

An Illustrated Guide to High Yield Debt Standard Covenants

High Yield Debt Standard Covenants

Purpose of Covenants

- Protect or upgrade, over time, the credit quality of the Company
- Protect ranking of the Notes in the capital structure of the Company
- Limit discretion of management while providing flexibility to operate and expand the business
- Generally, incurrence tests; not maintenance tests

High Yield Debt Standard Covenants (continued)

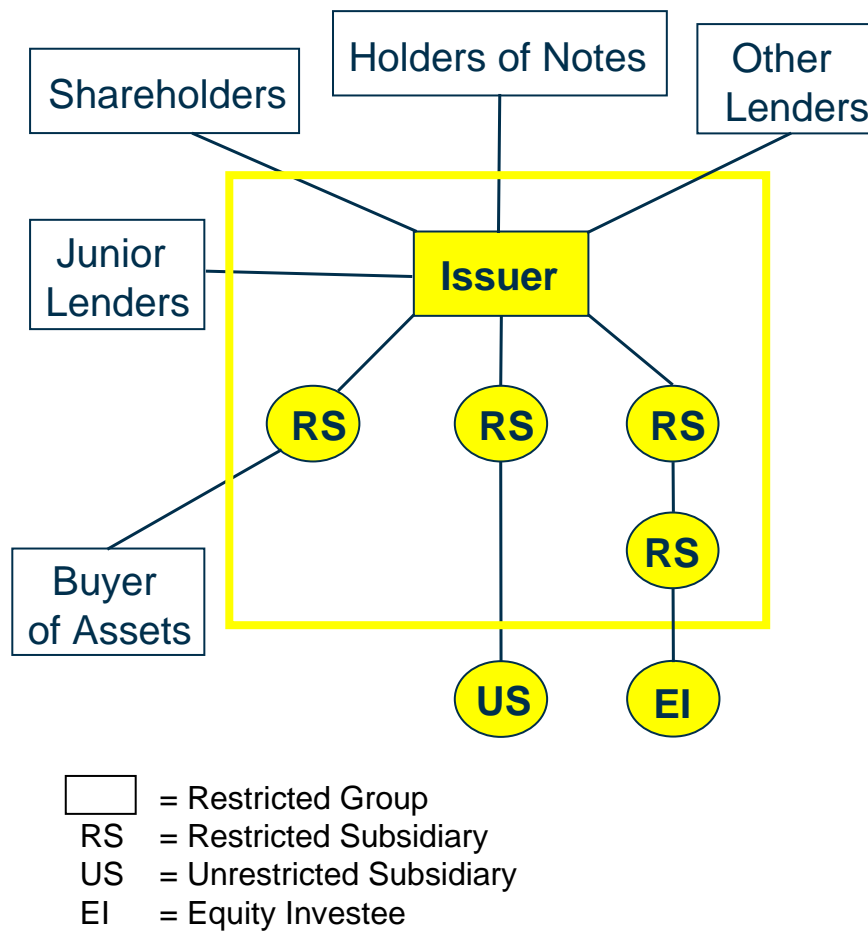
Investment Grade:

- Restrictions on Liens Securing Debt
- Limitation on Sale/Leaseback Transactions
- Consolidation, Merger and Sale of Assets
- Purchase of Notes Upon Change of Control and Ratings Event

High Yield:

- Limitation on Incurrence of Indebtedness
- Limitation on Liens
- Limitation on Restricted Payments
- Limitation on Transactions with Affiliates
- Limitation on Dividend and Other Payment Restrictions Affecting Subsidiaries
- Purchase of Notes Upon Change of Control
- Limitation on Asset Sales
- Consolidation, Merger and Sale of Assets

