The outbreak of COVID-19 could be the most significant event to impact the US economy in generations with the potential for ripple effects in the automotive market and supply chain for years to come. Accordingly, OEMs and suppliers from all tiers may need to rethink the supply chain model, from sourcing of raw materials to production of finished products and everything in between. The impact from the spread of the virus on industry, starting in vitally important Wuhan, and spreading globally, has been significant and immediate. Indeed, the “Big Three” automakers along with their European and Asian counterparts have felt the immediate effects of the virus, not only to protect their work forces, but as a result of falling markets and supply chain disruptions.
Ford, GM and FCA have suspended manufacturing in parts of the US and repurposed for production of COVID-19 medical devices.

Nissan has suspended production in the UK because of supply chain disruption and demand reduction.

Daimler has suspended European production as supply lines are disrupted.

Toyota has halted production in Europe because of government restrictions on the movement of people, supply chain disruptions, and falling sales.

BMW has stated that the closure of its European plants and its factory in South Africa will last until April 19 as it copes with lower demand caused by the coronavirus outbreak.

Honda has closed four US vehicle plants due to anticipated decline in the market as a result of coronavirus.

Toyota Europe is shuttering plans across the continent in the wake of government coronavirus-related shutdowns.

Renault is closing plants in Slovenia, Morocco, and Romania.

Volkswagen is suspending production as a result of the outbreak.

While new car sales have been running at approximately 17 million units within the US for the last 5 years, analysts had already predicted a pre-pandemic reduction in sales of 7-10%. Faced with the global pandemic, the revised market expectation is that the annual volume will be reduced by 20%, which will undoubtedly hit suppliers hard. Already tight margins, sole reliance on OEM production, and a precipitous corona-related market drop expose suppliers to significant risk for which they should be proactive. Indeed, the domino effect of plant closures and supply shortages across the extended supply network can quickly lead to significant supply chain disruption. While the current situation may seem dire, it may provide companies the needed motivation to revisit their current supply strategies and implement new, more protective models, while implementing short-term actions to mitigate risk exposure.

Survival and Loss Mitigation

Risk Management Plans. To the extent not already implemented, suppliers should quickly endeavor to develop and implement a robust supply chain risk management strategy focusing on business continuity. Such strategies should include (i) diversifying supply chains from a geographic perspective to limit risks from any one country or region where possible, (ii) securing multi-sourced key commodities to reduce reliance on individual suppliers, and (iii) implementing inventory systems to mitigate against supply chain disruption.

Protect Cash Flow. Suppliers should immediately develop detailed plans for cash management which includes a focus on collecting aged receivables and, to the extent possible, extending payables to conserve cash. Suppliers should also consider whether they will be eligible to receive government funds from the
Coronavirus Aid, Relief, and Economic Security (CARES) Act which is anticipated to be enacted in the next few days. Under CARES, in addition to providing for an additional $50 billion (almost $350 billion in total) for loans through the Small Business Administration, Phase 3 of the CARES package provides $500 billion in loans, loan guarantees, and other financing for “distressed industries” – though such financing now comes with more strings attached, including expanded restrictions prohibiting stock buybacks. Companies are encouraged to seek sophisticated public policy counsel to guide them through these programs in order to maximize their opportunity to receive such funds.

**Attention to Supply Network.** Tier 1 suppliers should enhance communications and discussions with key Tier 2 suppliers and beyond, as their health and operations directly impacts Tier 1 supplier order fulfillment performance—providing maximum time to work with Tier 1 suppliers on alternative plans, and/or to proactively alter supply chain plans to keep plants running at maximum efficiency within the likely supply-side constraints. Indeed, due to plant and workforce shut downs, suppliers at every level should expect significant declines in on-time in-full delivery performance from key suppliers. Therefore, increased attention to the status of inventory at the supplier location, supplier production schedules, and status of supplier shipments will provide early warning of shortages and allow upper tier suppliers to respond accordingly. For critical suppliers, working to get better visibility to their supplier performance (Tier 2 suppliers and beyond) can be very beneficial to predicting potential supply disruptions and working proactively to alleviate the impact. Companies that aren’t electronically connected to key direct suppliers and don’t have real time data on the inbound flow of products and materials, should move quickly to implement programs to access data and enhance management and decision making capabilities.

**Implementation of Alternative Supply Sources.** Once plant shut-downs and travel restrictions have eased, suppliers at all tiers should move quickly, where possible, to engage secondary supplier relationships and secure additional critical inventory and capacity. Alternative sourcing markets will vary greatly by supply chain and manufacturing expertise. Countries such as Mexico, Brazil, India, and Chile have historically been the most likely markets in which to diversify beyond China, yet the rate at which the virus appears to be spreading may have diminished these alternatives.

