Quest Masterclass

How to Recover from Distressed Debt?

How to Handle Finance at The Time of Crisis?

In recent years, the Credit Markets have expanded rapidly. This has been possible due to low interest rates in many parts of the world. In the present scenario, due to advancements in technology, many markets are subject to disruptions that couldn't have been imagined a few years ago. Also, due to various social factors, change in government policies and public views, the industry has come under a lot of stress. Thus, the financiers and businesses need to adapt quickly and effectively in this environment. Talking about lenders, government regulation and credit controls continue to evolve putting pressure on them. Moreover, in many countries, scrutiny of how lenders interact with borrowers experiencing financial difficulties has never been higher. This eBook focuses on how Credit Risk officers can help build a tandem between the lender and the borrower, predict warning signs of financial stress. And come up with tools and techniques to mitigate them.

3 Key Pain Points to Look for Distressed Debt Restructuring

Good debt restructuring begins with a clear understanding of income statements, balance sheets, and healthy cash flow, working capital cycle, and efficient ratio analysis. Financial forecasting is another important factor that one needs to take into consideration. This includes structures, assumptions, borrower's projections, and identifying causes of financial distress such as relationship between lenders, customers, suppliers, and macroeconomic factors. A credit risk officer needs to have complete knowledge about Insolvency laws, and should know the techniques on how to deal with formal and informal processes, Financial Restructuring, Operational Restructuring. Also, maximizing NPL collections and how to deal when negotiations fail are some of the most important attributes of an efficient Credit manager. Let's talk in detail about 3 key pain points:

