INSOL INTERNATIONAL

GLOBAL INSOLVENCY PRACTICE COURSE

Management and Business Failure

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Bob Rajan – Managing Director at Alvarez & Marsal (Munich)

- 25+ years of restructuring experience through Europe, North America, Latin America and the Middle East
- Advised corporates, portcos, large creditor syndicates, customer groups and boards either as advisor, interim management or Board director
- Previous client include Interim CFO of Douglas, NKD Group and NED at IVG Group, Galapagos, NED at Eircom, Interim CFO/CRO Stabilus, Restructuring Project Manager Schefenacker, TeleColumbus, Delphi, OEM syndicates, Marconi, Lernout & Hauspie, Slater Steel, NORTA
- Director at PwC in New York and Toronto

PwC LLP Partner – Business Recovery Services (London)

- 25+ years restructuring experience and licensed insolvency practitioner
- Involved in a wide range of industries, crisis situations and international business settings. Worked on assignments with substantial operations in UK, parts of Western, Central and Eastern Europe, North America and Africa.
- Administrator of Lehman Brothers; supported Co-op Bank with its significant capital shortfall; set up the Russian “bad bank” involving USD19bn of NPLs; advised the lenders to a global steel group; provided restructuring advice to the lending syndicate of a large European agribusiness and currently working on the insolvency of FTX

Our agenda today

- Current Trends in Restructuring
- Classic Symptoms of Distress
- Diagnostic Review
- Key ingredients of success
- Crisis Stabilisation and Stakeholder Management
- Financial Restructuring
- Fixing the Business
- Return to Normal

Current Trends in Restructuring

Current Trends in Restructuring

- What are we seeing these days?
  1. Growing complexity
  2. Attempt to globalise insolvency legislation
  3. Venue shopping with or without COMI – can I scheme it? Almost from everywhere
  4. Director's liability – still a wild card, especially in Germany
  5. What is happening with the high-yield market?
  6. Valuation, Valuation, Valuation – juniors stepping up to the plate

Growing complexity

- Restructurings today are characterised by
  - Increasing complexity
  - Larger number of stakeholders
  - Quickening pace in new developments
  - Europe not so afraid now of the word ‘insolvency’ or to use as a tool
  - What to do with the pension liabilities?
  - Depressed commodity markets and general global instability
- Result is more challenges to agreeing a consensual deal

Growing complexity

An understanding of enforcement and different insolvency systems is key…

Consensual & Enforcement	Insolvency
• Court and out of court routes (pre-pack, arrangements) • Enforcement powers • Debt for equity • Directors duties • Cultural dynamics • Commercial drivers (e.g. value) • Inter-creditor Agreements • Role of Security Trustee	• Recognition procedures/ triggers • Proceedings available • Debtor and creditor rights • Priority rules • Role and choice of advisors • Future reform – where are we heading?

Growing complexity

…as is an understanding of a credible contingency plan

- Insolvency framework and non-consensual options need to be properly understood:
  - What happens if the restructuring fails?
  - Credible Plan B – contingency planning
  - Mix and match approach
  - Salvaging value from the wreckage
  - "Best worst" outcome

Attempt to globalise legislation

- Ongoing upgrading of legislation and best practice.
- Is this leading to convergence?
  1. US still debtor friendly but are creditors more prevalent
  2. New legislation continue to get refreshed in EU
  3. Scheme anything you want through the U.K. New legislation proposed – moratorium, tool
  4. Eastern Europe
  5. China, Middle East, others
  6. What role will Brexit play?

Venue shopping – still playing a role?

- In the US (or maybe not even in the U.S. – Arcapita Bank in Bahrain)
  - Move to Delaware or Southern District of NY?
- In Europe
  - By not moving COMI (i.e. UK based documents)
  - Move COMI (effectively company's head office functions)
    1. Galapagos
    2. Wind Hellas – moved COMI twice
  - Changing law of instruments
    1. Apcoa
    2. DTEK
  - The recent x-border restructuring - Adler

Pre-packs not only in the U.S.

