

# Navigating Volatility: Key Considerations in Finance Documents

March 2020



# Unprecedented risks and uncertain times

- **Global disruption:** The global economy is grappling with uncertainty surrounding COVID-19 and its disruption to supply chains and impact on demand. The pandemic is a real global shock with economic dislocation likely to intensify over the coming months.
- **Markets:** Financial markets are unsettled by sharply declining commodity prices and the rapid implementation of unprecedented restrictions on people and their movements to prevent the spread of the virus. Stock markets are experiencing volatility not seen since 1987, with a trend of severe corrections from late February and into March.
- **Housing debt:** High levels of housing debt to income are at near record highs in Australia. Social distancing measures are expected to increase risk of non-performing loans without targeted intervention to avoid delinquency.
- **Unpredictable effects:** Stimulus packages to maintain confidence are being implemented by governments worldwide and the Reserve Bank has almost no room to further reduce its already historically low cash rate. While the objectives of the financial injections are articulated, the real economic and commercial effects are unpredictable.



# What should companies be considering?

Companies with debt facilities negotiated prior to the pandemic should particularly consider:



## Directors' duties

The company's financials should be closely monitored to determine if there is a general decline in performance, cash shortages, continuing losses, implementation of special arrangements or other indicators resulting in a suspicion of insolvency.



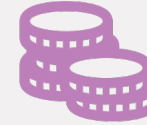
## Counterparty risk

Supply chain, capital and financing constraints and how these will affect counterparty performance under commercial contracts.



## Triggers in lending transactions

Non-payment and insolvency events of default, financial covenant compliance and other information and general obligations. We consider these in more detail on the next slide.



## Cash flow

Whether a company is able to pay all its debts when they become legally due and payable. This will be impacted by possible decreases in earnings and also availability of credit under financing agreements.



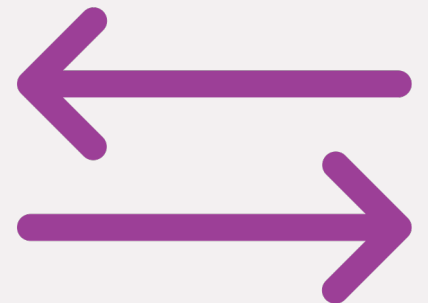
# Triggers in Lending Transactions

<b>Financial covenants</b>	Most financing documents include maintenance covenants that are to be complied with for the life of the loan facilities. Borrowers will need to consider the impact of COVID-19 on both earnings and cash with respect to financial covenant compliance.
<b>Information undertakings</b>	Information around the financial condition, business and operations of the group may need to be provided to a lender.
<b>Restrictive covenants</b>	Borrowers must consider covenants and consents when looking to increase liquidity by way of raising additional debt, disposing of assets or making business changes. Lenders that are asked to waive covenant breaches or grant consents might require consent or variation fees or, as was seen during the global financial crisis, or that the deal be repriced.
<b>Inspections</b>	Financing documents may give lenders the right to access the premises or books and records of a business or appoint independent experts to investigate and report on the affairs or financial condition of the business if the lender reasonably believes that a default is occurring or may occur.
<b>Events of Default</b>	Provisions that may be triggered as a result of COVID-19's economic effect include non-payment, insolvency, breach of financial covenants, and MAE clauses.



# MAE Clauses

- Material adverse effect or 'MAE' clauses are typically included to protect the lender from unforeseen changes to the borrower's financial situation and unexpected, drastic, market fluctuation. Generally speaking and given that MAE provisions largely come down to contractual interpretation lenders do not typically rely on the MAE as a stand alone event of default. Even if lenders are reluctant to call an MAE default, they will be less reluctant to draw-stop any available facility limits on the basis that they consider a MAE to have occurred.
- The question that arises now is whether or not the impacts of COVID-19 will have such an effect that results in lenders relying on MAE clauses as triggers of events of default. The last time this was seen to scale was during the global financial crisis.
- The definitions of 'Material Adverse Effect' and 'Material Adverse Change' are generally negotiated on a transaction by transaction basis and intentionally left vague and ambiguous. The APLMA facility documents include two suggested drafting options but, in either case, they tie back to the obligors' ability to meet obligations under the finance documents and the obligors' business or condition (financial or otherwise).
- MAE provisions are generally applicable in two circumstances:
  - as a stand-alone event of default; and
  - as a qualification or materiality threshold before certain other events constitute an event of default.



