NICHE-SEARCH

WORKSHEET 5 OF 9

Covenant Headroom Analysis — Pre-Loan Stress Test

Complete before signing any new credit facility. One row per active covenant in every active loan agreement.

Complementary worksheet for
Financial Ratio Analysis
by Ibrahim Anwar

SECTION 1

What This Is For

A pre-signing stress test that calculates whether covenant headroom survives two conditions: (1) the new credit facility being drawn and added to the balance sheet, and (2) a 20% revenue decline occurring after the facility is in place. Banks set covenant thresholds at the time of signing. Those thresholds apply for the full facility term — sometimes three to seven years. The operator's current ratio, DER, and ICR at the time of signing are the comparison points, but the covenants must be met through conditions that do not yet exist when the pen goes to paper.

Most covenant breaches happen in year two or three of a facility — not because the operator was careless, but because the downside scenario analysis was never done before signing. Revenue pressure, a bad quarter, a supplier price increase: any of these can push a ratio from adequate to breach. This worksheet makes that math visible before the credit documents are signed, not after the breach notice arrives.

SECTION 2

Benefits

What you get when you actually run this worksheet on a real situation:

- Identifies which covenant has the smallest headroom before signing, when there is still time to negotiate the threshold or restructure the credit draw.
- Quantifies the exact revenue decline percentage at which each covenant would be breached, so the risk is understood in operational rather than financial terms.
- Provides the negotiating basis for covenant threshold discussions — headroom analysis is the factual argument for requesting a wider limit.
- Creates a record that shows the pre-signing covenant calculation, which matters for any post-signing covenant compliance report.
- Reveals when a new credit facility would simultaneously breach a covenant on an older facility — a risk that is almost never checked without this worksheet.

SECTION 3

Framework To Use

Three-Scenario Covenant Stress Test

Every covenant is tested in base, downside, and upside scenarios before signing.

HEADROOM DECISION LOGIC — BEFORE SIGNING ANY NEW CREDIT FACILITY

SECTION 4

How To Use

Follow these steps in order. Each one builds on the previous.

1. List every covenant in every active loan agreement. Do not omit older facilities — a new loan can breach a covenant on a loan signed three years ago if it changes the balance sheet.
2. Enter the actual current ratio for each covenant. Enter the covenant limit. Calculate headroom: for minimum covenants (current ratio, ICR), headroom = actual minus limit. For maximum covenants (DER), headroom = limit minus actual.
3. Calculate the base-case projection: after the new credit is drawn and new assets are on the balance sheet, what is each ratio? Use the expansion plan's revenue and cost projections.
4. Calculate the downside projection: assume revenue falls 20% from base. Assume receivables lengthen by 15 days (customers pay slower in a downturn). Assume inventory builds 10% above plan. Recalculate current ratio and DER.
5. Calculate the upside projection: assume revenue exceeds plan by 20%. Recalculate.
6. Flag any covenant where downside headroom falls below 0.2x as a breach risk. Address it before signing — either by adjusting the credit draw amount, the repayment schedule, or the balance sheet before closing.
7. For the covenant with the smallest downside headroom: calculate the maximum additional credit draw that keeps headroom above 0.2x. Write that number before the signing meeting.

SECTION 5

Example Use

A South Sulawesi spice distributor with $3.1 million annual revenue is signing a $900,000 five-year investment credit to fund a cold storage warehouse. Two active covenants apply: current ratio minimum 1.2x and DER maximum 2.0x. Current position: current ratio 1.41x, DER 1.62x.

Current headroom: current ratio 1.41x minus 1.2x limit = 0.21x headroom. DER 2.0x limit minus 1.62x actual = 0.38x headroom.

After drawing $900,000 credit: new debt added to balance sheet, new warehouse asset added. DER recalculation: existing interest-bearing debt $580,000 + new $900,000 = $1,480,000. Equity $898,000 (no change at signing). DER = 1,480,000 / 898,000 = 1.65x. Headroom: 2.0x − 1.65x = 0.35x. Adequate.

Current ratio base case: new current portion of long-term debt added (first year's installment $180,000). Current liabilities increase by $180,000. Current assets increase by $900,000 cash immediately but fall by $900,000 when cash converts to warehouse asset — net: current assets unchanged, current liabilities up $180,000. Current ratio falls to approximately 1.28x. Headroom: 1.28x − 1.2x = 0.08x. This is below the 0.2x safe threshold — a covenant breach risk in the base case.

Downside (revenue -20%): receivables lengthen by 15 days. Average receivables increase approximately $128,000. Current assets increase, but short-term bank debt may need to be drawn to fund the working capital gap. If $100,000 short-term credit is drawn, current ratio denominator rises further. Projected current ratio under downside: approximately 1.10x — a breach.

Action before signing: (a) negotiate a 15-month grace period before the first installment, moving $180,000 out of current liabilities. New base-case current ratio: approximately 1.38x, headroom 0.18x — still tight but manageable. (b) Or reduce the credit draw to $750,000 and self-fund $150,000 from retained earnings to reduce the installment below $160,000 per year. New base-case current ratio headroom: approximately 0.22x — adequate. The operator takes option (b) and enters the signing meeting with the calculation already done.

SECTION 6

The Worksheet

Tear this out, copy it onto a fresh sheet, or fill it in directly.

Covenant Headroom Analysis — Pre-Loan Stress Test

Complete before signing any new credit facility. One row per active covenant in every active loan agreement.

COVENANT	ACTUAL NOW	COVENANT LIMIT	HEADROOM	PROJECTED BASE	PROJECTED −20% REVENUE	PROJECTED +20% REVENUE	BREACH RISK?