- Historically used in Chapter 11 for sale of a distressed enterprise in conjunction with s. 363 sale and/or cram down
- Senior-lender friendly process
- Often used in conjunction with SoA in U.K. (see next slide)
- Ireland – Examinership process with Eircom plc

Scheme anything you want…

- Germany – Rodenstock, TeleColumbus
- Spain – La Seda de Barceloan SA and Cortefiel SA
- Bulgaria – Bulgarian Telecommunications Company AD
- Netherlands - Nef Telecom Company
- Germany/Ireland - Grand
- Italy – Seat, Global Garden Products
- Kuwait – Global Investment House K.S.C.
- Ukraine – DTEK, Metinvest

UK – the new norm?

- When all else fails, SCHEME it!
  - ATU – Germany deal delivered through the UK without a COMI shift; did it solve ATU's problems?
  - New World Resources – Netherlands based but COMI shift followed by a twin track scheme
  - Afren plc – Scheme and then liquidated
  - DTEK – Scheme
  - Metinvest – Scheme as Plan B for failed Bond solicitations

- And the super scheme… …Restructuring Plans

High yield market

- U.S. professionals moving to Europe to attack high-yield market
- Not really junk bonds anymore
- Real viable refinancing solution
- Mostly governed by NY law
- Will moving COMI shifting come back?
- How to restructure?

Innovative Financial Instruments

- In recent economic crisis, some senior banks are unwilling or unable to perform debt-for-equity swaps
  - Use of Trust Structure
  - Risk of equitable subordination
  - Inability of senior banks to write-off debt

- Use of hybrid financial instruments
  1. Stabilus GmbH – external de-leveraging
  2. TeleColumbus GmbH – for tax purposes

Valuation, Valuation, Valuation

- In the U.S., valuation typically drives a restructuring
- Until recently, there was not much of a 'turnaround culture' in other jurisdictions
- Due to LBO bubble bursting, several junior creditors are now out-of-the-money
- Introduction of distressed investors – is this good for restructuring or adding fuel to the fire?
- Where does the value break?
  1. IMO Car Wash
  2. Stabilus GmbH

Classic Symptoms of Distress

Symptoms of financial distress

FINANCIAL

- Decreasing profitability
- Decreasing sales volume at constant prices
- Increasing gearing
- Management time increasingly spent on cash flow management and short term crisis
- Worsening working capital position
- Increase in debt
- Decrease in liquidity
- Availability of credit and funding increasingly restricted
- Adverse movement in share price
- Accounting practices
- Credit insurers getting jumpy

NON- FINANCIAL

- Loss of customers
- Top management team indecision
- Rapid management turnover
- Lack of planning / strategic thinking
- Lack of attention to detail
- Factional management
- Adverse image / media comment
- Lack of communication with stakeholders

Principal Causes of Decline

Diagnostic review

Objectives of diagnostic review

- Assess whether the business can survive in the short term and the need for emergency funding
- Assess long term viability
- Assess options
- Diagnose key problems and mix of strategies and actions needed
- Assess position of key stakeholders
- Preliminary assessment of management

Exercise on diagnostic review – Case Study Exercise
Question #1

- What are the key issues faced by Abaco and what is the order of priority?