# Unitranche / Term Loan B Facilities

Borrower friendly market conditions have resulted in 'cov-lite' financing packages becoming more prevalent. In particular, the Australian unitranche facilities and Term Loan B facilities have become popular financing arrangements. Such arrangements present both risks and benefits for borrowers in these uncertain times.



## Pricing

The flexibility afforded by these structures generally means that these facilities are priced at higher rates when compared to bank facilities. This might place higher strain on borrowers during these uncertain economic times.



## Financial covenants

Financial covenants are often 'springing' such that they will only apply once a certain drawing threshold has been met. If borrowers can manage their liquidity testing of financial covenants could be avoided.



## Additional debt

Incurrence of additional debt is generally less restricted being subject to compliance with leverage ratios (which are generally set wider than what would be permitted in the bank lending market).



## Asset disposal

Asset disposal are generally permitted on the basis that disposal proceeds are only required to be applied in mandatory prepayment of the facilities if a negotiated leverage ratio is prevailing or monetary thresholds are met.



# How can we help?



Financing: We have extensive experience advising participants in the alternative lending market and can assist with complex and bespoke lending structures, structured finance, distressed investing, and hybrid structures.



Debt-trading: Our team has advised on a number of significant portfolio sales and able to assist with the entire debt-trade from the pre-sale and due diligence stages through to the preparation and execution of sale documentation with the preferred bidder.



Sale of non-core assets: We can assist with structuring the sale of underperforming, higher-risk or growth-oriented assets so that your business has the liquidity to withstand the distress.



Financier and creditor negotiation: Maximising short-term liquidity, funding options and cash flow generation in times of distress requires clear communication and negotiation with key stakeholders and lenders. We are ready to assist you with achieving financial stability by advising you in those delicate and significant interactions.



Deals with alternative lenders: Our specialisation in the alternative lending market well places us to assist with providing introductions to, and assessments of, alternate funding solutions. We can also introduce you to financial advisers who can be on your side in negotiating with the alternative lender market.



Safe harbour: We can provide assistance to company boards and advise on the safe harbour process (including assisting in formulating the contingency plan and appraising options available) and ongoing directors' duties.



# Safe Harbour – Some Considerations

- While the Federal Government announced on 22 March 2020 a proposal for temporary relief from public liability for directors trading while insolvent (for further details, see <https://www.hamiltonlocke.com.au/post/insolvency-law-changes-are-not-a-silver-bullet>), at this stage the safe harbour provisions in the Corporations Act 2001 should be relied on.
- The safe harbour regime is designed to encourage directors in distressed or near insolvent situations to formulate a plan (or plans) that delivers a better outcome to the company than an immediate administration or liquidation.
- The purpose of the regime is to allow directors the ‘breathing space’ to formulate a plan of action to preserve the business and to avoid (as far as possible) the need to enter into voluntary administration.
- Provided the company is still able to pay its debts as they fall due and no action has been taken to suspend payments, appoint an insolvency practitioner or reschedule its debts, the commencement of safe harbour would not, in and of itself, trigger the insolvency or insolvency proceedings events of default under the standard APLMA facility documentation.



Please note this might not be the case in other facility documentation and directors should seek legal advice before commencing the safe harbour regime. In particular, in the alternative lender market, the definition of an insolvency event of default may capture the entry into safe harbour and trigger a breach.





# Our offering

Hamilton Locke specialises in solving complex client problems, and working with clients and advisers to build long-term relationships and value.

## WORLD CLASS CAPABILITY

Our team all joined us after careers in top-tier Australian and global law firms

## GREAT VALUE

We develop the best pricing approaches with our clients to strike the right balance of fairness, certainty and risk-sharing

## CUTTING EDGE EXPERIENCE

We have advised on hundreds of iconic, cutting-edge corporate deals and in the last 24 months advised on deals with a value totalling \$3 billion

## THE BEST APPROACH

We invest time at our cost to understand our clients' objectives, risk appetites and operating styles

## DEEP SECTOR EXPERIENCE

We have experience in a broad spectrum of industry sectors, including retail, financial services, technology, food and agribusiness and healthcare

# Our core team in times of distress



**Zina Edwards**  
Partner

T +61 468 992 183  
E [zina.edwards@hamiltonlocke.com.au](mailto:zina.edwards@hamiltonlocke.com.au)

Zina has extensive experience advising major trading and investment banks, syndicates, funds and public companies in relation to various high profile and complex financial turnarounds, restructurings and special situations. Zina has worked on a large number of distressed and performing portfolio sale transactions in Australia and across Asia acting for both purchasers and sellers. She also specialises in debt trading and alternative finance transactions and has acted for a wide range of funds and alternative capital providers.

