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COVID-19
May 7th 2020 Update: Government responses

Executive Summary

- **Pemberton continues to monitor closely the situation to evaluate the liquidity needs of portfolio companies** and work alongside them to structure appropriate solutions. One key aspect of this work has been to **understand the effectiveness of government measures**, particularly state-backed loan guarantee schemes. We have found that while these measures have helped some corporates, they have been generally difficult to access by private equity-backed companies and slow in their execution.
- The landscape is now quickly shifting as Europe turns its attention towards the difficult task of slowly emerging from multi-week lockdowns. **Governments are adopting different strategies as they attempt to strike the right balance between encouraging greater economic activity and maintaining the spread of Covid-19** at manageable levels. The patterns emerging indicate that the road ahead will be long and gradual, with significant restrictions likely to remain in place for an extended period.
- At Pemberton, we are in **active dialogue with our portfolio companies** regarding the state **guaranteed loans available in their respective jurisdictions**. We are **considering very closely the additional indebtedness** created by those loans and have put in place a framework to ensure **strong focus of stakeholders** on cost management and EBITDA generation. Depending upon the size of the government loan and materiality with respect to each portfolio companies' capital structure, we will seek to negotiate: (i) more control though **board observer seats**, (ii) better visibility through **additional financial projections** adjusted for the market disruption and (iii) appropriate compensation for our risk through **improved lending terms.**
- **We believe direct lenders will continue to play an important role as the crisis moves into this next stage**. By providing local expertise and long-term capital to a system in need of support, private debt providers can help identify, structure and deliver bespoke liquidity solutions to enable mid-market companies to navigate through these choppy waters.

How accessible are the state-guaranteed loan schemes in Europe?

- We have been actively engaged in dialogue with borrowers, sponsors, banks and advisors regarding their experiences accessing the government support programmes deployed in response to Covid-19. Europe's largest economies now all have loan schemes that can theoretically support mid-market companies.
- From a practical "on the ground" view, the accessibility of these schemes by private equity-backed companies and the length and complexity of their execution vary significantly across countries. Although PE-backed companies have had some success accessing these loans and are not explicitly left out of any of the schemes, many are facing particular difficulties.
- In Germany, for example, while not an explicit eligibility criterion for the KfW scheme, the scheme is not always available to PE-backed firms and some loans are being refused on the basis of the company's leverage among other reasons. In the UK, PE-backed corporates have struggled to access loans under the new Coronavirus Large Business Interruption Loan Scheme (CLBILS) because of the treatment of asset-light leveraged businesses as "Undertakings in Difficulty" under EU state aid rules making them ineligible for the scheme.
- Application processes have also proven slow and complex, in part because executing banks still need to run full credit approval processes for the portion of the credit risk not guaranteed by the state. In some countries applications go through a "double" credit approval process with the state bank also required to seek approval for individual loans, significantly delaying the receipt of funds.
- These delays are caused to some extent by limited processing capacity in the system and by the complexity of structuring loans to leveraged borrowers. That is why we believe there is an opportunity to enable direct lenders to play a greater role in supporting the economy during the crisis and empower them to provide expertise, capacity and capital to a stretched system in need of support.

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ANALYSIS AND KEY TAKE-AWAYS

Releasing economies from lockdown: a long and gradual road ahead

- It has been almost two months since Italy became the first European nation to go into lockdown on March 9th, and it appears most countries in Europe have now passed the peak of new infections.
- Governments have now started to put into action their lockdown exit strategies. While the gradual reopening of shops, schools, factories, offices and restaurants will enable economies to return to a rate of economic activity closer to their pre-crisis levels, activity is expected to remain significantly subdued as long as social distancing restrictions are in place. This is likely to be the case until a vaccine is widely available.
- Countries are adopting different strategies based on their specific experiences with the virus and the shapes of their infection curves. For example, certain shops have been allowed to remain open throughout the crisis in the Netherlands, while Germany has allowed some to start reopening from April 20th. In Italy and Spain, particularly restrictive lockdowns have started opening up on May 4th and France is set to follow from May 11th. The UK's government has yet to make concrete announcements regarding the easing of lockdown restrictions but an update is expected in the next few days.
- Within the country-by-country variations some patterns are emerging. First to go are the most restrictive constraints on personal mobility, followed by allowing nurseries, primary schools and small non-essential shops to reopen. Harder-hit sectors like travel and hospitality remain challenging to restart and indications suggest servicing capacity will be restricted, such as restaurants limited to operating at 30% capacity. If the economic response to the easing of restrictions is sufficiently strong, governments have also intimated their intention to start slowly withdrawing some of the support measures deployed to date.

