

Excursion: When Black Swans Arrive

The crisis related with the covid-19 pandemic has resulted 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.

In earlier 2020 a leading asset manager pronounced that as of now its investees would be judged along: board quality, environmental risks and opportunities, corporate strategy and capital allocation, compensation to promote long-termism and human capital management. – Only several month later it was clear that they would rather be judged on whether they can survive.

That the core element for a corporate's longevity is its culture and not a product, a market or a technology is meanwhile well-proven. - Finance as a tool to support a corporate's strategy is critical, though.

In flight training, instructors drill pilots that in case of an engine failure the very first task is to stabilize the plane and establish best glide (alas: minimizing rate of descent). – In a lockdown, funding-related measures available to companies comprise a (theoretically: wide) spectrum of alternatives, such as a straightforward deferral of interest payments, the extension of debt maturities, all sorts of creative financings, also bond exchanges. With each of these strategies having profound implications for shareholders, creditors as well as employees.

In the course of a severe global crisis and respective macro-related effects kicking in, stock and bond markets are expected to trade far below their highs, whilst corporates race to shore up their finances: If credit lines are avail, one may draw them down which can probably be swiftly achieved. Raising new debt however, will probably only be possible from current investors (and not new ones). And, crucially, such exercise will require a thorough screening of all standing agreements with creditors and bondholders, with a special focus on covenants and rankings. - Accessing government-backed stimulus packages in multiple formats may provide some relief.

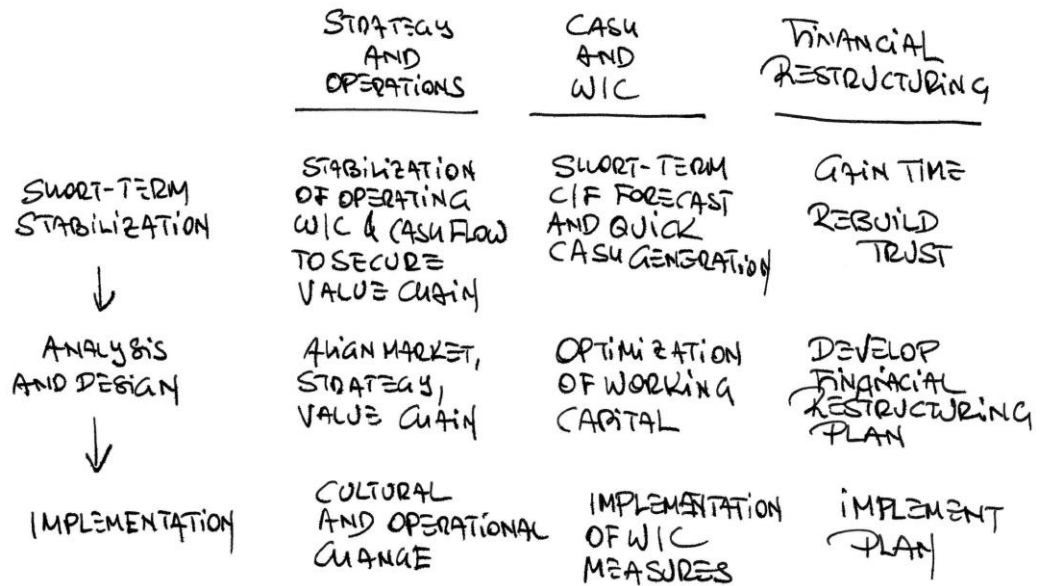
In regards to working capital-related measures, the obvious tool is stretching out payables to vendors. The textbook solution of collecting receivables more aggressively and pursuing rapid asset sales are probably less realistic in midst of a domino effect accompanied by depressed valuations.

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

Companies which will eventually be permanently shrunk by the crisis and have excess cash avail may consider a repurchasing program of their own debt, thereby locking in the benefit of depressed bond prices. 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 debtor's 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 is passed over to creditors. Having said this, such procedures may provide firms a reprieve from their obligations, space to develop a plan for survival, a process supervised by a judge. Whilst such a procedure can stop lawsuits, facilitate access to cash, allow companies to terminate unprofitable leases and contracts, as well as to de-lever or even sell itself, the downside is: This process can be hugely expensive and time consuming. - Sometimes, though, the best alternative is really just the least worst ...



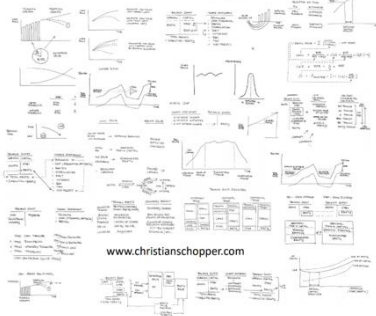
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