

The Global Restructuring Market – Were Earlier Forecasts on The Mark?



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For struggling companies facing crisis situations such as the current COVID pandemic, having a proven advisor, with established restructuring and debt advisory teams, strong relationships with lenders and vital access to capital and equity, is crucial.

Earlier this year, IMAP's Global Debt Advisory & Restructuring Team held a virtual roundtable, discussing the financial effects of the COVID-19 crisis. Now, our IMAP Experts return to share their perspectives on how things have evolved since March.

They explain how the various phases of the COVID cycle have unfolded, the effects and subsequent lender reactions. They also look at the restructuring market, reflecting on expectations versus reality and the outlook moving into 2021.

DEBT ADVISORY GLOBAL VIEW

GERMANY



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At IMAP M&A Consultants AG in Germany, we offer comprehensive dedicated “Special Situation” M&A services along the entire cycles of a company crisis. Our mission is to stop loss in value through M&A as early as possible, to maximize returns for current shareholders and lenders. Our current focus is the liquidity and profitability crisis and as always, to ensure that the objectives of debt restructuring and the M&A process, are aligned so that we achieve the optimal overall result for our clients.

Results of the COVID-19 Pandemic

If we go back to April, we said we didn't expect a wave of insolvencies until the Fall and in fact, due to government measures (suspension of the obligation to

file for bankruptcy until year end and financial support programmes), the number has dropped. However, we expect this to rise at the start of 2021 when these measures are no longer in place.

Interestingly, rather than taking on new debt during the crisis, a study by the German IFO-Institute has shown that only small numbers of family-owned businesses took on the state-backed loans made available in response to the pandemic, preferring instead to use short-time work and tax referrals.

At the same time, the pandemic hasn't in fact, hit the country as hard as initially expected. Indeed, we have witnessed a strong recovery in the second half of 2020. It has however, left scars. We are seeing reduced equity and working capital, with companies making less investments. Furthermore, banks are putting pressure on companies, many of which we believe will then look to M&A as a solution to increase their equity and improve their cash position.

We increasingly see the restructuring of global companies becoming an international task, as such there are increasing opportunities for international collaboration throughout the IMAP organization.

OUTLOOK & BUSINESS CONTEXT

Increasingly diverse challenges and complexity for companies

▶ Continuous government measures such as the prolonged suspension of the obligation to file for insolvency (until 12/2020), state-backed financing and the implementation of a new legal framework for out-of-court restructuring will likely prevent an insolvency wave

IMAP Germany well-positioned through out-of-court track-record

IMAP
50% Distressed M&A in Germany

▶ Due to the suspension of the obligation to file for insolvency, it is assumed that the number of insolvency applications will fall to 18,000 in 2020. Up to 24,000 insolvencies expected in 2021

Effect from suspension of the obligation to file for insolvency until 12/2020

Year	Number of company insolvencies in Germany (cases in k)
2015	22
2016	21
2017	20
2018	20
2019	20
2020	18
2021	24

▶ Inclined balance sheets, reduced working capital and capex backlog lead to fresh money demand in rising markets ▶ M&A solutions

▶ Medium-term: refinancing of state-backed loans in 2 to 3 years ▶ Debt Advisory

▶ Restructuring of companies is increasingly becoming a global task both for Debt and M&A Advisory:

- Global footprint of companies (sale of non-core businesses around the world)
- Global diversification of debt & private equity funds
- Different jurisdictions increase the need for comprehensive advice

DEBT ADVISORY GLOBAL VIEW

BRAZIL



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In Brazil, the COVID-19 crisis has been less significant than expected. Though there was a major decrease in activity, we have seen a V-shape curve, whereby many sectors are recovering well, including: Construction, Services and Transportation, though those directly affected by social distancing remain depressed.

As 80-85% of the corporate credit raised is by banks in Brazil, there were concerns that the pandemic would cause banks to retract. However, due to a combination of government stimulus and new insurance options, as well as low levels of inflation and subsequently unprecedented record low interest rates, credit in fact increased. We also see significant demand for debt capital market instruments by higher yield-seeking investors, as well as for new IPOs, which previously nearly nonexistent we believe are a new area of growth and opportunity.

