

DEBT COMPLIANCE SERVICES
Web-based Covenant Management

**Best Practices in
Debt Compliance Management**

Jeff Wallace, Co-Founder

www.debtcompliance.com

Agenda Topics

- Why accurate and comprehensive debt compliance is more important than ever before
- Common compliance weaknesses
- Best practices in debt compliance
- Applying web-based technologies to debt compliance
- About Debt Compliance Services LLC

Access to Capital

A primary CFO & Treasurer responsibility is maintaining their company's access to capital by:

- Optimizing the capital structure of their company
- Maintaining excellent relations with capital providers and the credit rating agencies, and
- **Ensuring that their company is in compliance with all requirements of their debt agreements**

The Increased Focus on Debt Compliance

- Lenders can use any covenant breach to re-price the credit
- In today's economy, auditors are more aware of their risks in providing their assurance of no default to the lenders
- Senior management is more concerned about the loss of credibility with the Board, lenders, vendors and other creditors
- Under the new SEC proxy rule 33-9089, companies must disclose the Board's role in risk oversight, including how such risks are identified, managed and mitigated

Lenders' Expectations

- Debt compliance is a key filter by which lenders evaluate a company and the competence of its management team
- Lenders expect companies to:
 - Fully understand all of the requirements of their debt agreements
 - Effectively manage operating performance to the debt agreements' restrictions
- While the CFO and Treasurer cannot cure poor business results, their job is to minimize the impact by not surprising their bankers:
 - Forecasting the financial covenants to identify future compliance risks
 - Pro-actively managing their bankers about these risks
 - Seeking consents before the fact, not waivers and amendments after the fact

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Calculating Ratios is the Easy Part of Compliance

- **Negative Covenants**
 - Restricted payments
 - Liens
 - Loans, leases and guarantees
 - Operating restrictions
 - Permitted baskets
 - Stock buybacks
 - Change of control
 - Acquisitions
 - Hedging restrictions
- **Affirmative Covenants**
 - Financial Reporting
 - Insurance coverage
 - ERISA filings and events
 - Corporate events
 - Legal undertakings
 - Environmental compliance
 - Litigation reporting
- **Reps & Warranties**
 - Continuing
 - Post-closing events
- **Events of Defaults**
 - Payment failures
 - Mandatory prepayments
 - Cross-defaults

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The High Monetary Cost of Default

\$50M 3-Year Facility, \$40M O/S in \$000

Cost	BPs	Year 1	Years 2 & 3	Total
Amendment/Waiver Fee	50**	\$250		\$250
Default Interest Spread*	200	133		133
Increased Spread	200**	800	1,200	2,000
Increased Comm't Fees	50	50	100	150
Legal and Audit Fees		250		250
Total Cost		\$1,483	\$1,300	\$2,783

Lost management credibility? Priceless

*Assumes 2 months to renegotiate

**Per CFO Magazine, June 2011, quoting an S&P 1Q09 report

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The High Non-Monetary Costs of Default

1. Press releases and 8-K public disclosure
2. Loss of credibility with the banks, the CEO and the Board
3. Temporary/permanent loss of access to credit
4. Business disruption, customer and vendor concerns
5. Financial restatements and being cited by the auditors for a material weakness or a significant deficiency
6. Workout, forced refinancing, fire sales, and Chapter 11
7. Substantial diversion of management time

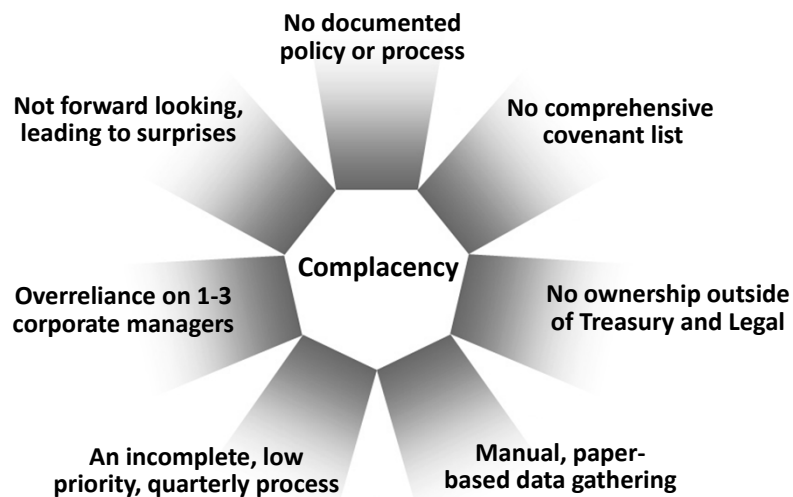
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Common Compliance Weaknesses



