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Negotiating the challenges of a debt restructuring process

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Debt restructurings are often delayed or fail due to a lack of adequate preparation and focus on details that may be needed throughout the process.

Debt restructuring is a challenging, demanding task which takes up a great deal of senior management's time (which is better utilized focusing on business issues) and, if done badly, can lead to significant loss of value for stakeholders.

A company usually commences debt restructuring negotiations with a standard set of objectives:

(a) To have some relaxation in the short term

(b) To make their debt load manageable by having repayments aligned to cash generating ability

(c) To gain more headroom or raise additional debt (often in order to meet working capital needs)

Lenders will also have an agenda: perhaps around increasing security, re-pricing their risk or maybe even reducing debt exposure. A failure to prepare and focus on the necessary details throughout the process may lead to unexpected problems, delays in securing a successful debt restructuring solution or even ultimately result in a bad deal.

Lenders will typically ask themselves a series of questions:

- What's the problem and how long do we have to fix it?
- What do we think about this business and its outlook?

- Is this the right management team for this company and do they have support?
- How much money is needed?
- How much are shareholders contributing?
- What are the other lenders doing?
- What are our alternatives?
- What are the right terms for support?

This paper covers areas of focus for borrowers to consider which will help answer the above questions.

Look ahead: Cash flow servicing details are critical

Lenders will focus on the cashflows that will service their debt and enable its repayment. They are generally more amenable to entering into debt restructuring negotiations if the company provides clear and comprehensive information which they need to secure their internal approvals – and companies need to prepare themselves to be scrutinised extensively on such submissions.

Creditors will typically want to see a driver-based business plan that sets out recent results, an assessment of the current position and the company's projected cash flows available for debt servicing (CFADS). Such CFADS need to be supported by reasonable and achievable assumptions. They will also want a proposal that shows the action being taken to deliver the plan, balances funding tenor for long vs short-term needs, shows shareholder commitment and explores all sources of funding thoroughly. Areas for deep-dive review are likely to be prioritised based on the impact on future profitability and cash conversion.

Look back: Understand underlying causes

During any debt restructuring process, it is important to understand the underlying causes of the company's performance decline and the need for the restructuring. The company should be proactive in recognizing what went wrong and should not communicate denial or unfairly blame others (for example, a lack of support from creditors).

A restructuring must be holistic and lead to sustainable change in the direction of the business. A plaster will not work where a surgery is required. Often, this means that the company's management needs to plan and implement deep strategic and/or operational changes to avoid a second round of debt restructuring in short order.

Look around: Is the company part of a broader group?

Companies that are part of a broader group must also ensure that any requested amendments and new funding requirements are directed to the relevant parts of the group as appropriate. The impact of cross-default or negative pledge provisions or restrictions included in the group's various borrowings must be considered during any restructuring. Undertaking a debt capacity analysis by entity will help but may lead to difficult decisions around the future of parts of the group. Further, if there are any issues with regards to intercompany or related party receivables, lenders would want these to be addressed prior to or before the restructuring. These have known to be a hurdle to lenders agreeing to any deal.

Lead effectively

Creditors will want to be comfortable that the management team is capable of navigating the company through the debt restructuring process and implementing the business changes needed to deliver the new plan. The management team must act as a source of comfort and take accountability in the eyes of the creditors, while instilling and demonstrating clear behaviour of responsibility, efficiency and governance.

Strike a fair balance

Any agreed debt restructuring plan will be based on the:

(a) Current debt level

(b) The existing security structure (and available asset base)

(c) Any new money needs

(d) The company's future ability to service the applicable debt structure

To achieve success, the company must carefully map out debt exposures by lender, including existing security structures and allocation by entity. One of the biggest challenges is the question of, "Who pays?" Shareholders or lenders? And as between lenders, which lenders? While providers of new money often demand super-senior priority status, existing lenders will not be willing to easily give up any existing security. A careful balance must be struck between existing and new financiers when developing a funding strategy to address the new money requirements. Borrowers often significantly underestimate the complexity of inter-financier issues.

Companies are often overwhelmed by the intricacies and complexities of a debt restructuring. External advisors can help navigate and act as an important mediator between stakeholders, while providing overall process management and expert guidance. In most cases, a successful debt restructuring is much more than a simple refinancing or tweak to the terms of a company's existing debts – it is often a more fundamental change in the way a company operates and governs itself, and it needs to be carefully planned and executed in order to ensure a balance of risks and rewards for all stakeholders involved.

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