SULLIVAN & CROMWELL LLP

Finance & Restructuring

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I. Financing

State of Debt Financing Markets

- Bond Market
  - Investment Grade
    - Large IG issuers have generally had access to market
    - Investors have preferred longer-dated tenors (i.e., minimum five years)
    - Government support of IG bond secondary trading helped stabilize trading
  - Non-Investment Grade
    - Limited data set but market appears to be stabilizing
    - Increase in primary issuances over past two weeks
    - Stabilization of secondary prices after initial drop

State of Debt Financing Markets, *continued*

- Loan Markets
  - 364 Day Facilities (IG/Crossover)
    - Preference of banks given lower capital requirement and less duration risk
  - New Long-Dated Revolver Commitment
    - More difficult to obtain
    - Banks pushing back on tenor
  - Term Loans
    - Secondary prices have generally appeared to stabilize
    - Limited new issuances, but the few that have come to market have been oversubscribed (except in sectors facing specific issues, such as oil & gas)

Companies that were distressed prior to COVID-19 have largely been shut out from new funding in the loan market

Other Debt Financing Sources

- Government Programs
  - SBA Paycheck Protection Program
  - Main Street Lending Facilities
    - In process
  - Others
- PIPE transactions
  - No significant volume yet
  - Expect these to pick up once government programs and amendment/ waiver pass

Financial Covenants Amendments

- Significant number of amendments to financial covenants have come to market
  - Lenders have generally (but not always) been cooperative
  - Covenant holidays through 2020 and sometimes longer
  - Add-backs for COVID-19
  - Annualization of EBITDA at end of holiday
    - Have also seen expanded addbacks and fixed EBITDA numbers
    - Issues with modeling and projections

Financial Covenants Amendments, *continued*

- Lender Asks
  - Consent fees (15 bps — 75 bps)
  - Interest rate step-ups
  - Push for anti-cash hoarding, though rarely obtained
  - Expanded negative covenant restrictions during covenant holiday (i.e., no dividends or stock-buybacks)
    - Borrower ability to flip back into covenants upon end of covenant holiday <u>or</u> exercise right to end covenant holiday early
  - Other Maintenance Covenants
    - Minimum liquidity
    - Industry specific metrics

Financial Covenants Amendments, continued

- New Playbook
  - Term lenders have been generally more cooperative than revolving lenders
  - Banks' focus is on liquidity issues rather than financial maintenance covenants
    - Pure financial maintenance covenants issues are generally addressed by amendment
- Distressed Borrowers
  - Companies distressed prior to COVID-19 and certain industries have had difficulty obtaining amendments
  - Lenders may use liquidity concerns to force restructuring
  - More likely to obtain forbearances than amendments

Other Typical Amendments

- Amortization
  - Deferred to balloon payment
  - PIK
- Interest
  - PIK option
- Sectors of Focus by Lenders
  - Hospitality
  - Food Service
  - Energy, Oil & Gas and Production
  - Transportation
    (air, auto and downstream supplies)
  - Entertainment and Sports
  - Retail