1. Problem Identification & Diagnosis
2. Response & Recovery
3. Cross Border Debt Restructuring

1. Problem Identification & Diagnosis

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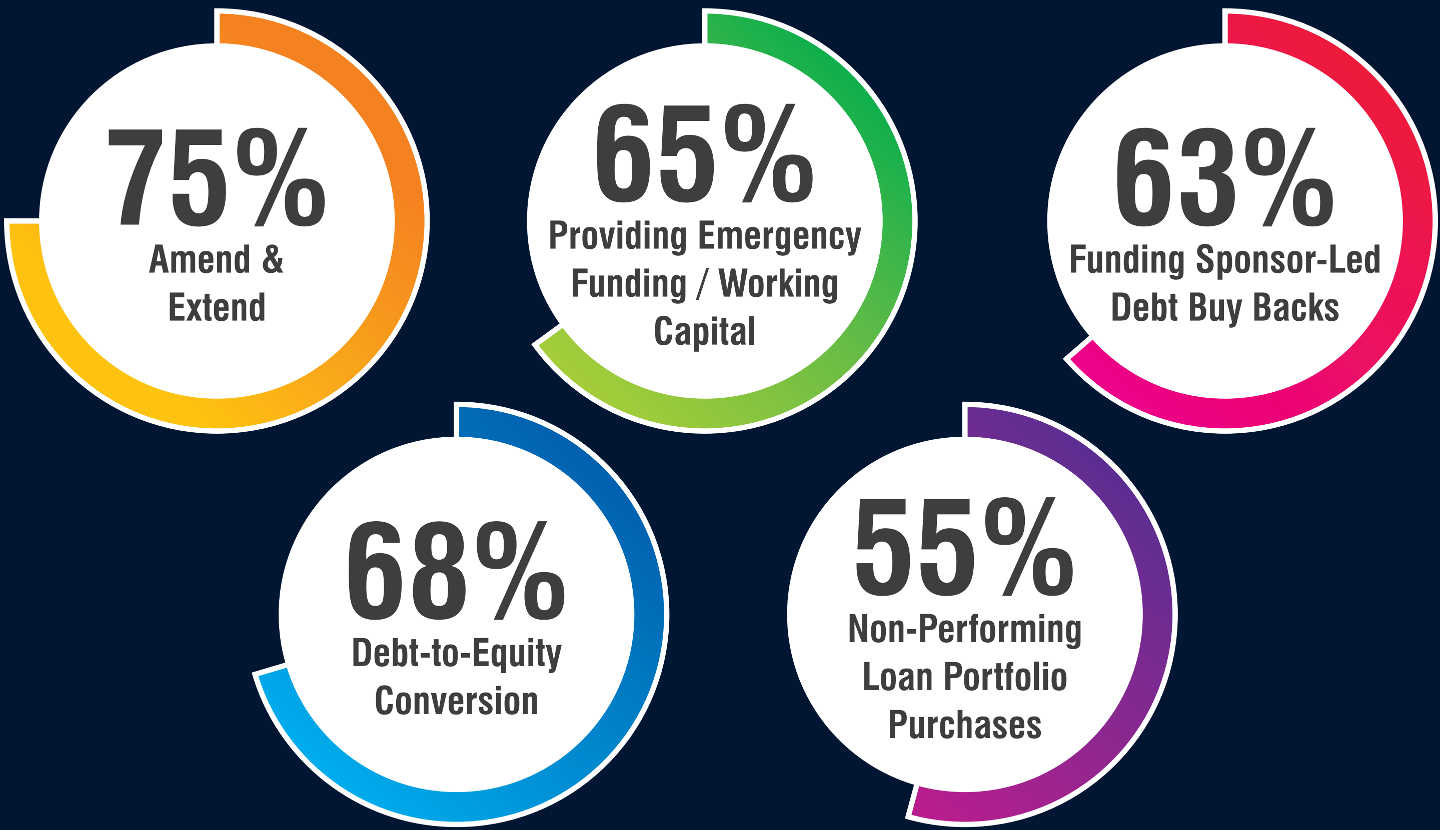
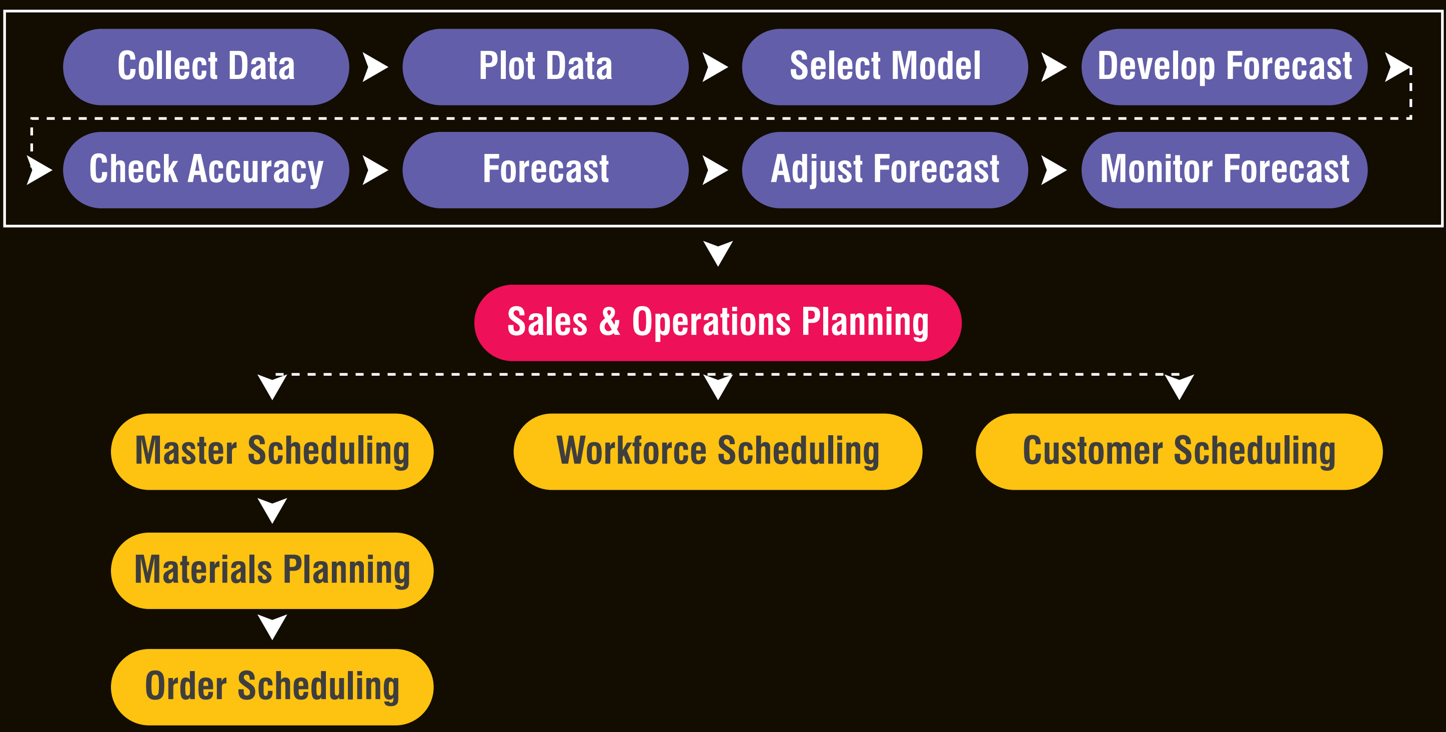
Top 5 Distressed Debt Investment Opportunities Ranked by Investors



Forecasting Process



Let's discuss financial forecasting techniques in detail.

