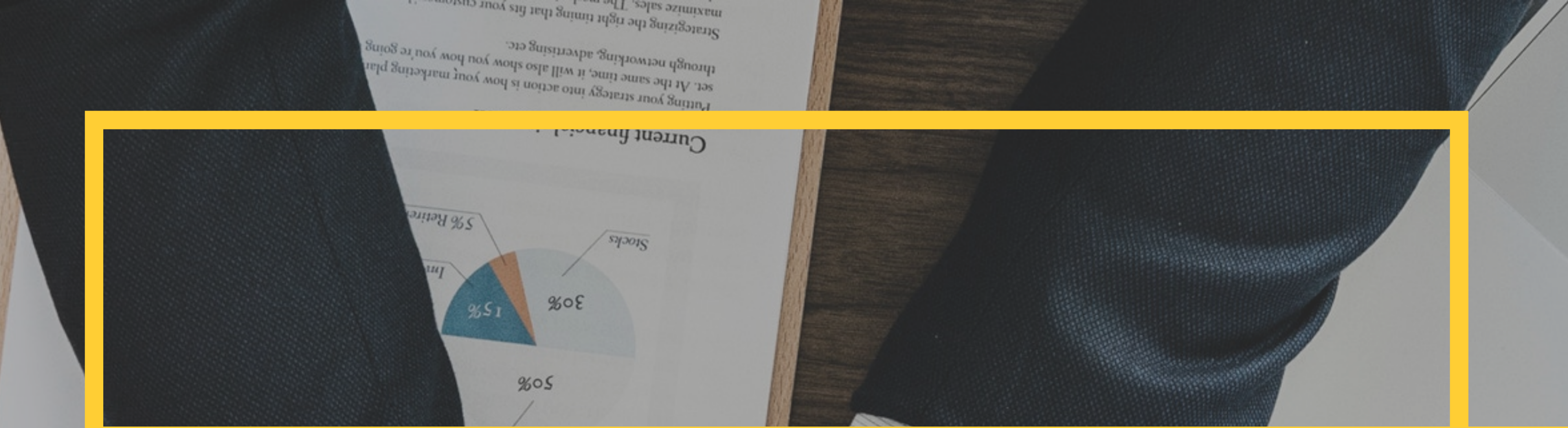

Managing Multiple Credit Agreements

Challenges, best practices, & checklist

CEREBRO CAPITAL

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CHALLENGES:

MANAGING MULTIPLE CREDIT AGREEMENTS

1) Variances in financial covenant calculations & ratios

If your company has multiple credit facilities, many times they originated at different times. Each agreement often has custom covenant calculations tailored to the particular context of the companies' financial performance at time of origination. Often custom add-backs related to projects or specific acquisitions may be included in certain loan agreement covenant calculations, but not in others. It becomes confusing when a covenant calculation for a senior secured term loan has a different calculation than a mezzanine term loan closed two years later. Cash Flow Leverage ratios are a common example of a calculation that can vary from agreement to agreement.

2) Subtle differences in term definitions

Each of your credit agreements might reference the same value but the definitions could vary greatly. For example, EBITDA is a common metric that can have very different definitions and add-backs from agreement to agreement. Another example is how values are annualized. Some agreements require trailing 3 month versus trailing 6 month metrics. It is likely that the same metric will have a different value on each of your various compliance certificates because of the variance in definitions.

Do you have a system in place?

Typically companies think that using an Excel spreadsheet and Outlook reminders is enough to manage credit agreements. However, deadlines and fine print can easily be missed without a systematic process in place. When companies need to monitor many loan documents, the process becomes laborious and complex. Challenges arise further when loan agreements are amended or there is turnover within the finance team.

On the last page of this guidebook, we share the advantages of new loan compliance software.

CHALLENGES continued:

MANAGING MULTIPLE CREDIT AGREEMENTS

3) Extensive list of non-financial triggers & covenants

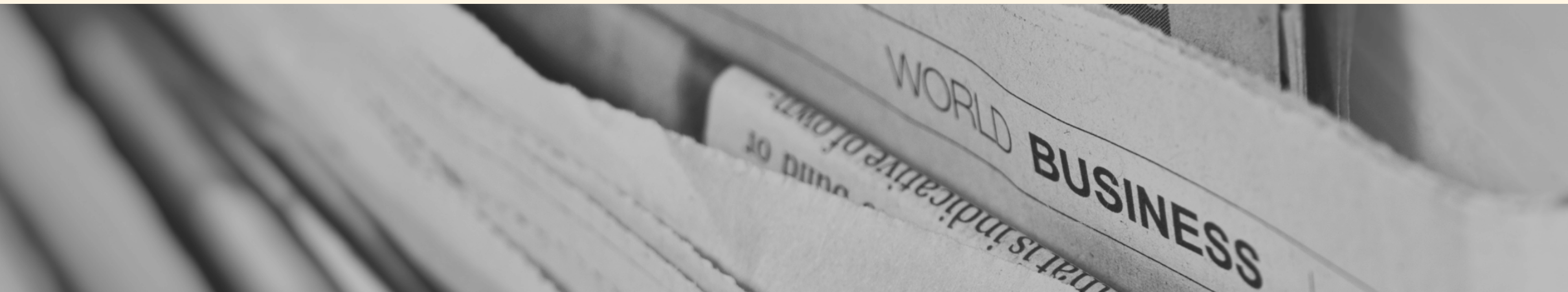
The bulk of the lengthy credit agreement will cover a variety of non-financials covenants, reporting triggers and fine print. Some of the hardest provisions to track are the different definitions related to permitted liens, permitted additional indebtedness, and limitations on capital leases. These buckets may differ across loan agreements. But because it is not required to report to lenders unless a limit is breached, many companies fail to track these properly. Lack of reporting opens the company up to the risk of accidental loan default.

