ASSOCIATION FOR FINANCIAL PROFESSIONALS

AFP Guide

Negotiating and Complying with Credit Agreements

In collaboration with Hunton & Williams

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Introduction

For many U.S. companies, the pressure is on to review and renegotiate their credit facilities. Here's why:

- Interest rates have already began to inch upward.
- There's rising demand for credit because of an M&A surge and relatively cheap debt.
- Banks are readying themselves for the onset of Basel III capital and liquidity regulations.

As a result, many practitioners report that their banks are urging them to review and potentially reopen credit facilities, even if they're not due for some time, in order to lock in advantageous terms. Interviews with bankers, consultants, lawyers and many practitioners confirm this trend. While credit agreements are a perennial issue for treasurers, they are more top of mind now.

As companies look to renegotiate existing agreements or put in place new ones, they need to keep certain things in mind. What's particularly important is building a document that will allow a company flexibility to run its operations successfully for the duration of the facility. That means that compliance with the credit agreement needs to be a day-one issue and must be monitored on a continuous basis.

This guide, produced in collaboration with law firm Hunton & Williams LLP, traces the steps companies take in negotiating their credit facilities and how they prepare for and execute their compliance responsibilities. It offers practical advice and best practices and includes six case studies that illustrate how companies of different sizes, in different industries and of various credit standing are negotiating and complying with their credit agreements.

This article presents the views of the author and do not necessarily reflect those of Hunton & Williams or its clients. The information presented is for general information and education purposes. No legal advice is intended to be conveyed; readers should consult with legal counsel with respect to any legal advice they require related to the subject matter of the article.

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Factors Driving Interest in Renegotiation

Several external factors are making companies rethink their credit agreements:

- Basel III capital and liquidity rules.
- Other regulatory reform like the anti-money laundering act.
- Rising interest rates and globalization.
- Banks' reassessment of their business models and retrenchment from certain regions.

What's Driving the Interest in Renegotiation?

Many companies are encouraged to review their agreements now, because of the shifting regulatory environment. "Some Basel rules require banks to hold higher liquidity, especially when it comes to financial borrowers and CP backup facilities," said Michael Nardo, executive vice president of PNC Bank. "So far, there hasn't been as much pricing impact as I expected, but that remains to be seen," he said. "A lot of banks have been encouraging clients to refinance now before prices go up."

The other big change is the inclusion of a lot of language designed to comply with strict AML (anti-money laundering) regulations to ensure the money is being used for legal purposes." At the same time, according to Nardo, the market has seen a rise in demand. "The demand for bank loans is not so much affected by the rush in the corporate bond market as the boom in the M&A market."

According to Bill Booth, executive vice president of treasury management for National & Specialty Businesses at PNC Bank, with respect to the increasing regulatory environment, PNC pays more attention to the nature of the industry and its inherent risks. "My sense is that banks are now focusing more on underwriting not just the financial risk but also the operational risks, such as reputational challenges and third-party customer or supplier challenges that can end up impacting the client's financial performance," Booth said. "Bankers end up asking more questions, designed to make sure they have a much better understanding of the underlying business risks associated with that company, than they did pre-crisis."

The big U.S. banks are on the front end of this trend, according to Bob Novaria, partner at Treasury Alliance Group. "They have to force the issues," he said. What he sees in his practice is that banks are forced to scrutinize their own balance sheets and reassess their strategies. "No part of their business is untouched," he said. "It's not just about cash deposits, as some may think," Novaria said. "All areas will be touched, though not equally, which of course makes the conversations between corporates and their bankers a lot more customized and complex," he said. Novaria advised companies to be proactive in reaching out to their banks. "It's an unsettling time and a good time to do your homework, understand how banks view you, and how banks assign the risk rating to your company versus what you think your risk rating is," Novaria suggested. "Be assertive and ensure there's mutual understanding and agreement. Cultivate new relationships, figure out whether or not you're exposed to future changes, and make sure your relationships are sustainable over time."

According to Novaria, this new urgency is not just about interest rates and regulatory change. "You watch what the market has done in the last few months and you realize it's more and more global," he said. "This plays into the credit space. Banks are rewriting their approaches. Credit is the elephant in the room. It's going to be harder and more expensive to obtain."

That means many companies will have to right-size their facilities and target what they absolutely need as opposed to what they used to get, according to Novaria. "Banks are reexamining and rebalancing their portfolio of customers. Corporates may not be able to get their first choice or the least expensive cash management bank, because they may no longer have access to the credit they need," Novaria explained.

Another pressure point: some banks are unexpectedly exiting certain regions, so companies are left to fill the gap quickly. That trend has caused many companies to change their RFP process to require more transparency on the part of the banks, according to Novaria. "It may take longer than it used to take to replace a bank because of all the regulatory and credit concerns."

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What Internal Factors Spark a Renegotiation?

1. Desire for increased financial flexibility.
2. The need to change covenants to allow access to capital markets or asset disposal.
3. A change in ownership structure.
4. A change in the company credit quality—for better or worse.
5. Upcoming maturity (so the facility doesn't become current on the balance sheet).
6. Upcoming transactions, such as an acquisition or asset sale.

Knowing When it's Time to Renegotiate

The external pressures in today's credit markets are one reason some companies are choosing to review their credit agreements. According to Nardo, "If everything is fine, five-year [IG grade}, deals usually get opened about a year from expiration to extend or change," so they don't go current on the balance sheet. In other cases, the renegotiation is event driven, for example there's a significant change in financial performance. Credit quality may have improved, suggesting the company can get better terms. Other reasons include the availability of more favorable terms, or a more favorable bank market, which then begs the question: Why wait and take the risk?