Brazil is the largest market in the world for Green Bonds, issuing USD 5 billion in Green Bonds in 2019. These are primarily in renewables, such as solar or wind plants and we see this a big avenue of opportunity as an increasing number of ESG investors look to Brazil for Green Bond projects.

We are also seeing some other interesting trends in Brazil. In order to raise debt at good levels, we are

seeing the use of convertibility features, such as warrants or equity tickets as part of the issuance. Increasingly, we are also seeing IP, including brands, as a form of guarantee - placing value on companies with a strong brand.

Our Debt Advisory Team & Services

For over a year, Brasilpar (IMAP Brazil) has actively been building a Debt Advisory team in response to client needs and the changing market, as capital raising becomes more popular in Brazil. Our team's considerable experience in investment banking, allows us to ensure our clients achieve the optimal capital structure for their companies. We help them manage financial risks and increase financial flexibility and ultimately, through the right financial strategy, maximize shareholder value.

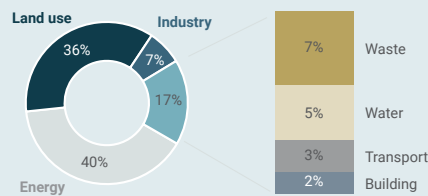
We have developed a strong relationship with a wide network of local and international banks in Brazil, Private Equity, Special Situations, Credit and Alternative Investment Funds, as well as with Wealth Management players, which enables us to provide our customers with access to the best banking, capital markets or alternative financing sources. Furthermore, we have developed an active relationship with Falconi Consultants, the leading Brazilian management consultancy firm.

LAC green bonds issuance (1)

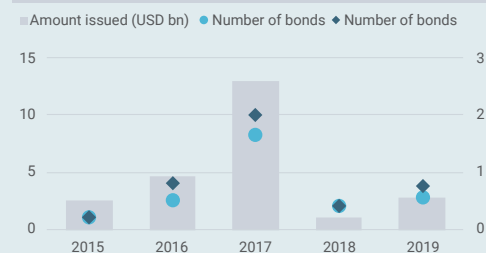


(1): Data as of 2 July 2019 Source: Climatebonds.net

Top 3 sectors: Energy Land use and Industry



Issuance in Brazil (2015 – 2019)