The process

IDENTIFY PRINCIPAL CAUSES OF DECLINE

↓

KEY ISSUES

↓

PRIORITISE KEY ISSUES

↓

ASSESS VIABILITY BASED ON
AVAILABLE GENERIC STRATEGIES

Factors determining the feasibility of recovery

Non-recoverable

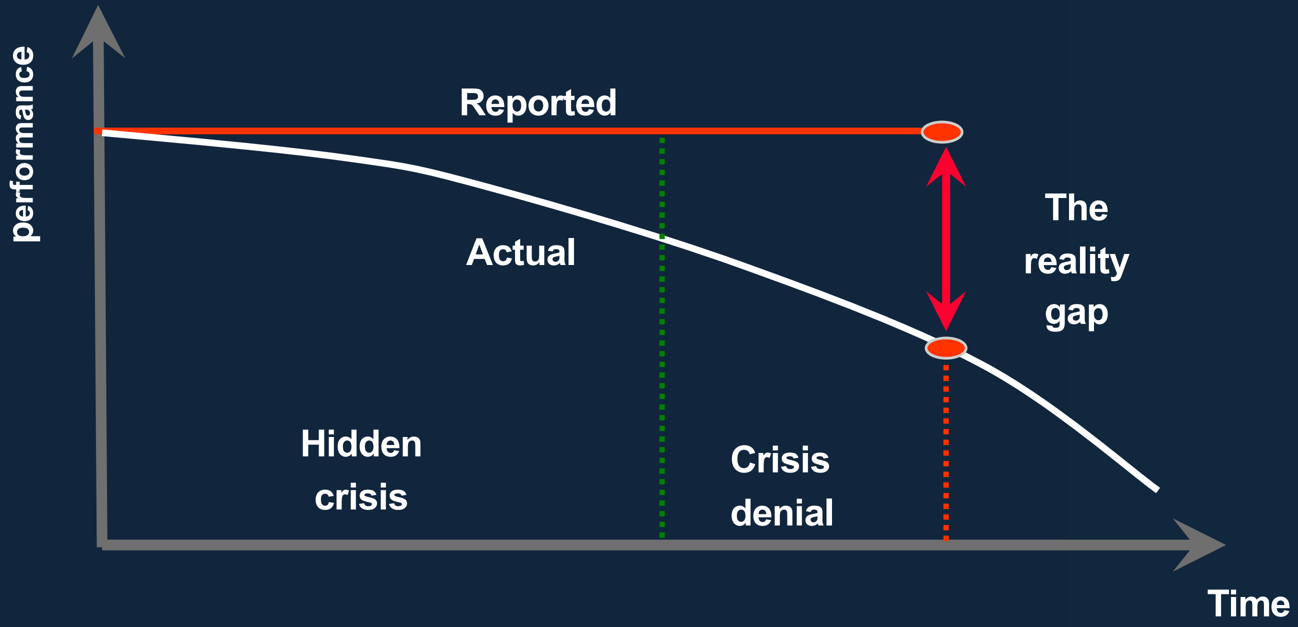
Recoverable

Failed turnarounds ('no-hopers') ← Short-term survival but eventual failure — Mere survival but unexciting profits → Sustainable recovery and good profits

- Poor management
- Many causes of decline
- Severe crisis
- Unfavourable stakeholder attitudes
- Constrained by historical strategy
- Unfavourable industry characteristics eg commodity product
- Unfavourable cost/price structure

- Good management
- Few causes of decline
- Mild crisis/no crisis
- Favourable stakeholder attitudes
- Historical strategy not a constraint
- Favourable industry characteristics eg product differentiation and focusing strategies available
- Favourable cost/price structure

The reality gap scenarios



Options assessment

- Immediate disposal
- Quick fix turnaround and disposal
- Turnaround
- Work out leading to liquidation
- Solvent liquidation
- Insolvent liquidation

