Managing Liquidity & Financial Risks during the 2020 Covid-19 & Financial Crisis

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An economist is an expert who will know tomorrow why the things he predicted yesterday didn't happen today.

- LAWRENCE J. PETER

Economic & Financial Risk

DJIA

Advanced Charting

S&P 500

Advanced Charting

Nasdaq Composite

Advanced Charting

Economic & Financial Risk

- Declaration of Global Pandemic by WHO following outbreak of Corona Virus, Covid19, (referred to as CV) has created widespread fear and anxiety
- Financial markets fixated on spread of CV and what it means to US & Global Economy
- Surge in CV cases in Europe, USA and world at large is creating a major “panic”
- Adoption of CV mitigation strategies including social distancing mandated policy, stay at home directives, and many actions taken by cities, states and US government to limit travel and face-to-face interaction has created economic dislocation of epic proportions
- Airlines, hotels, cruise lines, travel related industries and many consumer discretionary businesses (restaurants, apparel, retail stores and many other related industries) are crushed

Economic & Financial Risk

- A national health care crisis has created havoc and US economy is at a standstill, economic activity has come to an abrupt stop, consumer demand and US manufacturing has been impacted so severely that a US recession is immediate
- The intensity of US recession is “palpable” based on financial markets behavior
- Major stock market indices (DJIA, S&P 500, Nasdaq) corrected about 30% from Feb 19th all- time high, and stock market is -26% year to date and exhibiting unusual volatility with 1 day moves of -13% (March 16, 2020)
- The 11 year “bull market” has ended and many believe we are in a “bear market” as of March 16, 2020 with the S&P 500 showing a -26% year to date as of 3/16 but has recovered some of the deep losses in March-April period
- Volatility has created a “mini bull market” from March 23, 2020 to April 8, 2020 with major indexes (Nasdaq, S&P 500, and DJIA) + 22%, +25% and +28%
- The negative impact on “wealth effect” from stock market has further eroded consumer confidence

Consumer Financing Strategy

Consumer Financing Strategy

- Consumer Spending is key to economic growth
- Shelter in place and fear of Covid-19 spread will change consumer behavior for many years to come
- As consumers work from home and limit activity outside the home front, retail/restaurant & consumer discretionary companies will be struggling to survive
- Consumer spending will be mainly online and only selective sectors (foods, health care) will have demand > supply
- Fashion/apparel/footwear and consumer discretionary companies will be especially hard hit and many of these sectors are critical in IACC membership as Italy is a large exporter of consumer goods

Corporate Sector

Industrial Production in U.S. Fell 11.2% in April

Measure of factory, mining and utility output has steepest drop in records dating back 101 years

Coronavirus Lockdowns Trigger Rapid Drop in Retail Sales, Factory Output

April U.S. retail sales fell 16.4% and manufacturing output 13.7%, both records

Fed's Jerome Powell Says Economy Faces Long, Uncertain Recovery

It will be hard for public to be 'fully confident' without a coronavirus vaccine, central bank chairman says

Investment Between U.S. and China Falls as Tensions, Coronavirus Take Toll

Once-vibrant business relationship continues to slide, according to new report

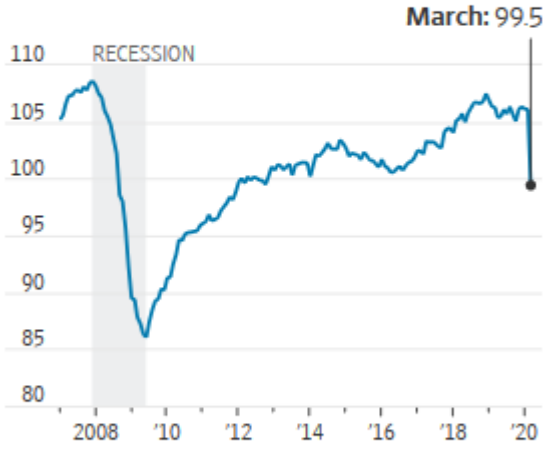
Germany Enters Recession but Fares Better Than Neighbors

