LOAN WORKSHEET #5 – HIGHLY LEVERAGED TRANSACTIONS AND LEVERAGED BUY-OUTS

Highly leveraged transaction (HLT) and leveraged buy-out (LBO) financing is the extension of credit in connection with the acquisition or restructuring of an organization where the resulting total debt to total assets ratio exceeds 75%. Generally, debt service coverage is dependent upon projected large increases in cash flow which result from one or more of the following: growth in sales; reduction of expenses; sale of assets or profitable operations; or issuance of subordinated debt debentures, or stock. Because of the unproven nature of the projections, these transactions have a higher degree of risk and require specialized lending skills. Banks engaged in financing HLT and LBO transactions that do not follow prudent underwriting, servicing, and collection policies subject themselves to undue risk of loss.

Evaluate	Comments
______ **1.** Does written policy contain the following criteria pertinent to HLT/LBO lending? **A.** A written statement that clearly defines HLT and LBO activity? **B.** The overall philosophy and objectives of providing this type of financing? **C.** A separate and specific management information system which tracks and analyzes portfolio performance? **D.** A requirement for annual audited statements and at least quarterly interim statements? **E.** Requirements for loan agreements which include minimum profitability and debt service coverage ratios? ______ **2.** Evaluate underwriting and servicing.	

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Evaluate	Comments
A. Obtain and review loan committee package for loans under review. Consider the following: • Is the package of sufficient detail for an informed credit decision? • Is the use of proceeds clearly defined? • Are loan proceeds used to fund deferred compensation plans (golden parachutes) for management? • Are large increases in projected operating profits adequately explained and justified? • Has there been a thorough investigation of management expertise? • Has the borrower previously undergone an HLT or LBO, obtained formal debt restructure or forgiveness, or issued new stock, subordinated debt or debentures within two years?	

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Evaluate	Comments
• Are appraisal assumptions realistic and have they been independently verified?	
• Have secondary sources of capital been identified in the event that projections are not met?	
B. Does management frequently compare actual results to original assumptions?	
C. Are events of technical default immediately and formally addressed with the borrower?	
D. Are exit strategies implemented prior to actual default?	
______ **3.** Evaluate financial information on selected loans. Evaluation should focus upon earnings before interest, taxes, depreciation and amortization; interest coverage; and sources and uses of funds.	
A. Obtain and review, at minimum, quarterly financial statements and annual audit.	
B. Do actual results meet or exceed original projections?	

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Evaluate	Comments
• If not, has management responded in a timely manner to effect corrective measures?	