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Covenant Compliance Checklist

- A comprehensive list of all key debt provisions and compliance requirements
 - Section reference
 - Category (affirmative, negative, or financial covenant, default event, notice, deliverable, etc.)
 - Brief description
 - Timing of notification, cure period
 - Responsibility by person(s)/position(s)
 - Default section reference
- Checklist forms the basis for compliance questionnaires customized to each responsible person/position

Debt Compliance Policy

- Objectives
- Assignment of responsibilities to operating and corporate management for being knowledgeable about what causes covenant breaches
- Description of the quarterly compliance process
 - Compliance checklist and questionnaires
 - Resolution of covenant issues
- Ongoing intraquarter covenant compliance
 - Responsibility for timely reporting of potential covenant issues
- Documented SOX procedures
- Loan administration

Financial Modeling

The Financial Model incorporates the debt agreements' definitions to calculate the required Financial Ratios

- The Financial Model calculates the current periods ratios but also projects into the future
- Integrated with the Corporate Budgeting and Forecasting processes
- Stress tested by Treasury to ascertain leeway in future periods

Permitted Baskets

- Examples are: Unsecured indebtedness, capitalized lease obligations, L/Cs, overdue trade payables, debt at acquisition of a sub, etc.
- Definitions of each basket
- Determine who can affect each basket
- Approvals necessary before increasing each basket
- Monthly tracking process

Web-based Data Gathering

Compliance data is collected via questionnaires to the responsible corporate parties identified in the Checklist

- Questionnaires answered **before** and **after** quarter-end
 - Only after quarter close is often too late
- Yes/No questions with explanations for **all** exceptions
 - Respondent reports on what happened – Treasury and Legal make the materiality decisions
- Questionnaires confirm that required numeric data has been sent to Treasury
- Questionnaires also educate the responsible parties on their actions and events that have compliance implications

Exception Analysis

- The questionnaires are analyzed by Treasury and Legal in an Exception Report which lists all issues respondents have identified this quarter **and** last quarter
 - Treasury and Legal work to resolve all exceptions
- The Exception Report and the Financial Model provide the background required for the CFO's review of Quarterly Certification Letter
 - In addition, provides information for the SOX 302 Quarterly Disclosure Process

Deliverables and Payments Calendar

A listing of the timing of all quarterly and annual compliance requirements required during the year, with references to the debt agreement section:

- Financial statements
- Auditor certificates
- Insurance certificates
- ERISA filings, etc.
- Due dates for fees, interest payments, etc.

Lender Management

Pro-active and open communication with Lenders

- Lenders do not like “surprises” and adversely evaluate companies that don’t seem to have a handle on their operating performance
- Advance warning of potential issues provides the basis for the Lenders to be more willing to work fairly with you
 - Bank credit committees are running the show these days, and your account officers need to show them that you are really in control

Company Training

It is essential that all appropriate individuals that may impact compliance are trained on the requirements of the debt agreement

- Many in the company may not be aware that the company has to borrow and why debt compliance is important
- Many covenants have little or no notice/cure period, which means Treasury needs to be informed before the fact, rather than after the fact
- Today, covenant compliance is an ongoing exercise, not something that can wait to the next quarter-end compliance review