A. Qualitative Techniques

1. Executive Opinions:

a. Opinions of key personnel from various departments including, operations, sales, production, are taken into consideration to arrive at meaningful future predictions.

b. Based on expectations, the management team makes required revisions.

2. Reference Class Forecasting:

a. Helps predict outcome of planned actions of similar scenarios at other places and different time period.

b. This method defies predictions based purely on human judgement.

3. Delphi Technique:

a. The experts are presented with a series of questionnaires.

b. The experts note down the answers to the first questionnaires and based upon their responses, a 2nd set of questionnaires is created.

c. The experts are then asked to revaluate their responses to the 1st questionnaire.

d. Ultimately, the experts reach a narrow shortlist of opinions

4. Consumer Surveys:

a. Based on different starting criteria, the forecaster generates diverse outcomes.

b. From the numerous scenarios thus presented, the management team selects the most likely outcomes.

B. Quantitative Techniques

1. Time-Series Forecasting:

a. This method is used to gather data over a period of time to spot the current trends.

b. The techniques that fall under this method are simple averaging, exponential smoothing.

2. Proforma Financial Statements:

a. This method makes use of costs and sales figures of previous 2-3 years.

b. This method is generally used in Mergers and Acquisitions.

3. Cause-Effect Method:

a. This method is used to forecast the cause and effect relationships of the variable with factors such as interest rates, level of consumer confidence, and change in consumer confidence etc.

b. This method is used to generate the forecast for the variable of interest through past time series on many relevant variables.

A Credit Risk Manager should also know about the various factors that cause financial stress. The below table represents the 2 major causes of stress. Let's explore them in detail.

Business Strength	Financial Strength
1. Number and strength of competitors.	1. Obligor's debt levels as compared to peers.
2. Number and strength of suppliers and customers and the mutual relationship between Corporate Governance and Management team.	2. Composition of capital and debt.
3. Composition and accountability of Board structure.	3. Should assess the cash requirement of the business.
4. Track record of the Management team.	4. Cash requirements may change over the company: High fixed cost businesses. For example, Start-ups will burn cash as compared to mature businesses that will generate cash.
5. Risk involved.	5. Assess the cash generation capacity of the business going forward.
6. Linkages between senior management and the obligor Strategy and Risk Management.	6. Should consider all mergers impacting operating cash flow: operating margins, working capital dynamics, taxes, interest payments etc.
7. Consider the strategic direction, comprising of strengths, weaknesses, opportunities and threats.	7. Quality, sustainability and volatility of earnings should be considered.
	8. Trends in future revenues or costs which are relevant to the obligor and its industry should also be considered.

2. Response & Recovery

A credit risk manager needs to understand the difference between formal vs informal Recovery Actions and execute accordingly. Restructuring in the Shadow of insolvency Law, Standstills/Forbearance Agreements, Creditor Steering Committees, and other challenges that exist in the emerging markets are of prime importance. They should possess accurate knowledge about moratoriums, Majority voting, Creditor classes, IPSO facto clauses, and reputational issues. Moreover, a sound knowledge of tools and techniques required for Financial Restructuring, such as Debt forgiveness, Refinancing, Amend and extend, Debt for equity swaps, Asset sales, New equity injections, Sale of debt etc. is essential.

Let's discuss in detail about a few options and tools available to restructure loans.

A. Business Stabilisation

- It Helps A Business to Recover From Short Term & Unexpected Financial Distress
- It Comprises of Short-Term Steps to Enhance Cash-Flow
- It Helps Establish Confidence With Stakeholders
- It Gives Sufficient Time to Implement A Longer Term Turnaround Process

B. Operational Restructuring

- It Helps Identify Factors for Operational Underperformance & Developing Strategies
- It Focuses on The Profitability of Operations
- Operational Restructuring Involves Review of Products & Markets To Evaluate Their Contribution To Profit
- Operational Restructuring Involves Aligning of Costs With Revenues
- Operational Restructuring Consists of Disposal of Non-Core Businesses

C. Turnaround Management

1. It is a process where an expert coordinates with the directors of a borrower in financial distress
2. It helps identify the factors of financial distress and create a strategy to counter it
3. It helps in restoring the financial health of the company

Now, let's understand Formal and Informal Debt Restructuring strategies and their advantages.

