



# Turnaround and growth financing for stressed companies

## Debt for equity swaps - issues and solutions for Romania

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# Agenda

- the Romanian situation
- early stage solutions for management
- debt to equity conversion
- key issues for lenders
- valuations and debt capacity
- case study

# Romanian situation

- reduced economic activity has been managed fairly well
- low interest rates, deferred capex and rescheduled credit lines have kept formal default levels low
- liquidation option when cash runs out and no viability
- insolvency process functioning but poor recovery rates
- lack of turnaround skills
- lack of out-of-court experience
- management denial is common
- banks reluctant to hold equity and realise losses
- no non-consensual conversion mechanism yet

# Early stage solutions for management

- objective forecasts and KPIs can provide early warning
- good communication instils confidence and can buy time
- timely action to restore liquidity include:
  - renegotiation of credit terms
  - cash and working capital management
  - focus on performance improvement
  - revisit strategy and management team
  - right size operations back to core?
  - look for balance sheet quick wins

# Debt for equity Triggers

- New money requirements



- Commercial implications of balance sheet restructure

Customers  
Suppliers  
Credit insurers  
Auditors



# Debt for equity

## Key questions lenders will ask



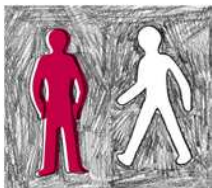
1. Is the business viable?



2. How strong is the management team?



3. Do the management team support the restructuring?



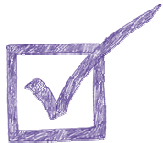
4. What is the exit strategy for the Lenders?

# Debt for equity

## Key questions lenders will ask



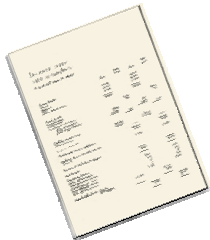
5. Is the debt for equity better than formal insolvency or an alternative solution?



6. Does a debt for equity swap avoid crystallizing a loss/ protect future value?



7. Where does the value break?



8. What is the debt capacity of the business?



9. What are the tax implications?

# Debt for equity

## Key questions lenders will ask

### 10. Lender Control Considerations

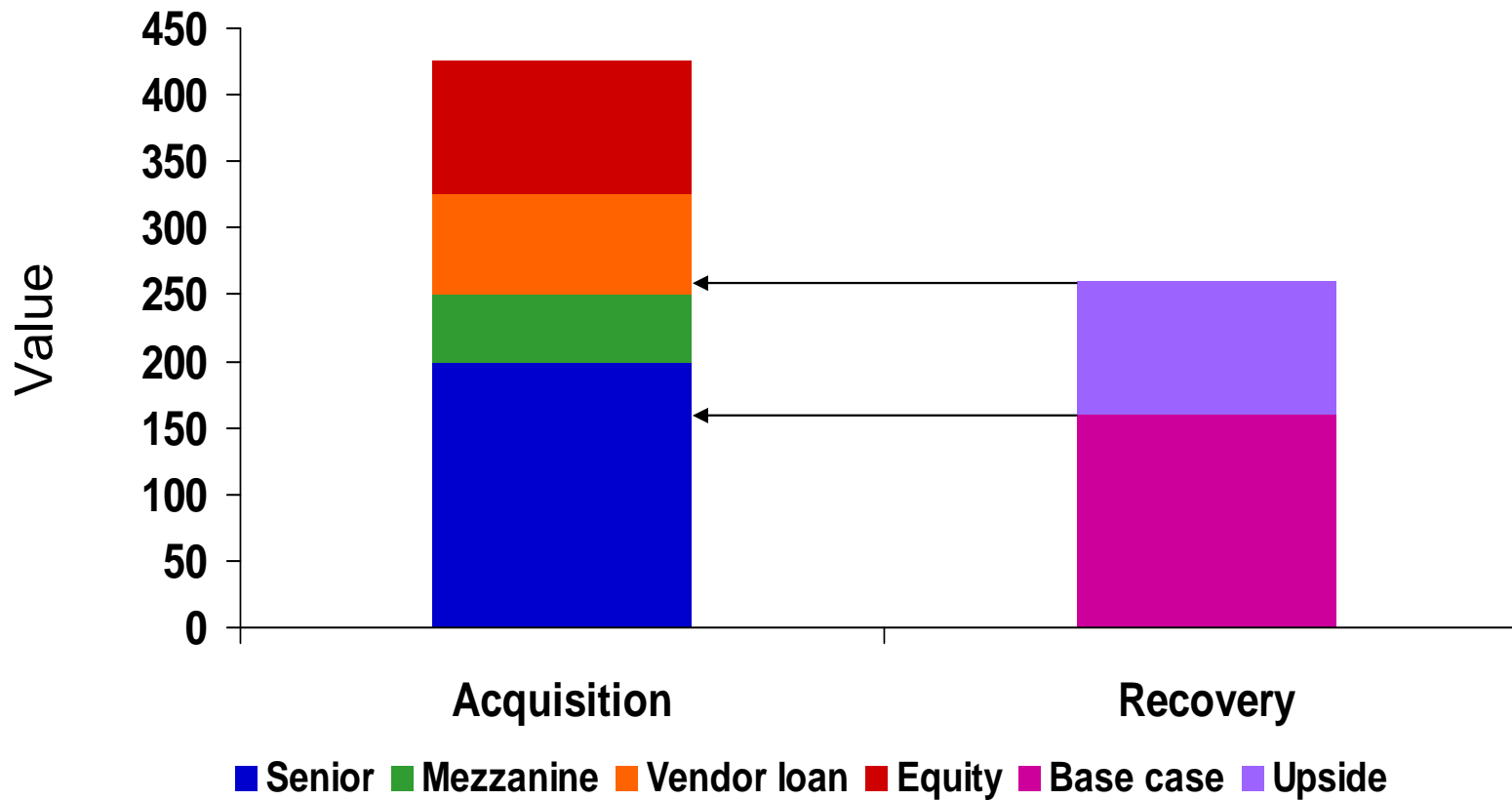
- Asset on lender's balance sheet
- Pension implications?
- Tax structuring?
- Returns and exit strategy?
- Rank behind unsecured creditors  
(unless lender debt stays whole)