**New Financial Projections.** While difficult to accept, it is critically important that suppliers recast operating cash flow projections. This includes revising assumptions, forecasts, and business plans that reflect the new corona-deflated market. It is important to prepare current projections that consider the best and worst cases for the next few months and longer.

Revising projections that consider the current environment and the impact from OEM shutdowns is an important part of making good operational and management decisions. While companies will now likely need to update projections more frequently to keep up with the near daily ramifications of the outbreak, it is important to keep thinking about best and worst cases. If there is a worst-case scenario that suggests a need for your company or a valued business partner to initiate a restructuring process, the sooner steps are taken to start the restructuring
process, the more options your business will have. A proactive approach is critical, especially in these fluid situations. Management that hides its head in the sand likely will not survive. In that vein, hiring experienced legal professionals and financial advisors early can provide credibility in dealing with lenders, trade creditors and investors and preserve enterprise value.

**Develop A New Financial and Operating Plan.** Triage is important. The automotive industry, in particular, has seen significant fluctuations over the years, as is evident from the GM and Chrysler bankruptcies in 2009 to milestone sales in 2016. Accordingly, the auto industry, including Tier 1 suppliers, is particularly adept at managing operations in times of stress. However, few companies have ever faced the dramatic, escalating crisis now present. Companies have little choice but to pivot meaningfully and strategic planning is key to survival. This planning has to address the new reality reflected not only by changes in supply chain operations discussed above, but by revised and updated financial projections which should include:

1. **Protecting working capital:** This includes an inventory of existing working capital, drawing on existing lines of credit and developing and implementing a cost reduction plan to achieve rapid positive cash flow benefits. As mentioned above, cash is king and must be preserved.

2. **Legal and business review of existing credit facility documents:** It is important to review loan and bond indenture documents thoroughly with a particular emphasis on non-monetary covenants and those monetary performance covenants that could cause a default. If covenant breaches are possible, it is important to be proactive and to develop a strategy to discuss standstill and waiver agreements with the lender and determine whether covenant breaches create cross defaults in other company obligations. To the extent a company has multiple levels of financing, it is important to review the inter-creditor agreements and include all tiers of lenders in discussions because if covenant relief is necessary, it will likely take a collective and collaborative effort.

3. **Identify any collateral that could secure additional financing:** Seeking additional financing may not be feasible given the current environment. That could change, however, and monitoring federal and state government relief initiatives such as CARES is vital. However, to the extent a company has unencumbered assets, additional liquidity may be easier to procure. It is important to identify assets that might be available to secure additional financing including real property, inventory, and account receivables. Furthermore, securing new guaranties from principals or other entities in the corporate enterprise may help to secure additional financing. To the extent existing loan documents require lender consent to incur additional indebtedness, consider requests to lenders sooner rather than later. Moreover, it is critical to consider the impact debt relief, if offered, will have on the ability to secure government relief offerings. Further, suppliers, like most companies, usually have several avenues for relief available—standstill and forbearance agreements, amendments, extensions, restructuring, increased indebtedness—all of which may provide the needed relief.
4. **Working with a professional legal and financial advisor team to open lender communications:** Many times suppliers that need to obtain additional financing on an emergency basis think that engaging professionals requires expenditures that the company is not in a position to make. However, involving professionals in the process provides significant credibility to the “ask” or request to lender for relief as investors may be more willing to respond quickly and positively if provided with information that has been reviewed by the company’s legal and financial advisors.

**What if maintaining existing financing is not viable?** Once management is aware of its company’s inability to perform, management must work with its board to establish strategies for each of its constituent groups, including, employees, lenders, trade creditors and suppliers, customers and investors. This strategy must also include developing communication plans for each of these groups. Professional advice is also necessary to manage financial disclosure required by regulators and oversight bodies, including the Securities and Exchange Commission.

Retaining legal and financial advisors is critical to address an impending default or forecasted inability to perform on contracts or other obligations. Management must have a strategic plan in place to address these serious issues and outside counsel and financial advice is necessary to consider options, minimize risk and maximize value and is a recognized exercise of a board’s duty of care to the company and its stakeholders.

Once the board approves a strategic plan, initiating discussions with lenders and other stakeholders will require financial disclosure including projections. Lenders will need to verify financial and operating information in order to consider requests regarding covenant relief, standstill and forbearance of defaults and restructuring the debt. The plan will likely include restructuring strategies.

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