

EXERCISE

COVENANTS AND EVENTS OF DEFAULT

Background

Your client, a bicycle manufacturer, is growing quickly, and they're in the middle of negotiating a term sheet for an asset-based loan with "standard affirmative and negative covenants." The general counsel wants to have a call to discuss a few questions she has about what to expect with the covenants at the documentation stage.

The GC writes you an email before your call with the following information:

- The company has a subsidiary that it uses for purchasing and warehousing portions of its inventory, and it has an intercompany loan arrangement in place to finance the subsidiary's activities.
- The bank indicated that it would impose a maximum Debt to EBITDA Ratio and that it expects the company will increase its net income over the life of the loan.

Instructions

Come prepared to discuss these questions:

- Can the company expect its subsidiary to be picked up by the covenants and what are the implications of that?
- Will it be possible for the company to keep its intercompany loan arrangement in place given the inclusion of standard negative covenants?
- Should the company expect the maximum Debt to EBITDA ratio to remain the same over the life of the loan?
- How will the lender track whether the company has increased its net income over the life of the loan?
- What documents will the company likely have to deliver each month, particularly if they enter into an asset-based loan?