Cash flow and COVID-19: how lenders can be proactive in the crisis

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The rapid response to coronavirus is resulting in a precipitous drop in commercial activity for many businesses, including healthcare organizations. While a surge in hospital demand is expected to provide care for the seriously ill, healthcare providers that deliver elective or non-urgent services are seeing patients cancel appointments or are being required to suspend services themselves … and we don't yet know how long it will last.

What steps should I be taking now?

After prioritizing the management of the most immediate clinical and operational issues, **cash flow degradation is likely to materialize in the next 2 to 6 weeks** (as early as April) when any current drop in activity results in reduced cash collections (assuming a 14 to 45 day average collection cycle).

Below, we recommend actions lenders should urge their borrowers to consider taking, as well as actions for lenders to explore in order to proactively manage cash flow issues through this difficult time.

ACTIONS FOR BORROWERS:

Develop a COVID-19 Business Continuity Plan or Business Hibernation Plan

While we hope the COVID-19 issues will be short term, there is no certainty. Tough decisions may need to be made to prioritize the business's short term survival through this difficult period and put a hold on activities that relate to longer term, strategic progress. Alternatively, the business may fare better by "hibernating" during the downturn, and re-emerging when economic conditions return that support the business's feasibility.

After financially evaluating the alternatives, the COVID-19 Business Continuity Plan or Business Hibernation Plan should be a high level outline of approach and actions for addressing cash flow, costs, staffing, capital expenditures, vendors, payers, customers and communications during the period of very low (or non-existent) commercial activity. While external factors cannot be controlled, there are many levers within the control of borrowers that can support their financial wherewithal to sustain through this difficult period and be well positioned to emerge when conditions return to normal (or even prepare for a surge in activity for healthcare treatments which have only been deferred).

An independent consultant combined with a strong legal team can be helpful to facilitate a review of contracts (including force majeure options / contractual default) and cost structures, evaluate strategic alternatives and develop a short to medium term business plan that has the confidence of lenders.

Prepare a robust 13-week cash flow projection

Many businesses focus on the profit and loss statement rather than using cash projections. This can be satisfactory where businesses have reliable cash flow and cash reserves … however in a volatile situation when volumes drop, liquidity can be quickly depleted.

> *"In a volatile situation when volumes drop, liquidity can be quickly depleted"*

Now more than ever, a refreshed (or new) rigorous 13-week cashflow projection is essential for liquidity and business planning:

- Include various "what if" scenarios to forecast different activity levels
- What are the cash pressure points? Identify the timing and amount of cash needed
- Lay out a detailed projection to identify avoidable / deferrable disbursements and enable difficult decisions to be made on cost as early as possible
- Consider all sources of cash, including non-operating sources
- Review contractual borrowing arrangements

The cash projection needs to be regularly refreshed to always see the 13-weeks ahead. Monitoring budget to actual is recommended to shed light on the reliability on the projection assumptions and foster improved accuracy in future versions.

Proactively manage cash flow

If cash flows are expected to be tight, quick action is needed to preserve or generate cash. Borrowers should:

- Take advantage of "one time" cash benefits such as evaluating payments which can be deferred or negotiating payment relief where possible
- Consider alternative suppliers which may provide better terms or at least provide negotiating leverage with current vendors
- Prioritize collections of accounts receivable – and consider inducements to expedite payment
- Avoid making lump sum payments in advance for expenses

If active cash management is still expected to be insufficient, the borrower should seek other funding sources…lenders should expect a funding request or borrowers should pursue asset sales or equity sources/rescue lenders to fill the anticipated gap.

Re-forecast P&L performance in light of new realities

For many borrowers, the current year budget is likely no longer relevant and realistic. Whether working with the existing or a revised budget, a reforecast will be essential to more accurately predict the realistic outcome for the fiscal year.

ACTIONS FOR LENDERS:

Engage with borrowers

Understand the impact of COVID-19 on the business by requesting the information mentioned above. As the situation unfolds over the coming weeks and months, closely monitor the borrower's cash and business activity to develop an almost real-time understanding of the business's financial needs and condition. Ensure your borrowers have a plan that appropriately manages liquidity but balanced against preserving collateral value.

Assess the adequacy and possible deterioration of collateral

Perhaps most important is a dispassionate evaluation of how possible courses of action may improve or place greater risk to collateral value and/or enterprise value.

Expect funding requests and evaluate cost-benefit

Evaluate your borrower's scenario analysis assumptions…it may be necessary to create your own sensitivity analysis to more critically assess risks.

Particularly if the disruption caused by COVID-19 extends from weeks to months, or even several months, lenders need to evaluate lending thresholds and capacity to extend new money or negotiate relief for borrowers through this period.

An independent firm can be used to review a borrower

Many skilled and talented management teams have limited experience managing through the degree of disruption and uncertainty caused by COVID-19. Lenders may benefit from an external review by an independent consultant to examine that a borrower's cost structures are prudent, identify and manage risks, and ensure that the financial information provided (particularly projections) are realistic and comprehensively developed… a financial advisor or Chief Restructuring Officer can support organizations through times of distress and help drive stabilizing actions.

Review exit options

Given the current market uncertainty from COVID-19, M&A activity has almost slowed to a halt so the option to engage remedies and sell may not necessarily be practical or feasible. However, a lender should assess its options under a variety of scenarios that are critically developed and challenged.

How we can assist

We provide leadership and advice to guide our clients through times of challenge and uncertainty. We specialize in precisely the kinds of business challenges that are faced through the disruption caused by COVID-19.

We support organizations in liquidity management, creditor/lender discussions, cost reduction and business model review. We work either as advisors to companies/lenders or provide supplemental leadership (such as Chief Restructuring Officer).

Everyone is affected by the COVID-19 pandemic. Having robust financial information and proactive borrowers and lenders will work towards the efficient resolution of cash flow problems through this period.

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