

## **CHIEF RESTRUCTURING OFFICER – A POWERFUL ROLE IN CORPORATE RESTRUCTURING**

by Dr. Dirk Schneider

**Corporate restructuring often requires financial and operational restructuring in parallel. Both elements are already challenging. During a corporate crisis and with the potential threat of insolvency the challenge might appear overwhelming. Different financing partners with diverging interests need to agree on a new financial and potentially a new governance structure. Strategic and operational realignments need to overcome the underlying reasons for the corporate crisis and support the new financial structure. In addition, the day-to-day business needs to continue with as little distraction as possible.**

**The following article discusses one restructuring case. It highlights the powerful role a temporary Chief Restructuring Officer can play in driving the process, ensuring consistency of measures and in obtaining alignment of different stakeholders.**

The family owned company is a third tier supplier to the automotive and several other segments of the light machinery industry. The company has significant production sites in three European countries and several smaller sites usually dedicated to a specific niche-market segment.

With historically stable yet non-spectacular growth rates the company had decided to embark on more aggressive, acquisition based growth which should also diversify product and customer base. Initial value adding acquisitions of several smaller production sites adding to the geographical reach or opening new customers in closely related segments confirmed the value potential of the new strategy.

During the 2004 – 2008 period acquisitions grew more sizable and did focus more on diversification than on growth in well-known segments. In addition, financing became more leveraged involving more financing parties and introducing significant covenant clauses.

The economic downturn in 2008 and 2009 led to dramatically lower EBITDA across all segments and highlighted unresolved integration issues in several of the newly acquired businesses. While there was no immediate insolvency risk, several covenants such as EBITDA/debt and operating cash-flow/interest had been broken and

banks demanded a substantially reduced debt-to-equity ratio to continue their exposure.

The owner, however, had already invested all available funds and provided private guaranties for several loans. While he was highly interested to support the financial restructuring and the subsequent continuation of the growth strategy, he was in no position to provide additional equity.

### **Scoping the Arena**

As the immediate first step, the management negotiated a three months stand-still with financing banks and brought in a small advisor team to run a quick diagnosis and to outline a high level restructuring concept.

On the operational side, the quick diagnosis did reveal that several of the recent acquisitions had not delivered expected synergies especially on the cost side. In fact, some acquisitions had effectively not been integrated at all. Scenario planning showed that several acquisitions even after operational cost optimization and in an upswing economy with corresponding revenue growth would not cover their cost of capital. Structural cost reductions as well as selected product redesigns were required. Both streams of activities would require

fresh capital not available in the existing setting.

On the financial side the diagnosis did confirm that equity holders were not in a position to invest fresh funds and existing lenders were not willing to settle for a covenant reset to reflect the current situation without an agreed upon restructuring concept. Some of the banks had already sold their debt to a distressed debt investor who initially was not available for discussion but indicated he might be interested in a debt-to-equity swap.

A quick market scan combined with a rough value estimate of some non-core businesses did indicate that their disposal should be possible at least above book value.

Consequently, the restructuring concept did include divestment of several non-core businesses and a yet unspecified debt-to-equity swap combined with operational and structural restructuring of the core-businesses. Based on these cornerstones and the introduction of an external Chief Restructuring Officer (CRO) coordinating the operational and financial restructuring work the banks did agree to extent their stand-still until a financial restructuring was signed.

Major uncertainties did remain, however, on the likely impact of any debt-to-equity swap on corporate governance and on the source of fresh funds for restructuring of the core businesses.

### **Restructuring the balance sheet**

Although high level guidelines for the financial restructuring had been agreed, negotiating the details turned out to be a time consuming and in part an adversary process. For several months it was not clear, how much debt the distressed debt investor already had or could obtain and whether he was aiming for a majority equity-stake. Equally unclear was at what price several

non-core activities could be divested or how much equity dilution the owner would be willing to accept and who would contribute fresh funds required to support operational restructuring. Increasing distrust between management and financing banks further complicated the situation.

During this phase the role of the external advisory team changed from an advisor of management to a broker on behalf of the owner coordinating the various parties involved in the financial and operational restructuring. To spearhead this effort a partner of the advisory team changed on a temporary basis to the role of Chief Restructuring Officer (CRO) effectively overseeing all operational and financial restructuring activities, orchestrating refinancing negotiations and coordinating all external stake-holder communication. In this way a trust-based relationship with all parties, especially with financing banks and their advisor could be established so that a multi-step restructuring solution could be developed and implemented.

First, the owner family agreed to a capital reduction to align equity with the net-value of the company and a subsequent capital increase with exclusion of any subscription rights to provide for a debt-to-equity swap.

Second, the distressed debt investor consummated the capital increase through a debt-to-equity swap. To minimize the risk of any differential liability in case of a further financial deterioration, the company did provide a certified fairness opinion on the value of the debt which was presented to the Commercial Register at the time of registration.

Third, the company divested several non-core activities against cash at significantly above book value and thus did improve its debt/equity ratio.

Last, with these alignments in place, the distressed debt investor, by now the majority shareholder, agreed to provide suffi-

cient fresh capital through a bullet mezzanine loan with accruing interest and an equity-kicker at maturation.

### **Communicating with stakeholders**

While negotiating the financial restructuring the CRO also initiated an operational turn-around including immediate head-count reductions and several other short- and mid-term efficiency improvements. Furthermore, the CFO led a comprehensive communication strategy informing key stakeholders about the restructuring process and its detailed progress. In addition to the financing parties, key suppliers, credit insurer and the workers counsel were closely and regularly involved into the communication flow keeping them updated in particular on the progress of the operational restructuring.

Communication with suppliers and credit insurer had been a controversial issue since it was not clear whether they knew or would necessarily learn about the restructuring. There was a clear risk of provoking tighter payment schedules which might have further deteriorated the liquidity situation. With hindsight, however, it turned out that the chosen very open communication of operational and financial restructuring plans, followed up by regular milestone updates with suppliers and credit insurer did maintain sufficient trust to continue with regular supply and payment terms throughout the restructuring process.

In this context it did prove highly effective to channel all communication efforts

through the CRO. This did ensure the overall consistency of the message and established additional credibility by introducing a “new face”, not connected to management decisions of the past.

### **Conclusion**

Involving an external CRO, although initially only requested by financing banks, did support the restructuring in several highly valuable ways.

First, having a dedicated CRO to coordinate all restructuring activities did ensure that financial restructuring was in line with cash-generating capabilities of the restructured operations thereby avoiding unpleasant surprises.

Second, the remaining management team could focus as much as possible on critical day-to-day business needs thereby minimizing any disruptive impact on the ongoing business.

Third, channeling all stakeholder communication through the CRO did ensure full consistency of all messages with actual restructuring progress. This helped to maintain strong overall support of critical stakeholders such as credit insurers, labor unions and financing parties.

Overall, the temporary role of an external CRO did provide very powerful and possibly enabling support to this complex operational and financial restructuring.

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