The length of time necessary for borrowers and banks to negotiate documentation for a credit facility varies based on the size and complexity of the facility and the number of banks involved. Negotiations for high-grade borrowers "can take as little as three weeks, particularly if the company is renewing an agreement it already has in place, and it is just making some changes to terms and pricing," said Rich Levin, managing director of Consumer and Retail Corporate & Investment Banking at Bank of America Merrill Lynch. Some commonly negotiated areas include pricing, covenants and other restrictive language. "The timeframe is extended in circumstances where the facility is negotiated for the first time, or the company is borrowing to fund an acquisition," Levin said.

However, in general, recommended Jeff Cappelletti, CTP, a principal with Upper Third Consulting, companies should always begin the work at least a year before the revolver expires. "It sometimes takes longer to get what you want," he cautioned.

This is also the time for companies to consider whether to change banks. Whether companies do will affect the cost of the facility. If it's merely a renewal, companies can use any unamortized cost and spread it over the new facility. However, with a new agreement, unamortized costs from the old agreement may need to be expensed immediately. "That may be a decision-making factor," said Brad Larson, CTP, a treasury consultant and ex-practitioner. In one case Larson was involved in, the company didn't like one of its banks. But, after reviewing the impact of switching, the company decided to begin a conversation with the bank instead, thereby reducing its commitment and improving the relationship along the way.

Rethink the Bank Group

A refinancing is a good opportunity to rethink the composition of the bank group. That may mean a chance to reallocate the economics of the multiple relationships, adding new banks or eliminating weaker banks.

- **Introduce competition.** According to Mike Sommer, assistant treasurer at Scotts Miracle-Gro, to the extent the company can have some competition among banks, that's really the only way to improve the terms of the deal. "The classic example is conducting an RFP," he said. In its most recent renegotiation, Scotts did an informal RFP and put together a short document that outlined what it wanted and what's important to the company. It then asked the banks to provide a proposal and pricing that would help the company reach those goals. "I believe we got a better result versus starting negotiations with only one bank from scratch," said Sommer.
- **Get the banks educated.** According to Jigisha Desai, CTP, treasurer at Granite Construction, getting the right banks to be in the group is critical. "It's very important that my bank group is comprised of banks that understand the engineering and construction sector," she said. "The facility will have covenants and you may need waivers occasionally, because of the cyclical nature of the business," she said. "You need banks that will not overreact because of one bad quarter."
- **Select a strong lead.** Dana Laidhold, treasurer of the Carlyle Group, also advised treasurers to choose a strong lead. "Choosing a capable lead bank means you don't have to deal with the whole syndicate one-on-one in negotiating every term," she said.

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Understanding the Risk-Reward Trade-Off

When obtaining credit, borrowers should always be conscious of the risk-reward relationship framework considered by their banks. "It is important for borrowers to remember when structuring a credit facility that the protection afforded to the lender comes as a package," said Levin. Restrictions, covenants or security, and price should all be commensurate with the risk. "When banks give up something in one area, they are likely to look to get something extra in another," he said.

Collateral is typically only requested for non-investment-grade (non-IG) credit facilities. "Some assets can serve as collateral more effectively than others. Banks value collateral with a haircut as one factor in determining a credit limit," Levin said. But things may change. In some cases, companies must switch from unsecured to secured facilities if their business or credit quality deteriorates. The collateral may be real estate, inventory, receivables, existing cash and investments (usually in a restricted account), or machinery and equipment. "Some companies migrate to a position where asset-based financing is their best alternative," Levin noted. But collateralization is not only for non-IG companies. Some IG companies prefer to continue to put up assets to attain greater flexibility and better pricing (see Granite Construction case study on page 12).

With secured facilities, a lot of the negotiations focus on the value of the inventory, or what it would be worth in the case of a fire sale, according to Larson. When looking at receivables, banks want to know how solid they are, i.e., who are they with. They may be worth more or less at different times of the year, for example more just before Christmas, less after the holidays. There's always an annual audit, but there's also negotiation around what would trigger an audit.

In a way, all facilities are secured, either by collateral or the good name of the company. As the former treasurer of BP America, Novaria rarely had to deal with issues of collateral. For many companies today, however, the use of collateral has added flexibility in terms of pricing and covenants. "You should look at your balance sheet now. The banks may trigger that conversation before you're ready," he said.

Where the Pushback Occurs

When negotiating a credit facility, there's often a lot of back and forth between companies and their banks.

1. **The details.** Bank lawyers are focused on dotting the I's and crossing the T's. "The devil is in the details," said Novaria. Companies prefer standardization across their debt agreements, matching the language between the revolver and other notes. Most of the time, the pushback occurs around contingencies or timing issues.
2. **Covenants.** According to Cappelletti, the number one pushback is around covenants. "Companies know they're coming, but banks want them most restrictive while companies want them as flexible as possible."
3. **Fees**. Cappelletti said the other area of pushback is fees. Again, companies know they are coming, but they sometimes suffer from sticker shock.
4. **Ancillary business.** Some of companies noted that they've also experienced pushback in terms of how much ancillary business each bank can expect based on its credit commitment. Some banks can be pushy. Practitioners say it's an artful process to negotiate with banks without overpromising and under-delivering.
5. **The 20%.** "You'd find the same boilerplate language in 80 percent of syndicated bank facilities," said Nardo. "It's the 20 percent left over that drives the conversation. Where you see the differences and changes are in the covenant levels and baskets."

