Fixed Charge Coverage Ratio's Comeback

How rising rates have brought Fixed Charge Coverage Ratio ("FCCR") to the forefront of borrowing conversations and its impact on borrowers' debt capacity.

FCCR became an afterthought for many over the last decade. Today, it's a limiting factor. By pressure-testing FCCR, borrowers can better assess how much debt their business can manage (their debt capacity) and prevent financing surprises.

What is FCCR?

FCCR evaluates a company's ability to cover its obligatory costs. Costs that must be satisfied to keep the business up-and-running and in good standing, or its "fixed" costs – including taxes, capital expenditures (e.g., for facility/equipment upkeep) and financing principal & interest payments.

The ability to cover these costs is measured by the ratio of operating profit (EBITDA) to fixed costs. Lenders set a minimum threshold, typically just above 1.0 – as less than 1.0 would mean profits are less than fixed costs, and the business risks insufficient funding to meet its obligations.

$$\text{FCCR} = \frac{\text{EBITDA}}{(\text{Taxes} + \text{CapEx} + \text{Interest} + \text{Amort})}$$

More Than a Metric

FCCR addresses the critical lending question: "Will the borrower make enough money to pay me back on time?" (i.e., via scheduled principal and interest payments). As a result, lenders use FCCR extensively – during underwriting, in loan covenants, and as part of internal tracking systems to assess portfolio risk.

FCCR is not your average metric. It's nearly a full cash flow statement in a single formula – capturing what lenders truly care about. It's also an inescapable economic reality – a sustainable business must (eventually) generate enough profits to meet its financial obligations.

FCCR Formula
EBITDA
Taxes
Capex
Interest
Principal Amort
Total Fixed Charges
EBITDA
(÷) Fixed Charges
FCCR

Cash Flow Statement
EBITDA
(-) **Taxes**
(-) **Interest**
(-) Chg in NWC
Cash from Operations
Capex
Cash from Investing
Debt Issuance / (Repayment)
Cash from Financing

FCCR's Comeback

After 10+ years of near-0% rates – parallel with the growth of non-bank financing carrying low principal amortization – FCCR lost its mathematical relevance. FCCR became out-of-mind, out-of-sight. Some went so far as to make FCCR covenants "springing" (present only under certain conditions) or dropping altogether, and Leverage (Debt-to-EBITDA) took the spotlight.

However, with SOFR currently above 5% - FCCR is back (seemingly with a vengeance). Year-over-year, many borrowers have faced a near-doubling of interest rates – causing companies with the same leverage to experience FCCR compression, as shown below.

This dynamic has redefined what an appropriate amount of debt financing is. The last column for the example company shows to re-establish last year's FCCR cushion would require a 30%+ reduction in debt / leverage (resulting in 2.4x leverage vs. 3.5x previously).

($000s)	2022	2023	*%Chg*	2023	*%Chg*
Debt Outstanding	$35,000	$35,000		$23,750	*-32%*
EBITDA	$10,000	$10,000		$10,000	
SOFR	0.5%	5.3%		5.3%	
SOFR Margin	6.5%	6.5%		6.5%	
Effective Int Rate %	7.0%	11.8%		11.8%	
Taxes	$2,175	$1,545		$2,043	
Capex	$1,750	$1,750		$1,750	
Interest	$2,450	$4,130	*+69%*	$2,803	
Principal Amort	$700	$700		$475	
Total Fixed Charges	$7,075	$8,125		$7,070	
FCCR	1.41x	1.23x	*-13%*	1.41x	--
Lev Ratio	3.50x	3.50x		2.38x	

Prevent Surprises

With SOFR above 5%, fixed charge coverage can no longer be assumed and must be proactively considered by borrowers.

Whether front-running covenant tightness or evaluating how much debt your company can manage before seeking financing, pressure-testing FCCR will help existing and prospective borrowers prevent surprises.

We've created a tool for companies to evaluate their debt capacity by pressure-testing FCCR.