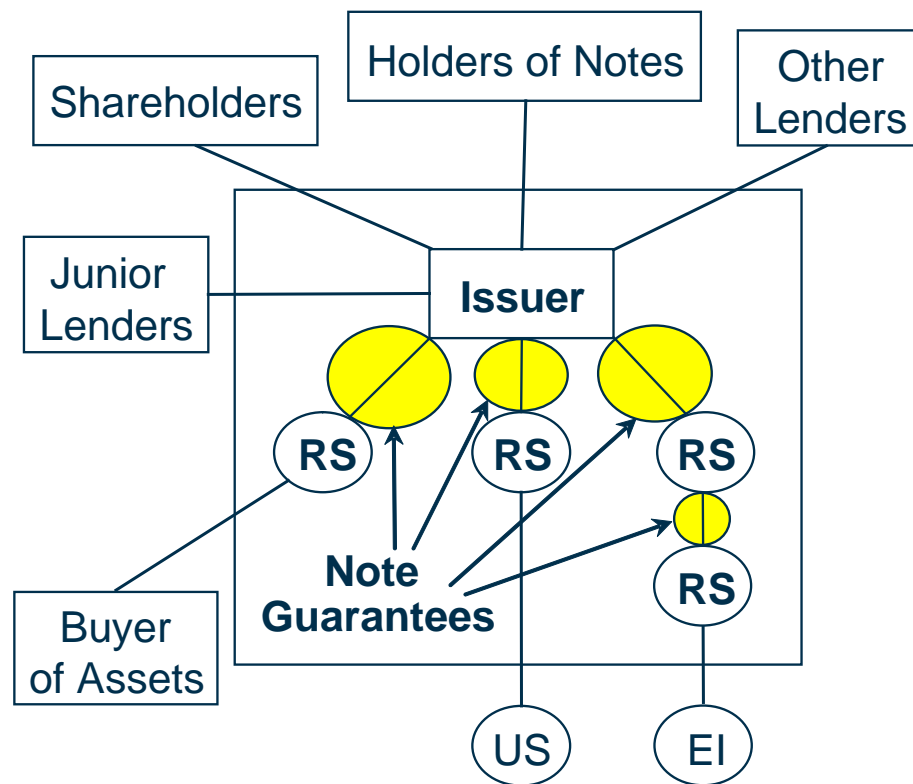
High Yield Debt Standard Covenants (continued)



Restricted and Unrestricted Subsidiaries

- Restricted Subsidiaries are subject to the indenture covenants, and their earnings (and losses) will generally count towards the consolidated net income and the consolidated adjusted EBITDA of the restricted group for purposes of the covenants.
- Unrestricted Subsidiaries and Equity Investees are not subject to the indenture covenants, and their earnings will generally only count towards the consolidated net income and the consolidated adjusted EBITDA of the restricted group for purposes of the covenants if received by the restricted group in cash, and their losses will not count

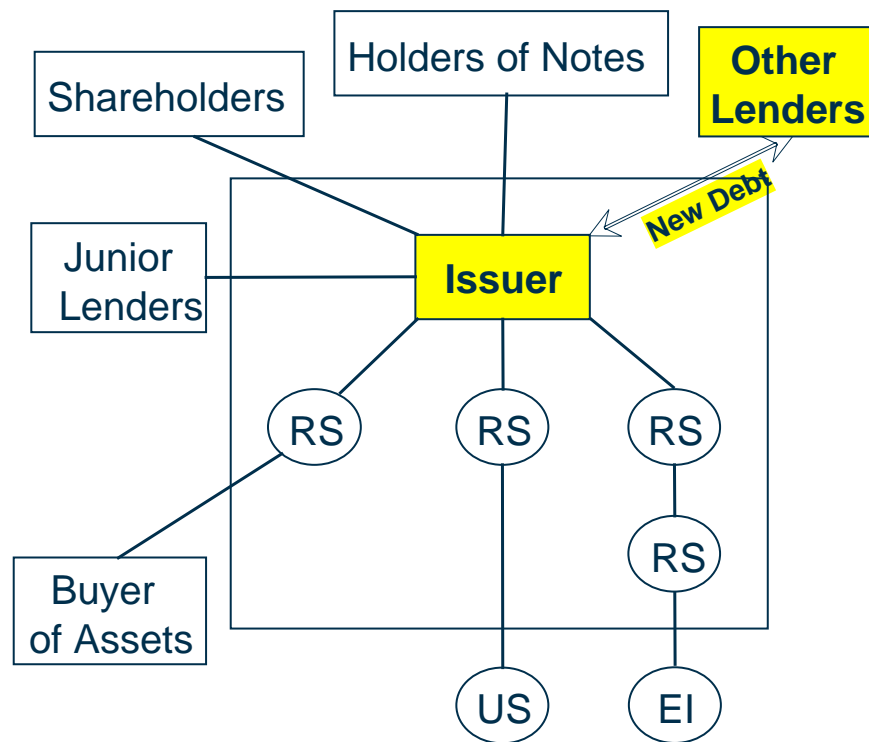
High Yield Debt Standard Covenants (continued)



