Operational Restructuring and Turnaround

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GPLLM Global Professional Master of Laws

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Tenzor Ltd.

- In operation since 2009
- Focuses on corporate restructurings and working capital management
- We work end-to-end: from problem to solution
- Projects included UK, Europe, US and emerging markets - Ukraine, India, Russia, Turkey, Argentina, Hungary, etc.
- Prior experience in both banking and well-run blue chip company- great mix for turnarounds
- I am also a co-founder of TenzorAI- developing AI based solutions for working capital management and financing

Why Turnaround?

- Insolvency may be an efficient solution if there are substantial assets in the business (based on actual liquidation value), and they can be easily secured.
- Otherwise, one needs to keep the company as going concern as the best way to recover - and this is not only lender's decision.
- To do so, one needs to answer why the company exists and how is it linked to its environment.
- Bank lender makes a one-off decision to lend-supply chain partners making their decisions (including granting credit) every time they trade

Five "C's" of Turnaround

- **Control**
  - Creditors seek to control assets and decision making
- **Capability**
  - The team (existent, new or interim) need to be capable for the task
- **Credibility**
  - Turnaround plan and the team need to have credibility with all stakeholders
- **Clarity**
  - What is the company's core business, how it fits with the industry structure and does the business model match it
- **Co-operation**
  - Lending group are not the only stakeholders. Ongoing support from suppliers, customers, distributors and others are vital for survival

Steps for Distressed Turnaround

- Diagnostic – “post deal” due diligence
- Fixing the team
  – Loyalty
  – Competence
  – Communication
- Re-defining the business
- Process optimisation

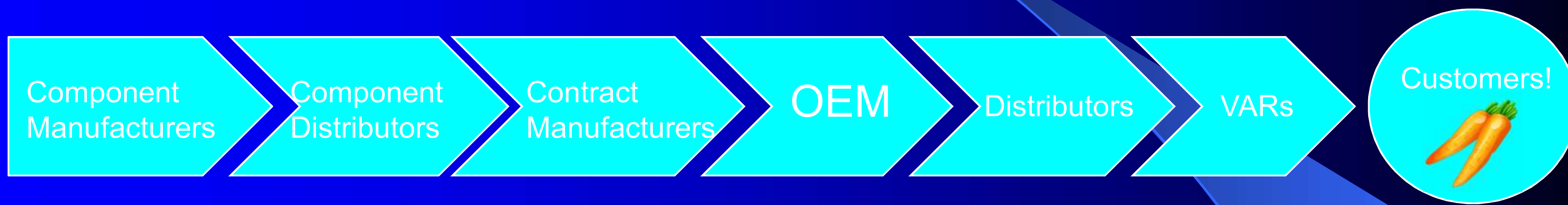
Fixing the Team

- Building loyalties
- Motivation - not just money
- Understanding informal networks
- Identifying kick backs, leaks and frauds
- Approaches to bringing new people
- Making the culture shift

Industry structure and Supply Chain

- Global industry structures changed massively
- A platform company "Produces nowhere but sells everywhere... know where the clients are and what they want and where the producers are. Platform companies then simply organise the ordering by the clients and the delivery by the producers (and the placing of their logo on the product just before delivery).“- GaveKal
- Integrated and collaborative supply chains.
- Contract manufacturing, outsourcing, muli-tier distribution
- Changed structures are often ignored by analysts

Supply Chain- Distribution of Risk and Reward



- Understanding the supply chain is core to determining the future of the company.
- How is wealth and risk distributed?
- What is outsourced to whom? Who does financing- is the company a bank? Should it be?
- Is the issue overall health of the chain, distribution of rewards and risks at a particular layer or just company specific issues?
- Who can "shortcut" the chain and what would be consequences?
- Who is going to loose the most if company disappear and what can they contribute to rescue?

Working Capital- Good Starting Point

- Most of the problems of companies manifest themselves in working capital (A/R, Inventories, A/P)
- Aged debtor list and its analyses vs. sales:
  - Are receivables real?
  - Is ageing real ?
  - Why payments are late – disputes vs. credit?
  - Are sales real?
  - What happened prior to sale?
- Sale is converting inventory to A/R showing a profit. Did it:
  - Push the problem next level?
  - Channel overstocking?
  - Produce uncollectable A/R
  - Is there actual end user demand?

Working Capital Analyses – cont.

