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COVID-19 Solvent?

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The COVID-19 pandemic is causing economic turmoil in many sectors of the U.S. and global markets, wearing away the balance sheets of companies and triggering bankruptcies for many brick and mortar retailers, restaurants and fitness centers, as well as oil and gas, travel, hospitality, and gaming companies, and others. There are also tenants that have delayed (stopped) paying rent on their leased locations, which of course trickles downhill to property owners.

Companies that were highly leveraged coming into the pandemic have seen their situation exacerbated due to the current environment, forcing many to file for bankruptcy protection.

The current market volatility, in conjunction with the economic impact on businesses that either are still closed or operating at reduced capacity, is making it more challenging to value a business for debt or equity financing. A company's current liquidity and its ability to meet its current obligations is key to its success. The solution for some companies has been to raise equity in a "down round" financing, for others, they have sought more debt (not just PPP debt). But as liquidity declines and balance sheets become more leveraged, longer-term insolvency-related issues start to surface.

The issue is not that debt is bad for a company, but rather that much of this new "Covid debt" is being used to finance corporate survival rather than financing receivables, or growth and profit producing capital projects such as acquiring new manufacturing equipment and facilities. How can one develop reasonable financial projections for a business when it is unclear as to when the business can open again, will it close again, or whether there will be restriction to the way it can operate?

Given the complexities in the valuation of both debt and equity in the current environment it becomes more important that both boards and lenders protect themselves from fraudulent conveyance claims by getting a solvency opinion from an experienced independent third-party provider.

Directors Role

The responsibilities and duties of a company's directors are difficult enough during good times. However, in periods of questionable solvency, directors also need to consider the interest of the company's creditors so as not to expose themselves and the company to potential claims. A company's solvency may come into play in fraudulent conveyance, bankruptcy alter ego, and due diligence to shareholders and creditors.

Liquidity vs. Solvency

While liquidity is primarily related to a company's ability to meet its short-term obligations, solvency, within the context of a business, is defined as a business's ability, to meet its long-term debts and financial obligations. A Solvency Opinion is an opinion from an independent advisor confirming that upon the consummation of a contemplated transaction, that:

1. The company's assets exceed its debts;
2. The company will be able to pay its debts as they come due;
3. The company is not left with unreasonably small assets or capital.