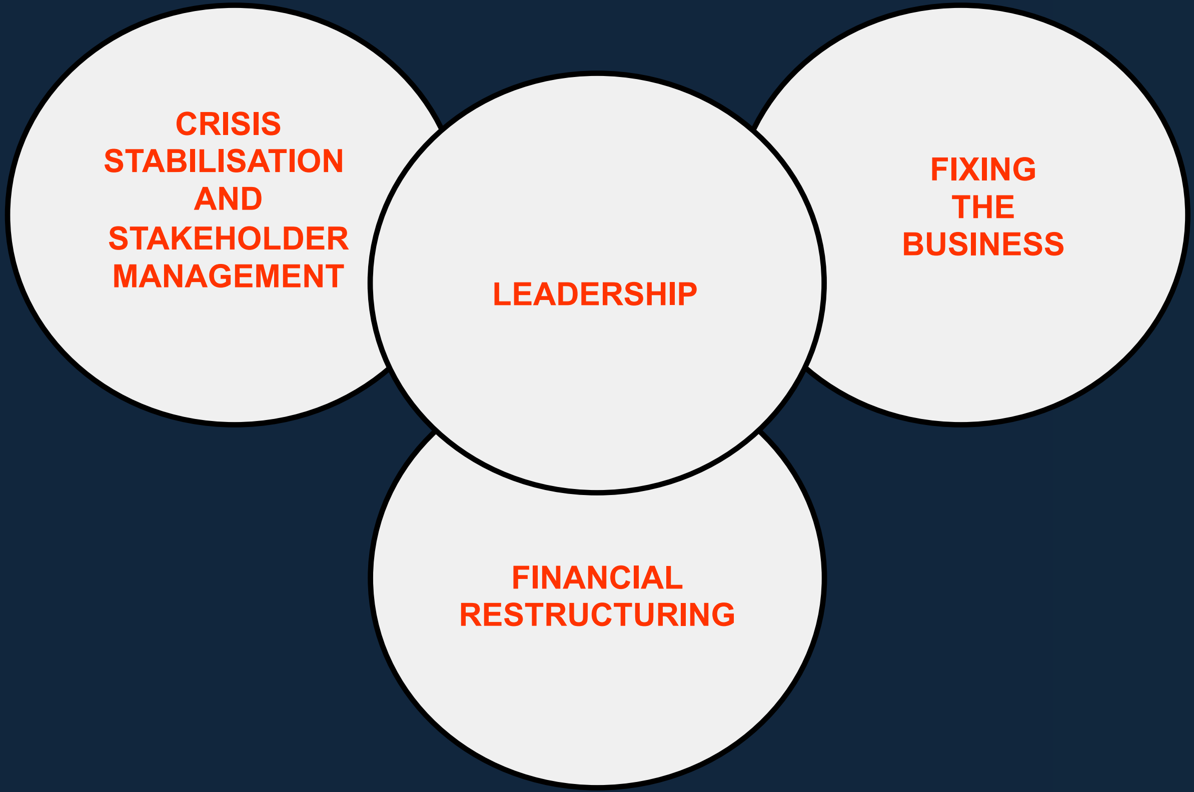
Output from diagnostic review

- Accurate analysis of current financial position
- Assessment of short-term funding needs – cash flow forecast for at least 3 months
- Funding plan
- High level assessment of key strategic and operational issues
- Conclusion about viability
- Options assessment and recommendations
- Assessment of the management team

Stakeholder agreement

Key ingredients of a successful turnaround

The turnaround framework



New leadership

- Change at the top usually required but how much?
- Increasing financial complexity in larger turnarounds leading to splitting of roles
  - CRO responsible for crisis stabilisation, stakeholder management and financial restructuring (may be also CFO)
  - CEO responsible for the operational turnaround

What are you looking to achieve?

Rebuild stakeholder confidence

Leadership team to turnaround the business

Re-establish a sense of direction

Achieve some early wins

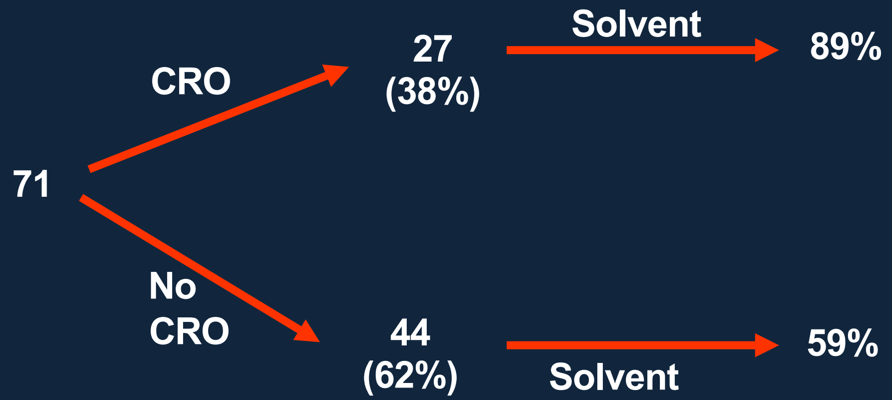
What leader are you looking for?

