

Restructuring the future

Overview of the restructuring market during the financial crisis and future outlook

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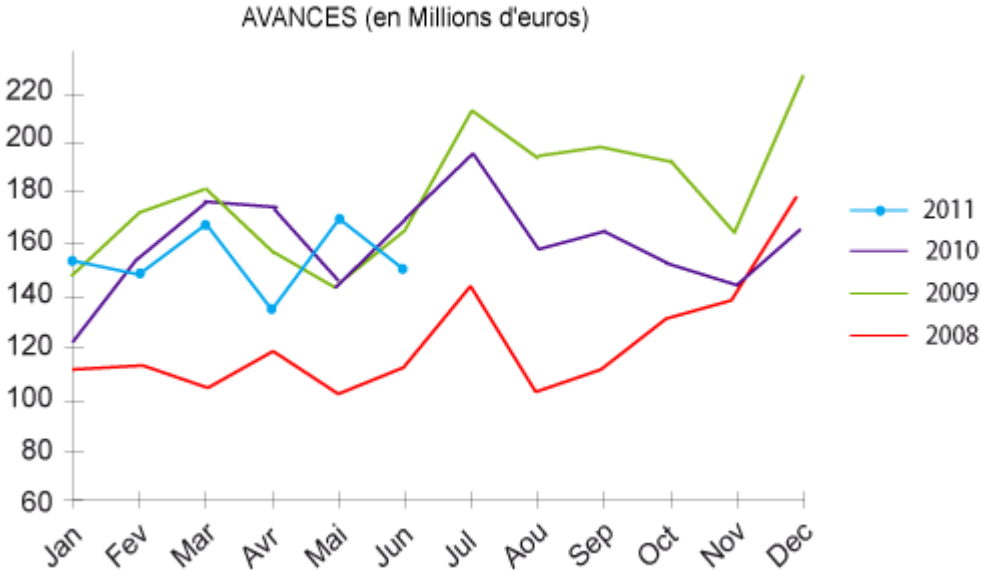
Agenda

- ▶ Some data
- ▶ Assessment of reflationnary measures
 - ▶ Measures concerning cash
 - ▶ Measures concerning capital
- ▶ Different ways to handle financial issues
 - ▶ Confidential procedures
 - ▶ Legal procedures
 - ▶ The specific situation of the LBO
 - ▶ Large and small caps
 - ▶ The evolution of Banks behaviors
- ▶ A new tool : the SFA (Sauvegarde Financière Accélérée)
- ▶ The EU insolvency regulations : the Nortel case

Indicators

- ▶ Due to the existence of confidential procedures, the data about restructuring are incomplete.
- ▶ Nevertheless, if we use the data communicated by the Délégation Unédic AGS (opening of legal procedures with the help of the AGS), 2010 showed :
 - ▶ 1 266 « procédures de sauvegarde » (-10,3%)
 - ▶ 9 749 « redressements judiciaires » (-16,3%)
 - ▶ 14 045 « liquidations judiciaires » (-16,1%)
- ▶ The deceleration of the number of economic failures appeared in 2010 is confirmed in the first quarter of 2011.
- ▶ Nevertheless the level is still high as it is still superior to the 2008 level (before crisis).