Importance of private capital during this crisis

- Considering the difficulties companies are facing to access government support measures swiftly and the long road ahead out of lockdown, we believe private capital will continue to play a significant role in supporting mid-market borrowers through this crisis.
- Public market volatility has stemmed the flow of capital and US and European banks are provisioning for more than $50 billion of loan losses this year, the largest such amount since the GFC.[1] This will hinder their ability to underwrite new loans for existing and new borrower relationships.
- Addressing companies' liquidity needs requires bespoke solutions that involve several stakeholders including private equity sponsors, local banks, governments and direct lenders. Structuring these solutions can be a complicated endeavour requiring specific expertise to carefully consider the legal, financial and business impacts of any new liabilities incurred.
- **Private credit managers like Pemberton** that benefit from the backing of long-term institutional capital, a pan-European footprint and local market expertise, can step in where governments, banks and capital markets fall short.
- As the sole lender in a majority of our transactions, we maintain close dialogues with all of our portfolio companies and are continually monitoring their liquidity needs. Our local presence enables us to actively work with our portfolio companies, helping them navigate through this crisis and tailor appropriate solutions to the issues they face.

[1] Financial Times, May 3rd 2020: Banks to book more than $50bn against bad loans.

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OVERVIEW OF PUBLIC SUPPORT MEASURES & LOCKDOWN EASES

Bold indicates updates from prior report

	UK	France
Tax	• Deferral of VAT payments for businesses and income tax payments for self-employed workers • Business rates holiday for companies in the retail, hospitality and leisure sectors and nurseries	• Deferral of social contribution payments • No-penalty extensions on certain VAT, corporate & local taxes • Selective tax and social security charge rebates
Loans & Guarantees	• **Bounce Back Loans: Govt. to offer 100% guarantees on 6-year loans to SME businesses between £2k-£50k** • **Start-ups support: Convertible loans of £125k-£5m for working capital purposes (3-year loans at minimum interest rate of 8%)** • CBILS: BBB[2] to support SME access to bank lending, overdrafts & working capital facilities; provide lenders with an 80% guarantee on loans up to £5m and to cover fees and interests payable in first 12 months • CCFF: BoE facility committed to purchasing investment-grade commercial paper • **CLBILS: Govt. to provide 80% guarantees on loans of up to £50m for businesses that cannot access CCFF or CBILS**	• Various support measures by BPI[3] France including 3-7-year loans to SMEs with 12-month deferred capital amortisation, 90% guarantees on new loans and overdrafts below €20m • Private sector banks undertaking to offer 1-5-year loans starting at 25 bps margin, up to an amount equivalent to 3 months of turnover with guarantee from French state between 70% and 90%
Employment & Income Support	• State to cover 80% of salary of furloughed workers and 80% of trading profits of self-employed workers affected by Covid-19, up to £2,500 per month • SMEs can reclaim up to 2 weeks of statutory sick pay per employee • One-off grants made available to eligible SMEs and companies in the retail, hospitality and leisure sectors	• Companies who place staff on temporary leave may reduce their salaries to 70% which will be reimbursed by the state • Solidarity fund for independent business owners forced to shut down
Others	• Landlords unable to start eviction proceedings or lease forfeiture for at least 3 months; Some lenders have offered 3-month mortgage holidays • Suspension of wrongful trading law to minimize risk of premature insolvency proceedings • Temporary 6-month suspension of National Rail Franchises to ensure continuity of service	• **Several sector-specific support measures** • Suspension of rent and utility bills for vulnerable SMEs • Banks have undertaken to defer by up to 6 months the repayment of loans or interest payments and to waive penalties on maturity extensions • Banque de France to support borrowers in negotiating a rescheduling of their loans
Lockdown Easing	• Government has a legal deadline of May 7th to review its lockdown recommendations • An announcement is expected in the next few days.	• From May 11th shops and markets excluding large shopping centres will be allowed to reopen, though bars and restaurants will remain shut until at least the end of May • Primary schools will be allowed to reopen on a voluntary basis from the same date, with middle and high schools to follow later in the month • The state is also considering gradually withdrawing the exceptional temporary unemployment scheme

[2]BBB: British Business Bank, British state-controlled bank. [3]BPI: Banque publique d'investissement, French state-controlled bank.
Please note that this information has been sourced from local government websites.

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Bold indicates updates from prior report