RESTRUCTURING GLOBAL VIEW

UNITED STATES

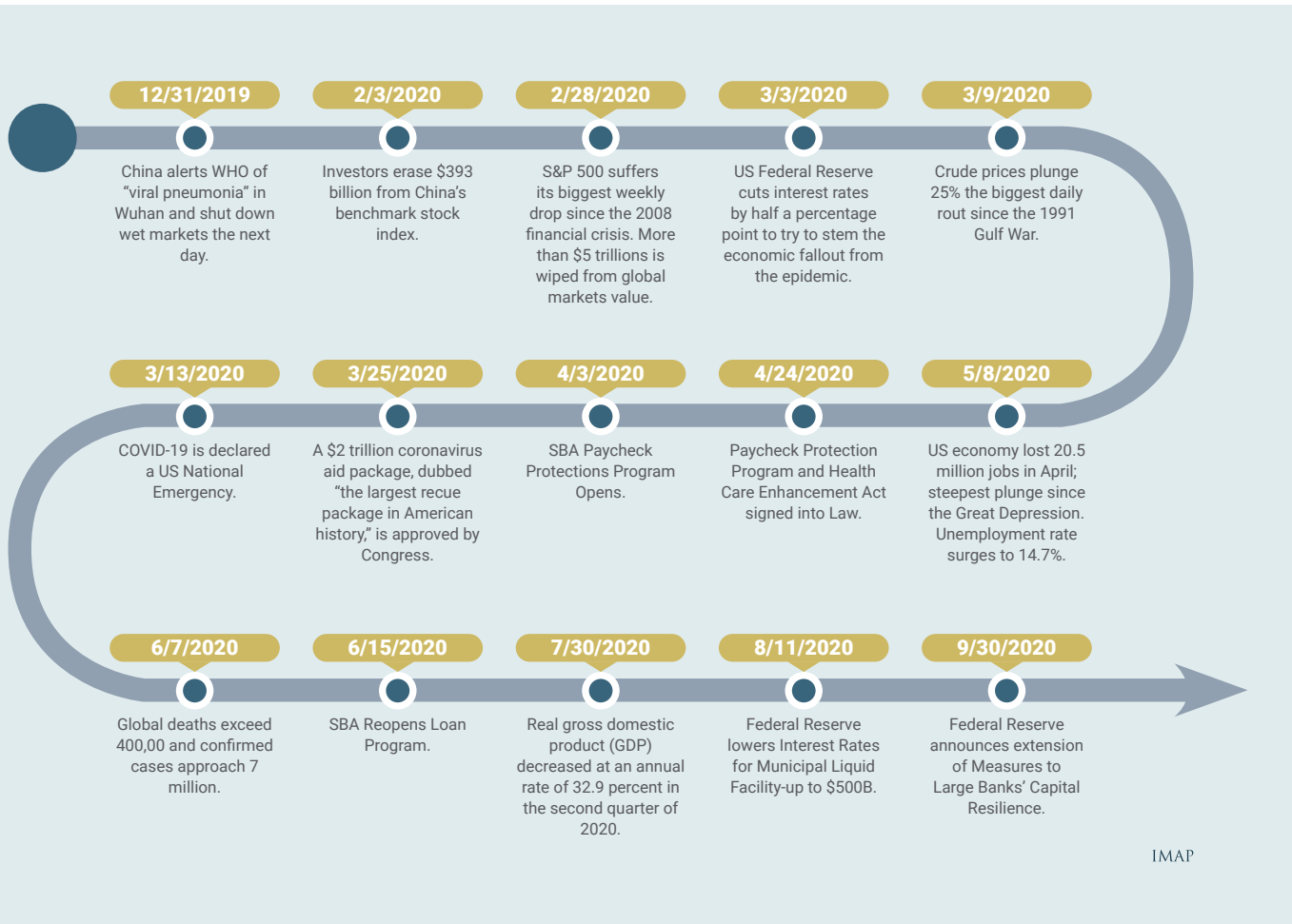


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Back in April, we were only just beginning to understand COVID-19 and how it was spreading. Looking at the early effects on the U.S. market and how it was reacting, everyone believed we were between full spread and containment, though in hindsight, we were far from containment. The industry specific restructurings we were expecting at that stage, didn't appear, primarily due to the USD 2.2 trillion pumped into the economy by means of the U.S. Government CARES ACT, resulting in the industries holding back, waiting to see how the market would evolve.

In the timeline below, we can see the actions effectuated by the U.S. Government to stabilize

the markets. Initially, we were in a state of limbo, waiting for events to unfold in China. In February, their markets took a big hit, and subsequently, so did ours. We saw an energy plunge, the U.S. Federal Reserve cut interest rates and a state of emergency was declared. There were still a lot of unknowns and it was only in April that we began to see the effects of closing down one of the largest economies in the world. The U.S. economy began to plunge, and it wasn't until the summer, we saw signs of the virus being contained. At the same time, we began to see movement in the restructuring market; clients began contacting us, needing help to solve liquidity and operational challenges and capital markets began to open.