Best Practices in Debt Compliance



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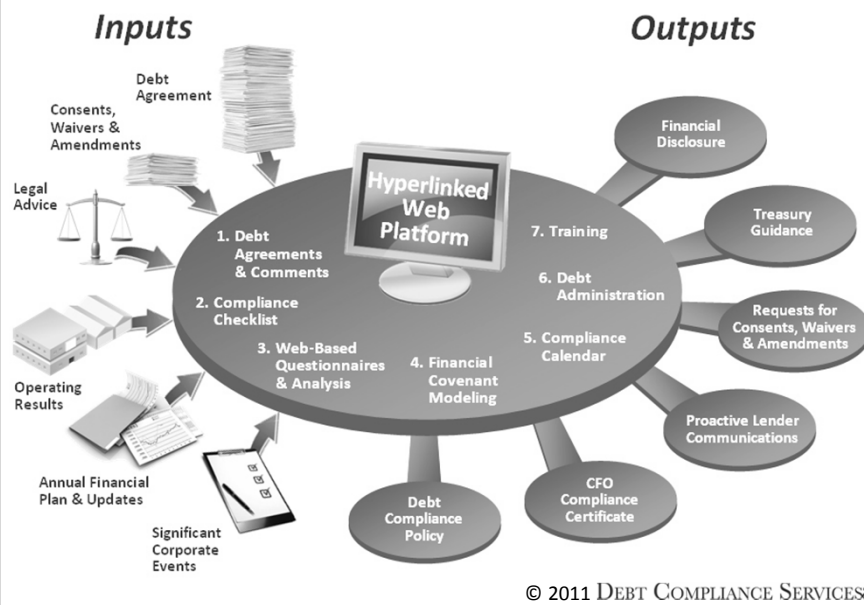
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Using Technology in Debt Compliance



Debt Agreements using Wiki Technology

- Converting debt agreements to web pages
- Linking all defined terms and section references
- Allow comments on the web page, rather than writing margin notes on hard copy
- Allow documents (emails, lawyer opinions, etc.) to be uploaded to specific web pages
- Version tracking of amendments
- Include covenant checklist and calendar linked directly to the debt agreements
- Contextual search capability of all agreements

Web Technology Applied to Questionnaires

- Covenant listing drives questions about those covenants allocated to the people most knowledgeable about that covenant requiring a Yes/No/Don't Know/Not Applicable answer with explanations if a negative response
- Questionnaires have a respondent and a reviewer
- Questions are in a web database, allowing extensive reporting capabilities:
 - Validation of answers
 - Exception analysis

Conclusion

- The risks of breaching covenants are greater than ever before because banks are eager to use even slight technical defaults to re-price the credit risk
- The risks are now too great to leave to an informal, incomplete and manual process
- Develop a compliance policy grounded with a comprehensive compliance checklist
- Technology can:
 - Improve collaboration between Finance and the business units
 - Significantly reduce compliance time
 - Minimize errors that turn into expensive defaults

About Debt Compliance Services

- **Debt Compliance Services LLC**, founded in early 2009, is the only firm providing an integrated, automated solution to covenant management. It is a joint venture of Corporate Finance Solutions, LLC and Greenwich Treasury Advisors LLC
- **Jim Simpson**, DCS Co-Founder, has 35 years of financial corporate and consulting experience, which includes managing or advising on \$4 bn in debt deals as CFO of two middle market companies, Treasurer of Novartis USA, KPMG, Greenwich Treasury Advisors and at Managing Partner at Corporate Finance Solutions, which he founded in 2002
- **Jeff Wallace**, DCS Co-Founder, also has 35 years of financial corporate and consulting experience as VP-International Treasury at American Express, AT at Dun & Bradstreet, AT at Seagram, CPA at PWC, and Managing Partner at Greenwich Treasury Advisors, which he founded in 1992

Contact Information

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What DCS Covenant Manager™ Delivers

- A web-based, automated debt compliance process developed with the client that is comprehensive, efficient, and collaborative
- Debt agreement(s) are converted into hyperlinked web pages and then linked to a compliance database, calendars, tailored web questionnaires, a historic database of the responses, and an archive
- Reading and researching the debt agreements is quick and thorough, clicking links rather than flipping pages, supplemented by our customized FAQ's on key topics and debt administration matters

