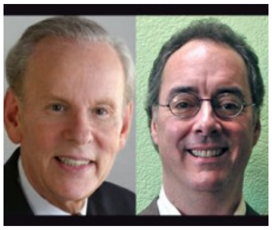
Demystifying the Debt Term Sheet

By RBR-TVBR on Jul, 26 2012

 *By John R. Brooks and Erwin G. Krasnow, Esq.*

Thanks to your taking our advice on putting together a persuasive business plan (see our articles, "How to Make Your Case for 'OPM,'" Radio Business Report/Television Business Report, May 31, 2012, and "How to Maximize Your Chances of Getting 'OPM,' Part Two," Radio Business Report/Television Business Report, June 12, 2012), you've almost reached the finishing line in obtaining OPM. Congratulations — you have your equity term sheet in hand, and you have a pretty good idea of what it says (see "Demystifying the Equity Term Sheet," Radio Business Report/Television Business, July 5, 2012). Someone believes enough in you and your business plan to put an investment proposal on their fancy letterhead so that you can shop for the rest of OPM you need to get your deal done. That would be the lenders.

As we've discussed in our previous articles, the lending landscape for terrestrial broadcasting has contracted dramatically in the last few years. See "Seller Financing: The First Last Resort in a Tough Sales Market," April 30, 2010, and "Attracting OPM (Other People's Money," May 2, 2012. There are a few lending institutions still open for business, but they're cautious. They may still be nursing bad loans made before the 2008 debt bubble exploded. Others, looking for new lending opportunities, may be skeptical over the lack of a broadcast station's hard assets.

With an equity term sheet in hand, you have at least some credibility, and that carries a lot of weight with lenders. Furthermore, if you've taken anything away from our articles (and certainly you have), you've developed relationships with several lenders. More than one of them probably has a relationship with your potential equity partner. It's all about relationships.

So let's go through your debt term sheet.

Structure: Depending on the perceived risk and leverage, the lender may split the loan into a senior and subordinated "tranche." Leverage multiples are a couple of clicks lower today than they were before 2008. The senior loan may be limited to no more than 4 times EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) and with respect to the subordinated loan, 5 to 6 times. The subordinated loan stands behind the senior loan with respect to collateral rights – station assets and licensee stock – which are all pledged to the lender.

Rates and Fees: Prepare for sticker shock. Most loans are pegged off of the recently infamous London Interbank Offered Rate ("LIBOR"), which is currently around 1%. The "margin" over LIBOR is on a declining ladder tied to reductions in leverage. The top margin could be 10% or more and locked in for a year after closing regardless of leverage. Lenders want that sweet yield.

Up-front fees could be 2%, maybe more. It's all a matter of how lenders perceive risk and scarcity of money.

Warrants: As if the rates and fees aren't enough, the lender wants a piece of your hide. And yes, that's your hide, not your investor's. Sounds punitive but it's their money and they have their own people to answer to.

Prepayment Fees: It takes a lot of work to deploy capital into a new investment, so your lender wants to give it time to pay off while they focus on other things. If you're presented with an offer you can't refuse in years 1, 2 or 3, they want to be compensated.

Covenants: Standard covenants include leverage, debt service coverage ratios, minimum cash flow and a long list of other requirements such as complying with the FCC rules, maintaining your insurance, paying your bills and taxes, and so on.

Default: Default language is very harsh and intimidating. Do we really lose the company if you blow a covenant? Not necessarily. The language is meant to instill the notion that your lenders are serious about the loan agreement and, if necessary, they'll have their lawyers write you nasty letters. But no one wants that; it's a last resort.

Let's face it, everyone knows that, despite all good intentions and well thought out business plans, things don't always go as planned. (Someone once quipped: "Murphy was an Optimist!") It's the nature of the business. Lenders and investors put a lot of capital at risk. They want to be protected and rewarded. They try to be fair. They root for your success and don't want to be sitting in a conference room in an adversarial situation. It doesn't make for good PR.

If there is a common theme in this article, it's one word: relationship. And by the way, everything's negotiable.

John R. Brooks is a 25-year broadcast finance veteran, most recently as a Managing Director with Wells Fargo Foothill. He currently works as an independent broadcast consultant and writer. He can be reached at john@iheartcasey.com and (415) 272-5123.

Erwin G. Krasnow, the co-chair of the Communications Group of Garvey Schubert Barer, is a former General Counsel of the National Association of Broadcasters, a coauthor (with John M. Pelkey and John Wells King) of Profitably Buying and Selling Broadcast Stations and Washington counsel to the Media Financial Management Association. He can be reached at ekrasnow@gsblaw.com and (202) 298-2161.