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Professional Perspective

Seeking Lender Relief During Uncertainty and Distress

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Periods of uncertainty and distress create many questions that businesses must answer. Will they have the human resources and materials with which to produce goods and perform services for your customers? Will their customers pay their bills? What will their cash flow look like? Can they retain all or most of your employees until things improve? How much can they cut expenses and delay payables so that liquidity does not run out? How much (if any) availability do they have on open credit lines?

For many businesses, lender relief is the first and most critical step to bring immediate financial relief. For other companies, maintaining current lending arrangements and avoiding cancellation of credit facilities due to a default are critical to survival. Either way, communicating early, openly, and honestly with your lender is critical to survival during periods of uncertainty and distress. Below is a suggested approach to addressing your lender, but note that there is no "one size fits all" answer. The unique aspects of every business situation, when taken together with the more global issues, should be taken into account.

Initial Lender Communication Action Plan

- Reach out now to your lender. Do not wait–even if just to tell your lender the obvious. Your intent is not to cause panic, but rather to gently provide notice that a further discussion of your company's situation may be coming: "We are not seeking relief from the lender at this time. We're closely monitoring the situation. We have implemented an action plan. Stay tuned. We will keep you informed."
- Give the lender a detailed list of the things that you have done to preserve cash and to stabilize the business during this period of disruption. Explain that it is an ongoing process to identify further reductions/cost savings. All lenders want to know that you have done everything to help yourself before seeking relief from them (assuming that you plan to seek lender relief at a later date).
- Lenders do not like surprises. And they especially dislike borrowers who are dishonest, unrealistic, or do not give sufficient notice of a brewing problem. Accordingly, convey one of the following:
    - There is no "crisis" at this time; you have enough liquidity for the time being, but an extended period of little, greatly reduced, or no revenue may cause you to take action to preserve the business, and you are just calling so the lender knows that you are on top of the situation.
    - You already are experiencing a cash flow crisis due to revenue being reduced or shut off, you have developed an action plan to conserve cash, and you would like to walk the lender through that plan.
- You welcome the lender's advice on how to address your situation and any requests for financial information. You have nothing to hide. Your message is: "We need to work together."
- You do not know what your future cash flow will look like, and you are revising your cash flow projections continuously.
- Given the uncertainties, projected revenue and income in the short term are questions that cannot be answered yet.
- Prior financial projections should not be relied upon.
- You are staying close to your customers so as to know what their purchasing needs and plans are. (Lenders expect prudent borrowers to conserve cash until they have a better idea of how the borrower's customers will react.)
- You are in constant contact with your vendors. (The lender is likely to ask you to stretch out payments to vendors before considering any relief from the lender.)

- Your business is fundamentally strong. Upon a return to normal business conditions, everything will be fine.
- If no immediate relief from the lender is needed at this time, note to your lender that it is possible that relief may be required at a later date depending on how economic and business conditions unfold.
- Keep in mind that the Federal Deposit Insurance Corporation (FDIC) is recommending that financial institutions work with borrowers affected by the Covid-19 pandemic. Lenders should be more willing to work with borrowers that show that their issues are pandemic related and can be resolved with short-term solutions designed to get the borrower through the issues created by the pandemic.
- Consider taking a draw down on your existing credit line to cover your expenses over the near term before your lender(s) takes steps to restrict availability.

Include Senior Management

The lender will observe which members of the borrower's management team attend any initial meeting(s) with the lender (whether by conference call, videoconference or otherwise). The most senior management of your company (and equity stakeholders, if privately owned) should participate. That demonstrates respect for the lender. The lender takes the matter seriously, and so should you. A seasoned middle-market lender once said that they observe whether the borrower's management is appropriately dressed and whether the guarantor has brought appropriate parties to the bank meeting.

The Role of Borrower's Professionals

- One of the first things that your lender will observe is who the borrower's legal professionals are and whether the professional has the requisite expertise in restructurings, workouts, and bankruptcy/distressed situations.
- The lender will also take notice of who is providing financial advice to the borrower and the level of the adviser's experience with distressed situations, especially in the borrower's industry. Lenders prefer dealing with professionals with experience in advising their clients regarding making hard decisions about reducing expenses.
- The lender will also want to see that management's business practices and assumptions are appropriately challenged.
- The role of the borrower's professionals is to anticipate every question that may be asked of the borrower and to demonstrate to the lender that the borrower is in control of the situation, including reducing expenses (as may be necessary) and preserving liquidity. The lender also wants comfort that all steps are being taken to preserve its collateral value.
- Your initial presentation to the lender must anticipate the questions that will be asked. And, the answers must be thorough, with well-based assumptions. Alternatively, clearly state the variables that are unknown or uncertain.
- A turnaround consultant and/or chief restructuring officer (CRO) works in tandem with management, but reports to the board of directors. A board should take comfort in knowing that a CRO and/or other turnaround consultant is on-site advising and challenging management as appropriate, and that such a professional is not jaded by any specific history and is able to see the forest from the trees.
- The lender may require that the borrower hire a financial adviser that the lender has worked with in the past and has confidence in.