Meeting the Compliance Challenge

Experts and practitioners say that the compliance needs to be discussed at the outset. "In general, you should have that discussion early in the term-sheet negotiations," said Kim MacLeod, partner at law firm Hunton & Williams LLP. The term sheet includes customary representations, covenants and events of default, and any specifically negotiated terms. "At the term-sheet phase, we generally suggest that companies focus on issues that are really important to them, for example, expressly permitting any contemplated acquisitions or dispositions and negotiating additional flexibility in terms contained in their existing credit facility," MacLeod said.

Larson agreed: "You start off with the definition of compliance and move the discussion of what it means to be compliant to the front of the conversation," he said. Sometimes what the banks put in makes no sense. "They're [the banks] often using standard language meant to address any situation that may not apply to you. It makes for extra work and confuses the situation," said Larson.

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If there's an issue later on, those non-relevant items can unnecessarily trip up the company.

According to MacLeod, there are typically more detailed conversations around negative covenants than around representations and warranties and affirmative covenants. For example, a company may be looking for bigger lien, debt or investment baskets, or they may want the ability to distribute unlimited dividends. Borrowers are advised to talk about carve-outs to the covenants early in the process in order to avoid complications later. "The material business issues need to be discussed up front to make sure banks buying into the facility have a clear understanding of those issues," MacLeod said. "A lot of times, syndicate banks may not see the full credit agreement until as few as five days before closing. That's why it's very important to ensure key business issues get vetted at the initial phase of negotiations."

The subject of covenants can be a standalone guide; however, there are a couple of key issues treasurers should keep in mind:

1. **Be careful what you sign up for.** "You should never agree to something you can't comply with, but people do that all the time," said Jeff Wallace, managing director of Debt Compliance Services (DCS). Sometimes treasurers say they'll be able to comply and promise to hire extra staff to do it. "That never happens," Wallace noted.

Default Risk is Large and Underestimated

Actual and Estimated 5 year Hard Default* Rates by S&P Ratings	BBB	BB	B	CCC/C
2014 S&P Annual 30-Year Study	2.2%	8.4%	20.6%	47.5%
2012 AFP Survey Estimate	2.6%	5.5%	4.5%	17.8%
2015 DCS Survey Estimate	2.5%	3.0%	6.3%	7.5%
DCS 5 Year Technical Default** Estimate	8%	18%	30%	54%

*Missed payments, distressed debt exchanges, and bankruptcy filings

** Any other kind of default based upon S&P rating transitions data from their 2014 study

Source: Debt Compliance Services LLC

Responsibility/Compliance Team

	2012 BBs >$500M	2015 BBs >$500m	2015 Top 10%
Grade	C+	B-	A+
Number of Companies	(48)	(37)	(14)
HQ Treasury	73%	95%	100%
HQ Legal	25%	32%	57%
HQ Accounting	50%	41%	79%
Chief Compliance/Risk Officer	2%	0%	29%
Internal Audit	10%	3%	21%
SOX Compliance Staff	10%	3%	14%
Foreign Financial Staff	13%	8%	7%
Other Departments	6%	8%	29%
Number of CT Departments	1.9	1.9	3.4

Source: Debt Compliance Services LLC

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2. **Be realistic about default risk.** Also, "most companies dramatically underestimate their risk of default; many also think that if a default occurs, all they need to do is have lunch with their bankers and all will be forgiven," Wallace said. A 2012 survey jointly conducted with Hard defaults (see chart on page 5) depend on credit quality. However, technical defaults, which vary in seriousness from missing a deadline to break a covenant, can be a lot more frequent than most treasurers think.

According to Wallace, one way to ensure the company is in compliance is to have a well-articulated debt compliance policy. Often compliance reaches beyond treasury into operations. That means treasury needs to formulate the right questions to ask of operations management. For example, was there an asset sale? Or was there an environmental incident that needs to be reported to the lenders?

"It's really important that the business units that are going to be responsible for compliance with the credit facility read the loan documents, or are at least familiar with likely compliance issues," said Hillary Patterson, an associate at Hunton & Williams. "Often the CFO and treasurer are aware of the constraints built into the loan documents, but sometimes other people impacted by their terms and restrictions are not as familiar," she said. "It's important that everyone in charge of making decisions that may be hampered by the credit facility is aware of the relevant restrictions." (See chart on page 5.) For example, if there's an acquisition basket, the M&A team needs to know what the limits are and be part of the negotiations when those limits are established because they are likely to be in place for the next 4-5 years.

Cappelletti cautioned companies to approach banks early if they see any trouble looming down the road. "Don't go to the bank at the last minute," he said. "The best thing is to go to the bank as soon as you know and tell them: 'In three months we may violate a particular ratio.' That way the banks have time to prepare and are much more likely to work with you."

"Sometimes companies don't spend a lot of time keeping their banks up to date," Larson said. "I disagree with that approach; when companies keep their banks in the loop they have a much higher level of trust if things turn bad," said Larson.

There are ways to ensure surprises don't happen. "One of the first things I do is create an abstract of the entire credit agreement, so I don't have to look through 300 document to find information," said Larson. "I also make a list of everything that has to be monitored. If you wait 2-3 years to look at it and then try to rebuild history of some of the 'buckets' you had thought would be immaterial, you may forget something." While most companies file compliance certificates quarterly, many credit agreements require borrowers to make representations every time they draw down on the facility in order to ensure that they are creditworthy and solvent.

Another way to spot trouble early is to look at historical events. In order to prepare for a refinancing, MacLeod and her team encourage clients to look back at old correspondence, including emails, to see what compliance issues have come up when administering existing credit facilities. "We try to keep a list of compliance inquiries we received from a client," she said. Inquiries might include whether the company can guarantee indebtedness of a foreign subsidiary, whether it can issue letters of credit in a foreign jurisdiction, or whether it can enter into a large capital lease. "Be thoughtful about issues you've run into in the past, or flexibility you may not have had in the past," MacLeod said.

