Restructuring in Distress - Strategies

The principal aim of a turnaround is swiftly removing a company from immediate danger of going into liquidation, followed by activities and tasks that should help restoring corporate value.

Corporate distress can have various shapes and formats, whereby early warnings are, among others: Worsening profitability and industry outlook, a deteriorating working capital position and liquidity, declining financial indicators (including share and bond prices), or upheavals in regards to employees and / or management.

However, certain indicators may not be found in public domain: For instance, only a diligent review of a firm´s bank balance sheet´s comments and notes may expose possible commitments to (future) investments or capital expenditures, perhaps even guarantees.

The state of distress changes everything within a firm and – from a Corporate Finance perspective – immediately shifts the primary focus on cash and cash returns, with most commonly applied parameters of not much use any longer. Instead of focusing on return-related ratios, payback is now one of the core measures to pay attention to. Above all, though, liquidity is of the essence: Therefore, indicators such as the cash conversion cycle have to be looked into and worked with right away.

There are no general rules how to structure a successful turnaround from distress, not least as applicable legal frameworks and regulations differ, whilst playing an important part in creating feasible alternatives.

Restructuring requires balancing stakeholders´ interests with a view to achieve a fair sharing of burden: Current debt holders, for instance, are interested in high levels of repayment, ideally receiving some cash immediately, avoiding write-downs, if possible. Shareholders, on the other hand, would ideally like to see a limited dilution of their shares. Should new investors be involved, then their focus will perhaps be on control, certainly, though, high returns with good exit opportunities. However, also numerous other stakeholders have to be considered, such as employees (securing jobs, pensions) suppliers and customers (securing receivables, maintaining business relationships) or the government (securing tax and social security contributions, jobs).

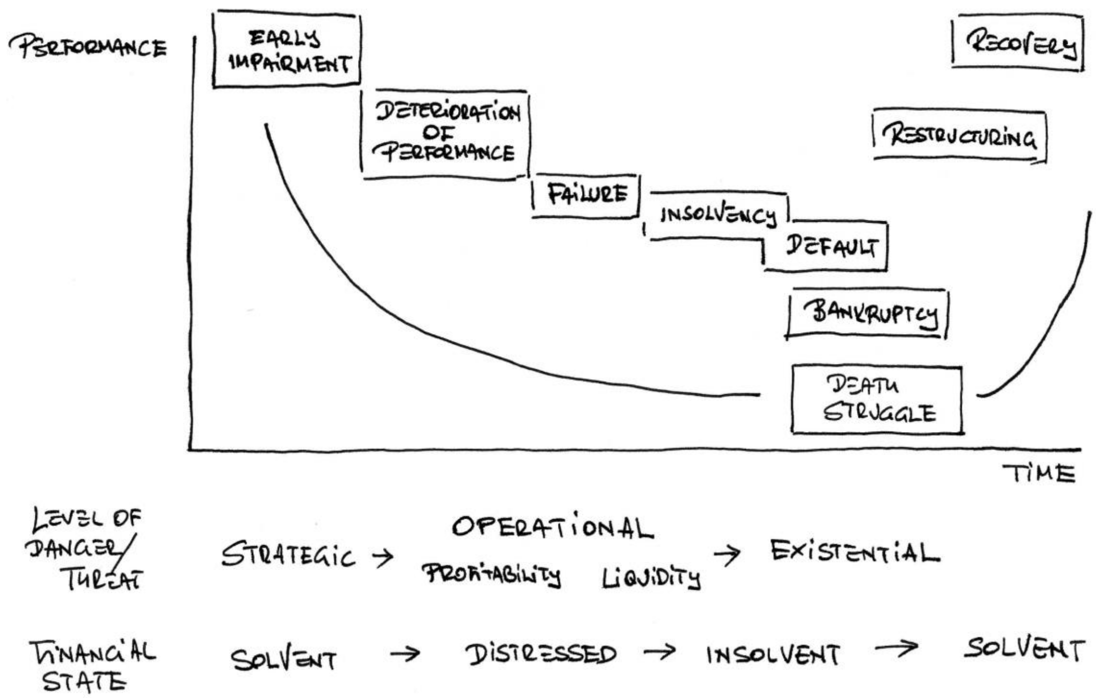
Typically, in the course of a restructuring in distress, following phases can be observed:

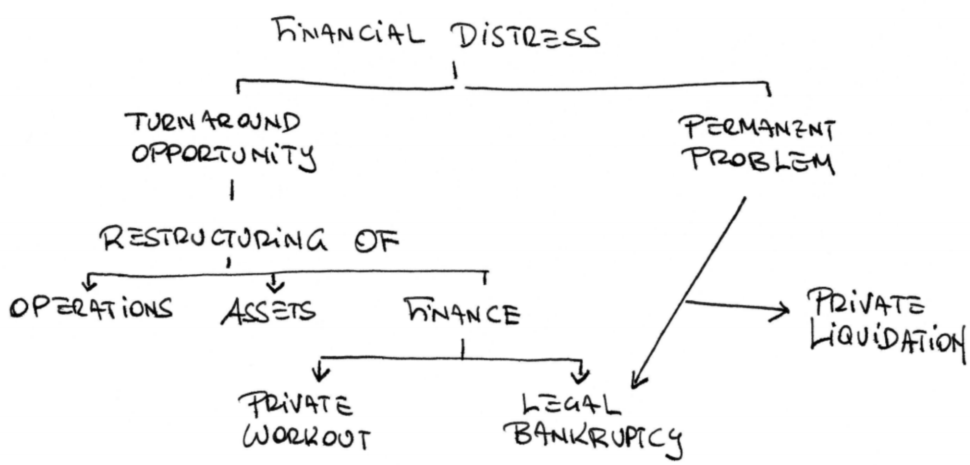
Stabilization phase: Core focus is to instill confidence among stakeholders (e.g. investors, employees, customers, suppliers, authorities) to preserve and restore company value. Reliable liquidity forecasts have to be developed whilst measures of improving cash flow implemented. Thereby, focus on vendor management will be key to free up sufficient time to assess the potential for a turnaround as well as next steps.

Assessment Phase: Restructuring alternatives are compared with a view to maximize the expected value of the intended turnaround plan. This involves testing financial forecasts und undertaking sensitivity analyses. Combined, these assessments should reveal a comprehensive financial and strategic picture, thereby also help identifying the areas of greatest liability, which could point towards a bloated inventory, overextended debt or simply poor management.

Implementation Phase: A recommendation is formulated to either restructure the firm, sell it, or exit the business for good. The recommendation will also address the issue whether next steps should be implemented within a legal bankruptcy procedure or not. Whereby bankruptcy restructuring can offer certain advantages: Used as a tool within a sale process, for example, it can help reducing a firm's overall debt load.

On the path forward, accompanying steps will need to be implemented in parallel, such as raising capital, determining a medium-term feasible capital structure, or initiating various debt restructuring procedures for loan providers as well as bondholders.


PERFORMANCE
EARLY IMPAIRMENT
DETERIORATION OF PERFORMANCE
FAILURE
INSOLVENCY
DEFAULT
BANKRUPTCY
DEATH STRUGGLE
RESTRUCTURING
RECOVERY
TIME
LEVEL OF DANGER/ THREAT
STRATEGIC →
OPERATIONAL
PROFITABILITY
LIQUIDITY
→ EXISTENTIAL
FINANCIAL STATE
SOLVENT → DISTRESSED → INSOLVENT → SOLVENT


FINANCIAL DISTRESS
TURNAROUND OPPORTUNITY
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RESTRUCTURING OF
OPERATIONS
ASSETS
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