase at par (or 101). In such situations, credit investors may capture equity-like returns while maintaining investment-grade exposure.

The recent Electronic Arts (EA) take-private provides a clear example: a large-cap, unlevered balance sheet, long-dated bonds priced well below par, and a clean CoC clause that triggered a repurchase at 101 following the LBO announcement and ratings downgrade. This case underscores how capital structure mechanics, rather than corporate fundamentals alone, can drive convex return opportunities in credit portfolios.

LBOs en vogue again

After grinding to a halt in 2022, sponsor activity is slowly returning. The take-private of Electronic Arts by PIF, Silver Lake, and Affinity Partners for \$55 bn – the largest all-cash sponsor transaction in history – has brought the LBO market back into focus.

Three forces currently support a resurgence in LBOs:

- > Record private-equity dry powder, estimated above \$2.5 trillion globally.¹
- > Falling forward funding costs, particularly for high-grade issuers.
- > Cheap equities: many quality large-caps still trade at post-pandemic valuation lows.

Together, these trends have revived sponsor appetite for large, cash-generative companies with headroom to relever.

Implications for credit investors

Activist and sponsor-driven transactions are typically equity-friendly but credit-adverse. Shareholders benefit from asset sales, spin-offs, or take-privates that “unlock value” while creditors face rising leverage and subordination risk. However, for bondholders sitting in discounted paper with CoC puts, an LBO can be an unexpected gift.

¹ <https://www.spglobal.com/market-intelligence/en/news-insights/articles/2025/7/global-private-equity-deal-value-up-19-in-h1-2025-91443230>

TABLE 1: CORPORATE EVENTS HIT CREDIT PROFILES

Overview of Events and its impact on credit profiles

Event	Positive Credit Impact	Negative Credit Impact
Take-private / LBO	Bonds taken out at 101	Releveraging risk
Spin-off	Debt remains with stronger entity	Debt trapped in weaker entity
Asset Sale	Proceeds used for deleveraging	Cash returned to equity holders
Special Dividend / Buyback		Leverage increase, weaker credit

A repurchase at 101 on bonds trading in the 70s or 80s can deliver 20-30 points of contractual upside – a far better risk-adjusted return than the equity premium.

Credit investors should therefore focus on balance sheet quality and legal structure, not just headline event risk.

plus ratings downgrade below IG), requiring the company to repurchase the bonds at 101% of par once both conditions are met. For investors who accumulated these bonds in the mid-60s to high-80s, the resulting 20-35-point gain far exceeds the equity premium. The EA transaction shows that in clean, unlevered capital structures, the best LBO trade may sit in the long-dated bonds—not the stock.

Case Study: Electronic Arts

Electronic Arts is a textbook example of how a large-cap LBO can create bondholder optionality. The company is being acquired by PIF, Silver Lake, and Affinity Partners in an all-cash \$55 bn take-private, with shareholders receiving \$210 per share, a 25% premium to the unaffected price. The financing includes roughly \$36 bn of equity and \$18-20 bn of new debt underwritten by JPMorgan, leveraging EA to ~7-8x EBITDA from effectively zero net leverage pre-deal.

FIGURE 1: THE DAY THE INDENTURE MATTERED

Price development of EA's 2.95% 2051



For bondholders, the focus is EA's 2.95% 2051 notes, issued during the 2021 low-rate period and long ignored due to their low coupon and duration risk. The indenture contains a double-trigger CoC clause (change in control

Why the Covenant Language Matters

In LBOs, the outcome for creditors often depends less on the borrower's leverage and more on indenture mechanics. Most investment-grade bonds feature Change-of-Control provisions, but the details matter. The EA 2051s, for instance, require both a change in ownership and a ratings downgrade to trigger a mandatory repurchase at 101% of nominal. The clause is powerful because it is mechanically enforceable, not tied to leverage ratios or financial tests.

However, these protections can be circumvented. Weak indentures may include merger exemptions, holdco substitutions, or defeasance provisions² allowing the issuer to pre-fund all future payments and discharge the covenant package entirely. In such cases, bondholders lose the upside of a CoC take-out, effectively holding long-dated treasuries instead of corporate risk. For investors hunting high-convexity LBO trades, covenant quality is the hinge between a windfall and a disappointment.

Eyes out for the right company

Attractive candidates share three characteristics:

- > Long-dated bonds trading below par, cheap due to rates, not credit.
- > Low leverage and consistent free cash flow, implying capacity to relevel.
- > Equity underperformance or structural inefficiency, inviting external pressure to "unlock value".

² Defeasance allows an issuer to deposit sufficient treasuries to cover all future payments, thereby discharging most covenants—including the CoC repurchase obligation. If executed prior to the trigger, the bonds reprice like escrowed-to-maturity treasuries (typically mid-70s) rather than converging to 101.

These are often high-quality, cash-rich issuers that can sustain higher leverage and thus attract sponsors or activists. For credit investors, they offer exposure to capital-structure change rather than credit repair – a subtler, higher-quality source of convexity.

Three-Step Process to Identify High-Convexity Trades

1. Find the Right Bonds

Screen for below-par, long-dated investment-grade issues where spreads and cash prices reflect duration and coupon dislocation, not deteriorating credit. Prioritize low-coupon paper with CoC puts, ideally in the \$70–\$90 range, where the asymmetry to a 101 take-out is meaningful. Assess liquidity, maturity, and fundamental credit quality – the thesis only works if the bond is cheap for technical reasons, not because default risk is rising.

2. Test the LBO Logic

Analyze whether a sponsor-led transaction makes economic sense: stable cash flows, visible cost levers, tangible assets, and leverage capacity up to 6–8x EBITDA without breaching coverage thresholds. Market capitalization (typically <\$100bn) and free cash flow yield determine feasibility. The best setups are unlevered, under-earning companies with scope for operational improvement and financial engineering.

3. Verify the CoC Trigger Mechanics

Once a plausible LBO or take-private case exists, dig into the indenture language. Confirm the double-trigger structure (change-of-control plus ratings downgrade), review carve-outs (e.g., merger exemptions, defeasance clauses, hold-co substitutions), and test for structural workarounds that could neutralize the put. Only a handful of bonds have airtight protection – identifying those early is what creates alpha before the market prices in the event risk.

Conclusion

Well-structured take-privates or LMEs can transform a bond's risk–reward profile. The key for investors is to do the work early—before the CoC optionality is reflected in prices. These setups are rare, but when all three elements align – discounted bonds, credible LBO logic, and enforceable covenants – they can deliver equity-like returns from investment-grade risk. Timing remains critical: once the market catches on, the 101 is already in the price.

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Philipp Graxenberger and Josef Pschorn oversee Alternative Credit Strategies at XAIA Investment, specializing in identifying inefficiencies in the credit market, particularly within complex capital structures and special situations. Their expertise spans credit arbitrage, relative value, special situations, and restructurings.

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