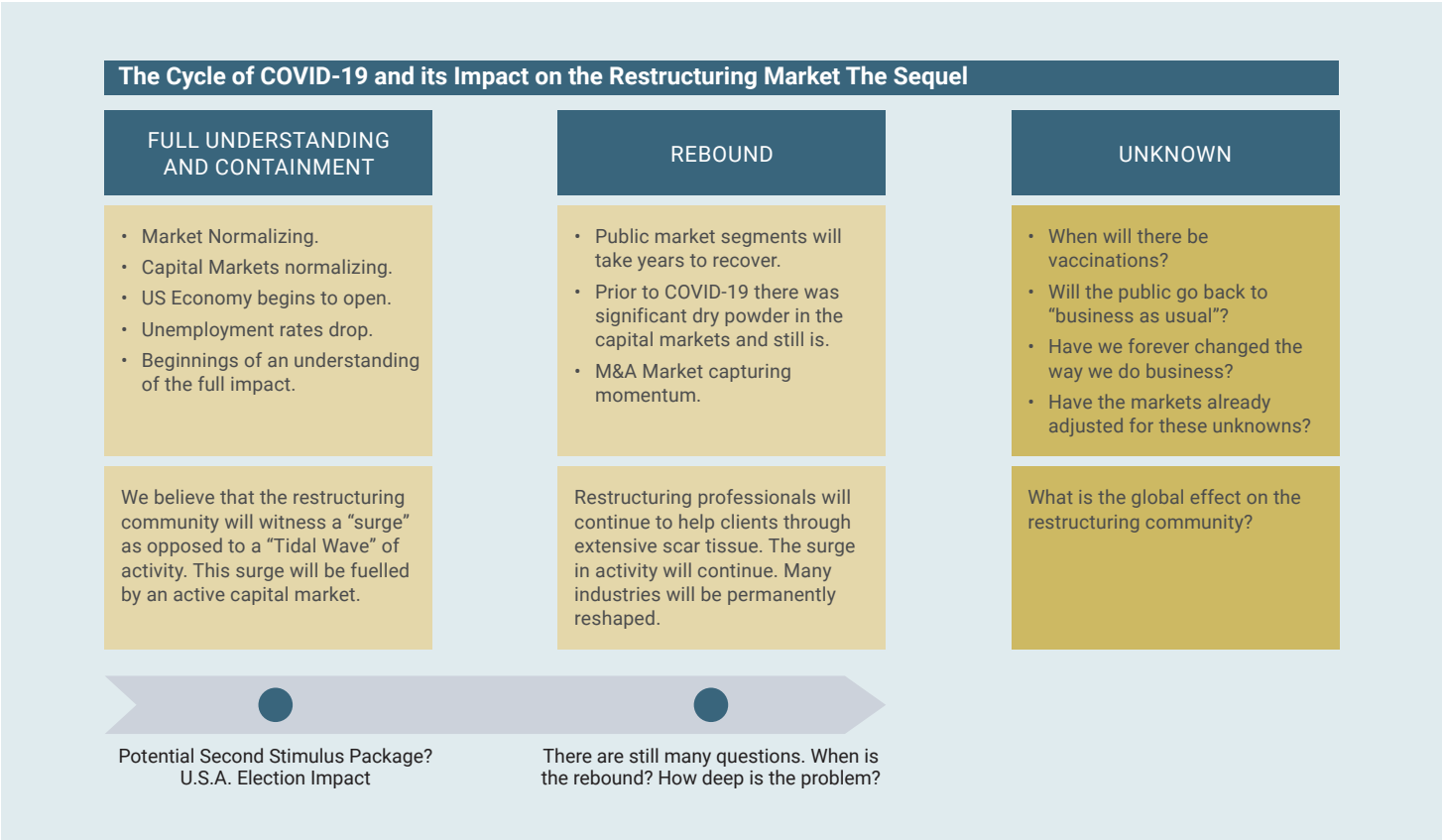
RESTRUCTURING GLOBAL VIEW

UNITED STATES

So Where are We Now and What's Next?

We now have a better understanding of the virus, have learnt to live with it, and there is a vaccine on the way. The U.S. economy is on an upwards trajectory, with GDP seeing record growth in October. Markets are normalizing and our unemployment rate is dropping significantly. We are now seeing a surge, as opposed to a wave, in activity in the restructuring market,

albeit later than expected. Earlier in the year, we were primarily discussing balance sheet restructurings, when capital was the main strategy for turning businesses around. Businesses are now realizing they need to look more deeply into their operational issues and those teetering on the edge, previously supported by the liquidity in the market, are the ones who will be most affected.



Are we in the rebound phase yet? I believe we continue to be several months behind schedule. Regardless of the U.S. election results, we will see another stimulus package, though many industries will be permanently reshaped, and clients will have a lot of scar tissue. There are still many unknowns

and we still don't know exactly how this will affect the global restructuring market. That being said, I do think the restructuring industry will be remarkably busy over the next 3-5 years, trying to find solutions and heal companies with wounds pre-COVID, and subsequently magnified by the pandemic.