Other Key Issues

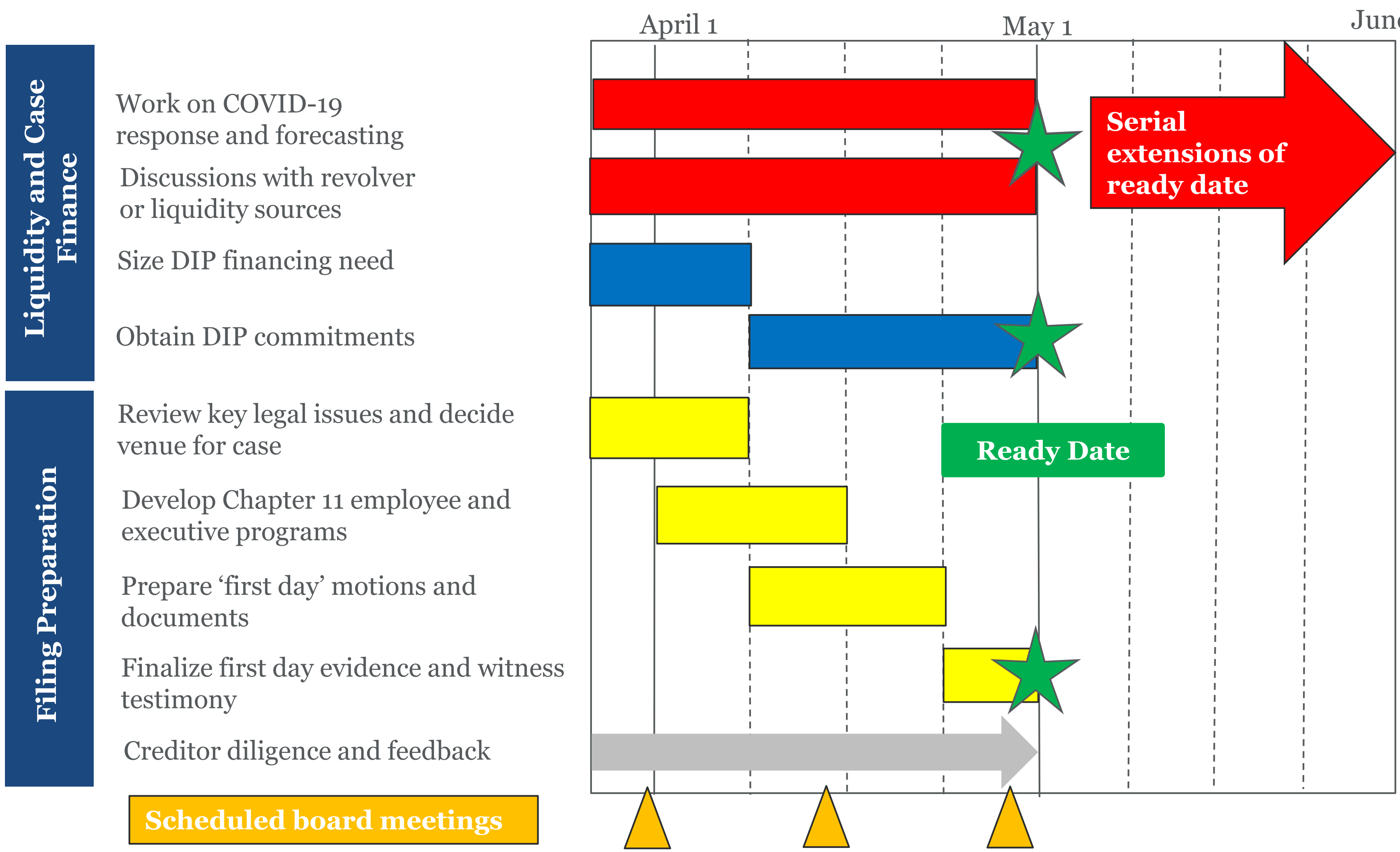
- Financial Modeling
  - How long to assume shut-down?
- MAE
- ABL Issues
  - Borrowing Base
    - Receivables
      - Quality
      - Bankruptcy or distress of counterparties
    - Inventory
      - Access to sites
      - Effects of issues with selling – liquidation values
    - Permitted Discretion
  - E&P - RBLs

Other Key Issues, *continued*

- Construction/development loans
  - Meeting conditions to draw-down
    - FM
    - MAE
    - Practical constraints – title company bring-downs, lien searches, etc.
  - Abandonment triggers
  - Schedule delays
    - Impact on achieving renewable project credits
    - Deadlines for achieving construction completion
- Project/special purpose vehicle loans
  - Limited working capital/debt baskets to serve as buffer
  - Material contract counterparties actions may trigger covenants/EoDs
  - Additional focus on insurance – delay in start up/business interruption

