

# Advisory Outlook



## The use of Restructuring to Preserve Value



**Kwabena Asante-Poku**

Cash flows of many corporates (“Borrowers”) have been squeezed by tougher market conditions and in some cases lack of appropriate planning and execution. Currently, several Borrowers cannot generate sufficient cash flows to sustain their debt burden. More than ever, financial managers are saddled with the task of finding solutions to reduce cash outlays especially operating and financing costs. The importance of proactive debt management as an essential part of business strategy in times of market volatility cannot be overstated. Debt burden can very quickly spiral out of control as repayments are missed, penalties mount, and covenants are broken. Soon the business is faced with the threat of bankruptcy or liquidation.

Open and candid engagement at all stages with financiers is therefore extremely imperative. Increasingly, Borrowers are asking commercial banks (“Banks”) to restructure their loan facility (“facilities”).

Similarly, Banks are under significant pressure to restore and improve net interest margins, interest earning assets, while ensuring that non-performing loans remain below the threshold set by the Central Bank of Nigeria. To ensure that future profitability of both corporates and banks are not compromised, the trend where loan facilities are restructured without a good understanding of the Borrowers and their business drivers needs to be discouraged.

**As an early preventive action, corporates, and their bankers, can use informal restructuring workouts to preserve shareholder value and reduce the required specific provisions for non-performing loans.**

These informal restructuring arrangements between creditors and debtors are often agreed on the premise that cooperation will prevent greater loss, and that banks will work with the distressed debtors to resolve financial difficulties that would otherwise likely lead to liquidation.

### Informal Workouts

Given the absence of adequate insolvency laws with provisions to govern business restructuring in Nigeria, any out of court restructuring is considered an “informal” arrangement. Informal workouts serve as a timely alternative to recovering funds loaned to Borrowers.

The key principles governing informal workouts were first conceived by the Bank of England in the 1970s when the United Kingdom was in recession. This approach, commonly known as the “London Approach”, has been adopted in various forms globally and is based on the assumption that cooperation will prevent greater loss to Corporates, Banks, and in turn, the wider economy. Insolvency legislation at the time did not provide for voluntary restructuring and The Bank of England chose to become actively involved with individual workouts.

The main objectives for the London Approach include - **minimising losses to Corporates, Banks and other parties through coordinated negotiations; and avoiding the unnecessary liquidations of viable companies.**

### Key principles governing an Informal Work-Out

Informal work-outs are based on the principle that Banks and underperforming or distressed Borrowers work together

**In recent times, economic activity in Nigeria has declined driven by low crude oil prices, reduced public spending, reduced Gross Domestic Product (GDP), depreciation of the Naira and limited access to foreign exchange. This has negatively impacted the financial performance of most businesses.**



**Seyi Akinwale**

to resolve financial difficulties that would otherwise have resulted in insolvency (receivership or liquidation). Prior to agreeing to restructure a facility using this approach, Banks have to assess relevant financial information relating to the Borrower, its business prospects, and sustainable debt capacity. This review is key in ensuring that Banks support companies that are viable and are not simply prolonging the inevitable.

At this point, the Banks may agree to defer taking punitive actions where the business fundamentals indicate that the interests of the Borrower and the Bank are better served by allowing the Borrower to continue to operate as a going concern. Once this has been determined, the starting point for negotiations is agreeing a “Standstill” where the Banks agree not to enforce their security or demand payment for their debts for a period of time with the aim of ensuring that a consensual restructuring agreement is negotiated and agreed.

During the standstill period, the Borrower will be required to provide the Bank with various information including:

- Details on the viability of the future profitability: Factors to be considered include the industry in which the company operates, product/service demand and the company's positioning in the industry. In our experience this information is crucial in preventing further losses to the Bank.
- Possibility of fund generation through either sale of existing non-core assets or divestment of unprofitable segments of the business;
- Financial projections which confirm the sustainable debt capacity levels of the business;
- Action plans to ensure that factors which contributed to the challenges being faced by the business are being addressed. For any debt restructuring to be successful, it should be accompanied by operational restructuring which addresses idiosyncratic issues that Borrowers face;
- Steps identified by the borrower as being key for a successful restructuring and how these will be incorporated by Management;
- Plans to ensure that payment terms would be renegotiated with other significant creditors to the business;
- Confirmation from other significant creditors that they aware that the borrower is going through a restructuring process and would not initiate any insolvency proceedings over an agreed timeline; and
- Management's capacity to drive the turnaround of the business.