Zina previously worked in the restructuring, turnaround and insolvency team of Herbert Smith Freehills in Sydney. She has also worked in the London and Moscow office of Allen & Overy as part of the global restructuring group.



**Nicholas Edwards**  
Partner

T +61 421 063 656  
E [nicholas.edwards@hamiltonlocke.com.au](mailto:nicholas.edwards@hamiltonlocke.com.au)

Nicholas is a partner in our restructuring and insolvency team who specialises in advising on contentious and non-contentious issues arising from large-scale corporate distress.

Nicholas represents financial institutions, insolvency practitioners, distressed debt funds, debtors and company directors.



**Hal Lloyd**  
Partner

T +61 415 929 315  
E [hal.lloyd@hamiltonlocke.com.au](mailto:hal.lloyd@hamiltonlocke.com.au)

Hal has more than 20 years' experience in mergers and acquisitions, private equity, capital raising and distressed transactions across a number of industry sectors.

Hal has been recognised for his expertise in a broad range of areas, including AFR Best Lawyer and Legal 500 Asia Pacific for Restructuring and Distressed Investing and Legal 500 Asia Pacific for Mergers & Acquisitions.

Hal was previously a partner at Baker & McKenzie and also worked at King & Wood Mallesons and Latham & Watkins in New York.



**Brit Ibanez**  
Partner

T +61 421 355 503  
E [brit.ibanez@hamiltonlocke.com.au](mailto:brit.ibanez@hamiltonlocke.com.au)

Brit provides a full range of dispute resolution services from risk management advice through to large-scale litigation with a focus on funds management, financial services, and corporate governance best practice. Brit's particular areas of expertise include advising responsible entities and trustees on the operation and management of their schemes, resolving shareholder oppression actions, advising directors about their potential liability in advance of making board decisions, acting for parties in joint venture and partnership disputes, financial services disputes, and conducting litigation about disputed contract rights and obligations.

# What our clients say



Zina Edwards is a standout lawyer in the finance and restructuring areas with a strong reputation for providing commercial solutions to complex transactions. Her technical brilliance and proactiveness were key to delivering a timely, creative and high-quality service for our deal. Zina's team is of an exceptional calibre – very competent, intelligent and thorough in the work that they do.

Warren Brandt, Director  
**The Eights Private Equity**



Negotiations were long and protracted, but throughout the entire process we consistently received sound, timely, and commercial advice. [The] team...worked tirelessly and professionally.

Gary Stead, Australia Country Head  
**Olympus Capital**



Each transaction was not easy and timeframes were very compressed – so it was good to have Zina and Monty on our side. Appreciate it. Safe to say we are fans of Hamilton Locke.

Frank Danieli, Vice President  
**Moelis Australia**



[The] team has a great reputation as providing top-tier style advice to the mid-market... also successfully driving innovation in legal services by deep partnering with clients and alternative billing practices.

Robert Read, Managing Director  
**Harbert Australian Private Equity**



We...rate [the team] highly for skills across a range of areas. We also value commerciality and cost effectiveness...again delivered a first class legal result, understood the commercial drivers and efficiently managed costs.

Todd Barlow, Managing Director  
**Pitt Capital Partners**



We would not have been able to get the right deal without your input.