II. U.S. Restructuring

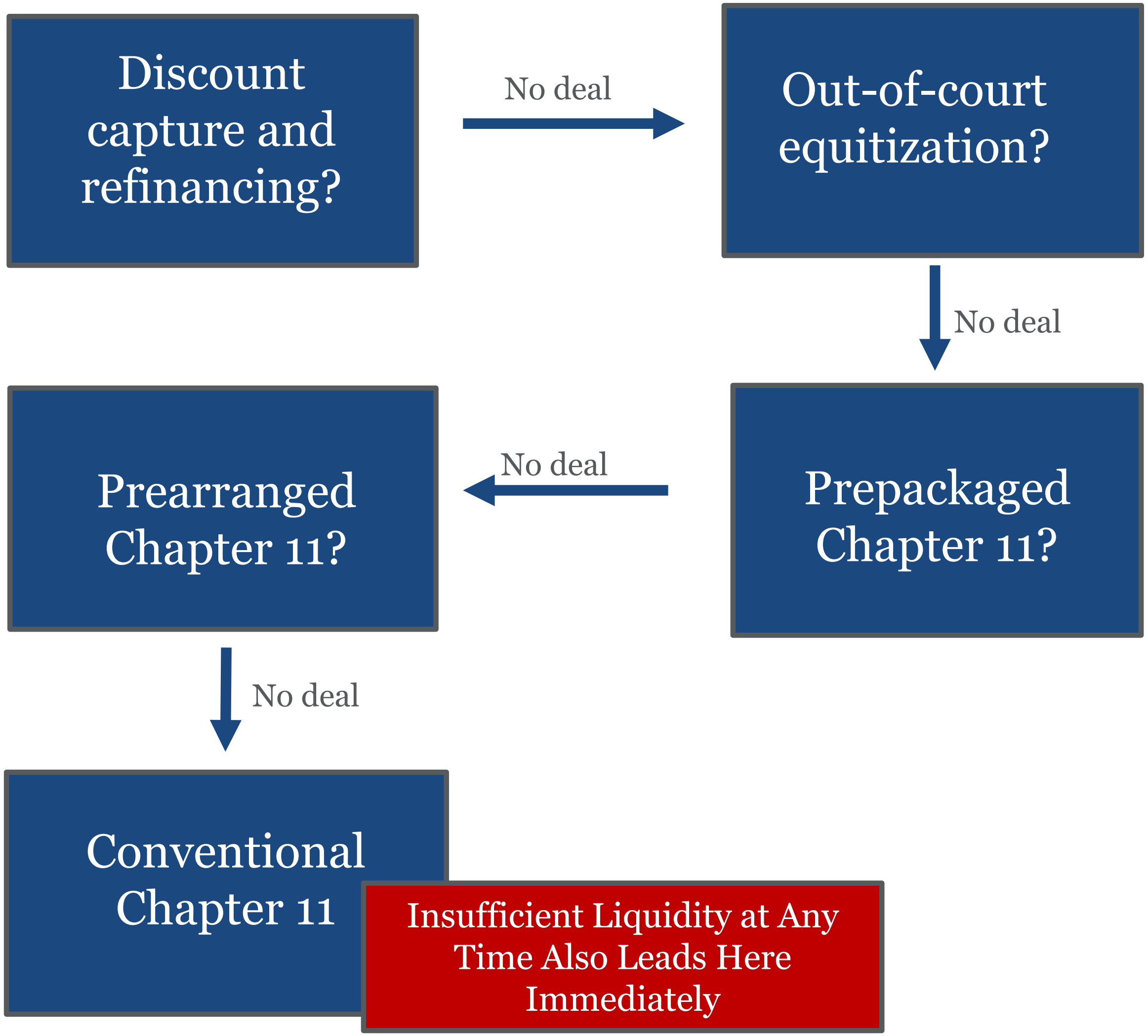
Contingency Planning During the Pandemic



Confidentiality Increased by a Staged Work Plan

	"Level"	Remaining Time Needed	Work Completed	
Internal, smaller group	3	5 weeks	• Brief board • Confirm D&O insurance • Form senior management team	• Engage main advisers • Outline case liquidity need • Select Chapter 11 venue • Engage valuation expert
Internal, larger group	2	3 weeks	• Prepare accounting systems for required reporting • Develop detailed case budget • Outline KEIP/KERP	• Prepare first-day motions • Size DIP loan • Engage other advisors
External	1	ready	• Complete DIP loan syndication and documents • Finalize first-day motions • Prepare investor relations materials	• Develop customer and supplier communications plan • Identify and prepare witnesses for first day hearing