Data show the divergent economic fortunes of major European countries

Make or Break

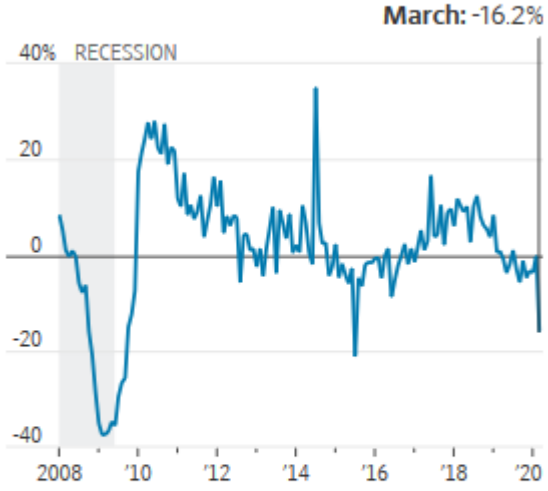
U.S. manufacturing output declined precipitously in March as the pandemic took hold...

Industrial production (manufacturing) index



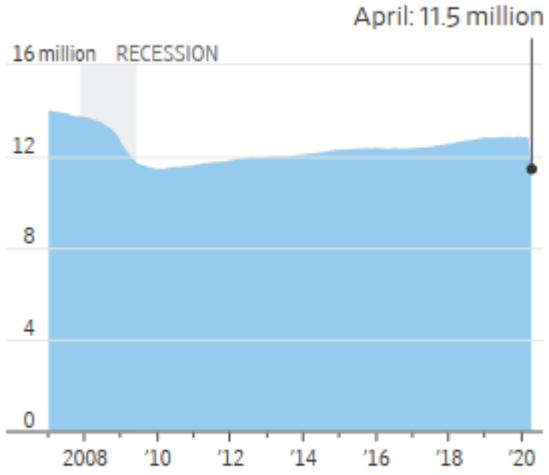
...as did factory orders for many durable goods...

Manufacturers' monthly new durable-goods orders, change from previous year



...contributing to a steep drop in manufacturing employment, which had never returned to levels reached before the last recession.

Total nonfarm private manufacturing employment



Note: Seasonally adjusted

Sources: Federal Reserve (industrial production); U.S. Census (orders); Bureau of Labor Statistics (employment)

Corporate Sector

- The volatility in stock markets and confidence crisis has spilled into Fixed Income (bond markets) and yields on US government bonds have dropped dramatically
- During a turbulent 10- day period around mid- March-end of March, the 10Y Treasury reached a 0.35% level vs 1.9% at January 1, 2020 and such large swings are reflective of many investors selling equities and going to US Government bonds, a way to have safety amidst periods of market turbulence-earning a 0.35% per year over a 10 year period for safety of US Government bonds might have its place as part of a bond strategy
- The 10y Treasury recently settled at 0.65% but reflects the fact that investors would rather earn 0.65% p/year on a 10- year horizon and indicates a “risk aversion” and lack of confidence in the US economy and equity markets
- As the US economy goes into recession, US corporations of all s types will face unprecedented hardship given the economic shutdown
- We are about to enter in recession that will be different and worse than the 2008 financial crisis (Great Recession) and the ensuing 3 quarters ending in 9/30/2020 will feel like a “Great Depression”

Corporate Sector

- Many small and midsize companies will institute layoffs as restaurants and many service- related businesses shut down for an extended period of time
- The shutdown of service businesses (hotels, airlines, travel, cruise lines, leisure & entertainment companies & other service businesses including restaurants, retail chains will face bankruptcy and default
- The service economy represents about 80% of US economy with the remaining 20% as manufacturing
- The US economy may face a recession different and worse than the 2008 financial crisis (the great recession)
- A confidence crisis in 2020, though different than the 2008 crisis, will be far worse as US Government and Federal Reserve Bank are using all tools to provide a fiscal and monetary stimulus to pump liquidity in the financial market and give businesses liquidity, and special provisions to handle the economic onslaught

Corporate Sector

- The 2020 economic situation will be a quasi “great depression” and survival of the fittest will be key
- Job losses are mounting exponentially with 36 million job losses as of early May with more to come
- Unemployment rate reached 14.7% on 5/8/2020 and will trend higher with estimates of 2quarter GDP -30%
- Even large size and Fortune 500 companies will face some difficulty (Boeing is in need of much liquidity and talk of a bailout surfaced) and airline/hotel/cruise/casino industries may need Government bailout or support—even pristine Fortune 500 names like Boeing are not immune

Companies that have recently filed for bankruptcy.