Additional Subsidiary Guarantors

- Limit structural subordination by requiring restricted subsidiaries to guarantee the notes if they guarantee other debt

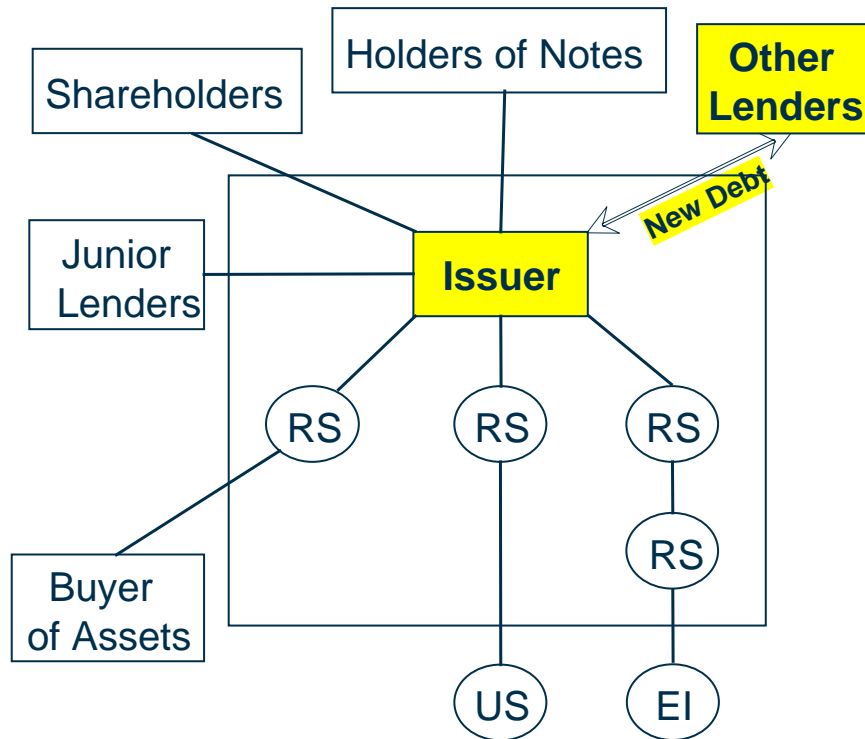
High Yield Debt Standard Covenants (continued)



Limitation on Indebtedness

- Limit the incurrence of additional debt based on the ability of the Company to service its overall debt
- Control structural subordination
- Generally based on a 2-1 fixed charge to adjusted EBITDA coverage ratio or a debt to adjusted EBITDA ratio, plus agreed-upon baskets

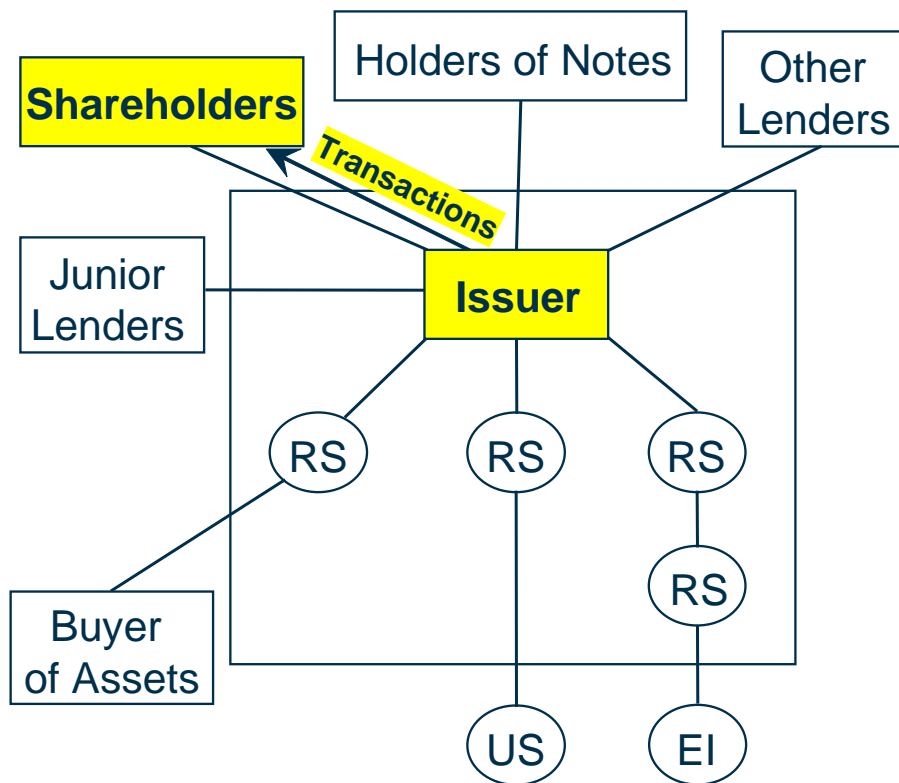
High Yield Debt Standard Covenants (continued)



