Capital Structure

Where to after the dust settles?

Significant swings in the stock market. Interest rate cuts. Federal stimulus packages. Today we are facing volatility that is unprecedented. COVID-19 shutdowns and closures combined with the impact of the energy markets provide for a bleak economic outlook.

Yet amid the turbulence, two things remain certain:

1. Debt is prevalent in operating companies - many businesses use leverage in their capitalization structures, the extent to which varies greatly among owners.
2. Cash reserves and cash flow will be tested - the current economic environment is causing economic stress for many businesses, impacting current cash flows and future revenue expectations.

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Today

Businesses are in survival mode. The Federal Government has moved to backstop financial institutions funding needs to prevent lenders from pulling back capital. For the most part, banks are aligned in helping their customers weather the storm and are actively implementing programs to address short term liquidity concerns.

The Big 6 banks have made a commitment to work with personal and small business banking customers on a case-by-case basis to provide flexible solutions to help them manage through challenges such disruption of revenue and receivables collection due to COVID-19. Each financial institution has approached this differently but examples of measures in place include:

- Deferral of payment on small business credit cards and credit lines
- Business loan payment deferral
- Increases on small business operating lines to help with short-term working capital
- May advance payroll to ensure consistency of paying employees
- Waived fees

Three Federal programs, the Business Credit Availability Program (BCAP), the Small and Medium-sized Lean and Guarantee Program (SMLGP), and the Canadian Business Emergency Account (CBEA) have been announced to provide additional sources of capital for businesses that need it. Refer to Appendix A for additional details on the programs announced to date.

Business are scrambling to access the various forms of relief and banks are working hard to respond to the significant demand.

Tomorrow

Once things begin to stabilize, businesses will need to adapt to a new reality. There will be ones that emerge stronger than ever and there will be others that are deeply wounded. Banks will be performing a detailed review of portfolios to determine areas of greatest risk and where problems exist. They will begin the process to actively work with clients to right size debt and recapitalize balance sheets. For the businesses that are wounded, existing lenders may move to reduce exposure which could result in another wave of cashflow shortfalls.

The good news is, that outside traditional bank financing, there are a number of alternative lenders ready to deploy capital. These lenders are well-equipped to fill the void left by banks.

What can businesses do to prepare?

There are many steps businesses can take today to best position themselves for tomorrow.

1. Connect with existing lender and understand relief available through COVID-19. Consider refinancing existing debt with a focus of extending amortization period and decreasing monthly cashflow requirements.
2. Understand what alternative financing sources are out there should this be a resource you need to access.
3. Develop a detailed cash flow forecast and balance sheet with multiple scenarios – what does it look like if revenue decreases 25%? 50%? What does it look like if this continues for six weeks? Two months? Six months? What is the impact of receivables are collected in 90 days instead of 60 days?
4. Create an action plan for right sizing based on the different scenarios so you can be proactive and prepared.
5. Assess strategic alternatives such as mergers, divisional carve outs or other transformational transactions that can augment the business as you move forward.

While the road ahead may not look pretty, there is still a path to long term balance sheet health. When faced with today's uncertainty, it's best to know your options, and be proactive to navigate forward.

Appendix A

	Date Announced	Description
BCAP Working Capital Financing Solutions	March 13, 2020	• $10B of capital • Up to $2M in working capital relief loans • BDC floating rate less 1.75% • Interest only for first 12 months • 24 month amortization • Guarantee on loans of up to $5M for exporting companies • Flexible terms and payment postponements for up to 6 months
BCAP Guarantee Program/ Co-Lending Program	March 27, 2020	• Up to $40B in capital provided through a Co-lending program between financial institutions and BDC • Up to $6.25M in operating credit, 80% provided by BDC, with the remaining 20% by a financial institution • Up to $6.25M in new operating credit and cash flow term loans, 80% provided by EDC, with the remaining 20% by a financial institution. Fixed guarantee fee of 1.8% on loan amount • Customers qualifying for either loans are eligible for a 6-month fee and payment deferral
Fee & Payment Deferral (EDC & BDC)	March 18, 2020	• If you are an existing client of BDC with a total loan commitment of $1 million or less, BDC will provide postponement of payments for up to six months, free of charge • If you are an existing client of EDC's Export Guarantee Program or EDC's Trade Expansion Loan Program, you are eligible for a six-month fee and payment deferral
CEBA	March 27, 2020	• Up to $25B in capital • $40K line of credit • at 0% interest until Dec 31, 2022 • requires no minimum monthly principal payments until December 31, 2022 • principal repayments can be made at any time • $10,000 loan forgiveness is available provided outstanding balance is fully paid on or before Dec 31, 2022 • It is available to Canadian employers with $20,000 to $1.5 million in total payroll in 2019, and operating as of March 1, 2020

Source: Department of Finance Canada, Canada.ca; BDC.ca