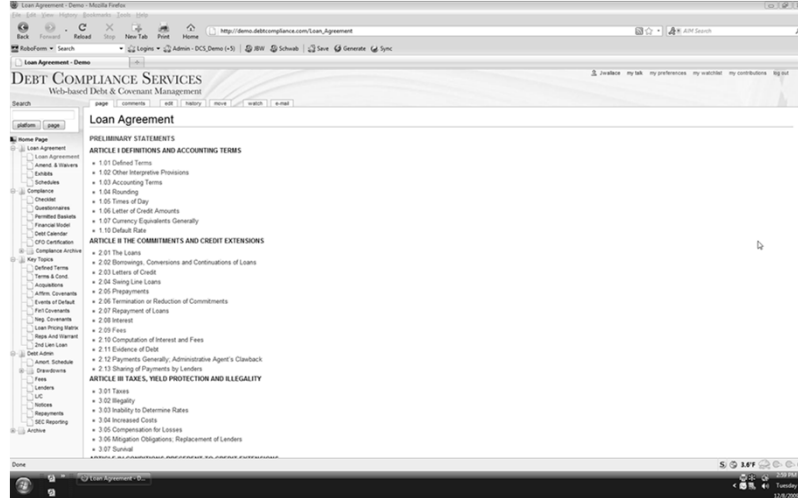
Testimonials and Articles

"Debt Compliance Services' tools reduce my risk, save me and my team time and effort, and have made our compliance reporting easy. Gone are the days when we would have to pull out our worn, dog-eared loan documents to review all of the various covenants and restrictions before making critical strategic business decisions. With DCS, reviewing our agreements is literally done with a few clicks of the mouse."

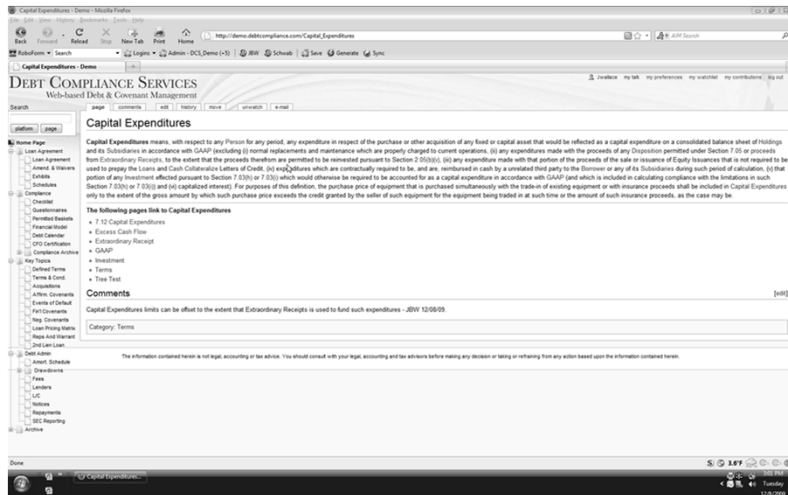
Al Gever, Executive Vice President & CFO, Smart Balance, Inc.

- "Tracking Covenants", *Treasury and Risk Magazine*, October 2009
- "Best Practices in Debt Compliance Management", *FEI's Financial Executive Magazine*, December 2009
- "...Debt Compliance Services ...[is an example of]... Treasury 3.0." *Treasury and Risk Magazine*, September 2011

