

Restructuring in Distress - Strategies

The aim of a turnaround is to swiftly remove a firm from the immediate danger of going into liquidation, followed by steps that should help restoring corporate value.

Corporate distress can have various shapes, 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 of distress may not be easily found in public domain: For instance, only a diligent review of a firm's balance sheet's comments and notes may expose commitments to (future) investments or capital expenditures, or even guarantees.

The state of distress changes everything within a firm: From a Corporate Finance perspective, primary focus is now on cash and cash returns, with most commonly applied parameters not of much use any longer. Not return-related ratios, but payback is now a core measure. Above all, though, liquidity is key: Therefore, each driver of the cash conversion cycle has to be analyzed 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 from country to country, 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 only limited dilution of their shares. Should new investors be involved, then their respective focus will perhaps be on control, certainly,

though, on 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 authorities (securing tax and social security contributions, jobs).

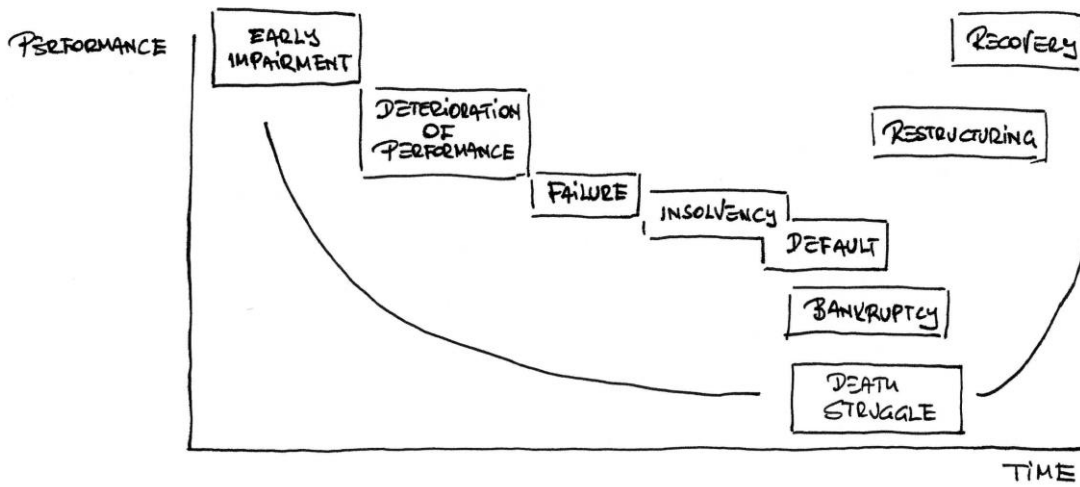
Typically, in the course of a restructuring in distress, following phases can be observed:

Stabilization Phase: 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. 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 and running sensitivity analyses. Combined, these assessments should reveal a comprehensive financial and strategic picture, 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 the context of 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 have to be implemented in parallel, such as raising capital, determining a medium-term feasible capital structure, and initiating various debt restructuring procedures for loan providers as well as bondholders.

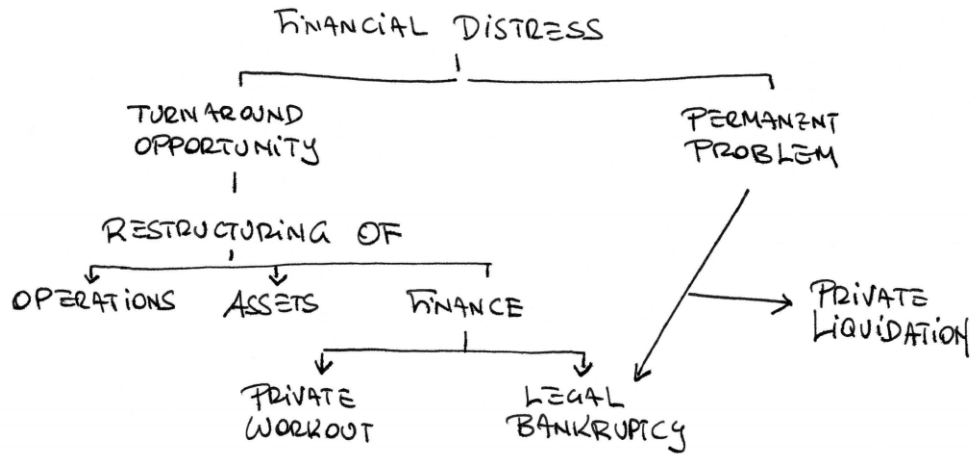


LEVEL OF DANGER / THREAT

STRATEGIC → OPERATIONAL PROFITABILITY LIQUIDITY → EXISTENTIAL

FINANCIAL STATE

SOLVENT → DISTRESSED → INSOLVENT → SOLVENT



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