RESTRUCTURING GLOBAL VIEW

CANADA



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As is often the case, Canadians measure their success or failure as in comparison to our friends south of the border. The timeline, trends and conclusions experienced in Canada are broadly the same as the U.S. market, with a few exceptions. In typically Canadian fashion, our COVID-19 public response in general has been positive, with constructive response to the restrictions, and without any widespread politicization. Our health policy has been seen to be reasonable and uncontroversial, and our federal stimulus strategy has been comprehensive and extensive. Mechanisms have been designed and implemented to forestall any widespread defaults, including replacement of student's wages in the summer, relaxation of unemployment insurance rules, comprehensive wage subsidies and perhaps most importantly, relaxed capital rules for banks. Across our society, we have been largely successful in softening economic the impact of the pandemic. Therefore, though the restructuring market has been active, we have not seen the anticipated large restructuring wave, nor the crisis mentality we saw back in the 2008 crisis. That said, there are key trends and learnings we can take away from some of the recent activity:

Debt Heavy Businesses in Need of Urgent Restructuring when Business Dries Up

A well-known example of this is global personal entertainment company, Cirque de Soleil. Acquired by a U.S. PE firm some years ago, it had a high debt load and was highly vulnerable when the pandemic hit and all shows stopped. The result was a very quick CCAA filing (the Canadian version of Chapter 11 bankruptcy). Hedge funds immediately began buying debt at a large discount, and consequently, La Cirque is now owned by creditors. A number of debt heavy retailers faced a similar fate, and clearly the combination of high debt levels and COVID-19 vulnerability has been too much to overcome with government support mechanisms.

Businesses with Strong Balance Sheets & Stakeholder Support Seizing the Opportunity to Expand

In a number of situations, strong players that had carefully cultivated a supportive stakeholder base have been able to take advantage of the COVID-19 crisis, even when their businesses are significantly affected. One such example is GoodLife Fitness, the most dominant player in the fitness sector in Canada. A

well-managed business, they have carefully cultivated a loyal following amongst their stakeholders and senior/subordinate debt holders. Following the closure of all gyms, their stakeholders gave them the green light to look at acquisitions of smaller competitors. In contrast, other regional players, with too much debt and generally weaker businesses were forced to take vastly different measures.

Strategic Buyers Buying Debt to Control Competitors

Well services provider Calfrac recently went through a restructuring process, whereby a strategic investor and direct competitor, the Wilks Brothers, aggressively buy tranches of debt. Historically we have seen this by hedge funds and aggressive debt funds, but not strategic investors, though we expect this to become more widespread.

Segments in Economy Previously in a Bubble, Now at Risk of Imploding

Historically, downtown Toronto had a highly active market constructing new condominiums, bought by strategic individual investors as rental units. The downtown Toronto rental market has been driven in part by younger professionals working in the financial services industry, and has been crushed due to most banks moving to remote work. Thousands of condominiums remain empty and yet construction continues. We expect to see the assignment sale market (unit resales completed prior to construction completion) increase, and the risk of developers going bankrupt puts the lending community at risk of owning these buildings. We could see significant disruption during the next 6-12 months.

Lending Issues in Private, Not Banking Sector

In Canada, since 2008, we have had an explosion of private debt funds as the major Canadian banks have had the luxury of being highly selective in their loans underwritings. For any given private lending fund, their prospects are now very dependent on the specific business segment they focused on. Though there are a number that are doing well and are actively lending, while there are also many in crisis, having ceased distributions and redemptions. We expect that there will be a number of attractive portfolio acquisition opportunities within the next 6 to 12 months.

RESTRUCTURING GLOBAL VIEW

INDIA



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At IMAP India, we follow the “Bear-Hug” principle with respect to client servicing; we work with them across their lifecycle and hence as a result, our product portfolio spans the entire lifecycle of a business. Our Debt & Special Situations Advisory teams also work together seamlessly since both products are focused on the client’s credit requirements. While the Debt Advisory team is focused on performing credits, the Special Situation Advisory team is focused on helping a Client facing liquidity or financial stress to achieve debt resolution by correcting the debt level through either financial or strategic solutions.

