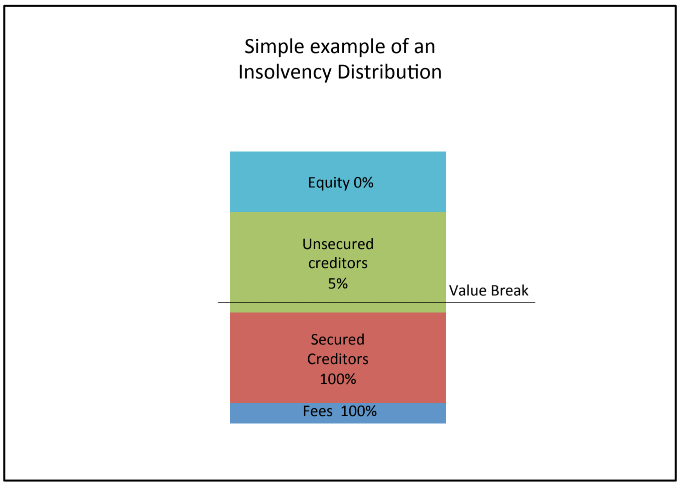
# Mini-guide to Consensual Restructuring

In order to understand the concept of consensual restructuring you first of all have to understand insolvency as the alternative.

An essential part of capitalism is that stronger businesses do well and the weakest fall by the wayside. For those that don't survive, there has to be a methodology of dealing with them. To that end, every country has insolvency laws governing how a failed business is dealt with.

In general, there will not normally be sufficient assets to pay all the creditors and so there has to be a mechanism to decide how the assets will be divided among the creditors and a process to appoint somebody with the responsibility to carry this out. Broadly speaking, the normal pecking order is that the professional fees of the process are paid out first, followed by secured creditors then unsecured creditors and lastly the equity (shareholders). In practice there are various complexities but in simple terms a typical example might look like the chart below. The value realised for the assets is shown as the value break and in this simple example it breaks in the unsecured creditors who only get 5% of what they are owed.




In the UK, this process is carried out by licensed Insolvency Practitioners (IP's). They effectively take control of the business and try to sell what they can and then pay off the creditors as per the legal order of priority. The directors lose all authority in the business and have little influence on the process after the filing.

There will always be a place for formal insolvency processes but at BM&T we believe they should be the last resort. Why? Because they are value destructive. The process is public and the assets are sold on a fire sale basis. There is little opportunity for the buyer to do due diligence, no warranties are offered and the risks mean that buyers pay a low price. The result is that creditors, in particular unsecured creditors, lose a lot and shareholders don't get anything.

Surveys have shown that unsecured creditors average a return from an insolvency of less than 5%. That can be catastrophic for suppliers, leading to job losses and further insolvencies. Indeed, research has found that around a third of all insolvencies are caused by the insolvency of a customer. Headlines on the sale of a business out of insolvency often focus on how many jobs have been saved but rarely mention how many were lost and certainly don't consider the collateral damage among the wider pool of stakeholders.

The alternative is a consensual restructuring or turnaround. This has two parts. Firstly the operational problems of the business have to be addressed. It has got into distress for a reason and whatever has caused it has to be remedied. Far too often advisers look to fix the balance sheet without fixing the underlying problem. Such restructurings are destined to fail and this is also a criticism of many insolvency-based solutions such as pre-packs and CVA's.

At BM&T we always look at the business issues first rather than putting them on the too difficult pile. What those issues are will be dependent on the business so it is impossible to generalise but it is all about getting quick and practical solutions to problems when time and cash resources are in short supply. It is not about spending weeks or months doing strategic analysis and producing large reports.

With a viable plan in place it becomes possible to see what the capital structure of the business should be going forward based on the cash flow the business can realistically generate. Sometimes the creditors can be paid in full over time. Often that can't happen and a restructuring has to be negotiated. That can include debt to equity swaps, creditors taking a haircut, new investors or any other techniques that get the desired result. The creditors will need to buy in to the proposed solution as being a better option than insolvency and that is key to gaining acceptance.

We refer to this as a consensual solution as it is all done by negotiation. The value in the business is preserved, stakeholders get a better result than in a formal insolvency, there is much less collateral damage and the business should not just survive but thrive.

We passionately believe that, where possible, this is a better way to deal with distress than formal insolvency and have a long track record of success, often where others thought all was lost.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