What to Do When Facing a Potential Violation

"If the company feels it is at risk of violating the covenant, it is incumbent upon the borrower to collaborate with its lead bank and negotiate a solution," said Levin. The breach may be technical (e.g., changes in GAAP) or performance related (e.g., deteriorating credit standing). According to Levin, the cause determines the actions available to the borrower.

1. **Seek a waiver for one specific event.** This approach makes sense if the reason is simple in nature and unlikely to recur. However, borrowers and their banks don't want to be addressing waivers on the same point on a regular basis.
2. **Amend the credit agreement.** This approach is appropriate where a change in a technical point in the agreement or the company's underlying business would lead to the borrower being unable to stay in compliance with the agreement's original terms on an ongoing basis.

There are usually waiver or amendment fees associated with any change. The cost is related to the work the banking team must do to execute the waiver or amendment, and borrowers are expected to pay all legal fees — theirs and the bank's.

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Compliance Takeaways

1. Don't promise what you can't deliver.
2. Review compliance on an ongoing basis.
3. Go to the bank early with any prospective violation.
4. Keep the banks in the loop — good relationships go a long way.
5. Create a checklist of key compliance items.
6. Educate management and business units on what decisions can lead to violations.
7. Sit in on conversations regarding acquisitions or asset sales.
8. Look and learn from past compliance issues.
9. Look forward to assess realistic compliance ability.

At the same time that companies look in the rearview mirror, they need to look out for what's ahead. Companies should think about their plans 4-5 years down the road, since credit agreements are often 4-5 years in tenor. "Build in the flexibility now to execute your business plan," Macleod said. Bankers will often say that it's best to just renegotiate as concessions are needed. "But it's better to negotiate in advance to the extent possible," she said. "It takes time and costs money to get the banks to approve an amendment or a waiver down the road. The more you can try to predict what's coming, the more you give yourself flexibility to execute."

The Role of Lawyers

Practitioners and experts say that the role of law firms in the negotiation of a credit facility cannot be underestimated, and it goes beyond just translating business terms into "legalese."

- **Provide consistency.** Keeping the same law firm, according to Levin, ensures the lawyers are familiar with the company and its preexisting debt.
- **Leverage market intelligence.** "The borrower's law firm plays a key role in advising management on what they see in the marketplace," said Levin. "In my experience, companies rely heavily on their lawyers for market intelligence."
- **Be aware of black-swan events.** "Lawyers are worried about exposure to events that have a low probability of occurring," Novaria said. But given the recent past, it's clear that things can happen that are 3-4 standard deviations away from what had been expected.
- **Provide legal assurance of business interests.** "Lawyers give you a peace of mind," Cappelletti said. "It's the same reason you have fire insurance. I tell them what the agreement should accomplish, and they make sure it legally represents the business interest."

Conclusion and Best Practices

As more companies and their banks are reviewing existing credit facilities, be it for internal or external factors, they should keep the following best practices in mind.

Break from the past.

The treasurer of a natural resource company has found that too often the parties to the agreement are wedded to the past. "Treasurers don't ask the question and don't make clear what they want," she said. It's important to tell the bank what's troubling the company and be clear about it. "Explain why it's important to you, and they will listen," she said. "Then ask the banks to think about your risk profile and articulate why they cannot accommodate the request." Just saying it's never been done is not good enough. "People spend too much time on precedents and too little time on asking for what they really need and understanding each party's needs," she said.

Keep notes.

This seasoned treasurer advised others to read the agreement cover to cover before every refinancing. In addition, she suggested that the treasurer keep a page within the agreement on which to jot down any issues that come up throughout the duration of the agreement with references to page and line numbers. "When the time comes, the list triggers my memory. It helps prioritize the conversation with the bank."

See it from both sides.

There will always be things treasurers want to change. In order to get the best terms, treasury needs to prioritize what's important and why. "It should also be aware of what's important to the bank and why," this treasurer said. "Treasurers should expect that if there's a good rationale for these requirements, then they can reach a win/win agreement. You have to be articulate on both sides and explain why a pain point is important."

Review agreement before earnings release.

While the natural resource company's compliance certificate is not due until 45 days after close, auditors want to ensure the company is in compliance with its debt covenants. To ensure

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there's no miscommunication, this treasurer reviews the numbers before earnings are released and compares them quarter over quarter. "If the numbers are up, there's no need for further analysis," she said. If the numbers are down, she runs the calculations to ensure full compliance and looks at other debt requirements besides the revolver.

Be proactive.

According to PNC's Nardo, a key best practice is to be as open and proactive as possible when there's an issue. Banks dislike surprises, such as finding out — after the fact — about an issue that the company knew about weeks or months in advance. "If they [the company] know there's an issue with the business that would cause problems with the facility, we want to hear about it as soon as possible," he said. "We never view early warning signs negatively. We view them as being part of a good business partnership."

Cultivate a relationship with outside lawyers.

According to Scott"s Sommer, it's important to develop a relationship with a law firm that has current and frequent syndicated credit agreement experience. "Their main job is to put the commercial agreement we negotiated into legal terms," he said. Just as important, however, is that the lawyers know the company, and companies like it, and see deals in the market all the time. "They know the [company's] relative positions of strength, and should have a good sense for the current state of market terms for various provisions of the agreement," he said. "It is useful to have someone who's had experience in these facilities with similar organizations."

Clearly define terms.