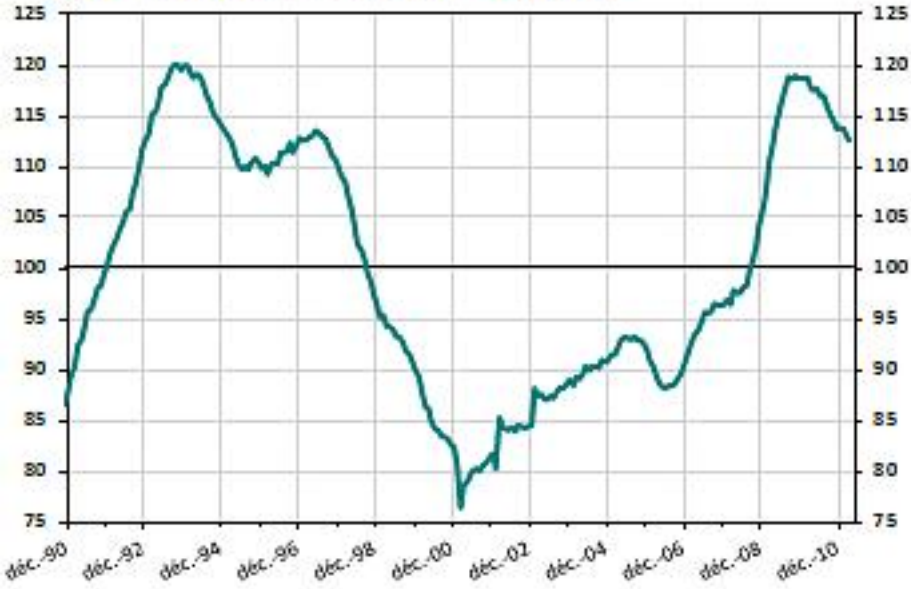
Some data : from AGS



Some data : From Banque de France

Indice de défaillance des entreprises

Cumul 12 derniers mois
100 = moyenne déc. 90 – avr. 11



Assessment of reflationnary measures

- ▶ Effects on short term cash flows
 - ▶ Tax measures (payment in advance of « credit d'impôt recherche », carryback, VAT credits, ...) and CCSF
 - ▶ CIRI and médiation du crédit
 - ▶ Guarantee OSEO

- ▶ Effects on capital
 - ▶ FSI
 - ▶ FMEA
 - ▶ FCDE
 - ▶ CIRI

Different ways to handle financial issues

Confidential procedures and legal procedures

- ▶ The forms of French pre-insolvency procedures, namely Conciliation proceedings and Mandat ad hoc, depend entirely on the ability of the debtor to reach a consensual agreement with all of its creditors on a contractual basis
- ▶ One advantage of those proceedings, however, is that there is no requirement to disclose the existence of either Conciliation or Mandat ad hoc proceedings, the details of which remain confidential except to the extent any agreement is formally recognised or 'homologated' by the French court.
- ▶ In Conciliation proceedings, the court appoints a conciliator who assists the debtor in its negotiations with third parties, and the debtor has a four month period, extendable by one month, to agree to a restructuring plan with its creditors.
- ▶ The Mandat ad hoc procedure is a very flexible procedure, with no fixed time frame.
- ▶ Existing management remains in control of the business.

Different ways to handle financial issues

Confidential procedures

- ▶ If we consider that a restructuring process only consisted in the past in deflating interests or extending debt maturities, 2009 marked a significant shift by generalizing a review of the whole company structure
 - ▶ Since then, the rule has been to ask equivalent efforts to each stakeholder, depending on his seniority
 - ▶ Mastering the negotiations then became more and more difficult for debtors

- ▶ In the last 18 months, traditional reorganizations have largely been supplanted by faster and more cost-efficient strategies (pre-packaged or pre-negotiated bankruptcies)
 - ▶ A high percentage of those combine new money as well as exchanges of debt. Contrast this to the situation 18 months ago when companies were literally running out of money

- ▶ However, company managers still do not always master the different conciliations mechanisms and preventive measures that could protect the entity from a legal procedure

Different ways to handle financial issues

- ▶ A large part of restructuring mandates concluded in 2008/2009 lead to 12 to 18 months financial commitments freeze through out-of-court restructuring solutions
 - ▶ 2011 will therefore be a crucial year, exhibiting the outcome at the end of these numerous procedures
- ▶ 2011 will display new situations where companies managed to get through the crisis, but their management did not realized enough efforts to adapt the economical/strategic model to cyclical difficulties
 - ▶ Financial restructuring, by improving balance sheet structure in a short time period, would enable companies to resist to upcoming cyclical difficulties only if the WC has been optimized, the costs rationalized and profitability improved for the long term
- ▶ Distressed companies will continue to be pressured to have an exit strategy in hand upon filing and that may generate considerable valuation litigation