Virgin australia
J.CREW
moviepass
Pier1
OneWeb
flybe.
GOLD'S GYM
DEBENHAMS
CMX CINEMAS CHATEAU
TRUE RELIGION BRAND JEANS

Companies expected to file for bankruptcy soon.

Hertz
JCPenny
sears
Neiman Marcus
kmart
VICTORIA'S SECRET
GNC LIVE WELL
Bath & Body Works
at home The Home Décor Superstore
Party City
GameStop POWER TO THE PLAYERS
J.Jill
ANN TAYLOR
Stein Mart
The Container Store
KIRKLAND'S Home Décor, Gifts & More
TAILORED BRANDS

Liquidity Risk

“The breakdown of the financial system was a major reason for both the Great Depression and the 2007-09 recession,” Mr. Bernanke said. Today, however, “the banks are stronger and much better capitalized.”

Liquidity Risk

- The 2008 crisis (The Great Recession) taught us that US banks were fragile and liquidity risk is #1 risk during recessions and economic slowdowns
- Liquidity risk caused the breakdown of US banking system during 2008 crisis
- Unlike 2008 crisis, the US banking system is much better capitalized and resilient
- Unlike 2008, US banks are not source of the problem but a potential solution to aid corporate sector & providing SBA Loans, PPP loans and working with Government on CARES Act requirements
- Cash is “king during a crisis period”
- Cash on the balance sheet is king and ensuring you have sufficient cash to carry you over for 90-120 days assuming this CV reaches a peak and eventually stabilizes

Liquidity Risk

- Managing bank relations, something we take for granted, is critical and hopefully you have a solid relationship with your bank to ensure you can access uncommitted lines of credit
- Are your Accounts Receivable protected with a credit policy and is your cash flow severely impacted if customers are late in payment or going into default & how good ar you at collecting on your A/R during adverse moments
- Do you have sufficient credit or bank financing available against your A/R, Inventory and other Assets
- Was your CFO/Treasurer and Finance Senior Management team & CEO conservative during the 11- year strong economic cycle and did you build a “cash cushion” and liquidity to plan for unexpected events (downturn, recession, economic slowdown)

Liquidity Risk

- Was your strategic plan sound and conservative or did you taken on debt(leverage) without regard for ensuring liquidity and allowing financial flexibility in the event the economic growth declined
- Don’t blame Covid-19 for bad management or reckless financial stewardship
- Negotiating with your vendors or seeking extended terms may help
- US companies that buy/source product from Italy (fashion/apparel/footwear/consumer goods, industrial machinery, jewelry, foods, etc..) may negotiate better terms with suppliers (pricing, longer terms)
- Seek financing options via your existing bank but look at other sources of financing as we are going through an unprecedent Health Care and Financial Crisis of epic proportions

Liquidity Risk

- Neiman Marcus filed for Chapter 11 bankruptcy
- J Crew filed for Chapter 11 bankruptcy
- 27/38 retailers with weakest profiles were owned by PE firms
- In addition to defaults, bankruptcies & financial downfall of retail sector, the situation is compounded by investments made by PE firms
- Credit exposure and write-downs of PE credit risk and interconnectedness to banks/FI may create some risk to financial system
- Non-bank FI sector-
- 59% of mortgage originations & underwriting shifted to non-bank sectors

Liquidity Risk

- Non-bank mortgage lenders include Freedom Mortgage, United Wholesale Mortgage. LoanDepot LLLC & many others
- Quicken Loans ranked as largest mortgage lender by originations for 1st time in 2019
- 2020 recession vs 2008 recession vs Great Depression-
- From 1929-1933, economy shrank for 43 consecutive months & Unemployment Rate climbed to 25% with a slow, gradual descent before economy started showing signs of life
- The severity of 2020 recession will match the Great Depression period as Unemployment rate may hit or exceed 25% during 2Q 2020, but duration will be much less