The Banks would review the above information, use it as a basis to decide sustainable terms of the restructured facility and identify relevant monitoring safeguards to prevent any potential future default by the Borrower.

### Challenges with Informal Work-outs

As with any approach, there are challenges that arise from an out-of-court restructuring, especially where the borrower is exposed to a club/syndicate of Banks and potentially large/significant creditors. **Once a Bank or creditor “breaks ranks” for instance, it makes it difficult to obtain the collective agreement necessary to consensually restructure the facility.** We recently supported a client with exposures to over six local Banks. These facilities were not syndicated and there had been a breakdown of trust and communication between the Banks and the Borrower. During the early stages of the informal process, one of the Banks instituted insolvency proceedings. It was then agreed that a Coordinating Committee which included PwC, legal advisers to the borrower and the Banks should take over the management of the process. The Coordinating Committee had representatives from the different Banks and this helped in harmonizing an approach to the restructuring for the greater good of all parties involved.

During an informal workout, **assessing the real financial and economic situation of a borrower can be difficult as the basis of any analysis relies heavily on information provided by the borrower.** This can be mitigated by ensuring that a variety of quantitative and qualitative information are analysed during the initial business review. In the case mentioned above, we provided the Banks with a Business Review report which answered key questions around the Borrower's - market, people, technology and debt capacity. This information formed the basis of the restructured loan facility which included an upfront good faith payment, syndication of the restructured facility, and tenor extension. The newly agreed terms were considered more favourable for the most part to the Banks and the Borrower.

**Where there are many different classes of debt and non-banking creditors, it may be difficult to structure a transaction binding all the different Banks** while ensuring that the large creditors are on board with the process. In such cases, the needs of the various classes of debt may be better served using formal insolvency procedures as these clearly set out how different classes of debt are to be treated independent of size or nature.

### Conclusion

Given our current economic climate and the absence of a formal legal and regulatory framework governing the restructuring process in Nigeria, it is now more important than ever before, to use out-of-court restructuring processes to ensure the survival of many businesses. **Avoiding bankruptcies of potentially viable businesses helps to preserve jobs, and can be a driver of economic recovery.**

Corporates and Banks, both need to understand and protect their rights, while maintaining cordial relationships with each other. Borrowers can seek the support of financial advisers to help with the restructuring process, while Banks can use them to monitor post-restructuring agreements to minimize the risk of defaults. Borrowers will also have to appreciate the financial, legal and strategic issues associated with any debt renegotiation. Formal insolvency proceeding in court, often delay the turnaround process, can be expensive or can end up being more complex due the adversarial nature of the judicial process. It is therefore in the interest of both the borrower and its bankers to utilise and adopt informal out-of-court restructuring solutions.

## PwC's Breakfast Session: Preserving Value in Challenging Times

When faced with economic uncertainty, management must consider the effect of the challenged economy on their business and their ability to succeed. Key questions to address are - "How do we preserve value?", "What should we do differently?".

Join us and other stakeholders as we explore practical steps to preserve value in these difficult times.

**Target Audience :**  
Chief Executive Officers, Chief Financial Officers, and Executive Directors

**Date :** Wednesday 27 July 2016

**Location :** Lagos

For enquiries please contact:  
**Olamide Abiru**  
pwc.advisory@ng.pwc.com  
+234 803 319 3017, 817 028 5694

**Attendance is strictly by invitation**

### About the authors

Kwabena is a Partner in PwC's advisory deals practice.  
He can be contacted through kwabena.asante-poku@ng.pwc.com

Seyi is an Associate Director in PwC's advisory deals practice.  
He can be contacted through seyi.akinwale@ng.pwc.com

### Our Advisory Practice

We use local and global knowledge to deliver strategies and solutions that are specific to you. Our teams bring experience and insights in Business Reviews / Restructuring, Change Management, Expansion Strategy, Human Capital Development, Investment / Fund Raising, M&A / Disposals, Market Penetration, Organisation Structuring, Process Optimisation, Profitability Enhancement, Regulatory Compliance, Risk Management / Controls, Tax Efficient Capitalisation, Technology Enhancement, Vertical Integration, and Viability Assessments.

### About PwC

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