Restructuring Market in India

In India, more than 50% of the banking sector is controlled by Government owned banks, leading to slower decision making; hence debt restructuring projects, undertaken by the Special Situation Advisory team tend to take significant time. Any resolution requires multiple iterations and hence corporates need at least 2 to 3 years to achieve turnaround post any downcycle in the business. We have worked on various situations including a recent one which involved distress M&A and financial restructuring with India’s largest Theme Park, whereby we brought together three strategic players to take control of the theme park, hotel and surplus land (parts of the same entity) to achieve the best recovery for the creditors; the process however spanned across 2 years. Similarly, we have worked with a Pharmaceuticals formulations company with operations across India and Europe to achieve debt resolution by a mix of financial and strategic steps.

Now let’s look at how COVID-19 has impacted the restructuring market in India; India had one of most severe lockdowns in March/April 2020, which led to a steep dip in economic activity. In fact, we were the most severely hit in terms of industrial production and manufacturing. Since

then, economic activity has gradually improved as can be seen by data on vehicle sales and GST collections. Moving into Q4 these indicators have reached levels higher than those in 2019. However, unemployment levels continue to be a concern and are only likely to be addressed once the Real Estate and Construction sectors return to previous levels.

In terms of capital availability, we are now back to where we were in February 2020; equity indices are now above pre-COVID levels and as a result, primary markets have opened-up and large corporates are raising equity to increase their financial flexibility. Looking at the debt markets, the regulator, Reserve Bank of India (RBI) has pumped in significant liquidity, as well as substantially reduced interest post COVID; however, most of the liquidity has found its way to larger corporates looking to rephase their debt obligations. There has been lesser credit available to smaller and medium sized corporates, as well as corporates focused on discretionary spending sectors. For borrowers whose financial position has been impacted by COVID, RBI has opened a restructuring window to help realign their debt obligations in line with expected cashflows. At the same time, the Government has put bankruptcy initiation on hold, to try and nudge creditors to work along with borrowers to find solutions. As in earlier instances, for many COVID impacted Corporates, the slower restructuring process and likely credit deterioration during this period is likely to lead to creation of a substantial pool of Non-Performing Loans (NPLs).

We expect that the moratorium on Bankruptcy initiation is likely to be set aside by March 2021, after which Borrowers will have to find solutions to provide exits to Creditors, either by achieving Financial or Strategic solutions.

RESTRUCTURING GLOBAL VIEW

INDIA

In light of the above, there is expected to be a lot of activity in the restructuring market over the next 36 months. Initially, we expect to be focused on working with clients to achieve debt restructuring based on the RBI package as well as helping large groups to achieve Holdco refinancing, and distressed M&A in

COVID impacted sectors. If we look further ahead, we expect a strong transaction pipeline focused on NPLs created by COVID, leading to a further increase in distressed M&A activity levels (driven by larger Corporates moving to consolidate their respective Industry).

SPECIAL SITUATION ADVISORY: LIKELY EVOLUTION OVER THE NEXT 36 MONTHS



0-18 months

- Debt Restructuring for COVID-19 impacted companies based on RBI package
- Holdco Refinancing of large groups (since most Holdco financings are by Non Banking players, which are not covered by RBI guidelines)
- Distress M&A activity based on Consolidation in COVID-19 impacted sectors

18-36 months

- Strong Transaction pipeline expected w.r.t. NPLs created due to failed restructurings in COVID-19 impacted sectors
- Distress M&A volumes to recommencement of proceedings
- Refinancings in COVID-19 impacted Corporates which perform better than expected as Restructuring packages

We believe there will be a lot of activity in the restructuring market over the next 36 months. We initially expect to be focusing on working with our clients to achieve debt restructuring based on the regulators package, helping large groups to achieve Holdco refinancing, and distressed M&A. If we look further ahead, we expect a strong transaction pipeline and a further increase in levels of distressed M&A activity.