


How corporate credit workouts actually take place and some other pointers

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What do you always need for a successful corporate workout?

- A clear understanding of the key peculiarities of the matter in hand
- Expertise to execute the workout and to manage the resultant business
- The money to get you there
- Sufficient time to execute and the necessary speed of execution
- The buy in of all parties, their willingness to compromise and the acknowledgement that perfection is not a requirement
- Finally, the acceptance that sometimes it's a lost cause

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Understanding the peculiarities

Understanding of the peculiarities of the matter in hand – some examples

- What really caused the problem
 - The economy
 - The industry
 - Specific circumstances
 - Financing
 - The people
 - Acquisitions or other corporate activity
 - Bad luck

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Understanding the peculiarities

- What are the potential external constraints and complexities
 - The law
 - Companies Act
 - S424
 - Business rescue
 - Insolvency Act
 - Regulations and regulators
 - JSE and SRP
 - The taxman
 - Labour unions
 - Franchises, licenses and key contracts

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Understanding the peculiarities

- Who's who in the zoo
 - The controlling / major shareholders
 - The directors especially the non-executives
 - Senior management
 - Do any of the above have an “unacceptable” history or conflicts of interest
 - The advisors
 - Key customers
 - Key suppliers
 - Key competitors

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Understanding the peculiarities

- Understand the liability side of the business and balance sheet
 - Maturity of funding
 - Number of lenders
 - Type of lenders
 - Covenants
 - Pricing
 - Special clauses on liquidation or similar
 - Contingent liabilities – long term leases etc
- Likewise understand the asset side of the business
 - Going concern vs. liquidation values

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Rules of the game in a workout

- We have no formal rules of the game such as in Hong Kong
 - A good and bad thing
- Informal rules do however exist
 - Rule No 1 - banks never manage a client and never make management decisions
 - The bank with the biggest at risk exposure becomes the lead
 - Onerous and time consuming
 - Will be supported by legal, accounting, forensic and corporate advisors as required
 - The company will likewise need advisors
 - New money is fundamental and ranks first
 - Equity (or equivalent) conversion participation based on unsecured at risk exposures
 - Calculated on a liquidation basis?
 - Note the impact of structural security

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Rules of the game in a workout

- Ranking of bondholders will depend very much on the bondholder rights as to whether they are treated more as shareholders or more as unsecured lenders
- Shareholders are at the back of the queue and typically receive a sweetener when there is no attributable value
- Secured lenders sometimes extend tenors
- Being a small creditor is generally no excuse, nor is being foreign
- Do we price for risk or make it work? – an endless debate
- Execute the recovery in stages if you have to
- Those directors and others that assist are recognised but crooks are relentlessly pursued

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Rules of the game in a workout

- You need to establish a mechanism to break deadlocks
 - Do you elicit third parties such as the SARB?
 - Schemes of arrangement create a limited legal solution
 - Will Business rescue work?
- For banks client confidentiality is sacrosanct
- Don't pour good money after bad
- Don't be obstructive - It's a small world and it can happen to you and people have long memories

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Some other pointers

- What is the state of the liquidation industry / liquidators?
 - New laws will need to be fully tested
 - Especially the Business recovery process
 - Small pool of experienced liquidators
 - Many have retired or fled the country!
 - Multiple appointments are mostly counter productive
- Where are the recovery funds, especially those with expertise
- Criminal sanction very difficult to achieve
 - Fraud is on the rise
 - Judicial process slow

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What should be the role of shareholders

- Air your views, be counted, be proactive and participate
 - We want to speak to the bankers, the board and other shareholders
- Use your vote
 - Call a shareholder meeting
 - Replace directors
 - Sanction schemes
- But beware of the dangers such as s424

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Interesting listed examples

- Toco – rampant fraud, including the final acquisition
- Macmed – multiple fraud
- McCarthy – ill advised diversification?
- Relyant – overgeared, contingent liabilities, structural security example

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Retail pointers

- Debt review under the NCA needs re-evaluation
 - For example, relative positions of secured and unsecured lenders
- Recovery using rehabilitation
 - Critical for home loans

Questions