It helps to tie the covenants to existing financial metrics, even if they're not based on GAAP. "An important part of the negotiations is clearly articulating the definitions of the terms," Sommer advised. "Be very specific. If it's debt to EBITDA, what is debt? Is it debt at a certain point in time? Is it average debt? A good credit agreement will have very clear definitions," he said.

Have the right controls. "We live in the world of too much compliance," Desai said. She encouraged people to ensure proper checks and balances. "In my group, the treasury manager reviews the compliance certificate. While I have to ultimately review and sign, I don't look at it to the extent staff does. It's also under SOX control," she added. "We meet with the PwC auditor as part of closing. We talk about covenants. We have enough check points that if it triggers something, people know about it," Desai said. "One person can't do it all; get enough people involved."

Have a checklist.

Finally, treasurers and experts stressed the importance of boiling down what may be a 200-page agreement into a manageable list of key items. At the Carlyle Group, every time Laidhold completes an agreement she develops a 1-2 page checklist of key compliance commitments — "thou shalts and thou shalt nots." "After a year," said Laidhold, "you don't remember all of the nuances." That list ensures the company is always in compliance with key measures. She also inserts key reporting dates immediately into her business calendar, that way she know nothing falls through the cracks.

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Case Study 1:
Greif, Inc.

- Non-IG global industrial packaging and Services Company.
- $1 billion secured credit facility with 25 banks.
- Key renegotiation reasons: Financial and operational flexibility, better access to capital markets.

Greif, Inc. (sales of $4.3 billion in FY 2014) is a leader in global industrial packaging products and services. The company also owns timberland across the U.S. According to Nadeem Ali, vice president and treasurer, the company has a $1 billion, senior secured credit facility with a total of 25 banks, some of which are farm credit banks, which do not require any ancillary business.

The credit facility was put in place in December 2012, four months after Ali joined the company. The secured nature of the facility — the "collateral" includes hard assets, such as equipment and machinery — did not make the negotiations more difficult. "We're a non-investment grade company," Ali explained. However, "if anything, the secured nature of the transaction made the refinancing process less challenging for Greif," he said. That's because the banks knew they were ahead of bond holders. "It gave us greater financial flexibility."

There were several reasons for the negotiation of the new facility, which was accomplished in just over three months. "The key factors, in no particular order, were: financial flexibility, e.g., whether we wanted to grow through acquisitions or organically; having access to the capital markets at all times; and operational flexibility, e.g., negotiating later cut-off times, increased flexibility to receive funds for the businesses; and negotiating better financial covenants."

When Ali joined Greif in 2012, it became apparent that he needed to do something about the facility rather quickly. "I was new to Greif and didn't have much information on current credit market conditions for a high-yield issuer," he recalled. "The first thing I did was to reach out to Greif's lead bank and other key relationship banks to get their feedback and input regarding what the market could accommodate in terms of size and tenor to at least get a baseline of credit availability in the syndicated loan markets.

Once we figured out what we wanted to do, the process was quite similar to an RFP," he said. "The question was: 'what can they deliver in terms of pricing and execution?'" After that it was about crafting the strategy and starting the overall negotiating process in terms of how comfortable everyone was with the legal document, which in their case involved amending some language. "For the most part we kept the core facility language and focused primarily on better pricing and covenants, as well as streamlining the number of banks," Ali said.

The formal negotiation needs to be the culmination of an ongoing dialogue, Ali advised, "So it's not a surprise at the last moment." That can cut down on the time it takes to complete the agreement. "You probably want to start talking to your banks 6-9 months ahead of time about what they can and cannot do."

Most of the pushback he experienced was in terms of how much ancillary business — or lack thereof — the banks have seen from Greif. "It's important to really evaluate the overall relationship with the banks. Are we partnering with them, be it in their global footprint or other capabilities?" he said. While credit market conditions may be outside treasury's control, "you better know what you're doing with each bank; that's especially true with global banks," he said. Treasurers often have less visibility into what the company is doing with banks at the local level, and it's hard to determine how much they are generating in total fees. "Talk to the banks and highlight the various current and future opportunities available to them," he said. That puts the company in a much better negotiating position."

The other issue that comes up a lot is what title they're going to receive, for example whether they'll be the left lead. That will determine what level of arrangement fees they'll receive. "You've got to make sure that matches up with them doing the heavy lifting in coordinating with the syndicate," Ali said. "You've got to socialize that upfront."

The day-to-day issues that impact treasury typically relate to items like the leverage and interest coverage ratios, which are constantly monitored. To simplify compliance, the company looks to leverage numbers it already produces for financial reporting, although the particular definitions of things like EBITDA may be different. "If interest coverage ratio goes up or down, that's a good barometer of how the business is

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doing," Ali said. "We get ahead of that in terms of forecasting. And, if we see that the business is going south, at least we can have a conversation with the lead banks."

"By constantly monitoring the agreement, in the unlikely event that something bad happens, you have enough reaction time," Ali said. "You don't want to scare them [the banks] but find the fine balance in terms of giving them enough of a heads up so you can amend the document to handle any changes and be better prepared." It helps if treasury has a handy checklist of key compliance criteria. "There's really only a subset of issues treasury needs to focus on."

Ali is a fan of using the same law firm. "Most companies have a long-term relationship with a law firm that helps negotiate financing agreements. That relationship is very important since the lawyers are often up to date on key terms and conditions and are also familiar with the preexisting agreement language. Legal fees can pile up, too, if the company retains a new firm that's unfamiliar with its credit agreement as they play catch up. The other benefit of using the same the law firm is that it sees multiple agreements with multiple clients and can provide some relevant market intelligence on comparable deals.

Case Study 2:
Scotts Miracle-Gro Company

- The $3 billion non-IG company is the world's largest seller of lawn and garden care products.
- The $1.7 billion secure facility relies on assets and subsidiaries' equity.
- While Basel III has increasingly become a topic of conversation, liquidity is deep.

