LEVERAGED LOANS

Swingline
A small, overnight borrowing line, typically provided by the agent

Term-Out
Allows the borrower to convert borrowings into a term loan at a given conversion rate
Usually a feature of IG loans
Often the spreads ratchet up if the option is exercised

Evergreen
An option for the borrower, with the consent of the syndicate group, to extend the facility each year for an additional year

Amortizing Term Loan A (TLa)
Term loan with a progressive repayment schedule that typically runs six years or less

Institutional Term Loan B (TLb), C or D
Term loan facility carved out for nonbank, institutional investors
Longer maturities
Back-end loaded repayments
Also includes second-lien loans and covenant-lite loans

Letter of Credit
Guarantees provided by the bank group to pay off debt or obligations if the borrower cannot

Bridge Loans
Loans intended to provide short-term financing to provide a bridge to an event
Event could be an asset sale, bond offering, stock offering, divestiture, etc.
Typically characterized by increasing interest rates if the loan is not repaid as expected

Equity Bridge Loan
Bridge loan provided by arrangers that is expected to be repaid by secondary equity commitment to an LBO
Example: LBO requiring $1B in equity, of which sponsor ultimately wants to hold only half --> $500m equity bridge
Repaid when sponsor brings in other investors

Incurrence Covenants
Generally require that if an issuer takes an action (e.g. paying a dividend, making an acquisition, issuing more debt), then it would need to be still compliant with the incurrence covenant on a pro forma basis

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Maintenance Covenants
More restrictive than incurrence covenants
Require an issuer to meet certain financial tests every quarter whether or not it takes an action

Affirmative Covenants
State what action the borrower must take to be in compliance with the loan (e.g. must maintain insurance)

Negative Covenants
Limit the borrower's activities in some way, such as regarding new investments
Highly structured and customized to a borrower's specific condition
Can limit the type and amount of investments, new debt, liens, asset sales, acquisitions, guarantees, etc.

Financial Covenants
Enforce minimum financial performance measures (e.g. current assets > current liabilities)
Bonds and covenant-lite loans usually containt incurrence covenants but not maintenance covenants
Five types of financial covenants
- ***Coverage Covenant:*** minimum required level of cash flow to required expenses
- ***Leverage Covenant:*** maximum level of debt (relative to equity or cash flow)
- ***Current Ratio Covenant:*** minimum ratio of current assets to current liabilities
- ***Tangible Net Worth Covenant:*** minimum level of tangible net worth, often with a build-up provision
- ***Maximum Capital Expenditure Covenant:*** limit capex to a certain amount, possibly increased

Mandatory Prepayments
Leveraged loans usually require a borrower to prepay with proceeds of excess cash flow, asset sales, debt issuance or equity issue
May be waived or reduced if issuer meets a preset financial hurdle, say debt/EBITDA
- ***Excess Cash Flow:*** typical required percentage 50-75%
- ***Asset Sales:*** typically 100%
- ***Debt Issuance:*** typically 100%
- ***Equity Issuance:*** typically 25-50%

Collateral
Lending against inventories and receivables permits issuer to borrow against 50% of inventory collateral (80% of receivables collateral)
Sometimes, holding company pledges stock in its subsidiaries --> risk to lenders here of substantive consolidation

Springing Lien
Borrowers may receive credit on an unsecured basis that becomes secured should specific events take place (say downgrade to HY)

LEVERAGED LOANS

Loan Spread Calculation

Loans on average had a 15-month average life between '97 and '04

So, if you buy a loan with 250 bps spread at a price of 101, you might assume your spread-to-expected life is 170 bps

15 months = 1.25 years

101 - 100 = 1 --> 1 x 100 = 100 bps for life

100 bps/1.25 years = 80 bps pa

250 - 80 = 170 bps spread-to-life

Distressed Loans

Trading at 80c or less --> akin to 1000 bp spread on bonds in distressed bond market

Technical Default

When the issuer violates a provision of the loan agreement, like a peformance covenant

Payment Default

When a company misses an interest or principal payment

Typically with a 30-day cure period