SECTION 6 (CONTINUED)

Reflection Prompts

After filling in the worksheet on the previous page, work through these.

1. List every covenant in every active loan agreement — do not skip older facilities. Common covenants: current ratio minimum, DER maximum, ICR minimum. Headroom = actual minus covenant limit for minimums; covenant limit minus actual for maximums. Flag Y in Breach risk column if downside headroom falls below 0.2x.

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2. Downside projection method: assume revenue falls 20%. Receivables lengthen 15 days: additional receivables = (15/365) × Annual Revenue. Inventory builds 10% above plan: additional inventory = ending planned inventory × 10%. Recalculate current ratio and DER after new credit is drawn, new assets enter, and new installment enters current liabilities. Write the resulting figure in the −20% column.

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3. For the covenant with the smallest headroom in the downside scenario: write (a) the maximum additional credit draw that keeps headroom above 0.2x — the ceiling of the negotiating space; (b) the minimum DPO extension with suppliers that would improve current ratio enough to widen headroom by 0.2x — calculated as: (DPO days target − DPO days current) / 365 × Annual COGS. These two numbers define the pre-signing adjustment space.

SECTION 7

Tips and Traps

TIPS

- Run this worksheet for every covenant in every active loan when considering a new facility, not only for the new loan's own covenants. New debt changes the balance sheet that all prior covenants reference.
- Use the downside scenario to negotiate covenant thresholds before signing, not as post-signing justification. Banks expect to be negotiated with before documents are signed; they expect covenant compliance after.
- The 15-day receivables lengthening assumption in the downside scenario is conservative — in actual revenue downturns, customers often slow to 20-25 extra days. The 15-day assumption is a floor for stress testing.
- After signing, build a covenant monitoring column into your monthly ratio dashboard. The headroom number should appear every month, not only when a breach is suspected.
- When presenting the headroom analysis to the bank, lead with the base case and show the downside scenario proactively. Operators who show their own stress test before being asked signal competence — the bank's credit officer runs the same calculation independently.

TRAPS

- Using the projected financials from the expansion plan as the base case without stress-testing them. Expansion plans rarely fail on the upside — they fail on the timeline and revenue ramp assumptions.
- Treating covenant compliance as a yes/no at the time of signing. Covenants are tested every reporting period for the full facility term. A covenant that looks comfortable at signing can breach in year 2 without any single dramatic event.
- Ignoring the current portion of long-term debt when calculating current ratio after signing. The first year's installment enters current liabilities immediately — this is the most common mechanism by which signing a new credit facility unexpectedly lowers the current ratio.

SECTION 8

Appendixes

Appendix A — Covenant Headroom Calculation Template

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For each active loan agreement, complete one block:

Loan description            : _____________________
Facility amount             : $____________
Outstanding balance         : $____________
Remaining term              : ___ months

Covenant 1:
  Type (min/max)            : _____________________
  Ratio measured            : _____________________
  Covenant limit            : _____________________
  Current actual            : _____________________
  Headroom                  : _____________________
  Downside (−20% rev)       : _____________________
  Breach risk (Y/N)         : _____________________

Covenant 2: (repeat block)
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Appendix B — Current Ratio Impact of New Installment — Quick Calculation

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When a new term loan is drawn, the first year's installment immediately enters
current liabilities. This reduces current ratio before a single payment is made.

Annual installment = Loan amount / Term in years (simplified, ignoring interest)
Current ratio after signing =
  (Current Assets before) / (Current Liabilities before + Annual Installment)

Example: Current Assets $850,000, Current Liabilities $620,000 before signing.
  Current ratio before = 850,000 / 620,000 = 1.37x
  New loan $500,000 over 5 years. Annual installment = $100,000.
  Current ratio after = 850,000 / (620,000 + 100,000) = 850,000 / 720,000 = 1.18x.
  Headroom against 1.0x floor = 0.18x. Headroom against 1.2x floor = −0.02x (breach).
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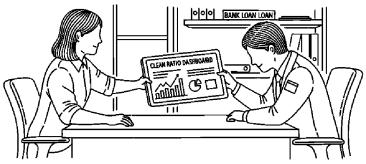

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by Ibrahim Anwar

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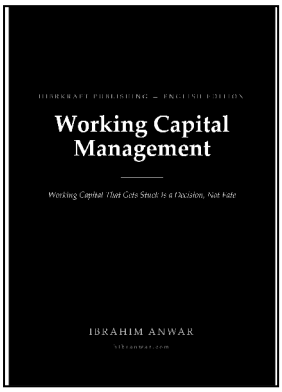

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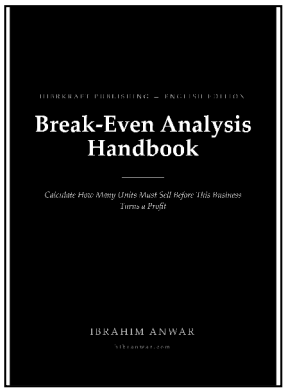

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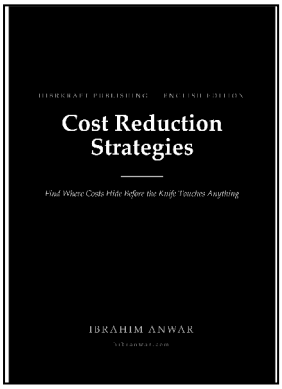

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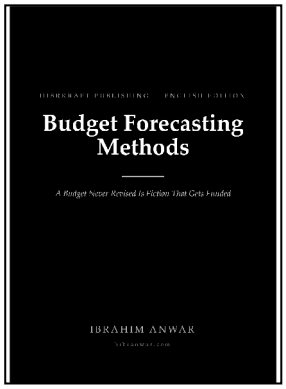

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