Two different ways to handle financial issues, mainly depending on anticipation

Legal procedures

- ▶ If clients operational performances in 2011 still do not enable to cover financial commitments and moratorium payments, a new negotiation process will be necessary, often leading to a legal procedure
 - ▶ Have the cost structure, profitability and WC really been improved? Subsequent operational restructuring would be needed otherwise
 - ▶ Negotiations may also end up in a legal procedure if a consensus between secured and unsecured creditors is not reached: certainly, when an unsecured creditor group is offered zero recovery, litigation is usually expected to follow
- ▶ In several LBO cases where the number of stakeholders were significant, like SGD, shareholders, mezzaneurs and banks unanimously agreed to make a strong effort (a “Sauvegarde” plan), only to serve as a dissuasive threat in order to force minority stakeholders to accept the original plan
- ▶ However, the “Sauvegarde” procedure should not be used by the debtor without any preemptive action, it would be perceived as too aggressive by creditors, like in the Belvédère or Coeur Défense cases

The specific case of LBO

LBO funds

- ▶ 2009 saw a large number of procedures linked to LBO issues, which lead to an increasing professionalization of the European restructuring market
 - ▶ LBO funds were amongst the first players to consider restructuring solutions since September 2008 and for at least 12 months, to support their most suffering holdings
 - ▶ 2009 was marked by the 'Autodistribution' out-of-court conciliation: a new investor, TowerBrook Capital, brought fresh capital to the company, with the 70 creditors accepting to divide the debt burden by 4 against a conversion for 21% of the capital
 - ▶ Other players then followed this example, like former PAI-owned Monier (200M€ new capital inflow and a debt conversion, 120 lenders and 3 new funds involved; PAI finally lost its whole stake), Akerys, Kaufman & Broad, Materis, Sia, Navimo, Geoxia, Retif, CPI, Numericable, Terreal, Mondial Tissus, SGD...
- ▶ Even if LBO players suffered a little less in 2010, many restructuring topics incurred during this year (Deutsch Connectors, Financière Helios, Diana Ingrédients, Parkeon, Moliflor, Consolis...), but negotiations seem to be easier today, with always a room for shareholders who are ready to re-invest
- ▶ Traditional LBO funds sometimes dropped the smallest investments, which were engaged in a restructuring process, whereas Turnaround funds paradoxically did not particularly benefited from attractive investments during this crisis, outpaced by distressed debt funds
 - ▶ Distressed debt funds used the conversion alternative to enter the capital of target companies

The specific case of LBO

- ▶ Due to the soft pace of the economic recovery that is currently underway, a majority of LBO companies are still unable to generate enough EBITDA to satisfy the LBO financial commitments
- ▶ A substantial part of bullet debt packages arranged in 2006-2007, which has not been reimbursed yet, will mature in 2013-2014 (the well-known Wall of Debt).
- ▶ However a majority of CLOs will reach the end of their reinvestment period (5 years) in 2011-2012, which make it necessary to anticipate the renegotiations, that would be more difficult after that
 - ▶ The approaching Wall of Debt, combined with higher taxes, financial reform and potentially higher interest rates, contribute to an optimistic outlook for sustained corporate restructuring activity in years to come

Large / Small caps

- ▶ In parallel with the first LBO restructurings topics from mid-2008 to mid-2009, large groups subsidiaries/factories restructuring issues appeared and multiplied later, finally followed by family-owned entities, listed or not
 - ▶ Each type of entities had in common the wish to adapt its business plan to this adverse environment, as well as managing cash from operational activities
 - ▶ Large corporations have been proactive clients, by anticipating future debt refinancing situations through preemptive debt profile restructuring
- ▶ French banks were able to accept debt conversions on large cross-border deals but were more than reluctant in the case of small caps
 - ▶ More than a legal hurdle, French banks are culturally and operationally unprepared to become shareholders of their clients ; this situation contributed to the tension that still weigh on negotiations with small companies
- ▶ A significant number of small caps are now facing a risk of being caught in a legal procedure because they were not able to finance their job safeguard measures in an out-of-court conciliation process
- ▶ 90% of French company managers currently believe that they will be able to anticipate any cash gap that could occur in the next few years. This view may be overoptimistic because managers often seek advice at a stage that is too late. That is particularly the case for small caps managers, who seldom perform rolling 12-month detailed cash forecasts when the company is believed to be in good health

Large / Small caps

- ▶ In the 3 to 4 years to come, small and mid caps engaged in a restructuring process will have to support the organization rupture generated by the necessary business model adjustments
 - ▶ The companies that will not be able to carry out these adjustments may be forced to liquidation
 - ▶ The others that still exhibit a competitive edge will have to be accompanied during the performance improvement process
 - ▶ The next years will be marked by a shift from systemic risk experienced during the past 2-3 years, to individual risk specific to each companies