- Visible and hands on
- Good communicator
- "Hard-nosed"
- Evaluate management
- Evaluate Operations
- Leads by example
- Clear thinker
- Common sense
- Motivational
- Focused
- Flexible

Assessing the impact of a CRO

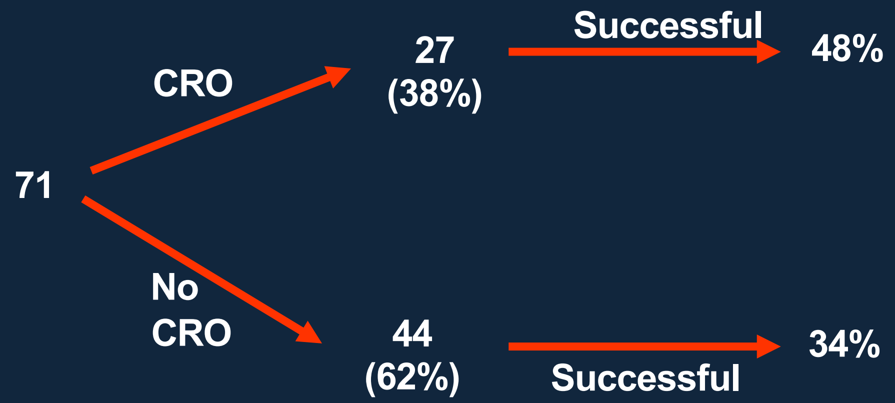
- 71 distressed entities across Europe
- Analysis of the relationship between:
  - Companies with/without CRO; and
  - Share price and time