4) Cross default & cross collateral provisions

When a company has multiple creditors, often there will be cross default or cross collateral provisions tying the agreements together. It can become confusing which agreements are connected and which are independent. If a covenant breach in one agreement occurs, the issue could become more severe with cross default provisions in place.

5) Modeling & forecasting

Creating an Excel model for one or two financial ratios might seem easy enough but modeling different covenant ratios for more than one agreement with each having several add-backs, different ratios and various definitions becomes more complicated. Nevertheless, companies should always create covenant models that forecast through maturity dates. Knowing far enough in advance about any potential covenant defaults helps the company avoid issues or proactively contact lenders to discuss amendments or waivers.



Financial Covenants

Communicate early & often

If you forecast any covenant defaults, contact your lenders early. While its a difficult conversation to admit that a trip might occur, the penalty of tripping the covenant and notifying the lender after the fact is much more severe. Lenders will be more willing to offer amendments or waivers if the borrowers offer them honest but detailed explanations well in advance of the actual violation.

1) Create a master definition file for each agreement.

Clearly define each covenant and each variable within each covenant. Subtle differences between similar definitions and ratios should be highlighted to ensure proper covenant calculations between each agreement.

2) Ensure every add-back line item is included even if the values are zero.

In the event that there are add-back concepts that do not have a value for a certain period, it is important to include the add-back concept in the calculations with a zero value. For example, if you can add back "Stock Compensation" but you have no "Stock Compensation" to report in the past or near future you should still include this line item in your calculation and record "0" is for each period. This will ensure that these add-back concepts are considered for future periods and are never missed.

3) Forecast financial covenants through maturity of the facility or at least 2 years in advance.

Companies should always create covenant models that forecast through maturity dates. Knowing far enough in advance about any potential covenant defaults helps the company avoid issues. If the model indicates a potential default, it's in the interest of the company to notify lenders early.

BEST PRACTICES

Non-financial Covenants & Triggers

It is unusual to have to report non-financial covenants to the lender unless a provision is triggered. But these provisions and any missed deadlines are just as likely to cause a loan default if they are violated. Lenders will have just as much legal power to call back the loan or enforce penalties if the borrower fails to comply with a non-financial provision no matter how tiny or seemingly inconsequential.

Are you paying attention?

40% of borrowers missed a non-financial covenant in their credit agreement and didn't even know it.*

Limits

Any limitation on certain concepts like debt, liens, capital leases, etc should be tracked in separate areas and reviewed at least quarterly.

Deadline Reminders

Reminders for all covenant testing periods should be tracked in a reminder system or shared calendar such that the finance team is always aware of upcoming deadlines and review periods.

Review Periods

Non-financial covenants can be continuous provisions. This means they don't have test periods and can be triggered at any time. This is different from a covenant that might have a specific test date. In those cases of a specific test date the covenant only needs to pass on that certain date and could fail at other times in the year. Continuous covenants can be tripped at any time; and therefore, they should be reviewed regularly.

Legalese

Often credit agreements contain fine print and provisions that are confusing due to the legal terminology. Make sure counsel clearly defines any legalese so the finance team can appropriately monitor and track all the non-financial fine print.

*Based on a study of new Cerebro Capital Compliance Navigator users on-boarded in 2018.

LOAN COMPLIANCE CHECKLIST:

- [ ] Review loan agreements and ensure the most recent amendments, waivers and notices are saved.
- [ ] Create separate spreadsheets for each agreement with financial covenant ratios. Ensure definitions are accurate and all line items are included (using a value of 0 if necessary).
- [ ] Use forecasted financials to populate covenant ratio spreadsheet forward at least 2 years. Review cushion analysis on each metric and notify lenders early if potential for a trip.
- [ ] Create separate list of non-financial covenants for each agreement ensuring legal language is easily understood.
- [ ] Mark each non-financial covenant as continuous or date specific. Create policy for reviewing these every month, quarter, or year.
- [ ] Setup email alerts and calendar notifications for 30, 15, and 1 day prior to lender reporting deadlines. Ensure more than one employee is notified in the event primary party is out of the office.
- [ ] Save compliance certificate templates for each agreement in the format requested by each lender. Note that values across certificates can vary due to variances in definitions and ratios.
- [ ] Review & track which agreements include cross default and cross collateral provisions.

If you would like help with any of these steps or would like to explore how a software system can automate many of the tasks, click to learn more about Cerebro's Compliance Navigator platform.

https://www.cerebrocapital.com/compliance-navigator-features/

Compliance Navigator

TOOLS & BENEFITS

Cerebro Capital offers the only SaaS platform designed to manage and monitor loan agreements, helping finance teams more easily track all financial and non-financial covenants. Cerebro's team of loan experts will review your credit documents and create your custom digital dashboard with little to no setup required on your end.

Benefits of the platform include:

- Automated Compliance Certificates
- Audit trail for financial calculations
- Easy review of all non-financial covenants
- Alerts & reminders for each team member
- Summary dashboard across portfolio of loans
- SaaS platform requires no integration

Cerebro Capital is destined to transform the way middle market companies analyze, manage, and source their corporate credit facilities. The corporate borrowing industry has changed little in the last 30 years, until now. By offering best in class online software, world class security, and industry expertise, financial executives can transparently evaluate the corporate borrowing industry and easily monitor their loan compliance.

Learn more about Cerebro's Compliance Navigator and Portfolio Navigator platforms.
https://www.cerebrocapital.com/portfolio-navigator/

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