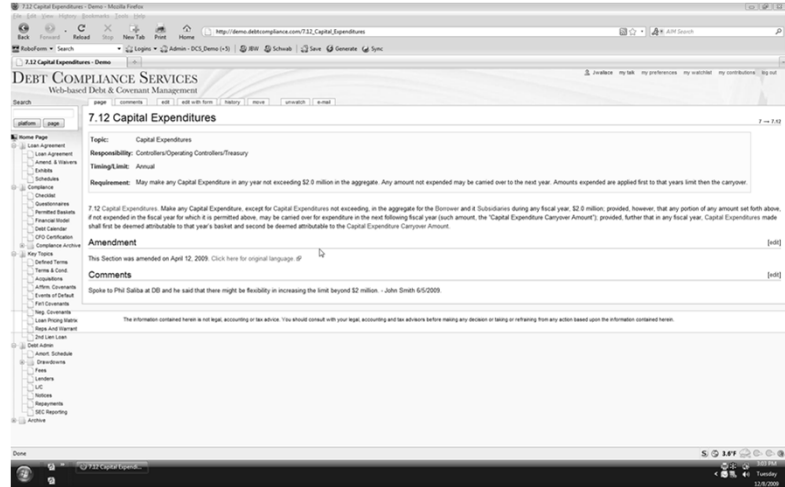
Main Page



Defined Term with Linking and Comments



Recording a Covenant Requirement



Covenant Compliance Checklist

Responsibility	Section	Topic	Requirement	Timing Limit
Contractors	6.0300 Accounting Policy	Accounting Policy	Material Change in accounting policies or financial reporting	Priority
Contractors	6.0200 Auditor's Certificate	Auditor's Certificate	Inaudited quarterly financial statements on a comparative basis of Holdings and Subsidiaries for 1st 3 quarters. Certified by Borrower. (can be fulfilled or satisfied partially with Section 6.0500) (can be delivered electronically) (due after the end of Quarter (90 Days for June 30, 2007))	Quarterly
Contractors	6.0100 Quarterly Statements	Quarterly Statements	Subsidiaries for 1st 3 quarters. Certified by Borrower. (can be fulfilled or satisfied partially with Section 6.0500) (can be delivered electronically) (Contractor with 6.0100 and 03) (Annual and Quarterly)	Quarterly
Contractors	6.0100 Annual Statements	Annual Statements	Audited consolidated balance sheet, income statement, shareholders' equity and cash flow on a comparative basis of Holdings and Subsidiaries. (can be fulfilled or satisfied partially with Section 6.0500). (Can be delivered electronically) (60 after FYE)	Annual
Contractors/Operating Controllers	6.17 Solvency	Solvency	The Borrower is solvent (each new Credit Extension)	Ongoing
Contractors/Operating Controllers	7.14 Accounting Changes	Accounting Changes	May not make changes in accounting or reporting practices except as required by GAAP	Priority
Contractors/Operating Controllers	6.0200 Real Property Lending	Real Property Lending	Real property being acquired pursuant to Sections 5.01, 5.05(C)(i) and (ii) and 5.13	Priority
Contractors/Operating Controllers	7.01 Leases	Leases, Pledged Leases	Including real property acquisition during the fiscal year, real property acquired or leased and any other charges within 90 days of FYE. Has been excepted for as listed in 7.01 (a) - (k), including (i) other lease of up to \$5 million, provided there have not been other Charges during the fiscal year.	Priority
Contractors/Operating Controllers/Treasury	6.09 Books and Records	Books and Records	Written proper Books and Records	Quarterly
Contractors/Operating Controllers/Treasury	7.0200 Investment Restrictions	Investment Restrictions	Advanced Investment Restrictions up to the \$2.0 million basket	Priority
Contractors/Operating Controllers/Treasury	7.0300 Advances	Advances	Advanced Investment Restrictions by Officers, Directors and employees not to exceed \$1.0 million in the aggregate in the second anniversary and 500K thereafter	Priority
Contractors/Operating Controllers/Treasury	7.0300 Accounts Receivable	Accounts Receivable	Accounts Receivable in the ordinary course of business	Priority
Contractors/Operating Controllers/Treasury	7.0300 Investments in Subsidiaries	Investments in Subsidiaries	Permitted Investments by a Loan Party in a Subsidiary that is not a Loan Party of the Borrower	Priority
Contractors/Operating Controllers/Treasury	7.0200 Overhead Trade Payables	Overhead Trade Payables	Trade payables limited by more 90 days continued in good faith up to \$40,000.00	Priority
Contractors/Operating Controllers/Treasury	7.0200 Letters of Credit	Letters of Credit	Documentary Letters of Credit having an aggregate face amount of not more than \$3.0 million at any time	Priority
Contractors/Operating Controllers/Treasury	7.0200 Indebtedness related to hedging or overcollateral protection	Indebtedness related to hedging or overcollateral protection	Hedging by Treasury, Agency or cash management services.	Priority
Contractors/Operating Controllers/Treasury	7.0200 Leases	Leases	Cashless Leases, Synthetic Lease Obligations and purchase money obligations under title #7.0100 up to the \$2.0 million limit	Priority

Questionnaire Dashboard

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Home Modules Reports Users Mass Email Processes Settings Password Log Out