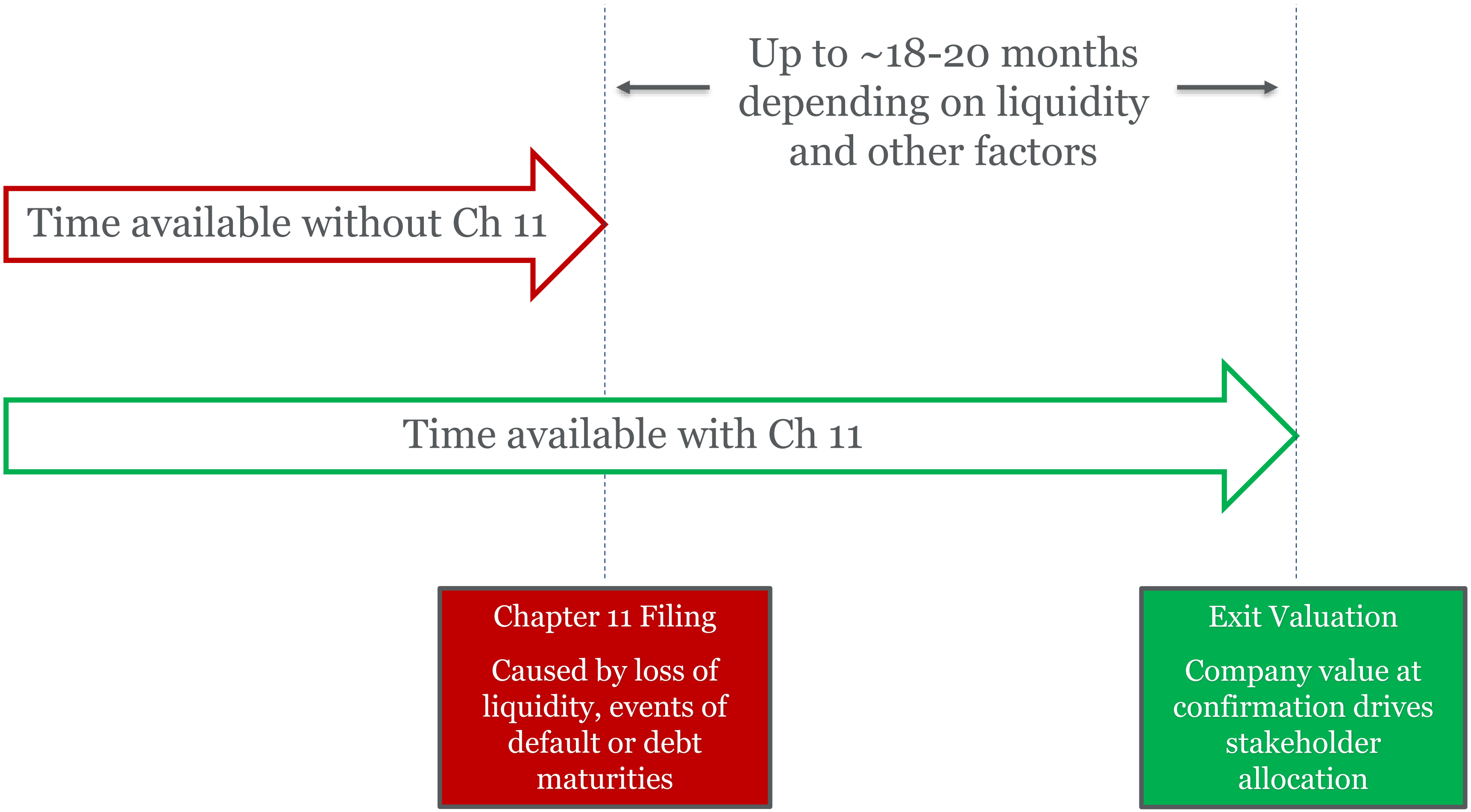
Decision Tree for Balance Sheet Restructuring



Can the Normal Chapter 11 Requirements for Exit be Satisfied During the Pandemic?