Limitation on Liens

- Limit the ability of the Company to use assets to secure other debt and therefore limit effective subordination of the notes

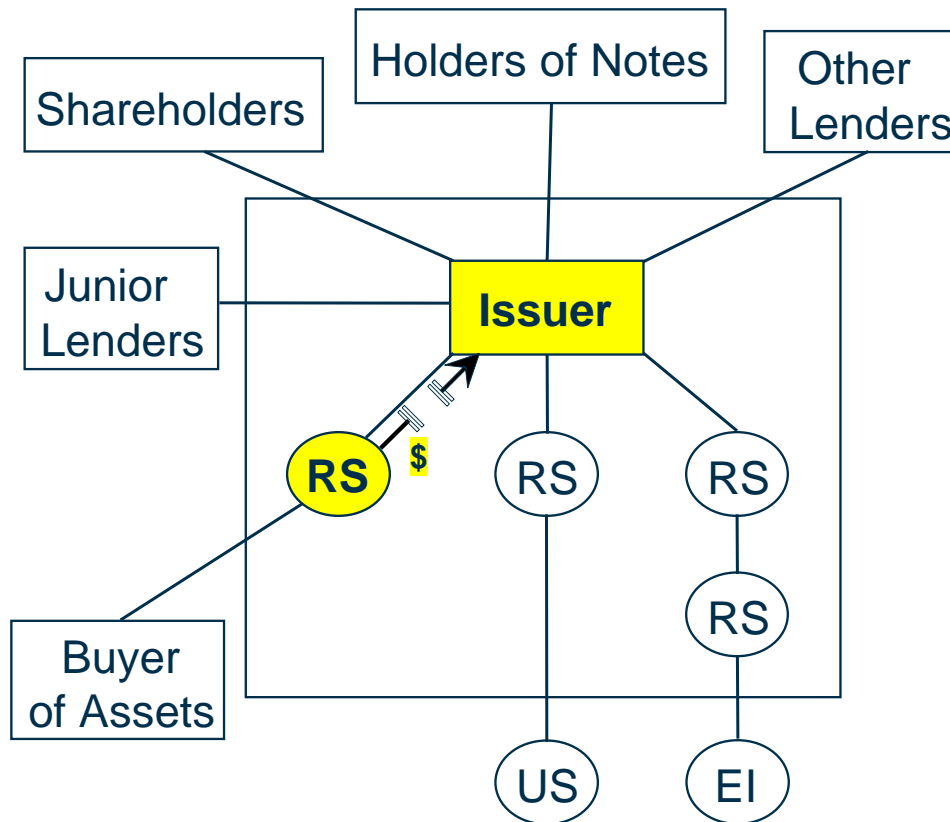
High Yield Debt Standard Covenants (continued)



Transactions with Affiliates

- Limit transactions with large stockholders or other affiliates
- Generally, transactions above a threshold require arm's-length terms and board approval, and transactions above a higher threshold also may require a fairness opinion

