

## Excursion: When Black Swans Arrive

**The covid-19 pandemic-related crisis is expected to result in a swift adaption of new technologies (e-commerce, remote working) as well as in a re-thinking of supply and distribution chains (higher inventories, critical production close to home), next to new health and safety regimes. Foremost, though, it's a crash course in corporate survival.**

Earlier 2020, the world's largest asset manager pronounced that as of now its investees would be judged along five measures: "Board quality, environmental risks and opportunities, corporate strategy and capital allocation, compensation to promote long-termism and human capital management". - No, they won't: They will be judged on whether they can survive.

That the core element for a corporate's longevity through history has been its culture and not a product, a market or a technology is meanwhile well-proven. Having said this, finance as a means to support a corporate's strategy is by times critically relevant.

In pilot training, instructors drill students that in case of an engine's failure the very first task is stabilizing the plane and establish best glide (alas: minimizing rate of descent). - In a lockdown, measures available to companies comprise a wide spectrum of alternatives, such as a straightforward deferral of interest payments, the extension of debt maturities, creative financings or bond exchanges. Needless to say, each of these strategies has profound implications for shareholders, creditors as well as employees.

With a severe macro-related and / or global crisis kicking in, stock and bond markets are expected to be far below their highs, whilst corporates race to shore up their finances: If credit lines are avail, one may draw them down. Whilst latter can probably be speedily achieved, raising new debt (realistically from current investors only) will first require a thorough screening of agreements with all creditors and bondholders (e.g. covenants, rankings). - Accessing government-backed stimulus packages in multiple formats may provide some relief.

In regards to working capital-related measures, the obvious tool is stretching out payables to vendors. The textbook tools of collecting receivables more aggressively and pursuing quick asset sales are, both, probably less realistic in midst of a domino effect accompanied by depressed valuations.

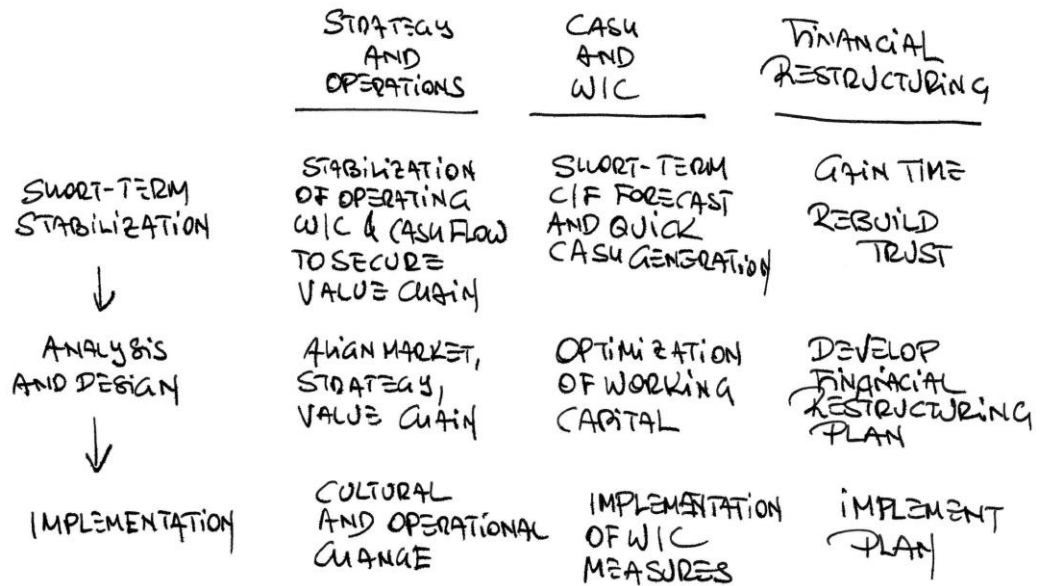
In summary: Companies are being forced to re-order priorities as swift action is required. Whereby the overriding aim is simply: Buying time. - Therefore, having a profound understanding of a firm's liquidity provides a good, first indication of how much time is available.

Companies which will eventually be permanently shrunk by the crisis or cannot easily access new funds may consider a repurchasing program of their own debt, thereby locking in the benefit of a fall in price. Also, indebted companies may consider exchange offers whereby investors swap their existing debt for new bonds with longer maturities. In that case, companies secure more time whilst bondholders usually benefit from higher coupons, possibly some fee income and a higher priority in the capital structure.

Firms which are technically in default by now – not least due to a pre-crisis non-investment grade credit rating – may consider a distressed exchange, whereby companies forestall bankruptcy by giving investors a steep discount on the value of their bonds in the form of new debt, stock or cash. Such types of transactions typically occur at private equity-backed companies saddled with debt, as they allow the buyout firms to stay in control.

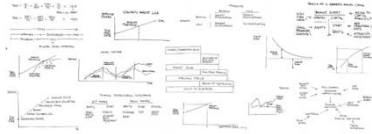
If all fails, then bankruptcy may be the only option for the weakest firms around: In that case, shareholders will be wiped out and control goes over to creditors. Having said this, such procedures may provide firms a reprieve from their obligations, space to develop a plan for survival with a judge supervising the process. Whilst such a procedure can stop lawsuits, facilitate access to cash, allow companies to terminate unprofitable leases and contracts, allow a company to de-lever or even sell itself, the downside is: This process can be expensive and time consuming.

Sometimes, though, the best alternative is really just the least worst ...



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