1. Emergence corporate structure and business plan, described to stakeholders prior to plan voting
2. Commitments for new working capital financing and any other required emergence financing
3. Arrangements to retain and incentivize emergence management team, often using a post-reorganization equity incentive plan
4. Consensus on treatment of ‘fulcrum classes’ and the mix of equity, debt, other instruments or cash these classes will receive in the plan
5. Corporate governance arrangements after emergence, including extent of board continuity
6. Treatment of junior stakeholders and other dissenters, often requiring litigation to resolve

Hibernation?



Fiduciary Duties Do Not Change for Delaware Corporations, Even During Insolvency

- Normal fiduciary duties apply during periods of financial distress
  - Duties of care, loyalty and good faith
  - Protection of the business judgment rule
  - Relevance of the same common sense governance practices
- Fiduciary duties run to the corporation, not to creditors directly
  - No direct duty to creditors (Gheewalla)
  - Creditors have contractual rights, with bargained-for limits
  - There is no "duty to file" or "wrongful trading" or other special liability for officers or directors

The Main Difference is that Creditors may Enforce These Fiduciary Duties in Limited Circumstances

- **Outside of Chapter 11.** Creditors (rather than stockholders) can bring a derivative action if they prove a corporation is balance sheet insolvent (rarely occurs)
- **In Chapter 11.** Creditor representatives may obtain standing to bring fiduciary claims in the place of the corporation not otherwise settled (common in liquidations; otherwise not)
- Since creditors might control the prosecution of fiduciary claims in the future, it is prudent for a corporation in the zone of insolvency:
  - to consider "enterprise value" as well as "stockholder value" as part of a business judgment record
  - to pay special attention to potential conflicts of interest between different corporate subsidiaries that may be insolvent
- However, over-reaction to the threat of creditor litigation is not warranted – the business judgment rule continues to apply

Affected Companies Can Pursue Stockholder Value Aggressively, so long as there is a Contingency Plan

- Delaware courts have held that
  - courts should not second-guess good faith judgments about how to weigh different risks to enterprise value
  - ownership of equity is not a conflict of interest for officers or directors, even in the zone of insolvency
- A potentially solvent company may pursue a low chance at stockholder value even at a substantial risk to creditor recoveries
- On the other hand, a company concerned about the harm of excessive leverage or illiquidity, also may pursue transactions that are adverse to classes of junior creditors, even stockholders, to protect the enterprise

So long as a company stays liquid and can protect its business with a Chapter 11 filing if needed, it has significant optionality on the path(s) it pursues

III. European Restructuring

A Town Called Austerity

It is a slow day in the small town of AUSTERITY, and streets are deserted. Times are tough; everybody is in debt, and everybody is living on credit.

A tourist visiting the area drives through town, stops at the motel, and lays a $100 bill on the desk saying he wants to inspect the rooms upstairs to pick one for the night. As soon as he walks upstairs, the motel owner grabs the bill and runs next door to pay his debt to the grocer. The grocer takes the $100 and runs down the street to retire his debt to the dairy farmer. The dairy farmer takes the $100 and heads off to pay his bill to his supplier, the Feedco. The guy at Feedco takes the $100 and runs to pay his debt to the travelling fortune-teller whom he keeps visiting at the conference suite at the motel to find out when the crisis ends.

The fortune-teller has also been facing hard times and has been looking into her crystal-ball and offering customers “fortune credit”. The fortune-teller rushes to the motel and pays off her conference room bill with the motel owner. The motel proprietor then places the $100 back on the counter so the traveler will not suspect anything. At that moment the traveler comes down the stairs, states that the rooms are not satisfactory, picks up the $100 bill and leaves. No one produced anything. No one earned anything... However, the whole town is now out of debt and looks to the future with a lot more optimism, AND THAT IS HOW A STIMULUS PACKAGE WORKS.

