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DEBT FINANCE POST-LOCKDOWN

PREPARE FOR THE WORST, HOPE FOR THE BEST

The debt markets were dominated by amendments and waivers, extension requests and short-term loan facilities earlier this year. We helped clients across the credit spectrum amend and restructure their debt capacity, in the form of loans, private placements and capital markets issuances. Many of our clients also accessed the UK Government's support initiatives, including the CCFF and the CLBILS. Our takeaways from the COVID-period financings are summarised in our June Briefing, Lessons from Lockdown.

Refinancing requirements are anticipated to peak in 2022/23. There also remains the possibility of many companies requiring a second round of COVID-financing. There is the potential for debt markets to become quite crowded again in the relatively near future. A number of our clients are already starting to re-evaluate financing arrangements put in place in the initial stages of the lockdown period, from both public and private sources.

This publication outlines some of the key issues for treasurers contemplating debt financings, refinancings or restructurings in the coming months and some of the themes that are starting to emerge.

What's happening in the loan market?

Tightening terms

It is scarcely necessary to observe that the uncertainty surrounding the pandemic and its ongoing effects will continue for some time. Echoing the patterns of previous crises, it is reasonable to expect that lending criteria will tighten and banks scanning an unpredictable horizon (especially those harder hit by the economic effects of the pandemic) may re-focus on domestic markets and/or more stable sectors. We have seen some signs of this already, as well as a tendency towards increased pricing and tighter terms where finance is made available. This environment requires a compelling proposition for new transactions and brings lending relationships more sharply into focus.

A&E vs full refinancing

The loss or indifference of one or two banks on a refinancing may not be a material concern for companies with larger syndicates. For others, the need to keep the group together may mean that full refinancings - or loan financings - are not their first choice of transaction. Those with syndicated facilities, may consider structures which are not reliant on buy-in from the full lender group to push out maturities (for a fee), until the outlook becomes more stable. Alternatively, they may look to other debt products.

Some companies are starting to initiate post-lockdown amend and extend transactions. These might involve the exercise of extension rights, accordion facilities or techniques such the creation within existing facilities of new or “hollow” tranches (a new tranche of debt within a facility into which lenders' commitments are “rolled”). More recently, we have also seen the revival of 2008/9-era forward start loans – parallel loan facilities, which become available for drawdown on the maturity of the existing facility, in which existing lenders are invited to participate.

Transactions along these lines aim to lock in the support of key banks. A downside to these types of structure is facility shrinkage if the required level of lenders do not sign up. However, there are ways to mitigate the risk of shrinkage. During the last down cycle, for example, we saw some forward starts with “accordion” features, which enabled borrowers to ask lenders to increase their commitments (up to a cap) or bring new lenders into the forward start before the beginning of the availability period.

As amendment transactions build on existing terms rather than re-opening them completely, negotiations can be less complex and time-consuming than a full refinancing. Whether they are the right option for a particular borrower, however, tends to depend on a variety of factors; what amendments are permissible within the terms of existing financing arrangements, moods within the bank group and the financial position and prospects

of the business. For example, a full refinancing may offer more attractive terms to a business that has accepted more onerous lending terms to shore up the balance sheet during the early COVID period, but is emerging in better health than expected.

Syndicated vs bilateral

A further structural option for loan financing requirements that some corporates might consider is reverting to bilateral loans in preference to syndicated loan arrangements. Bilaterals are perceived by some as a means of putting pressure on lenders to improve terms. This approach can be successful for stronger credits, although in some cases, in particular where syndicated loan arrangements are collapsed into bilaterals, lenders often look for "most favoured nation" protection to ensure that they continue to enjoy the same rights as other creditors.

LIBOR vs alternative rates

A specific factor for corporates to take into account currently in the context of both refinancings and amendments, is that any loans which reference LIBOR and extend beyond 2021 will need to be updated to accommodate alternative rates. During the transitional period from now to the end of Q1 2021, the UK Working Group has recommended that all new or refinanced sterling loans must include "clear contractual arrangements" to facilitate conversion to SONIA or other alternatives ahead of end-2021, through "pre-agreed conversion terms or an agreed process for renegotiation". Borrowers should anticipate the need to address this issue in any amendment or refinancing transactions, as well as in the context of new loans (or indeed any other LIBOR-referencing products)[1].

What are the alternatives to loans?

Bonds

The debt capital markets were all but closed in the early weeks of lockdown, but fuelled by the support of central banks, they have since shown great resilience, from high grade through to high yield. Spreads widened during the early weeks of the COVID period, but subsequently reduced, in particular in the high yield market, which returned reasonably swiftly to pre-pandemic issuance volumes[2]. The covenant-free structure of investment grade bonds is very attractive for companies in that bracket. Issuer-specific COVID-19 related disclosures continue to be required, but the market has become more settled in its approach to these issues.

ESG

We have seen continuing interest in ESG issuance in a number of different sectors. There are some indications that ESG can be priced more advantageously and prompt pricing tension as a result of the introduction of a different class of investors. ESG requirements however, need to be factored into timetables, which can be slightly longer[3].

Convertibles

Convertible bond issuance tends to increase during periods of dislocation or disruption in the debt markets. After a relatively fallow period, there are signs that issuers and investors are looking to these again, as part of the "crisis toolkit", including ESG-linked convertibles. Recent practice for investment grade issuers with listed equity has been to list after issuance thereby considerably reducing execution times (as a result of there being no requirement to prepare a prospectus).

Private placements

The private placement markets have remained active during the pandemic. US private placements in particular are widely used by non-US companies, providing access to new investors without a formal credit rating or public reporting requirements. Private placements offer significant flexibility in terms of both issue size and the currencies and maturities on offer.