	Germany	Netherlands
Tax	• Deferral of income and corporate tax payments, reduction of tax prepayments, and suspension of enforcement measures and penalties	• Deferral of VAT, income, corporate and wage taxes and suspension of late payment penalties
Loans & Guarantees	• KfW[4] existing loan program extended with state commitment to provide unlimited additional support • Maximum loan size increased from €25m to €1bn and guarantee increased from 50% to 80% for large corporates and 90% for SMEs • **New loan "KfW Schnellkredit" introduced, i.e. loans with no risk assessment, for general corporate financing and working capital requirements, up to €800k** • Economy Stabilisation Fund put in place to provide up to €500bn of loans and guarantees to large and mid-sized corporates • Insolvency regime adapted to facilitate restructurings by relieving pressure on management to file for insolvency • Elimination of equitable subordination risk, claw-back rights, and lender liability for all new loans extended until September 2020	• **Extension of existing Government Corporate Debt Guarantee Scheme (GO-C) for SMEs and corporates, loan size from €1.5m to €150m, guarantee max. 80% of the loan size for corporates** • **Guarantee fees to be paid by the bank to the State, to be partially passed on to the borrower via interest rate** • Lowered regulatory capital requirements to free €8bn of bank capital • Some banks have offered deferral of repayments on existing debt facilities (6-month repayment extensions on loans up to €50m)
Employment & Income Support	• **Initially, the employment agency paid 60% of net pay difference (67% if employee supports min. one child)** • **New bill passed on April 23rd 2020: if working hours are reduced by >50%, employees will receive 70% (77%) of net pay difference from the fourth month and 80% (87%) from the seventh month of short-time work** • **New bill effective until December 31st 2020**	• Companies affected by a 20% or more reduction in turnover can apply for a compensation of up to 90% of labour costs (based on the updated regulation initiative NOW) • Varying with the extent of turnover loss, the government will provide an advance payment of 80% of the requested amount of compensation for the company to be able to continue the payments to their workers (up to an employee's individual salary of €9,538 per month)
Others	• Commercial tenants temporarily protected from lease termination due to missed payments • Other accommodative measures for VAT, insurance, energy and air traffic taxes • Reduction of VAT from 19% to 7% on food and beverages served in restaurants, cafés, and bars (Effective from July 1st 2020 to June 30th 2021)	• Compensation scheme under review for industries affected by governmental measures (i.e. aviation, hospitality, leisure)
Lockdown Easing	• Since April 20th light lockdown easing measures, as re-opening of shops under a certain size and highest elementary school classes in school • With announcement on May 6th next big step of lockdown easing • All retail stores to reopen (regardless of size) • Restaurants and Bars to reopen in May • All school classes to resume until summer • Bundesliga to resume on the basis of ghost games	• Most shops have been allowed to remain open throughout the crisis • Nurseries and primary schools will be allowed to reopen from May 11th • Secondary schools are expected to reopen by June 2nd • Restaurants, bars and fitness clubs are expected to remain shut until at least May 19th

[4]KfW: German state-controlled bank.
Please note that this information has been sourced from local government websites.

OVERVIEW OF PUBLIC SUPPORT MEASURES & LOCKDOWN EASES

Bold indicates updates from prior report

	Italy	Spain
Tax	• Deferral of tax collection and controls • Tax-based incentives to encourage corporates to sell impaired receivables • Temporary suspension of social security contributions	• Deferral of tax processes and payments
Loans & Guarantees	• CDP[4] to provide up to 80% guarantees on bank loans to corporates • Central Guarantee Fund to provide guarantees on SME loans • Freeze on revocation of SME credit facilities and loans and deferral of all loan instalments and rental payments due before September 2020 • **Additional "Liquidity Decree" now addressing larger companies (turnover >€50m) with irrevocable first demand guarantee issued by SACE (Italian export credit finance agency)** • **Liquidity Decree with overall amount of €200bn, maximum loan percentage covered by the guarantee equal to 90% of the financing for companies with fewer than 5,000 employees**	• ICO[5] to provide loan guarantees for companies and self-employed workers covering renewals and new financings (a maximum of €100bn Guaranteed Line) • **A first tranche with €20bn shared 50/50 among large companies and SMEs/self-employed, a second tranche with another €20bn was entirely devoted to SMEs/self-employed. A third tranche of c.€25bn will be released shortly** • Funding provided to Spanish export credit agency to shore up liquidity of exporters • Loans made available to SMEs to buy equipment necessary to enable employees to work from home
Employment & Income Support	• Extraordinary unemployment benefits for employees of companies with reduced work • Self-employed workers granted access to National Solidarity Fund to support home mortgage payments • One-off tax-free contribution of €600 to freelance, seasonal and entertainment sector workers	• Special state benefit for self-employed workers who suffer from a loss of income • Employers exempt from paying 75% of social contributions for workers on temporary lay-offs or short-work arrangements • Deadlines for tax obligations derived from tax proceedings have been extended until May 30th 2020 unless the regulation provides for a longer deadline
Others	• Financial contribution to enterprises to purchase personal protective equipment for workers • Damage compensation to the aviation and cruise sector • Export credit agency support to boost exports	• Utility suppliers prevented from cutting electricity, gas or water of vulnerable customers • Vulnerable customers may be eligible for a deferral of principal or interest payments on mortgages • Controls imposed on foreign direct investments involving the purchase of significant control of a company • Debtors are not required to file for insolvency while the state of emergency is in effect, and creditor-initiated filing not allowed until 2 months after its end
Lockdown Eases	• A number of lockdown restrictions were lifted on May 4th including allowing visits to relatives and exercising outdoors • All plants, factories and other manufacturing facilities were allowed to reopen, as well as certain shops • New announcements on May 18th and again on June 1st	• On May 4th, hairdressers and other appointment-based businesses were allowed to reopen, and restaurants were allowed to resume take-away services • Workers in certain industries deemed non-essential, including in manufacturing and construction, were allowed to return to work • The next phases expect to see small shops, hotels, tourist apartments and ultimately restaurants allowed to reopen, though with restricted capacity

[5]CDP: Cassa Depositi e Prestiti, Italian state-controlled bank. [6]ICO: Instituto de Credito Oficial, Spanish state-controlled bank.
Please note that this information has been sourced from local government websites.

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