ALANTRA

POSSIBILITY IS IN THE ASCENT

Is this the new normal?

An update on financing through uncharted times

MAY 2020

What is the “new normal”? How the mid-market can survive and thrive

For many weeks now, most of the world has been in lockdown owing to the coronavirus pandemic. While healthcare systems battle to treat patients, business owners are struggling to stay afloat and manage their finances. The impact on humanity, both economic and health-related, is widespread and difficult to fathom.

Since March, governments have announced financial rescue packages for businesses. However, the aid available varies significantly depending on businesses’ size and market, with larger firms on the whole better supported. That means mid-market companies are struggling to survive with cash deposits that typically last weeks and not months or years. A recent article in The Economist found that small and medium-sized businesses (SMEs) have suffered the greatest losses with seven in ten owner-managed firms in the UK losing over half their revenue, and 60% of employees working in smaller firms have lost their jobs in the US.

> **The most viable advice for mid-market firms is to prepare, not only to survive but to adjust business models for the potential new normal**

During lockdown across Europe and the US, businesses have had to adapt to a number of immediate and potential challenges; from addressing urgent funding and operational issues, to pivoting the way they operate and adapting to new models, such as digitization. The question that cuts across industries and markets is: how long will this last and what will be the fallout for businesses when this is over? This can appear to be an impossible question to answer. As Paolo Gentiloni, the EU Commissioner for the Economy said to the Financial Times, “We have no previous analysis of the impact of such a widespread lockdown in major economies.”

The most viable answer to this question for mid-market firms – particularly those in hospitality, tourism, retail and automotive– is to prepare, not only to survive but to also adjust cost-bases and even generate models for the potential new normal. At Alantra, we’ve been working with our mid-market clients across Europe and the US to respond to these challenges. We’ve seen successful outcomes that use alternative debt and refinancing solutions for many mid-sized companies which are acutely affected by this crisis. Successes that those firms couldn’t have achieved through other means alone, such as government funding.

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Government bailout packages are not enough

Governments across Europe and the US have positioned themselves as lenders of last resort. Public support is an interesting option, but for many companies it won’t be enough to preserve long-term business needs.

France

Bruno Le Maire, France’s finance minister, announced a EUR300bn state guaranteed loan program - distributed by commercial banks, supported by BPI France - in addition to other direct measures such as partial activity or deferrals of tax/social payables. Such measures are well-received but they may not be sufficient due to their relatively short-term impact.

Germany

In Germany, the government announced three comprehensive measures in March. However, it is unclear whether mid-market companies will qualify or receive enough liquidity through these schemes:

1. Immediate liquidity through an increased number of KfW loan programmes
2. Flexibility for businesses to benefit more easily from “Kurzarbeit” i.e. loosened reduced hours compensation
3. Rapid deferral of business tax payments enabled by the fi cal authorities equivalent to billions of euros.

Spain

Two €20bn tranches and an expected €24.5bn additional tranche loan and guarantees rescue package – which aimed to support businesses of every size – have been deployed already with the government now pushing for Europe-wide support in the form of corona bonds.

UK

Government-backed loans and guarantees worth GBP330bn and equivalent to 15 per cent of UK GDP, as well as GBP20bn in other direct measures announced in March have been hard to deploy with many small businesses being left behind because processes weren’t in place fast enough and different banks interpreted the measures in different ways. A consistent approach from lenders to private equity-backed structures has still not emerged.

USA

In the U.S.A., the Paycheck Protection Program was created as an incentive for small businesses to keep employees on the payroll through June 30. The US770bn program excluded most private equity-owned businesses and has experienced delays and funding gaps. The funding allows only a small portion of the loan to be used for operating expenses beyond payroll to receive loan forgiveness. In addition, the Federal Reserve announced it is establishing a Main Street Lending Program to support small and medium-sized businesses. The program is not yet operational as the Fed is in the process of creating the infrastructure with partner lenders to sell eligible loans to an SPV established by the Federal Reserve.

Solutions to succeed the “new normal”

There are alternatives and supplementary funding options to government aid and if the immediate need for many companies is to refinance or even restructure current indebtedness, at Alantra we are poised to advise our clients in those negotiations.

There is also an opportunity for companies with strong balance sheets not only to weather this storm but to come out in a better position when the crisis is over and industry consolidation begins. We understand the banking and alternative lending spaces and have strong relationships within both. At Alantra, we have a dedicated team of over 30 bankers who counsel clients to reshape their debt by negotiating new terms or raise new debt and money through alternative sources such as debt funds, direct lenders, insurance companies and bond issuances.

Recover better

In our experience through this crisis, companies and industries across Europe and the US are facing short-term and mid-term challenges and changes, each of which have unique financing solutions. While the needs of individual companies will differ, there are some overarching themes.

Companies should ask the following two questions as they prepare for alternative financing:

Short-term challenges

How will you reshape and diversify the debt to preserve as much liquidity as possible to keep going forward? Options include:

1. Fully drawing RCFs where not already done so
2. Re-purposing other undrawn facilities (e.g. capex lines)
3. Rescheduling amortisation
4. Considering asset-backed options

Mid-term challenges

Can you raise new financing in order to strengthen your current cash position and/or fund?

1. Clients or suppliers which have to be replaced
2. Competitors that have to fold owing to economic disruption – opportunity for growth in market share
3. New business models arising from changing practices
4. Unpredictable rate of market recovery

Flexible alternatives

Companies that are prepared to look at longer-term solutions can not only benefit from traditional funding, but should seek alternative lending solutions with more flexible terms to complement bank loans. They can also ensure a safe cash position to thrive and win in the post COVID-19 world in their sector by being able to invest in new business or by acquiring companies or assets at attractive valuations in the downturn.

Since 2017, private debt funds have raised $388.9bn globally, with dry powder reaching $276.5bn as of the second quarter of 2019, according to PitchBook. Although private debt funds have been looking to support their existing portfolio companies, there is liquidity in the market and we have seen that many private credit firms are looking for deals across Europe. Having interacted with over 250 private debt funds and insurance companies in the last four years and completing over 100 transactions with them, we know what works best and how to structure deals with mid-market businesses and those players.

Alantra Debt Advisory

Alantra has unique experience in all kinds of debt raising situations, including the combination of traditional lending solutions with alternative funding. Today, Alantra has a team of c. 30 professionals in five countries dedicated to debt, refinancing and restructuring transactions.

65+	€1.5Bn+	c. €6Bn
Debt transactions in the last two years	Refinanced in the last two years	New debt raised in the last two years

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Alantra is a global investment banking, credit portfolio advisory and alternative asset management firm focusing on the mid-market with offices across Europe, the US, Latin America and Asia.