The Presentation Supporting the 'Ask'

- Prepare projections of income and cash flow. These projections may be prepared with a range of conservative, likely, and optimistic scenarios. It is better to hit the low numbers than to miss a single set of presented numbers.

- For key metrics such as sales, receivable collections, vendor credit terms, and SGA/human resource costs, detailed sub-schedules are appropriate. These sub-schedules should reflect the drivers that could cause the financial projections to be met or missed. They also should reflect that management and its professional advisers have fully considered the projections presented and the need for relief from the lender.

- With ABL financing, what will the projected indebtedness due to the bank be under each of the conservative, likely, and optimistic projection scenarios, assuming that loan relief is provided and assuming that no loan agreement relief is provided?

- If you are seeking relief from the lender, including but not limited to increased advance rates, reduced reserves, reduced block, or a payment deferral, project outstanding lender indebtedness under each scenario and if/when you might expect to be able to return to the contractual terms of the current loan agreement.

- For internal purposes initially, including your overall lender negotiation strategy, prepare a liquidation analysis. What is the lender's collateral worth (net of liquidation/administrative costs and any senior secured indebtedness) if the lender refuses to cooperate? Does the lender really want to accept the responsibility or liability of conducting the liquidation? How would the assets need to be liquidated? How long would it take? What are the likely liquidation sale values? What would be the costs?

Sequential Negotiations

A lender negotiation is not a single-session negotiation. A prudent borrower should not seek to achieve too much too fast. That does not mean, though, that negotiation sessions should be spread out over an unreasonable period of time while the borrower implodes. The sequential negotiations may be expedited. The steps for negotiation should be:

First Contact: **Advise the Lender That:**

- A problem has arisen (or that the borrower sees a problem arising in the near future).
- The borrower is developing an action plan to address the problem.
- Seeking relief from the lender may be necessary.
- The borrower will be keeping the lender well-informed.
- Any information sought by the lender will be provided.
- The borrower's representatives can and will be introduced.

Second Contact: **Demonstrate to the Lender That:**

- Presented financial projections of income, cash flow, etc. have been well-thought out and have sound bases.
- The borrower understands the lender's concerns and how the lender prefers to address the borrower's problem–to the extent feasible.
- The borrower is taking appropriate action to solve its problems, such as cost cutting.
- Other constituents, such as vendors and labor, also are being asked to make concessions.
- Lender relief is critical; there are no alternatives.
- The borrower can and will return to a satisfactory repayment plan after a period of relief.
- The proposed relief sought from the lender is in the best interests of the lender, given the alternatives.

Third (and Further) Contacts:

- Create a list of bullet points to discuss.
  - Which requests are absolutely essential?
  - Which ones can be compromised?
  - Which requests are throwaways?
- Develop a strategy for further potential relief at a later date without the need for further expensive and time-consuming additional negotiations; i.e., the agreed-upon concessions or "price" to be paid to the lender should include optionality.
- Do not get "ratcheted." You will have to pay or make a concession every time you seek further relief. Get relief for as long a period of time as is possible.
- Offer the lender something (such as a portion of sale proceeds from assets to be sold, excess cash flow payments if and to the extent projections are exceeded, etc.) in exchange for a longer relief period.

The Threat of Bankruptcy

For uncooperative creditors (whether secured or unsecured), there is always the alternative of the threat of a Chapter 11 bankruptcy filing. Borrowers and creditors should understand how bankruptcy may play out in order to see why a consensual out-of-court workout is a superior option.

- Bankruptcy judges like to preserve jobs and maximize value/recoveries for all creditors, including unsecured creditors. Shutting down a debtor, particularly at the outset of a Chapter 11 bankruptcy case, is not consistent with that desire.
- Bankruptcy courts may not be a friendly place for an uncooperative lender that forces a borrower derailed by distress into an avoidable or free-fall bankruptcy.
- A bankruptcy judge may ask a lender seeking foreclosure or to shut the debtor down how it would do anything different than what the debtor is doing in Chapter 11, or why the debtor should not be given the chance to turn things around using the toolkit available to companies in Chapter 11.
- Chapter 11 is expensive. Ultimately, the costs of Chapter 11 may largely come out of the pocket of the lender.
- With relatively few exceptions, the total enterprise value of a debtor's business will dramatically decline in Chapter 11. Large customers may be reluctant to place orders. Customers may be concerned about future deliveries. Vendors may immediately go onto COD terms. This will further exacerbate cash flow problems.
- If the lender seeks to cause the debtor to sell its assets (through a quick "363" bankruptcy sale), until the uncertainty in the economy has settled, there may be no buyers other than vulture purchasers.
- Obtaining expedited "first day" bankruptcy relief from the bankruptcy court typically needed to provide a company/debtor with a "safe landing" in Chapter 11 may not happen.
- Lenders need to be cooperative with borrowers in order to mutually work to preserve a debtor's going-concern value and in order for vendors to continue supplying the debtor to allow for the debtor to attempt to catch up for prior losses. Obtaining expedited relief from the bankruptcy court may not happen.