All Questionnaire Modules

Module Name	Responsibility	Respondent	Reviewer	Status	Issues	Finalized	Reviewed	Date Due
ABC_#1	ABC	Respondent	N/A	7 questions (100% answered)	1	No	No	12/10/10
ABC_#2	ABC	Respondent	N/A	7 questions (100% answered)	1	No	No	12/10/10
Accounts_#1	DCS Demo Group	Tabact	N/A	7 questions (100% answered)	4	No	No	12/10/10
Accounts_#2	DCS Demo Group	Tabact	N/A	7 questions (100% answered)	3	No	No	12/10/10
APD_#1	APD	Respondent	N/A	7 questions (100% answered)	0	No	No	12/10/10
APD_#2	APD	Respondent	N/A	7 questions (100% answered)	1	No	No	12/10/10
Cash_#1	DCS Demo Group	Quasoon	N/A	8 questions (100% answered)	1	No	No	12/10/10
Cash_#2	DCS Demo Group	Quasoon	N/A	10 questions (100% answered)	1	No	No	12/10/10
Cash_#3	DCS Demo Group	Quasoon	N/A	3 questions (100% answered)	1	No	No	12/10/10
EX_#1	EX	Thicke	N/A	7 questions (100% answered)	0	No	No	12/10/10
EX_#2	EX	Thicke	N/A	7 questions (100% answered)	0	No	No	12/10/10
FSO_#1	DCS Demo Group	Respondent	N/A	1 question (100% answered)	1	No	No	12/10/10
HS_#1	DCS Demo Group	N/A	N/A	2 questions (100% answered)	2	No	No	12/10/10
IP_#1	DCS Demo Group	Respondent	N/A	1 question (100% answered)	0	No	No	12/10/10
Legal_#1	DCS Demo Group	Green	N/A	7 questions (100% answered)	3	Yes	No	12/10/10
Legal_#2	DCS Demo Group	Green	N/A	9 questions (100% answered)	2	No	No	12/10/10
Legal_#3	DCS Demo Group	Green	N/A	8 questions (100% answered)	1	No	No	12/10/10
Legal_#4	DCS Demo Group	Green	N/A	8 questions (100% answered)	1	No	No	12/10/10

Questionnaires Exception Report

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Home Modules Reports Users Mass Email Processes Settings Password Log Out

09/30/2010 DCS Demo Exceptions Report 12/16/2010

Sort By: Module | Subject | Reference | Responsibility | Responses | Response

Respondent/Reviewer	Module/Q# Reference/CR/QR	Subject/Question	Response
Respondent/N/A	ABC_#1/94 7.2011 Events of Default Judgments/12/10	(Judgments) Has there been one or more judgments for the payment of money in an aggregate amount exceeding \$25,000,000 (to the extent not covered by insurance) rendered against the Borrower and/or any Restricted Subsidiary and the same remained undischarged for a period of 60 consecutive days during which execution shall not be effectively stayed?	Don't know
Respondent/N/A	ABC_#1/91 3.09 Litigation: Compliance with Laws/12/13	(Litigation) Are there any actions, suits or proceedings at law or in equity or by or before any Governmental Authority now pending or, to the knowledge of the Borrower, threatened in writing against, including the Borrower or any Restricted Subsidiary or any business, property or rights of any such Person?	Issues: Suits outstanding are already mentioned in financials.
Tabact/N/A	Accounts_#1/92 5.04(b) Information - Annual Budget/12/18	(Annual Budget) Within 90 days after the commencement of each fiscal year, did the Borrower deliver to the Administrative Agent a detailed Consolidated Budget for the fiscal year?	Issues: We have until 1/29 to file the budget. We are planning on filing the budget with the rest of our annual reporting package.
Tabact/N/A	Accounts_#1/93 5.04(a) Information - Annual Statements/12/15	(Annual Statements) Within 90 days after the end of each fiscal year, has the Borrower delivered to the agent its audited Annual Financial Statements?	Issues: See above on budget question.
Tabact/N/A	Accounts_#1/95 5.04) Information - Collateral/12/14	(Collateral) Has the Borrower delivered to the Collateral Agent concurrently with the delivery of the Financial Statements a certificate executed by a Responsible Officer, showing updated versions of the Schedules (other than Schedule J) to the Guarantors and Collateral Agent and/or setting forth any and all changes to (or confirming that there has been no change in) the information set forth in or contemplated by such Schedules since the date of the...	Issues: Not yet, we will file with the rest of the package.