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Addressing the financial impact of COVID-19

Negotiation support for lenders

Public policy measures put in place to contain the spread of COVID-19, and the inevitable public concerns, combined with turbulence in the financial markets, are resulting in significant financial and operational disruption for many companies. Staff quarantine, supply chain failures, and sudden reductions in demand from customers are creating serious issues for companies across a wide range of sectors.

A number of companies now face weeks, if not months, of exceptionally poor trading conditions. For most, the revenue lost in this period represents a permanent loss rather than a timing difference and is putting sudden, unanticipated pressure on working capital lines and liquidity, and even longer-term business viability.

Lenders are going to be asked to provide additional support to borrowers through covenant relaxation and new money. In certain cases, the scale and urgency of the funding requirement will be substantial; hence lenders, both existing and new, will rapidly require information to make educated decisions and may need support through the negotiation process.

Leader considerations

What is driving a covenant breach, is it just COVID-19 or are there underlying issues?

Covenant breach: Lenders will need to assess whether a breach is a one-off, or whether the whole covenant suite needs re-sizing. It is key to understand the underlying driver of underperformance; i.e. more than just a short-term COVID-19-driven shock?

- Impact of breach: A rapid assessment of the impact of potential breach is required. Any breach is likely to impact audit signoff, and presentation of debt as current on the balance sheet. Additional commercial impacts can include cross defaults and enforcement actions by secured lenders, licenses and contracts put in jeopardy, and the ability to win new work reduced.

What is the scale and duration of any new money ask and terms?

- Timing and quantum: This will be the primary concern for existing lenders together with payback.
- Funding losses or working capital: It is important to understand if new lending is funding losses or working capital. Consider monitoring the use of funds for the purposes agreed.
- Ability to work new facilities into the existing capital structure: Review existing facility/intercreditor documentation (analyze borrowing capacity within existing baskets, etc.), and ensure consents are being sought if required for changes to super senior provisions, security and borrowing baskets.
- Identify potential sources of collateral for additional borrowing: These include property, inventory, receivables, other unencumbered assets, and unrestricted subsidiaries.

Leader considerations

What are other stakeholders doing to support the business?

- Company: What self-help measures are being undertaken before approaching lenders?
- Shareholders: It is important to understand quickly what part, if any, they can or are playing in supporting the business.
- Key customers / suppliers: Determine whether customers or suppliers who depend on the business as a key part of their supply chain can contribute to a funding package through vendor financing, OEM advances, or modified payment terms for receivables and payables.
- Other lenders: Are other lenders taking actions; e.g. calling loans, suspending facilities, or enforcing securities?
- Alternative lenders: Existing lenders may be at their risk limit for a single credit or sector. Alternative lenders that can deploy capital flexibly at short notice may offer an alternative solution, though clearly the terms will need to be negotiated.

Suggested lender approach

- Confidence in the "ask": Lenders need assurance that any "ask" has been independently tested and challenged, and that the risks and downsides are well understood. Lenders will need "red-flag" diligence on revised trading and cash flow forecasts, together with a security review and stakeholder analysis.
- Negotiation support: The terms of any support package may have to be rapidly negotiated and agreed to between different lender groups, advisors and the borrower, with hastily assembled security packages to support new funding. A consensus-building approach will be essential for lenders.
- Innovative solutions: COVID-19-related financing solutions may be urgent and non-standard. This may require expert guidance and knowledge of the special-situations market to bring new sources of capital into play alongside existing lenders on acceptable terms.

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