Key Financial Support by European Governments

1. **What is the key financial support that has been provided by governments in the largest European countries to support troubled companies during the COVID-19 crisis?**

General Observations:

- Multiple Actions – rate cuts, fiscal support (cuts and deferrals) and large lending schemes
- No uniformity, no caps and ability to source multiple programs from different governments
- Certain schemes are devised by governments for specific corporates with specific needs (e.g. airlines)
- Need to comply with State Aid Rules – fast tracking by EU Commission and a "Temporary Framework"
- Lending Schemes will constitute "financial indebtedness" under credit documentation so position the loan tactically in the group (e.g. Holdco's outside the recourse group), check baskets and permissions or procure consents – most lenders have been supportive
- Insolvency Reform – extensive for e.g. UK s.214 Insolvency Act 1986 has been eased for wrongful trading liability, and in Germany filing obligations for over indebtedness have been suspended, lender liability for new money has been suspended and shareholder loans are not currently equitably subordinated

Key Financial Support by European Governments, continued

1. **What is the key financial support that has been provided by governments in the largest European countries to support troubled companies during the COVID-19 crisis?**

Government Lending Principles in Europe

To a lesser or greater extent, all of the government lending programs have been characterized by the following key features which have been supported by the EU Commission:

- **Size of Program** – varies €200bn Italy – KfW program in Germany is potentially unlimited
- **Program** – may be a Guarantee Program or Commercial Paper Program funded by issuance of additional central bank reserves, business interruption loan schemes
- **Guaranteeing Entity** – Government directly, ECAs, Government investment/development banks, Central Bank, other quangos – possible Treasury backstop
- **Beneficiaries** – entities registered in home state – operations in home state – state of incorporation irrelevant – typically non-banks of FI's – make a material contribution to the home state
- **Guaranteed Amount** – 70% -80%
- **Maximum Amount of Loan** – based on % of turnover in host state (25% is common), multiple of 2019 wages, up to 18 months of proven liquidity need – some countries have caps for investment grades or SMEs
- **Calculation of Turnover** – based on turnover/labor costs in host state, larger companies may be able to include consolidated turnover
- **Maximum Maturity** – three to six years
- **Fees** – 50 bps for first year with step-ups in third and fourth years to 100-200 bps – Could be market guarantee fee
- **Priority** – not senior – pari – some specific support loans require a debt write-down in advance
- **Use of Proceeds** – some states impose home state use on labor, working capital opex and capex – more latitude in other countries
- **Collateral** – case by case basis – some guarantees by business owners of SMEs
- **Employment Commitment** – job preservation is key in certain states – not others
- **Dividend Stopper** – yes – degree of uniformity – duration varies – can be a prepayment event

Likely Opportunities in Europe for Investors

2. Looking forward, what are the likely opportunities in Europe for investors as governments exit their capital investments in companies they have supported throughout the crisis?

Government balance sheets and credit ratings may be under scrutiny as Europe emerges from the crisis, and there may be pressures from the EU and the ECB – a number of possibilities to deleverage are likely to create investor opportunities

Issues – politics, timing of recovery, liquidity, scale and bandwidth, advisers and procurement, state aid

Options

1. **Debt Forgiveness**
   - Politically, highly unlikely – especially if shareholders benefit and these companies pay dividends before any pending elections
   - Experience from the financial crisis shows this is unlikely
   - "UK Government Investment" and "UK Finance Investment" approach – behave commercially, professionally and assertively
2. **Nationalization**
   - Political issues – last resort?
   - May depend on sector – transport – rail, buses and airlines
   - Valuation
   - To preserve continuity and to avoid insolvency
3. **Reprioritization**
   - May involve creating a hybrid instrument or subordination contractual or structural – e.g. Holdco PIK
   - May depend on sector and requirement/need for new capital
   - To preserve continuity and to avoid insolvency
4. **Equitization**
   - Possibly – again depends on sector
   - As a prelude to attracting new money and investment
   - State Aid clearances
   - Conversion economics
5. **Debt Sales and Refinancings**
   - Use of government investment banks e.g. British Business Bank and replacement guarantee schemes at lower levels of cover
   - Perhaps favored option
   - Discounts – Valuations
   - Liquidity and demand
   - Potential partial equitization as part of a recap
6. **Exits – Business Sales or IPOs**
   - Liquidity and timing of recovery
   - Partial Equitation
   - Underwriting
   - Demand

Sullivan & Cromwell LLP