As non-investment-grade Scotts Miracle-Gro company, the syndicated facility includes a collateral package — hard assets and pledges of subsidiaries' equity — according to Mike Sommer, assistant treasurer. "Our agreement allows for us to borrow at the parent level and at multiple U.S. and non-U.S. subsidiaries," he said. That ability to borrow at the sub level was part of the structuring negotiations with the banks. The five-year, $1.7 billion revolving credit facility includes over 20 banks. Because the lawn and garden business is profoundly seasonal, the company borrows heavily leading into the spring selling season and collects receivables in June and July.

Because the facility is not considered asset-based lending, there's no provision in the credit agreement to report the value of the collateral, which makes things a lot simpler, according to Sommer. Whether a deal is secured or not, the negotiation of the covenants and compliance with baskets or any restrictive language are a big part of the process. "You know you're going to have covenants. Some will be standard. But how they're structured is a big part of the conversation," he said.

At Scotts, the compliance certificate is filed quarterly. That's when the company affirms its debt ratios, etc. "We also look at the negative covenants and test those during the course of the quarter. "You have to know your triggers and limits," Sommer said. That means a treasury representative needs to be involved in any business change or acquisition conversation so they can assess how the change will affect the company's compliance with its debt agreements. If the transaction is forecast to have no impact, it's left at that. If there's a gray area, or it's open to interpretation, it will be brought up for discussion with the lead bank to make sure everyone is on the same page. Obviously, if there's going to be a clear breach of covenants, the company will seek a waiver or amendment.

Sommer has been working in the non-investment-grade environment since 2004. In the past 12-18 months, he's experienced some interesting dynamics in conversations with banks. "Banks will come out and say, 'Here's what's going on: BASEL III is phasing in, and that will put pressure on capital; the LCR will put pressure on our lending; and our SIFI status will require us to keep extra capital, too. The syndicated bank market has been very attractive to borrowers by historical standards for a while now; so brace yourself for change.'" In response, he said, "We nod."

When the banks get to the end, "they essentially ask us if we would like to borrow more money at better terms," Sommer said. Ultimately, the banks' actions have not yet caught up to their verbal message. According to Sommer, there's so much supply in the syndicated loan market that the banks are simply accepting lower returns. "The market continues to be borrower friendly, at least for now. For treasurers, now is the time to take advantage." If companies need five-year money,

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they might want to consider renegotiating sooner rather than later.

The time it has taken Scotts to renegotiate its facilities has been short, because it has typically been a renewal situation. "We had an existing structure in place. From the time we decided to do it until the documents were in place it takes 4-6 weeks," Sommer said. Scotts most recently renegotiated its agreement in 2013, and is currently working on another refinancing. "On October 29, the company entered into a revised credit agreement. "Overall, we were able to arrange a slightly larger amount of committed credit at slightly better terms (25 bps tighter spread) than our previous credit agreement (consistent with market conditions), but with fewer banks (18 vs. 26)," said Sommer.

Case Study 3:
Natural Resources Company

- A natural-resources company with an unsecured $700 million credit facility.
- Starts the process with figuring out what it needs to change and prioritizes.
- Spends more time on compliance because deliverables to audit firms have changed.

The natural resources company discussed in this case study has an unsecured, $700 million, five-year credit facility with just under 10 banks. The facility was renegotiated in 2013 after an acquisition, said the company's vice president and treasurer. Every time the company renegotiates, it tweaks the language. "I always try to remove some extra language from the agreement," said the treasurer, "because almost always the banks want to add some."

For example, the previous renegotiation yielded substantial changes to the ERISA language in the credit facility. "I prefer to understand all the language myself and what it means in terms of compliance," she said. "The nice thing about renegotiations is that it's an opportunity to clean up, if something is not working out operationally," she said. Of course, the banks have flexibility on some things and not others.

More recently, banks have come under stress from rules such as Basel III. "The banks' capital is getting utilized by letters of credit (LCs) sub-limits and swing lines as if fully used," said the treasurer. That's why it's important that treasury understands how the banks calculate the change to their capital, and how that changes over time. The treasurer particularly likes to protect her swing line, which requires only same-day notice and provides quick, flexible and cheap capital for short-term needs.

The process of renegotiations starts with figuring out what the company wants to achieve. "What are your capital and liquidity needs? What are your objectives around terms? What's the tradeoff in terms of cost versus letting the current facility run its course?" she said. In her case, "I clearly see increased capital hurdles over the next three years, so it may be a good time to refinance now, before it impacts pricing." Observing the volatility in the equity and public bond markets, she expects banks to feel the pinch with about a one-year delay.

One thing that may slow things down is that the banks have more committees today than previously. "There's always been a credit committee," she said. "A couple of years back the banks added a capital committee. Since then some have also added a relationship committee." As a result, the banks are looking at each deal in terms of the company's credit worthiness, its impact on their capital position, and what sort of business it can generate to justify the credit commitment.

Just how prevalent compliance issues are as part of the negotiation process depends on the credit quality of the organization. For this company, there are no compliance issues because of its financial performance and investment-grade status. "We've got plenty of room," said the treasurer.

Preparing for compliance has become more difficult for public companies mostly because of their auditors. "I have to spend more time on it, not because anything changed, but because my deliverables to auditors are different," the treasurer said. "Before, someone prepared the documents, and I reviewed them and signed off. But that's not nearly enough anymore," she said. "Now the person prepares it, and I have to review it in a different manner. I have to do auditing checkmarks and different tags, e.g., comparing to source materials or recalculating the math." That extra work takes extra time. "If you have complex covenants, that's really painful," she said.