Banks behavior

- ▶ A lot of banks, as well as funds, put themselves in a wait and see position in 2009, due to the lack of visibility on the potential economic recovery at that time. A majority of 2009 restructurings were performed in this environment, in parallel with large State subsidies that were not supposed to continue in 2010

- ▶ Regarding debt to equity conversion issues, several major European lenders strived to play a dynamic role with companies for which operational activity was still profitable (in boni), but bought at an excessive price under the debt amortization program originally planned
 - ▶ Lenders initially refused to become shareholders, but then began to accept conversions and to bring new cash from 2009, often acting together with other lenders/funds to avoid that the restructuring only benefit to the historical stakeholder
 - ▶ The debt-to-equity conversion was then chosen each time it was necessary to protect underlying assets economical value, as well as pushing for fresh capital inflow from new shareholders
 - ▶ This approach, more expensive in terms of Bales II capital requirements, requires a real willingness to get involved beyond the lender role

Banks behavior

- ▶ It became more and more difficult to reach an agreement in the cases where the number of banks involved was too high ; several lenders were choosing to drop the client, making a consensus agreement more difficult to reach and therefore multiplying collective procedures
- ▶ The modest reduction in filings in 2010 was the result of freer credit and willingness of mortgage lenders to amend and extend secured debt
- ▶ The progressive recovery of banks over the crisis period enabled them to adopt a softer attitude to the clients (CPI or SGD conciliations for instance)
- ▶ However, upcoming restructuring activity will depend on the financial markets absorption capacity, especially as regards high yield bonds, for refinancing and new financing to come
 - ▶ Although the credit freeze is beginning to thaw for some markets, access to capital is still limited for many companies in bankruptcy proceedings
 - ▶ A double-dip recession and the maturing of leveraged debt obligations would do little to further loosen credit markets

A new tool : the SFA (sauvegarde financière accélérée)

- ▶ The French Parliament recently approved a law that makes available a new version of “Sauvegarde” proceedings capable of imposing a restructuring plan relatively speedily on minority hold-out financial creditors.
- ▶ The new version of the Sauvegarde procedure, the Accelerated Financial Sauvegarde, is a variant of the original Sauvegarde procedure (which will continue to be available), but one expected to be particularly useful for companies financed by leveraged buy-outs or otherwise seeking solely to deleverage their balance sheets. The new law comes into effect on March 1, 2011 and is becoming known as the French Pre-pack.
- ▶ The basic Sauvegarde procedure provides a restructuring procedure for companies in financial difficulty and, importantly, does not require unanimous creditor approval in order to implement a restructuring plan. .

A new tool : the SFA (sauvegarde financière accélérée)

- ▶ Experience to date of the use of the basic Sauvegarde procedure has shown that it usually takes several months to implement a restructuring plan, and this delay has sometimes led to a significant deterioration in the value of the business.
- ▶ The new variant of the procedure provides for a much speedier implementation of what is essentially a pre-negotiated plan.
- ▶ The Sauvegarde restructuring plan must be approved by two-thirds in value of the votes cast by each of the following committees (1) a committee of the debtor's main suppliers and (2) a committee of all the debtor's bank lenders.
- ▶ If the plan is adopted by both committees and any applicable bondholders' general meeting and is then also approved by the court, it becomes binding on all members of the committees and on the debtor's bondholders, including any creditors in those constituencies who voted against the plan.

A new tool : the SFA (sauvegarde financière accélérée)

- ▶ The new Accelerated Financial Sauvegarde, or Sauvegarde Express, only applies to financial creditors, *i.e.*, credit institutions and bondholders.
- ▶ Suppliers of goods and services will continue to be paid according to their applicable contract terms and are not subject to the moratorium on enforcement action, which applies only to the financial creditors.
- ▶ Accordingly, those creditors are not involved in the approval of the plan, and there is no suppliers committee.
- ▶ Because the restructuring plan will have been pre-negotiated in the Conciliation proceeding, the Sauvegarde Express procedure is being termed the French Pre-pack.



Nortel business rescue via formal insolvency

Testing the EU Insolvency Regulations

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THANK YOU

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