Over the last decade or so we have helped a diverse range of clients issue USPP governed by English and New York law. While documentation is based on templates developed in the US specifically for this product, in our experience, for UK and European issuers the terms are typically and easily adapted to English law and to dovetail with the issuer's existing lending terms and can be relatively quick to negotiate. The downside tends to be that noteholders are less flexible than banks, although certain transactions completed during the COVID period illustrate that it is possible to amend and issue PP notes in relatively short order.

Direct lending

Direct lending products may also come further to the fore in the coming months, especially for companies in the cross-over/leveraged bracket. Many credit funds have significant amounts of capital to deploy and as pricing widens in the leveraged debt markets, there is more scope for these funds to compete directly with the banks.

Unitranche facilities are increasingly being used outside the sponsor-led market. Unitranche facilities (term loans

[1] See further our briefing Transition from LIBOR continues.

[2] AFME high yield and leveraged loan report Q2/20

[3] Our briefing Treasury and ESG Strategy considers how treasurers can support their company's sustainability strategy.

that are split "behind the scenes" between senior and junior lenders, avoiding the need for senior and junior debt instruments and intercreditor arrangements) may carry the additional advantage of "covenant-lite" terms similar to the institutional "TLB" market.

COVID-period innovations

The prospect of bank retrenchment and/or less favourable loan terms tends to prompt focus on alternative sources of debt finance. The ups and downs of the last fifteen years mean that most of the products mentioned above will be relatively familiar to corporate treasurers. Will additional structures and products emerge? In addition to the array of alternative products mentioned above, we have seen some inventive structures being discussed more recently, including for example, loans with pricing linked to the borrower's CDS (as opposed to those of the bank, as we saw in the 2009/10 period). More innovative structures are generally aimed at liability management, which we would anticipate will also be a feature of this next cycle.

What if the path to recovery is longer?

A second wave of covenant flex

Many COVID-period covenant relaxations were offered for a reasonably short period - expiring in the first or second quarter of next year. Relaxations were typically offered in exchange for tighter reporting obligations, suggesting that lenders are likely to be on notice in many cases if it looks as if concessions need to be extended further. Some businesses may find that covenants originally set against one economic backdrop require more permanent adjustment to accommodate reduced profitability even as the crisis recedes. Needless to say, early dialogue with lenders will be important as these amendment periods expire and as the path forward becomes clearer.

UK insolvency reforms - COVID-period concessions

COVID-19 has had an adverse impact on many industries, with certain sectors such retail, travel and hospitality, particularly badly hit. Longer term uncertainty as to how these sectors will recover, coupled with other factors such as the lingering potential for a no-deal Brexit and the upcoming US elections may affect the availability of debt finance and prompt further amendments, waivers and inevitably, full-blown restructurings.

In the UK, the Government introduced temporary measures such as restrictions on creditors' winding-up petitions and a suspension of wrongful trading provisions to avoid knee-jerk insolvency filings. The temporary measures relating to winding-up petitions and wrongful trading are due to cease on 30 September 2020, unless the Government chooses to extend them and we understand this is being actively considered. While these measures have been helpful for companies facing challenges, liabilities have tended to increase for a number of businesses during the COVID period and the measures have not provided permanent fixes for companies' balance sheets.

UK insolvency reforms - permanent measures

In June, the UK Corporate Insolvency and Governance Act 2020 introduced several permanent changes designed to aid company rescue. These include the introduction of the restructuring plan procedure (closely based on the scheme of arrangement but with the inclusion of a cross-class cram-down mechanism), the moratorium procedure (designed to allow distressed companies a breathing space while they explore restructuring options) and measures to provide that termination clauses in supply contracts triggered by the insolvency of a counterparty will cease to have effect. While it is still early days for these new tools, we have already seen some of them being used in practice. For example, Virgin Atlantic has launched a restructuring plan and we are aware of several others in the pipeline.

It is hoped that these additions to the restructuring toolkit will help to provide flexibility for some companies to restructure in what is likely to remain a challenging period for certain businesses as Government support begins to tail off.

What about excess cash?

Repayment and pre-payment

Some businesses will come out of lockdown with a significant amount of excess liquidity, potentially the result of drawing standby facilities and/or raising new committed facility or government debt which turned out not to be immediately required. The simple answer may be that the relevant facilities are repaid or prepaid, according to their terms. Companies that no longer require government backed funding may wish to exit to free themselves (in some cases) from the restrictions attached to that money in terms of dividends and executive pay. Government funding is likely to be straightforward to exit; CCFF issuance, for example, can be prepaid (subject to a fee) and participation in the scheme, terminated by notice to the Bank of England. CLBILS loans typically include flexible voluntary prepayment rights on LMA-style terms.

What about M&A?

Another other option, of course, is to spend. M&A deals stalled as the pandemic took hold and event driven financing volumes declined significantly. In June 2020, in Western Europe M&A loan issuance was down 88% from the same time last year and LBO issuance was down 63%. In previous periods of post-crisis caution, the dearth of demand for M&A finance has tended to have a favourable

effect on the terms available to those who are in the market. The economic slump coupled with ultra-low interest rates, will no doubt create incentives for those that have the means to execute M&A, whether in the form of consolidations to save costs or opportunistic acquisitions of struggling companies.

Further information

Our multi-specialist financing and restructuring lawyers advise on the full range of debt products. We have extensive experience across the loan and debt capital markets including US private placements and other alternative debt products. For further information on any of the matters discussed in this briefing, please contact one of the lawyers below or your usual contact at Slaughter and May.

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