A. Formal Debt Restructuring

- **A** It Refers to Restructuring of Insolvent Entities Carried Out Under The Relevant Insolvency Laws of The Relevant Borrower's Jurisdiction
- **B** It Requires Approval by A Formal Supervision Body or by The Court
- **C** These Restructurings Can be Approved by The Applicable Majority of Creditors
- **D** It Involves Control of The Borrower Being Transferred Away from The Former Management Team
- **E** There May be Temporary or Permanent Change, Which is Dependent Upon Outcome Reached, Relevant Jurisdiction, & Process Adopted

B. Advantages of Formal Debt Restructuring

A
Borrowers & Creditors Have Plenty of Time Due to Suspension of Legal Actions

B
The Assets of The Borrowers Are Protected From Being Transferred by The Borrower's Management

C
One Set of Creditors do Not Enjoy Any Kind of Advantage Over Another Set of Creditors

D
In Case if The Restructuring Plan Fails to Get Approved, The Winding Up Process is Fast And The Proceeds Are Distributed To The Creditors Without Delay

C. Informal Debt Restructuring

- This Type of Restructuring Falls Outside The Purview of Formal Insolvency Laws
- It Provides For A More Flexible Approach As The Respective Debtor And Creditors Do Not Involve The Loss Of Formal Management Control By The Debtor's Management Team
- It Does Not Involve Supervision by A Formal Supervising Body or Court
- It Involves Unanimous Acceptance by The Creditors
- Documents Are Prepared That Govern The Relationship Between Debtors & Creditors For Creating The Restructuring Outcome As Well As Implementing It

D. Advantages of Informal Debt Restructuring

A
There Are Only A Few Limitations To Achieve The Final Restructuring Outcome As Solutions Can Be Tailored To The Existing Requirement

B
The Debtor is Often Protected From Following Lengthy & Cumbersome Insolvency Issues

C
It Is Fast, Cheap & Simple As It Can Be Achieved by The Consideration of Only The Relevant Creditors

3. Cross Border Debt Restructuring

Credit Risk managers must take into account of the Cross Border Debt Restructuring practices to mitigate insolvency issues such as addressing Insolvency Proceedings in Multiple Jurisdictions, UNCITRAL Model Law, concepts of 'Center of Main Interest (COMI)', Concepts of 'Main Proceeding' vs 'Non-Main Proceeding' and Out-of-Court Debt Restructuring. Reviewing of loan agreements, Standstills/Forbearance Agreements, Creditor Steering Committees etc. Let's see three approaches that can be adopted in relation to the administration of cross-border insolvency.

A. Territorial Approach: In this approach, each country exercises its own domestic insolvency laws with respect to the debtor's property and all of the creditors that lie within its territory. Extraterritorial dimensions do not play any role in this.

Universalist Approach: In this approach, any cross border insolvencies come under the jurisdiction of a single global insolvency regime. Regardless of where the assets of the claimants are located, they are distributed by a single insolvency office holder.

At present there are two legal regimes for solving matters related to International insolvencies. They are, EC Regulation on Insolvency Proceedings 2000 and the UNCITRAL Model Law on Cross-Border Insolvency. Both of them work by locating the main interest (or COMI) of the debtor.

The main features of UNCITRAL Model Law on Cross Border Insolvency are as discussed below:

A It Strengthens The Cooperation Amongst The Courts & Other Competent Authorities of A Particular Country & Foreign Countries That Are Involved in Cases Related to Cross-Border Insolvency.

B Guarantees Greater Legal Certainty for Investment & Trade

C Efficient Administration of Cross-Border Insolvencies That Protects The Interest of Debtors & Creditors

D Helps to Protect Investment by Facilitating The Rescue of Financially Troubled Businesses

E Helps Identify 'Foreign Main Proceeding' I.E., The Most Relevant Jurisdiction With Respect to Cross-Border Insolvency

F The Model Law Uses The "Centre of Main Interest(Comi)" to Identify The Principal Jurisdiction

G The Law Also Ensures That Insolvency Officials of A Particular State Are Identified in Other States as Well

H The Law Also Ensures That Other States Provide The Essential Cooperation to Smoothen The Insolvency Process in The Primary Jurisdiction Area

I The Law Also Puts A Limit Over Those Regimes Which Try to Favour Domestic Creditors Over Foreign Ones

CONCLUSION: Today, there exist myriad programmes on Distresses Debt Restructuring but unfortunately, most of them are devoid of tools, which can train Credit Risk managers to deliver competitive advantage by training them how to analyse the factors that can put pressure on a business, early signs of distress, managing a restructuring process, pros and cons of formal and informal workout processes, and techniques that are used to effect a turnaround to name a few. In our 4 day workshop, Peter Gothard, will teach you how to sail your way through the nitty-gritties of Distressed Debt Restructuring, through real-life case studies, and approaches used by lenders and borrowers in real world turnaround and restructuring cases. We urge you not to miss this opportunity, and take-home expert restructuring and turnaround skills.

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