

Coronavirus: the impact on financing transactions

The global implications of coronavirus have been unprecedented in many ways. The global pandemic has caused health and economic disruption. In the background, governments have taken measures to support the economy, but the uncertainty remains. Borrowers usually have to represent that no default or event of default has occurred and is continuing at the time of borrowing. Some of the trigger events such as non-payment, breach of financial covenants or insolvency may not yet have occurred so the principal event of default that might be relied upon is the MAC event of default which is triggered if any event of default occurs.

legislation has already been implemented to provide relief under certain circumstances.

As the effects of coronavirus on the primary and secondary debt markets continue, there will be ongoing implications for finance transactions. A "bridge" bond may be difficult to market (or simply impractical as investor meetings are postponed or cancelled), and so the take-out transaction will be delayed. This will affect the buyer, as the bridge pricing is likely to step up every three months in the first year of the bridge period.

M&A TRANSACTIONS AND COMMITTED FUNDING

Many leveraged finance deals are undertaken to fund the purchase price of M&A transactions. From a committed funding perspective, M&A transactions can effectively be split into two types of transactions: (i) certain funds; or (ii) non-certain funds. The impact of delaying M&A due to either banks' concerns over their ability to syndicate while the coronavirus situation develops, and thus reluctance to commit financing, and/or buyers' unwillingness to risk being caught in hung bridge debt.

A certain funds transaction is either required by regulatory reasons (usually due to mandatory takeover laws) or because the selling party wants increased certainty on the buyer's ability to close the transaction, and thus will not allow a financing condition in its sale and purchase agreement.

In a certain funds transaction, only extremely limited conditions or factors would allow financing parties to withdraw their committed funding from the deal. Thus, coronavirus should not have an impact on funding committed prior to the declaration of a pandemic and the buyer's ability to draw down should not be impacted. While this is likely that they will look to drawdown before positive for completion of the M&A, where the situation worsens to ensure they can acquire financing is on a bridge-to-bond basis, under the cloud of coronavirus, the

Other committed funding that borrowers will be keen to drawn upon at this difficult time will be available working liquidity facilities such as revolving credit facilities. Even for those borrowers that do not need the funds immediately, it is likely that they will look to drawdown before the situation worsens to ensure they can maintain liquidity. This raises the question of whether the pandemic would affect lenders

(Comm) provides some helpful guidance. In that case, it was held that a MAC had not occurred but the court set out the following points of consideration: (i) lenders should always review the financial information available to it regarding the borrower before relying on such a clause; (ii) the material change must substantially affect the borrower's ability to repay the loan; (iii) it must

<</L(en-GB)/MCID 611 >>BDC BT-21.3 (1o)-2.5I stahy t3(r)-1.9 l440.5 ()w (e)-20.4.5 (t)(i)-16.7 (a)8(r)1.4 ((a)-12.3 (b)-2.) <<80 rg /GS0 g(

permitted that may impact the calculation. There may be an add-back for non-recurring (or extraordinary or unusual) losses, charges or expenses. While the exact terminology will differ, it may be arguable (on a case-by-case basis) that costs related to coronavirus which are extraordinary in nature can be added back to adjust EBITDA. However, these all relate to amounts spent rather than lost revenues. In fewer deals, there is also an add-back for reductions that are covered by insurance and are actually reimbursed or that are likely to be reimbursed. This will require both a careful analysis of the exact add-back permitted, but also of any applicable insurance policy to ensure a good grounding for the determination that the applicable add-back conditions have been met.

- if the maintenance covenant is a “springing covenant”, then it may only be tested when an applicable drawing threshold is met. This means that if the company can manage its cash flows, it may be able to manage the testing of the covenant.
- in relation to equity cures (a sponsor’s ability to inject equity into a group to avoid/cure a breach of maintenance covenant), the ability to overcure will also be closely examined given the ongoing uncertainty of the impact of coronavirus, with sponsors’ potentially wanting to provide a cushion for the upcoming year rather than having to repeatedly provide emergency funding. Whether that is permissible will vary on a case-by-case basis.

ratios, there may be incurrence-based ratios, such as a net leverage or fixed charge coverage ratio debt incurrence covenant, and the ability to use each of these may be impacted as with a maintenance covenant. While the result is less severe than a default, the inability to use such ratios may impact the business (preventing, for example, the incurrence of additional debt or the payment of dividends or cash distributions to shareholders). These ratios, as well as certain additional tests such as “grower” baskets for various covenant restrictions, may be based on EBITDA. Thus, the discussion above related to EBITDA may be important.

- the rolling 12-month basis of EBITDA means that notwithstanding a near term coronavirus resolution, the virus’s effects will be felt for the 12-month period under EBITDA. This may particularly affect any seasonal businesses that rely on a busy first quarter (due for instance to seasonality), as they may have lost out on a boost they typically get from that quarter in their LTM (Last Twelve Months) test, which will impact them for the next year.

REPORTS, AUDITS AND INFORMATION

Frequent reporting is an important investor information right under finance documentation. This typically requires audited annual and unaudited quarterly information to be delivered under a high yield bond, as well as monthly information under certain loan agreements, in each case, within a certain specified time period.

TAKING ACTION: ISSUES WITH INCURRENCE COVENANTS

Many leveraged loan deals in the market are in fact now “incurrence” covenant based, which is the high yield bond covenant position, tested only when certain fundamental corporate actions are

financing (for which the borrower is typically a thinly capitalised special purpose vehicle with very little in the way of tangible assets) means that lenders are even more acutely focused on the successful delivery and performance of the underlying asset(s) to which the financing relates. Accordingly, there are two overarching features that require closer attention:

Financial covenants

- Financial covenants on project financings tend to be tighter due to the higher leverage in these transactions. Combined with the additional project related burdens (detailed further below) and the greater sensitivity to project implementation (given the borrower has no balance sheet to fall back on) there is a greater likelihood of financial covenants being triggered in the short term.
- Default ratios are typically only measured on a backward-looking basis which means that a financial covenant default itself is

pr-14.8 (h7 (n a b)-5.9)-35.4 Lang (2 (l)2.1 (y o)u21.5 1n)-24.9 (l)2.5.4 (i)-26.9 (k)-6.8 (e)-13.6 (l)-21 (y o)u21.5 1n if13.6 (l) rg .1 EM(nt)