Assessing the impact of a CRO



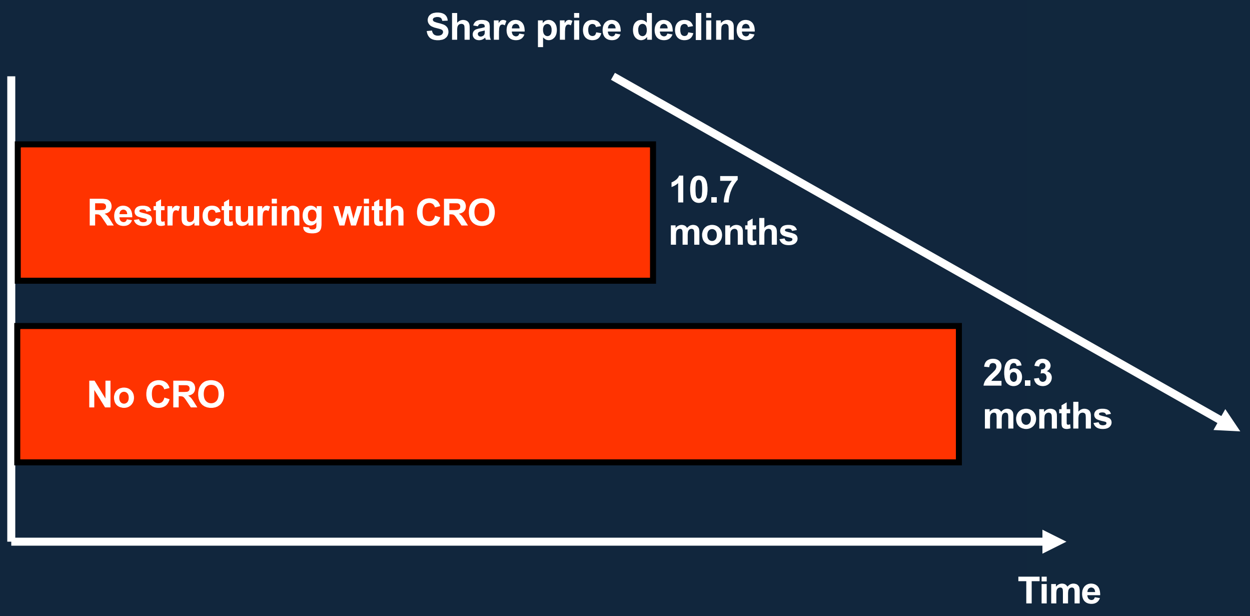
Source: Deloitte Touche Tohmatsu

Assessing the impact of a CRO



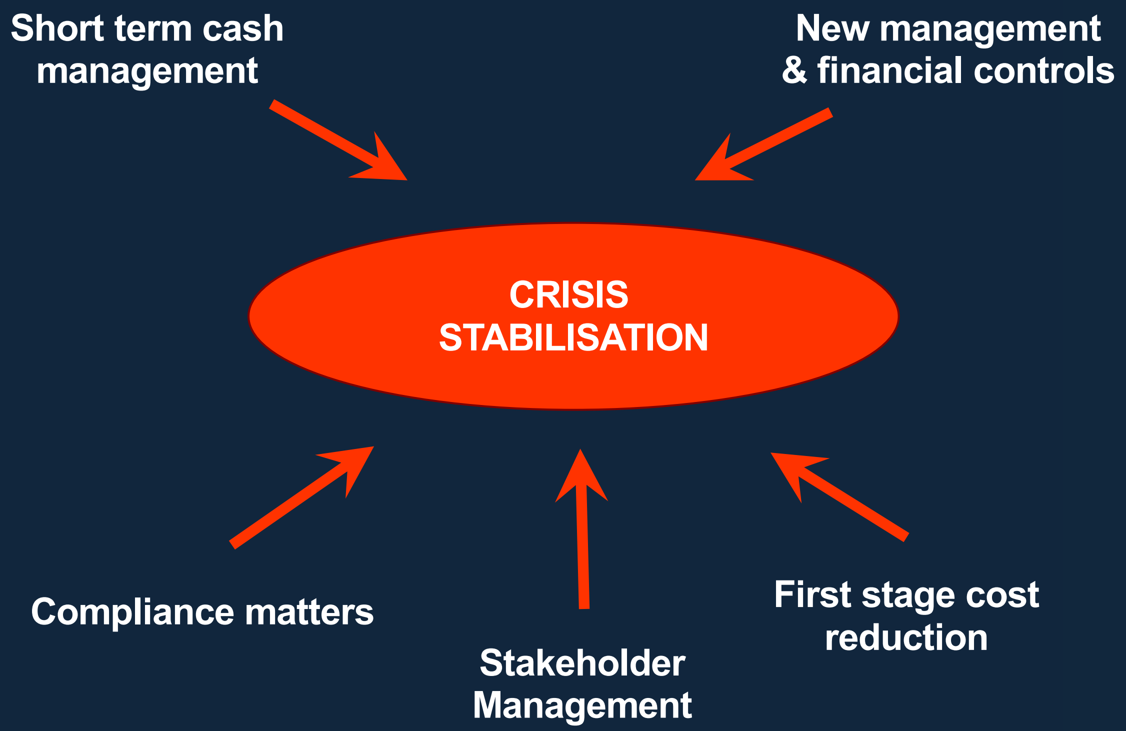
Source: Deloitte Touche Tohmatsu

Time value saved – declining share price



Crisis Stabilisation and Stakeholder Management

Crisis stabilisation



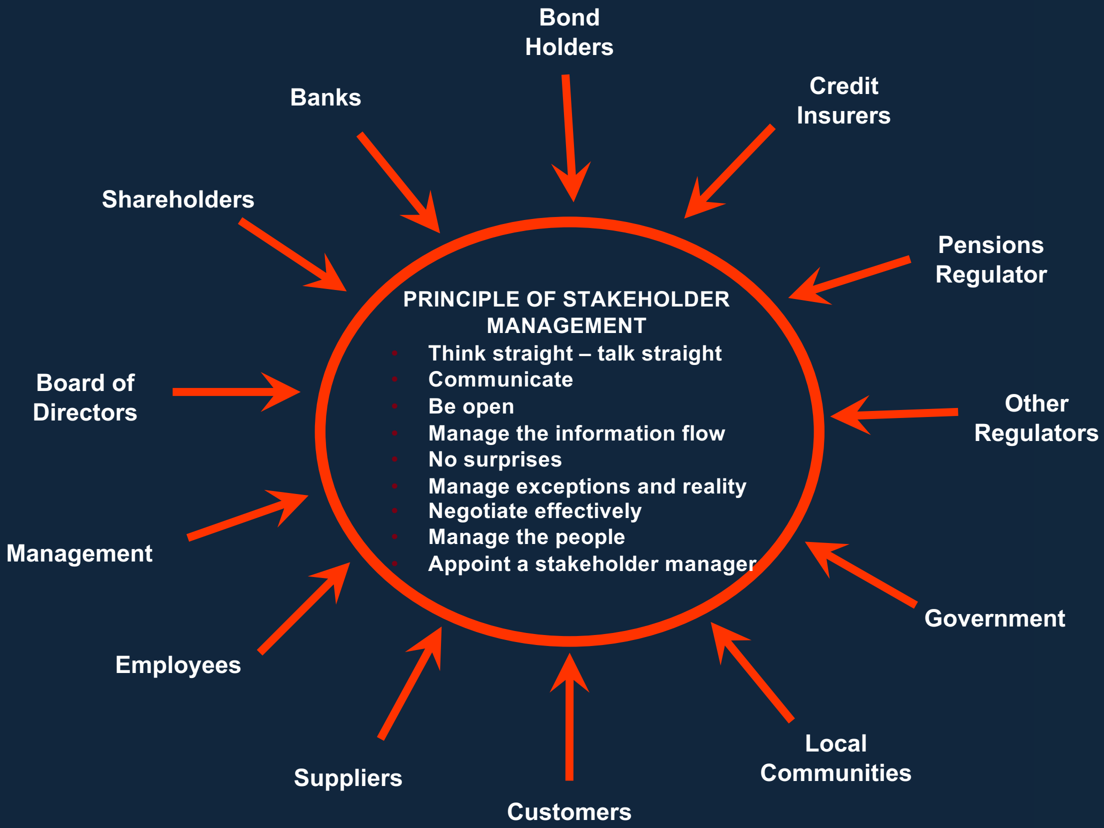
Short term cash generation strategies

- Reduction of debtors
- Extension of creditors
- Reduction of stock
- Stopping planned expenditure
- Short term financial support

Guiding principles of crisis stabilisation

- Cash is king
- Predictability
- Accountability
- Communications
- Autocratic leadership

Stakeholder management



Exercise on stakeholder management
Case Study Exercise
Question #2

- What is the stakeholder landscape?
- Amongst this, who are the key players and what are their respective motivations?

