Thinking about liquidity and funding alternatives?

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The coronavirus is having enormous impact on all of us globally. We have been getting a broad array of questions about funding options and liquidity risk management, including:

Drawing on a revolver

- Companies that want to draw their revolver need to satisfy borrowing conditions, which often include a representation as to absence of a material adverse event and sometimes include a representation that the borrower is solvent. Case law has to date held that disruptions must be highly material and sustained for an MAE to occur, but every analysis will be fact sensitive and may take into account these unusual world events including an analysis of the MAE language in question and the impact on that company.
- Companies will also need disclosure of the borrowing if the amount drawn is material (including a potential need to file a Form 8-K).
- Any borrowing will impact financial covenants, and companies should ensure that their borrowings will not lead to a potential covenant default.

Accessing the capital markets

- The most common options companies are considering include straight debt and convertible debt offerings. Straight debt offerings can take advantage of lower interest rates but need some market stability. Convertible debt tends to be more attractive in times of increased volatility and lower interest rates, and allows issuers to benefit from lower coupons and the absence of covenants. Investors like the embedded option, but such instruments can be dilutive as they involve issuing an equity-linked instrument at a time of depressed stock prices. Call spreads or capped call instruments can effectively increase the conversion price to lessen dilution.
- Companies that want to access the capital markets must be comfortable that their disclosure is accurate in light of the coronavirus. Does guidance need to be revised? If the company has not provided guidance, does it expect to miss analyst consensus for the quarter and should it inform the market? We note that given the extreme market conditions and unpredictability, some companies are suspending giving guidance.
- Given the highly volatile markets, companies should be prepared to have their offering ready to launch on a daily basis and wait for an appropriate window.

Tapping private funding sources

- Given experience in the 2008-9 financial crisis and the material increase in pools of private capital, some companies with a need to move quickly may consider bespoke alternatives such as convertible preferred instruments. These alternatives will be within the business judgment of the Board, and will involve negotiation of various key terms including coupon, conversion price, maturity, and redemption terms of the convertible equity security. In addition, companies will need to consider governance, standstill and liquidity terms, and whether shareholder approval may be needed (depending on the size of the investment).

Companies will need to assess the pros and cons of each of these options and make a business judgment as to whether adding to their cash reserves is sensible and outweighs the potential cost.

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