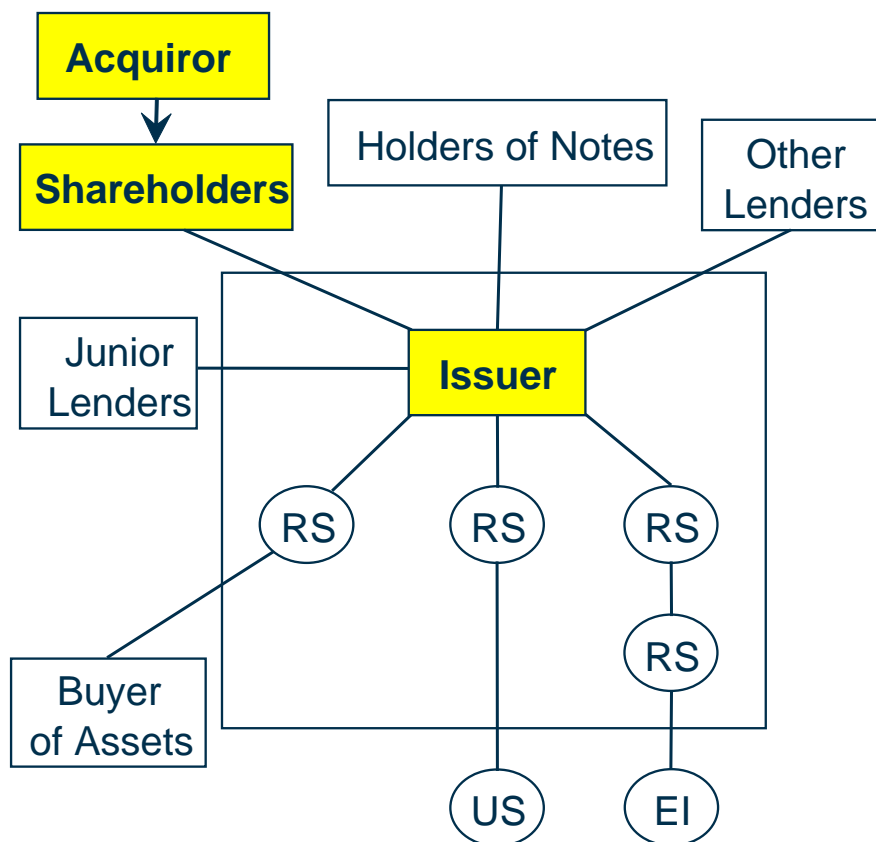
High Yield Debt Standard Covenants (continued)



Limitation on Dividend and Other Payment Restrictions

- Prevent cash flow needed to service debt from being trapped at a Restricted Subsidiary

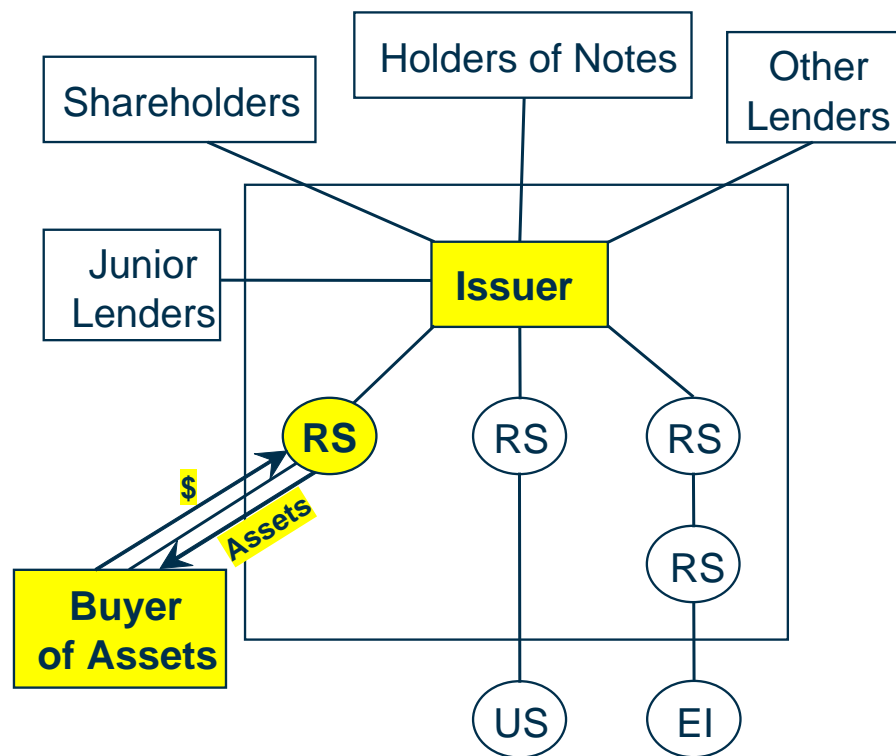
High Yield Debt Standard Covenants (continued)



