March 30, 2020

Preserving Liquidity during the COVID-19 Pandemic

Over the past two weeks, many companies, large and small, identified the near-term threats to corporate liquidity posed by COVID-19 and borrowed under existing committed lines of credit. Many may soon find that this initial step, while necessary, is not sufficient to provide them with enough cash to survive a prolonged crisis. These companies will need to manage liquidity more creatively and aggressively, including by raising cash in traditional and non-traditional ways, and, on the other side of the equation, reducing cash outflows to the extent possible. Below are some considerations and ideas for companies in this situation:

Raising Cash

- **New Credit Facility, Existing Lenders:** The market for new loans to investment grade borrowers bogged down over the last week, with effectively no new credit available before quarter-end. Many banks imposed stricter controls on new credit commitments, including by requiring approvals from the highest levels of their institutions before entering new credit facilities. Meanwhile, the regular-way high-yield lending market has been available only in very limited circumstances. As the second quarter begins and fiscal and monetary stimulus starts filtering through the economy, lending markets may begin to loosen up, and companies should continue to check in with their principal banking relationships for new borrowing opportunities.

- **Capital Markets Open…for Some:** Some investment grade issuers successfully accessed the bond market last week and issued longer-dated securities, albeit at far wider spreads than normal. But relief appears to be on the way in the form of several new Federal Reserve lending initiatives that will be implemented in coming days and weeks (see below) and will likely (or have already started to) provide liquidity to the investment grade capital markets and the commercial paper market. The high-yield bond market, on the other hand, has been and remains completely closed.

- **Government Programs Available…for Some:** The Federal Reserve this week announced the creation of the Primary Market Corporate Credit Facility (PMCCF). Under this program, a special purpose vehicle funded by the Treasury will make loans directly to, and buy bonds directly from, investment grade-rated companies headquartered in the United States with material U.S. operations. The debt will be issued at rates "informed by market conditions," with a limited option for borrowers to pay interest in kind, a commitment fee of 100 basis points, and maturities up to four years. Further details on terms and implementation mechanics are to come. And the Coronavirus Aid, Relief, and Economic Security Act passed by Congress last week (the "CARES Act") created a range of additional programs that will provide liquidity directly to certain types of businesses across the credit spectrum (subject to important qualifications and conditions, including that such businesses agree to certain limitations on payment of dividends, repurchase of exchange-listed securities, executive compensation and, in some circumstances, reductions in workforce).

- **And for Others…Untapped Collateral:** Borrowers in the high-yield space, who have been frozen out of the regular-way markets, may need to consider more creative financing solutions. First among these considerations should be how and whether to leverage unencumbered assets in exchange for new debt financing. Non-U.S. assets, which are usually not pledged in U.S.-law high-yield financings and represent a potentially valuable pool of collateral to secure new lenders, may be a fruitful source of support for the incurrence of new U.S. debt. (This arises from recent changes to U.S. tax laws that eliminated (in many circumstances) the potentially draconian tax penalties for pledging such assets in this way.) Obtaining local lines of credit in non-U.S. jurisdictions secured by these assets can be an additional or alternative source of cash. In addition, certain types of assets (such as real estate and vehicles) are often carved out of the collateral package securing high-yield loans because they were deemed too cumbersome to pledge in a cost-effective manner. Borrowers should analyze their existing collateral packages carefully to identify such untapped sources of collateral for new financing. Finally, depending on the terms of the covenants governing the borrower's existing debt arrangements, unrestricted subsidiary borrowings backed by assets transferred from the corporate parent or its other subsidiaries may be possible. Each of these transactions can raise complicated issues, however, and their feasibility must be assessed with a critical eye to avoid inadvertently triggering a default in existing debt or unexpected tax costs.

- **Asset Sales:** Sales of non-core assets may also be considered if they can be consummated without disrupting normal business operations and if the borrower's existing debt permits the sale proceeds to be used to reinvest in the business rather than requiring that such proceeds be used to delever. Consider creative structuring using non-cash consideration if a debt repayment would otherwise be required with asset sale proceeds.

- **Get Creative with Receivables:** Consider discounting receivables and other payments due under contracts or otherwise incentivizing parties with obligations to the company to pay early.

Preserving Cash

- **Tax Relief Opportunities:** The CARES Act will create significant opportunities for companies to enhance near-term liquidity by claiming refunds or reducing upcoming tax payments. Taxpayers, especially those with losses, interest expense or alternative minimum tax credits, should evaluate this act closely and consult with legal and tax advisors about the options they may have.

- **Interest Expense Management:** Some lenders may be willing to defer cash interest payments, and lenders may also be willing to accrue payment-in-kind (or PIK) interest for some period of time in lieu of requiring cash payments. Many credit agreements only require the consent of a majority of lenders to forbear from exercising remedies. Depending on the situation, it may be possible to use the "remedies" provisions in a credit agreement to override, at least temporarily, the condition that all lenders must agree to a change in contractually mandated interest payments. However, the more extensive the change, the more likely it is to lead to objections from other lenders. Additionally, care must be taken not to trigger cross defaults in the company's other debt agreements, including public bond indentures.

- **Mind Your Payables:** Borrowers may consider examining their disbursements to identify payment terms that could be extended or modified consensually or, if necessary, non-consensually, without jeopardizing a valuable asset or contract. Grace periods, if any, should be utilized if needed. But companies should be mindful that these actions may have broad ramifications for the financial health of counterparties, key business relationships, and the company's reputation, and should not be taken lightly.

Though cash flows may be difficult to predict and options may seem limited, many companies can, with creativity, thorough analysis and persistence in examining all possible alternatives, obtain additional liquidity even in these turbulent markets.

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