Reading Credit Agreements and Indentures
by Professor Fernando Diz

Credit agreements have a very simple and logical structure. This is also true of indentures, which much like a credit agreement, represent the agreement between the borrower and the representative of the security holders (debentures, notes, etc), i.e. the trustee. There are, however, a few differences that emerge in the two agreements that are large due to the fact that in one case we are dealing with securities and thusly, their issuance must comply with securities laws.

The general structure of both a credit agreement and an indenture are presented below.

TOC CREDIT AGREEMENT	TOC INDENTURE
▼ **Credit Agreement**	**Indenture**
DEFINITIONS	DEFINITIONS
AMOUNT AND TERMS OF COMMITTMENTS	THE SECURITIES
REPRESENTATIONS AND WARRANTIES	[REPRESENTATIONS AND WARRANTIES AND CONDITIONS PRECEDENT ARE USUALLY REPLACED BY THE SECURITIES LAWS REQUIREMENT THAT THE ISSUER PROVIDES BUYERS OF THE SECURITIES WITH A PROSPECTUS]
CONDITIONS PRECEDENT	
COVENANTS	COVENANTS
AFFIRMATIVE	
NEGATIVE	
	SUCCESOR COMPANY
	REDEMPTION OF SECURITIES
EVENTS OF DEFAULT AND REMEDIES	EVENTS OF DEFAULT AND REMEDIES
	TRUSTEE
	DISCHARGE OF INDENTURE
	AMENDMENTS
	SUBORDINATION
	GUARANTEE
	SUBORDINATION OF SUBSIDIARY GUARANTEES
MISCELLANEOUS	MISCELLANEOUS

I. Definitions

You can use this section of the credit agreement to find most of the information that you are looking for. If you are not sure whether the facilities are guaranteed, you may search for the word "guarantee" and if there are guarantees you will find information about them in this section. Whenever something comes to mind, I suggest using the definition section of the agreement and/or the table of contents as the first places to look for the information.

II. Amount and terms of the commitments

If you want to know about the specifics of the loans, terms, fees, etc. you must read this section of the credit agreement.

Making the Loan

Revolvers and their sub-limits

Revolve around "commitments". Debtor can draw from commitment and what it draws is what is outstanding and appears on the BS. Can borrow repay, re-borrow and repay.

Revolvers usually have "sub-limits" for "swing-line loans", "letters of credit", "asset based loans" and other types of loans.

Swing-line loans are same day money available from the swing line lender.

Letters of credit are promises to pay if the borrower does not pay. They are "contingent loans".

Asset based loans are loans that are advanced to the borrower on the basis of "short term asset collateral", usually a fraction of the value of the debtor's receivables and inventory.

Reducing commitments: just as loans amortize, i.e. a reducing revolving credit facility.

Term Loans (never more than 7-8 years).

Their tenor is usually the same as that of the credit agreement and call for real amortization over their life' i.e. sizable pay-downs.

A Tranche (Bank)

B Tranche (Institutional): tenors are longer than A Tranche loans (6 months to a year longer) and small amortization requirements.

If we are looking at an indenture, this section will describe the security.

Making Money off the Loan: Loan Pricing and Fees

Base rate plus spread.

Base rate is usually LIBOR: London Interbank Offer Rate

Spread depends on the credit rating of the debtor or the Leverage usually measured as Debt/EBITDA.

Fees:

Commitment fees: a rate on the average unused commitment.

Facility fees: computed on both the unused and used portions of the commitment. Do not apply to Term loans.

Making the borrower repay the loan: Amortization and Maturity

Scheduled repayment:

Maturity date if nothing happens in between

Voluntary prepayments

Mandatory prepayments:

Borrowing bases (asset based deals) : upon reduction must repay.

Asset sales out of the ordinary course.

Debt and equity issues.

Excess cash flow, typically EBITDA.

Change of control (either an event of default or a mandatory prepayment).

III. Sections on Representations and Warranties and Conditions Precedent

The examination of these sections, although technical, can give us hints as to whether the underwriting of the loans is conservative, whether there are potential hidden liabilities, etc. Some credit agreements may contain appraisals of collateral that may be very helpful in the valuation of the assets of the debtor on a replacement cost basis. You will also learn whether there are other parties holding liens on the collateral, and other information that could be very important in the determination of the credit worthiness of the debtor.

Conditioning the Loan: conditions precedent and representations

Conditions

Opinions: as a condition to closing, formal legal opinions must be delivered affirming the legality, validity, binding effect and enforceability of the credit agreement.

Evidence that each security interest has been perfected (borrower must deliver to the banks a set of documents which may include:

i. Collateral agreement
ii. Security agreement
iii. Guarantee agreement
iv. Financing statement
v. etc.

The MAC condition: Material Adverse Change.

Appraisals

Insurance

Environmental Due diligence

Representations

Legal mater representations (lots of stuff here) Boiler plate.

Financial Condition Representations

Financial Statements

Solvency

Capital Structure

Subsidiaries

Existing Debt and Liens

Real property

Litigation

Status as Senior Indebtedness

IV. Covenant Section

Monitoring the Loan: Financial, Affirmative and Negative Covenants

- Subsidiaries
- Covenants: GAAP as a building block
  - *Financial*
    - Debt ratio (leverage ratio)
    - Interest coverage ratio
    - Debt service coverage ratio
    - Fixed charges coverage ratio
    - Capital expenditures
  - *Affirmative Covenants*
    - Disclosure
    - Visitation rights
    - Maintenance of insurance
    - Substantive consolidation
    - Use of proceeds
  - *Negative Covenants*
    - Negative pledge: restricts the borrower's granting of security interests in assets.
    - Debt
    - Fundamental changes
      - Mergers
      - Acquisitions
      - Dispositions
      - Sale leasebacks
    - Guarantees or Contingent Liabilities
    - Dividends
    - Affiliate transactions

Securing and Guaranteeing the Loan: Collateral

- Guarantees: Downstream, Cross-Stream, and Upstream
  - Risk of fraudulent conveyance

V. Events of Default

Enforcing the Loan: Events of Default and Remedies

- Events of default:

- Default in payment
- Inaccuracy in representations
- Breach of covenants
- Cross-default; cross acceleration
- Insolvency
- Change of Control
- Invalidity of Guarantees or Liens
- MAC clause

Remedies

- Stop lending
- Terminate commitments
- Accelerate
- Setoff

VI. Miscellaneous

This section may contain very important language about the types of amendments and waiver that may happen and the conditions under which they can happen.