The company has used the same lawyer, although she's been with two different firms. The idea was to maintain continuity. It's easier when

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the lawyer is familiar with why and how certain language got into the agreement, according to the treasurer. "It's helpful to have lawyer continuity because they know the history better," she said. Plus, in their case, the lawyer has proven to be creative in terms of solving problems in ways that work for both sides.

Case Study 4:

The Carlyle Group

- Private equity firm.
- Amended $750 million syndicated facility in 2015 for better pricing and flexibility.
- Advice: Know yourself and put yourself in the bank's shoes.

Private equity giant, The Carlyle Group, has a five-year, $750 million syndicated credit facility. In May 2015, it amended and extended the facility with three years remaining, achieving better pricing and additional flexibility in covenants. There are different reasons companies may choose to renegotiate their revolvers, according to Treasurer Dana Laidhold. "In our case, the lower pricing and enhanced flexibility provided sufficient value to justify the amendment," she said.

When starting the process, Laidhold's first step is doing her homework. "I work hard to understand the current credit agreement and the business environment, and to identify any benchmark terms whenever those are available," she said. With that information, she calculates whether, inclusive of fees, a refinancing would make economic sense. "You have to stay abreast of the market," Laidhold said, "and translate changes in the business into opportunities in your credit agreement."

Next, she develops a list of things she wants to amend. She also talks to counsel very early in the process. The idea is to benefit from the lawyer's broad view, attained from multiple clients' negotiations. "Counsel is always very current on the market," she said. "They have lots of clients, so they continuously see facilities. Plus, if you always use the same counsel, they know your agreement and your business generally and can lend good ideas to the list of 'asks,'" Laidhold added. "We build that list and then approach our lead lender."

From there, the negotiation process becomes fairly fluid back and forth. "You should try to be smart and knowledgeable. Know what's out there and prioritize your 'asks,'" she said.

Laidhold advised companies to involve as many internal people as possible early on in the process. "We bring in our CFO, Chief Risk Officer, accounting team and in-house counsel." she said. "The more people with specialized knowledge the smarter the agreement ends up being." Carlyle prides itself on its inclusive culture. "That's been a corner stone for us. We're 'One Carlyle.' When someone is working on something large, anyone who can have good insight comes on board to help."

The biggest focus along the way is on crafting the compliance issues. "They must be highly tailored to the business; don't go with generic, off-the-shelf language," Laidhold said. "It's efficient to work with banks that know your business and industry and have done credit facilities with other companies of your scale and footprint." It's not surprising that the banks are protective of themselves – especially banks that are new to the facility. "They'll ask a lot of questions and push for restrictive terms," she said. "The key is to explain to them how the business works and what would and wouldn't affect the company's ability to repay. That's what's it all about."

To ensure proper negotiation, Laidhold suggested the following:

1. **Know your business.** If you're new and don't know it intimately, make sure you can talk to people who know both the credit market and the business.
2. **Put yourself in the bankers' shoes.** "When things are not going well, it's often because bankers need to better understand the risks embedded in your business. If you can, get the conversation back to 'why,'" Laidhold said. "If you can understand why they are seeking a particular term, you can usually get to a mutually agreeable way to protect their interest that's also not overly restrictive to the borrower."

Case Study 5:

Granite Construction

- An investment-grade company, Granite chose to stick with a $215 secured facility to maintain flexibility and better terms.
- It starts off with a big wish list knowing it will settle for less.
- New facility was over-subscribed and has an accordion feature.

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Granite Construction has a secured, three-year $215 million credit facility with a relatively small group of banks. The facility was set up in 2012, and will come due in 2016, which is why Jigisha Desai, vice president of corporate finance and treasurer, is currently negotiating an extension and better terms. "The goal to have a new facility in place a year before, because if you do borrow under the facility, it becomes part of your current debt."

To get things started, Desai typically contacts the lead bank first. The facility relies on a long-term group of supporting banks with which she meets independently throughout the year. "This helps me get up to date information about what the market is looking like; what are the hot buttons; and to get market intelligence on structure, pricing, terms and conditions," Desai explained. "I meet with our lead bank and get their input and use that to put together a presentation to my CEO and CFO, and make the recommendation regarding what I think we should do regarding size, terms and when to launch."

It helps that the banks have had a long-term relationship with Granite, and they understand the ins and outs of the company and the way is puts together its projections and reporting. Once they agree on terms, treasury launches the deal and provides an update to the audit committee. That's not the first time the committee hears about the deal. The deal has to be approved by the board, so at the previous meeting, treasury informs them of what it intends to do. "We provide a business update and go through our 3-5 year projections, financial history and tentative term sheet," Desai said.

Typically the term sheet is negotiated in person with all the banks. This time is was done via a webinar, followed by a site visit. The changes include some refreshment to the baskets, some changes to the covenants, an increase to $250 million, and an extension to a five-year facility. "If we get oversubscribed, we may up the size to $300 million, but I'm really conflicted about this," she said. "Why pay for something we don't need?" The agreement includes an accordion feature that allows Granite to increase the size when needed. The risk is that the banks won't be there at that time. They get the right of first refusal, but then the company can go outside the group to seek additional financing.

"While we don't use the revolver for working capital, we do rely on it occasionally for mezzanine financing for acquisitions," she said. "That means we draw on it once in a while, then issue long-term notes to repay the floating, short-term debt. That makes the deal more attractive to banks that are pressured on liquidity and capital under Basel III for undrawn committed facilities."