Roger Jowett, Managing Director  
**Hastie Group**

# Selected transaction experience

## Distressed transactions and special situations

### TOPSHOP TOPMAN

Advising on the sale of the Australian business through deed of company arrangement

### TRAILSTONE

Acting for Trailstone in their capacity as secured party and KordaMentha as administrators on the sale and recapitalisation

### NONI B

SPECIALTY FASHION | GROUP

Acted for Noni B Ltd in the acquisition of assets and businesses from Specialty Fashion Group Ltd



Acting for the sponsor of a pre-packaged restructuring through administration of Krispy Kreme



Advising Alceon Group and Ezibuy in the acquisition of SurfStitch (from administrator)



Acting for receivers and managers of Edhod Pty Ltd (a childcare development business)



Acting for administrators of Zanui in relation to the sale of the business to Marlin

### Brookfield

Advising Brookfield on the acquisition of the Flow Systems business through a deed of company arrangement and subsequent restructure



Acting for Grant Sparks, Martin Ford and Grant Longley in their capacity as liquidators of Linc Energy Limited (In Liquidation)



Advising Centerbridge and Oaktree on all Australian Aspects of the takeover and recapitalisation of Billabong



Acting for the secured creditor on the restructure through deed of company arrangement



Acting for Moelis Australia on the restructuring of an existing syndicated facility agreement as part of the acquisition of the Redcape Group



The sale of the business of Lover Clothing by its administrators, Ferrier Hodgson, to Gazal Group



Acting for receivers of certain property including a number of shares in Donaco Limited which were sold by the receivers to a Thai counterparty



Acting for liquidators of Black Oak Minerals Limited on the sale of the Marda gold project to Ramelius Resources Limited



Acting for the mining division of an international bank as the provider of a super senior new money facility to the post restructure merged Emeco group



# Selected transaction experience

## Private and alternative financing



LONGREACH  
CREDIT INVESTORS

Acting for Longreach Credit Investors in relation to the provision of senior secured facilities to growth companies, including E&A Group Limited (Longreach's largest investment to date)

### ADM CAPITAL

Advising ADM Capital on its secured investment into a public unlisted growth company, including structuring the loan note facility, security and warrants, and subordination arrangements with existing shareholders and convertible noteholders



Advising Seagrass group in relation to an investment by Crescent which was, in part, structured as secured loan notes and converting notes



Acted for Moelis Australia on the senior secured financing raised to fund the acquisition of the real estate freehold and operating business of the Beach Hotel, Byron Bay



a nuveen company

Advising TIAA Henderson Real Estate on the transfer of their interest in a commercial tower in Sydney to a newly established related trust entity



Advising Highpoint Capital on its investment in a fintech company, structured as a convertible redeemable preference share and including a management equity ratchet

### CONFIDENTIAL

Advising a confidential lender on its secured financing to a childcare group for the development of childcare centres across Australia, and acting for the receivers and managers and lender in the restructuring of the borrower group



Advising a consortium of Deutsche Bank, Goldman Sachs and Värde in relation to their existing financing of a residential and commercial tower project which had gone into receivership



Advising Agrifunder and Tozer and Co in relation to a capital restructuring and secured note facilities issued to Nomura



Acting for The Eights Pty Ltd in relation to a secured convertible note that was advanced as part of the acquisition by Shepparton Partners Collective Pty Ltd of the SPC business from Coca Cola Amatil



Advising Alceon Group and Noni B on the accession of Noni B's new subsidiaries into a secured facility following the acquisition of several brands from Specialty Fashion Group



Acting for Moelis Australia on the restructuring of an existing syndicated facility agreement as part of the acquisition of the Redcape Group

## Alternative lending structures



tim finance  
YOUR PARTNER FOR GROWTH

Acting for TIM Finance as the borrower under a warehouse style facility provided by Alceon and in respect of the establishment of a new trust and the provision of securitisation style financing by a listed alternative asset manager to the newly established trust

### CONFIDENTIAL

Advising an alternative lender on a mezzanine financing of a property development including the structuring of a profit share and put option arrangement and the sub-participation of the mezzanine facility to downstream investors



Structuring a technology lead solution for ongoing lending products of Parc Capital including the automation of lending documentation

### CONFIDENTIAL

Advising on a receivables lending solution to be offered to consumers by an alternative credit provider



# Thank you.

## **SYDNEY**

Australia Square  
Level 42, 264 George Street  
Sydney NSW 2000

## **BRISBANE**

Riverside Centre  
Level 28, 123 Eagle Street  
Brisbane QLD 4000

## **MELBOURNE**

Level 13, 461 Bourke Street  
Melbourne VIC 3000

## **PERTH**

Central Park  
Level 27, 152-158 St Georges Terrace  
Perth WA 6000

[hamiltonlocke.com.au](https://www.hamiltonlocke.com.au)

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