Liquidity Risk

- As the US government puts together a “bazooka” to assist US small and midsize business, you may also look all US Government financing option and other options such as Small Business Administration for financing options to carry you through this difficult period
- Opportunities may exist to pledge additional collateral (building, other assets) for additional bank financing and possibly providing personal guarantees
- PE Firms, Hedge Funds and Corporations/Investors with significant capital may be able to make equity investments to Middle Market companies struggling with payroll needs, shortfall in cash, liquidity weakness and inability to meet the oncoming financial obligations during the next 1-6 months as economy comes to standstill
- PE firms stated that portfolio companies that went into bankruptcy during 2008 crisis was 6% and bankruptcies will reach 12% during 2020 recession—a worrisome signal (discuss Shadow Banking sector)
- Creativity will be needed to get through this difficult economic cycle

Liquidity Risk

- Approaching banking sector and building good & long-term relationships with banks is key to survival (KTS) and treating banks as a vendor and not a “strategic partner” can do long-term damage—banks are not your IT vendors or payroll processors
- Banks may be averse to new lending facilities and providing credit when a 2020 recession emerges is not an easy thing to do for banks when they are bombarded with credit losses and potential defaults, but the right advisor/consultant may be of great value in selecting the right lenders & assisting you in helping you secure liquidity during a time of distress
- Be transparent with your existing or new banks, give full disclosure, provide reviewed/audited financials, forecast for 2020 should include assumptions & worse case scenarios of Covid-19
- 2020 has created a situation of covenant relief requests where borrowers are demanding Loan Modifications
- Many borrowers want deferral of P+I or lower interest coverage ratios
- Banks may require to limit/suspend dividend payments, CAPEX & discretionary expenditures as preserving cash is key and banks will demand Liquidity ratios be maintained to ensure sufficient cash flow to meet payroll and critical expenditures

Liquidity Risk

- Discretionary expenditures will be & should be eliminated as companies struggle to survive
- Covenants discussions may vary but Debt/EBITDA, minimum EBITDA and minimum Net Worth are typical
- Opportunity may exist to approach non-bank FI lenders (BDC, PE firms, Financial Service firms, Factoring companies, Asset based lenders) that can offer credit facilities and provided much needed liquidity and working capital
- Non- bank lenders may offer advance rates of 80%-90% on Current A/R (1-90days) vs 70%-75% for banks
- Non- bank lenders may offer advance rates of 50%-60% on Inventory (days on hand) vs 40%-50 % for banks
- Get more “bang for your buck” with non-bank sector parties on advance rate basis
- Banks might offer a greater cash management/treasury/lending/deposit relationship vs limited capabilities of non-bank lenders
- Factors, ABL and non-bank lenders may be more restrictive in monitoring/administration of A/R repayments and may create administrative burdens for corporate borrowers vs. bank

Liquidity Risk

- Lending rates on middle market borrowers for banks, depending on creditworthiness & many factors, may range from Prime(3.25%) to Prime + 1% or Libor + 3% or Libor +4% with all in rate in 4.0%-5.0% range where rates from non-bank FI sector will be 1% to 3% higher
- Higher Risk––Higher Return: banks more conservative and prefer proven track records of profitability and good balance sheet metrics vs non-bank FI sector more aggressive & opportunistic on middle market companies
- Assess risk/reward of bank vs non-bank relationships
- Selecting the right lender is key
- Some non-bank FI lenders may provide attractive advance rates on A/R or Inventory and be more aggressive as banks selectively add on new clients

Liquidity Risk

- Some regional, community or foreign banks may have greater risk appetite than US money center banks
- The Foreign Banking Industry covers 120+ FBO's operating in USA and captures 35% of all lending in USA
- European, Latina American, and Asia-Pacific region banks are important players in banking industry and good source of credit
- KTS is building trust and confidence with banks and non-bank FI sector, and selecting a good advisor/consultant with credibility, expertise and proven track record may do a world of good
- Gloren Consulting Inc, not a health care remedy, but a Treasury, Bank Relations & Financial Markets remedy for corporate clients at a critical juncture

“Only Gloren Consulting can get us through this crisis.”

- Dr. Anthony Fauci