# Debt for equity

Value break - upside issue may provoke creditor litigation



# Debt for equity

## Debt capacity

- Serviceability
- Loan to value ("LTV")
- Security available and its value
- Industry norms
- EBITDA multiple
- Balance sheet structure



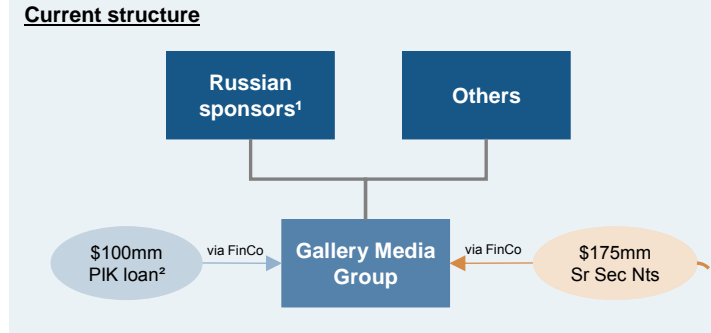
J.P. Morgan acted as exclusive financial advisor to the company on the debt restructuring of Gallery Media Group



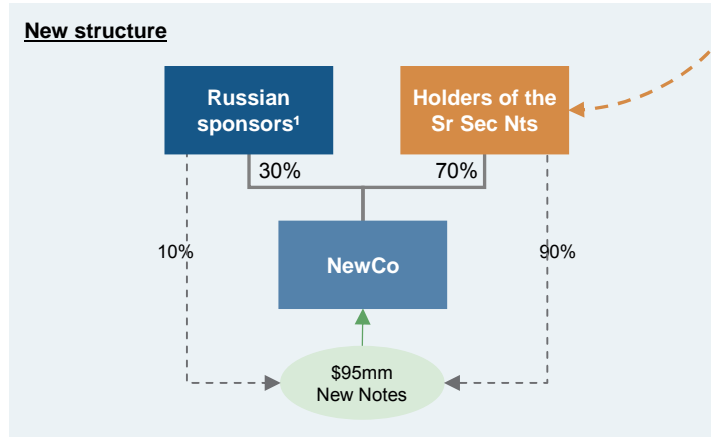
**Transaction details**

- In May 2009, Russian outdoor advertiser Gallery announced the postponement of the semi-annual coupon payment on its 10.125% Senior Secured Notes (issued in May 2006) and enter into formal restructuring negotiations with the bondholders
- In October 2009, Gallery announced that it has reached a **consensual agreement** with the bondholders
  - Under the terms of the agreement, total indebtedness is reduced to \$95mm ( "New Notes" to be issued)
    - The New Notes will have a 10% annual interest rate (PIK in year 1, cash thereafter) and a 5-year term
    - The existing PIK loan is wiped out
  - Following the completion of the restructuring, the existing bondholders will own 70% of the equity in a new company (NewCo) which will essentially own all the assets of Gallery
  - Two existing shareholders of the group, Baring Vostok Capital Partners and founder and former CEO Anatoly Mostovoy, will invest \$5mm in NewCo and provide ongoing support in return for 30% of the equity of NewCo and 10% of the New Notes
- The restructuring will be effected by way of a Scheme of Arrangement under UK law

**Group structure**



UK scheme of arrangement



<sup>1</sup> Baring Vostok Capital Partners and Anatoly Mostovoy <sup>2</sup> Initial principal excl. accrued interest

# J.P. Morgan acted as exclusive financial advisor to the company on the debt restructuring of Gallery Media Group (cont'd)



## Details of the agreement

- The agreement was approved by an **ad hoc committee** which represented more than 75% of the existing bonds outstanding
- There will only be **one class of NewCo shares** ranking *pari passu* with each other in all respects
- The **Board of NewCo** will be composed of 3 members, of which one each will be nominated by:
  - the largest holder of the existing bonds
  - the Russian sponsors
  - the majority of the remaining shareholders in NewCo
- Two Chief Restructuring Officers (**CROs**) will be appointed
- The **CEO** will be appointed by the simple majority of the Board, with the Russian Sponsors retaining certain veto rights
- The Russian Sponsors are entitled to an **exit bonus**, calculated as 21.4% of the difference of the proceeds of an IPO (or a similar exit event) and US\$384mm