Desai typically starts the process asking for the moon, knowing that she won't get it all. "This [new] is a five-year deal, and I want to make sure I have enough flexibility to last that long so I don't have to keep going back to the banks asking for amendments and adjustments to the baskets," Desai said. She also insists that the covenants put leverage at an appropriate level. All that is afforded by the fact the facility is secured. "That's the trade-off with the collateral," she said.

The company went from an unsecured to a secured facility in 2010, and it wasn't easy, particularly internally. It also had to be done very quickly — 13 days before end of the year, as a restructuring resulting in an impairment would have led to a default. "The banks wanted collateral," Desai recalled. The company didn't really have a choice. Breaching the financial agreement was not a possibility because of cross-default clauses in its commercial contracts.

While the financial standing of the company has since improved substantially, the facility is still secured by all the company's hard assets. "The collateral far outweighs the size of the facility," Desai said. But using all the hard assets made it easier from an administrative perspective. It didn't require an appraisal and other steps. It also made it possible to include a much more flexible package in the agreement that allows Granite to dispose of certain assets if need be. "While we can now go unsecured," said Desai, "I choose to look at this strategically. The agreement gives us greater flexibility in the covenants and basket package."

Adding the collateral initially made the deal more burdensome, but the ongoing compliance isn't any different. "We have a lot of assets; trying to get all that done [at first] was hard," Desai recalled. "Now it's not an issue. The agents handle all the disposition if we're selling and need to release the collateral."

To ensure covenants are fair, Desai benchmarks against peers. "I look to see what's

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in the marketplace," she said. "Are we reasonably structured? I want to understand the risk/return that drives the structure. I want to make sure that we don't have such a restrictive package that it makes it hard to do business." The covenants also have to match the covenants on the company's senior notes.

Covenants are reviewed quarterly. The review process is a big part of compliance, according to Desai, and thus also part of the SOX checklist that's reviewed with the company's auditor, PwC. "We go through it when we close the books," Desai said. "We also project compliance to the remaining year or year and a half," she said. "From an audit committee perspective, we report to them on where we are. The compliance certificate is prepared by financial reporting by reviewed by treasury."

Case Study 6:
Restaurant Chain

- The Restaurant chain has a $1.3 billion revolver refinanced in 2015
- It's first step was to come up with a list of "wants"
- It turned to counsel for market intelligence

This restaurant chain had a $1.3 billion revolver until it decided to refinance the bank facility in 2015 by securing future cash flows. Prior to that, it typically renegotiated its facilities a year before they came due. "One of the most important considerations when you look at a five-year facility, is that it becomes current on the balance sheet a year prior to maturity," the treasurer said.

To get the process going, this treasurer first sought approval from the Board. His next step was to engage a law firm and an investment bank. Then he came up with a financing structure and list of wants, announced the deal, and put it in the market for a marketing period while simultaneously finalizing the documentation. There's a pricing date, then a closing date. All in all, according to this seasoned professional, the process took about 6-8 weeks.

Compliance with covenants and baskets is always a huge part of the negotiation process. "You don't know where your baskets should be," he said. "It's a function of market conditions. You're trying to finalize documentation and, at the same time, negotiate covenants and terms and conditions." There are things companies know in advance: they know there will be a debt and interest coverage ratio. "What you don't know is what level those ratios will be at. Settling on those is a big part of the negotiation."

To get the deal done, companies need to seek out specialized legal advice, recommended this treasurer. "These deals are so complex," he said, "external counsel is critical. They will give you some market intelligence as well," he said. "In many respects, if you're having a disagreement with the bank about, for example, interest coverage, your lawyers can give you good insight because they see a lot of deals and are familiar with market conditions. They also probably know what that specific bank has agreed to in previous deals." He added: "You need to hire good lawyers and good investment bankers. Those things may not come cheap, but they're worth it. If they can shave 2-3 basis points off the cost, they pay for themselves."

The negotiations are about swinging the pendulum to the middle. "You have to realize that the [lead] bank is representing the broader community of lenders. They're there to help you sell the deal to the other banks," the treasurer said. Even if the bank itself is OK with a covenant, if it thinks others won't be, it will ask for a change. "Plus," he said, "You have to realize that it's more than just one term, or one covenant. You have to view it as a package. You may give something up one in one area to get another in another you care more about," he explained.

In most cases, the covenants are customized rather than pulled off existing financial reporting. The concepts may be similar from deal to deal, but what goes into them is negotiated. "In our most recent agreement, the definition of net income was not GAAP," the treasurer said. As deals get renegotiated, you can negotiate "add-backs" and make the ratio better. The fact that the measures are highly customized introduces complexity every quarter. "But it also means you can influence the ratio to get to a better result by changing the definition." Every time the deal is renegotiated, some small changes are made. Three years out, "you end up with a definition that is vastly different from GAAP. It keeps changing over time."

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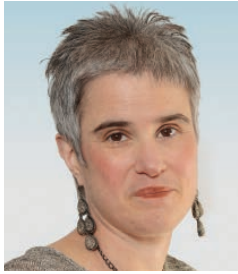

About the Author

Nilly Essaides is Director of the Financial Planning & Analysis (FP&A) Practice at the Association for Financial Professionals. Nilly has over 25 years of experience in research, writing and meeting facilitation in the global finance arena. She is a thought leader and the author of multiple in-depth AFP Guides on FP&A topics as well as monthly articles in AFP Exchange, the AFP's flagship publication. Nilly was managing director at the NeuGroup and co-led the company's successful peer group business. Nilly also co-authored a book about knowledge management and how to transfer best practices with the American Productivity and Quality Center (APQC).

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General Inquiries	AFP@AFPonline.org
Web Site	www.AFPonline.org
Phone	301.907.2862