Change of Control

- Protect against change in controlling equity interest by an investor or a group of investors
- Requires the Company to make an offer to repurchase the notes at 101% in the event of a change in control.
- Often has exceptions for equity sponsors and their affiliates

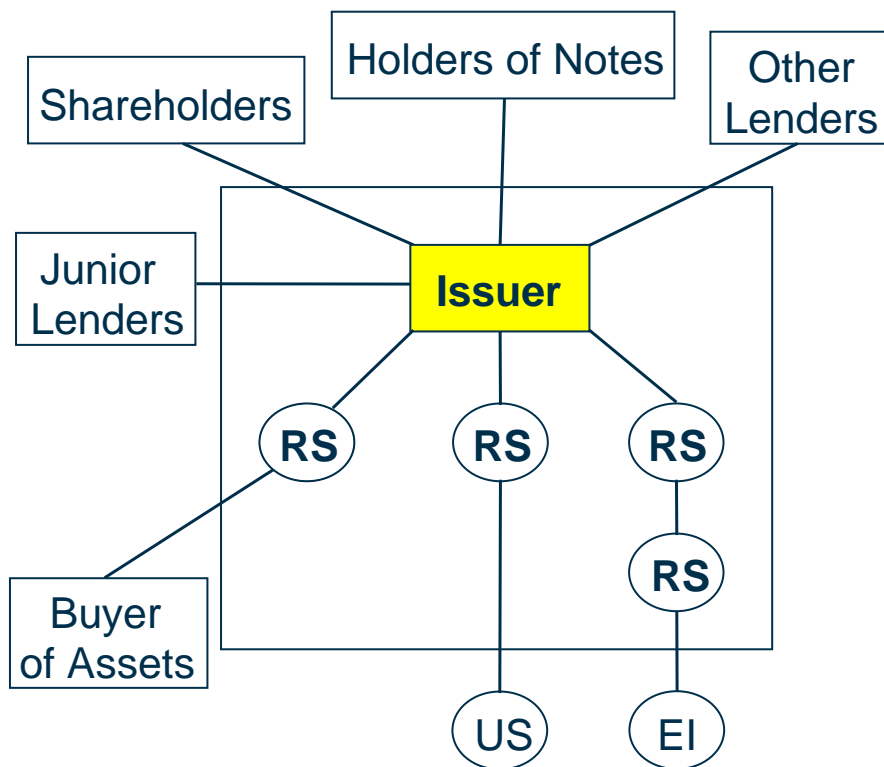
High Yield Debt Standard Covenants (continued)



Limitation on Asset Sales

- Protect income-producing assets
- Does not prevent sales of assets but governs the type of proceeds received and the use of proceeds
- Net cash proceeds must be reinvested in the business or used to repay senior debt within a specified time frame or used to offer to repurchase the notes at par

High Yield Debt Standard Covenants (continued)



Consolidation, Merger and Sale of Assets

- Prohibit transactions that will cause the Company or guarantors to cease to exist or reduce the creditworthiness of the Company
- Generally requires a successor company to assume the note and indenture obligations

High Yield Debt Standard Covenants (continued)

Comparison of Bank and High Yield Covenants

<u>Covenant</u>	<u>Bank</u>	<u>High Yield</u>
Financial Covenants	Present	None
Indebtedness	No incurrence test; limited defined baskets	Incurrence test and baskets
Restricted Payments	Generally limited to a dollar amount and special uses	Test plus baskets
Transactions with Affiliates	Arm's length and ordinary course; enumerated exceptions	Arm's length and required actions; enumerated exceptions

High Yield Debt Standard Covenants (continued)

Comparison of Bank and High Yield Covenants (continued)

<u>Covenant</u>	<u>Bank</u>	<u>High Yield</u>
Liens	Prohibited except baskets	Allowed subject to equal and ratable unless in basket
Asset Sales	Prohibited except limited amounts	Allowed subject to cash consideration and use of proceeds (put right under certain circumstances)
Change of Control	Default	Put right