Financial Restructuring

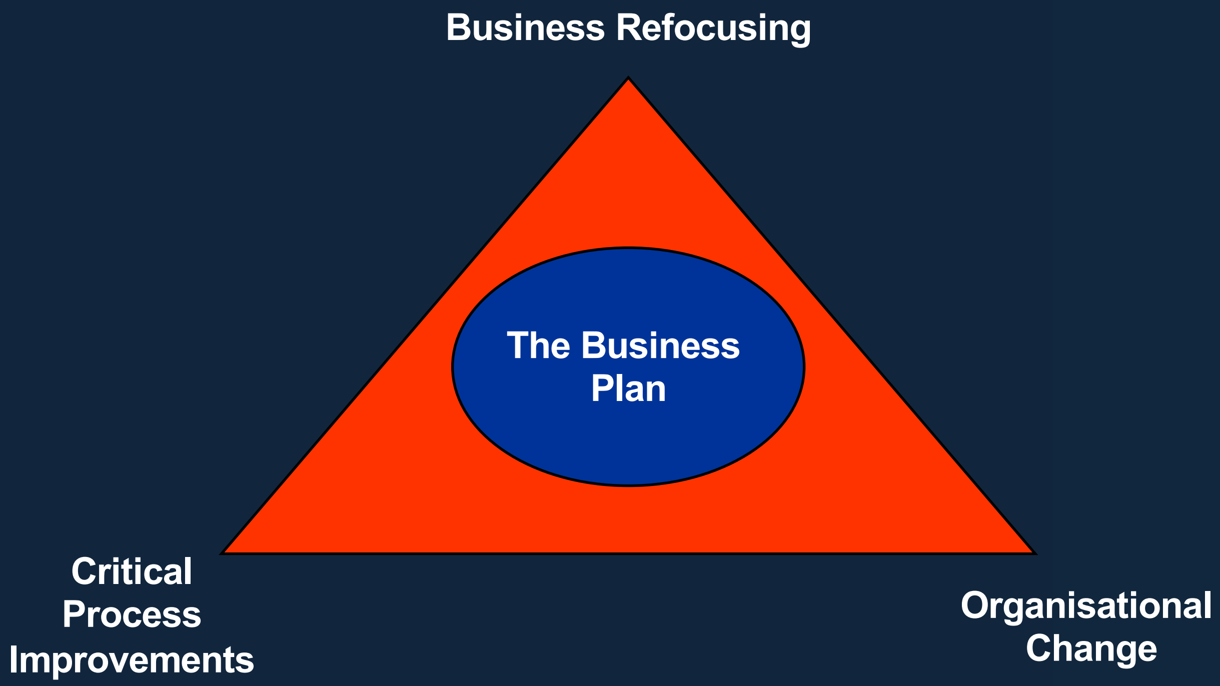
Refinancing outside of insolvency

- Refinancing is very often a two-stage process
  - Short term survival needs
  - Longer term financial reorganisation

- Longer term workout has to be seen as a better option than formal insolvency before financial restructuring becomes a feasible option

Fixing the business

Three key components



Business refocusing

- At the corporate level – exit whole businesses (divisions or operating companies) via
  - divestment
  - spin off
  - closure
  - insolvency
- At the operating company / business unit level, it is about changing product-market focus and reducing the number of SKUs

BCG matrix


High
STAR
?
Business
Growth
Rate
Cash Cow
Dog
Low
High
Market Share
Low

Product market refocusing

- Refocusing in turnaround involves
  - eliminating unprofitable product lines, customers and geographical territories
  - refocusing existing resources into product or customer segments where most short-term cash can be generated
- Identifying key segments involves
  - analysing market segment attractiveness
  - identifying competitive advantage / disadvantage

Most common critical process improvements

- Revenue generating improvements
  - sales and marketing mix
  - key account management processes
  - sales force improvements
  - incentive schemes
  - pricing (raise not lower)
  - margin vs. revenue maximization

Most common critical process improvements

- Cost cutting / performance improvements
  - overhead cost reduction
  - capacity reduction
  - reduction of labour cost
  - improvement of core production processes – machine utilization, scrap rates, workflow
  - reduction in number of locations – plants, offices, distribution centres, retail outlets etc.
  - IT effectiveness - resources, licenses, hardware

Organisational change

- Key levers that can impact short term results
  - change key people
  - communication, communication, communication …
  - introduce simple and regular performance management systems to ensure accountability (and act on underperformance)
  - appropriate pay / incentives
  - simplify organisation structure

Exercise on fixing the business
Case Study Exercise
Question #3

- Consider the strategic positioning of Abaco and draw up an outline to the main elements of a suitable strategy to take the company forward.
- Make a proposal for an implementation mechanism which would result in the company being (majority) owned by the senior lenders and the existing debt restructured down to the level assessed in (i) above. Provide a rationale for the mechanism chosen and any other payments you might make to get the restructuring agreed.

Return to Normal

Return to Normal – the Dangers

- Loosen tight controls too quickly
- Wrong people
- Over optimism about future potential
- Invest too much too soon
- Cost creep
- Do not build new capabilities
- Become complacent