- There are certain **transfer restrictions** attached to the shares of NewCo, including a mandatory bid for any person who acquires 33% or more of the equity and an agreed list of persons that are not permitted to become shareholders in NewCo

## Transaction highlights and J.P. Morgan's role

- J.P. Morgan helped the company to achieve a **sustainable capital structure** that allows to preserve liquidity in a difficult market environment and to act from a position of financial strength once the economic rebound sets in
- The future ownership structure and corporate governance were **carefully balanced** and designed to maximise value for existing bondholders, while at the same time reflecting the necessity for a strong and well-established local partner
- J.P. Morgan's clear focus was to **maximise value to all stakeholders** by ensuring a smooth, fair and transparent negotiation process at all stages
- A **consensual restructuring** was targeted from the beginning and the necessary, highly complex legal workstreams for a UK Scheme of Arrangement were initiated early on in the process to minimize implementation time once an agreement was reached
- This success is evidence of J.P. Morgan's unparalleled ability to **combine industry, country and product expertise**, and deliver a holistic product to the client
- The deal is one of the few examples of successful and consensual bond restructurings in Europe

# Final considerations

- It must be a commercial deal that works for other stakeholders:
  - equity sponsor unlikely to inject new money if too diluted
  - management may walk if incentive plan/equity split is unsatisfactory
  - new money investor will need control to implement a turnaround
- Consider equity holding SPV to avoid reporting on balance sheet or sale of debt to PE investor pre or post debt conversion
- Consider tax implications
- Each restructuring is deal specific - no magic formula

# Debt for equity Summary

## Pro's



- Debt holder return more commensurate with risk
- Balance sheet gearing improved
- Suppliers and creditors perception of business improved
- Avoids distressed realisation of value
- Stable platform for the business
- Management can be incentivised
- Time to negotiate
- Avoids insolvency process (benefits vs loss of control?)
- Hard-ball of sophisticated equity holders/other lender groups

## Con's



- Timeframe
- May be non-consensual as stakeholders have nothing to gain: disenfranchised = insolvency process
- Court and IP = complexity and cost
- Debt converted ranks behind unsecured creditors
- Equity arm of Banks become involved - different agendas ?
- Management distraction
- Valuation/marketing: [SIP 16](#)
- Impact on business/ execution risk
- Attitude of tax authorities to the transaction



**Thank you for your attention**

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