- Analysing late payments allows to uncover issues with quality, logistics, systems, etc. –credit management is the best source of information about the company issues
- A/P
  – Short terms – why terms are not offered? What can be done to regain them?
  – Long terms –are these sustainable?
  – Overdues- would these be tolerated?
  – Key question – are suppliers still supplying or are they already or about to stop?
  – May be significant cash outflow post acquisition/funding.

Working Capital Analyses-cont

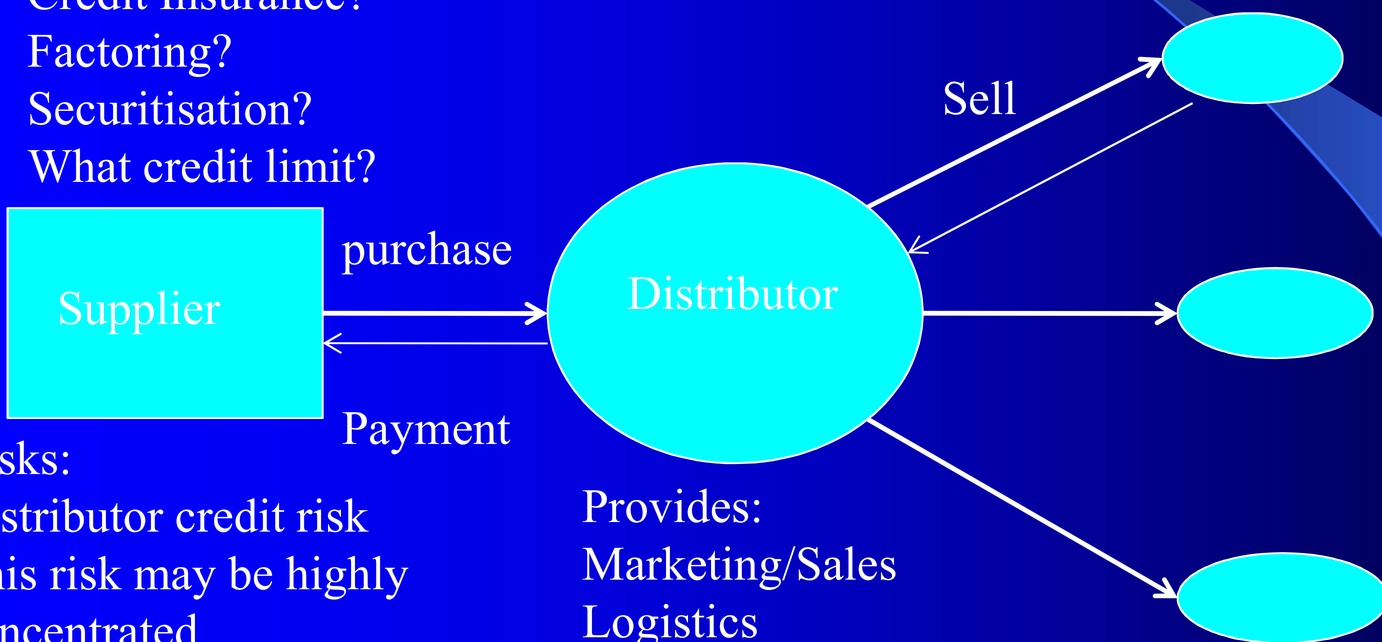
- Inventory
  - Clear distinction between finished goods, components and work in progress
  - Obsolescence
  - Components for wrong models? They may be perfectly good but perfectly useless
  - Is there a process for managing inventories?
- Overreliance on ratios - these are just averages
  - “Good” DSO may be a mixture of prepayments and massive overdue
  - “Good” DIO may be a large pile of useless stuff and a massive shortage of needed inventories
  - “Good” DPO may be a mixture of pre-paid suppliers and the ones who already stop supply and are looking for legal action

CAPEX/ Development Costs

- EBITDA focus creates a strong incentive to underinvest
- Company can run on close to zero CAPEX and even maintenance for a while – but this would mean massive cost in the future
- Cutting R&D improves short term profitability but negatively affects future cash flows.
- Cutting people improves profitability but in many business this is the main asset.
- Particularly relevant for industry buyers- often overestimating own ability to develop/support
- Death by a thousand cuts vs. exit strategy

Redesigning the Model - Distribution example

Credit Insurance?
Factoring?
Securitisation?
What credit limit?



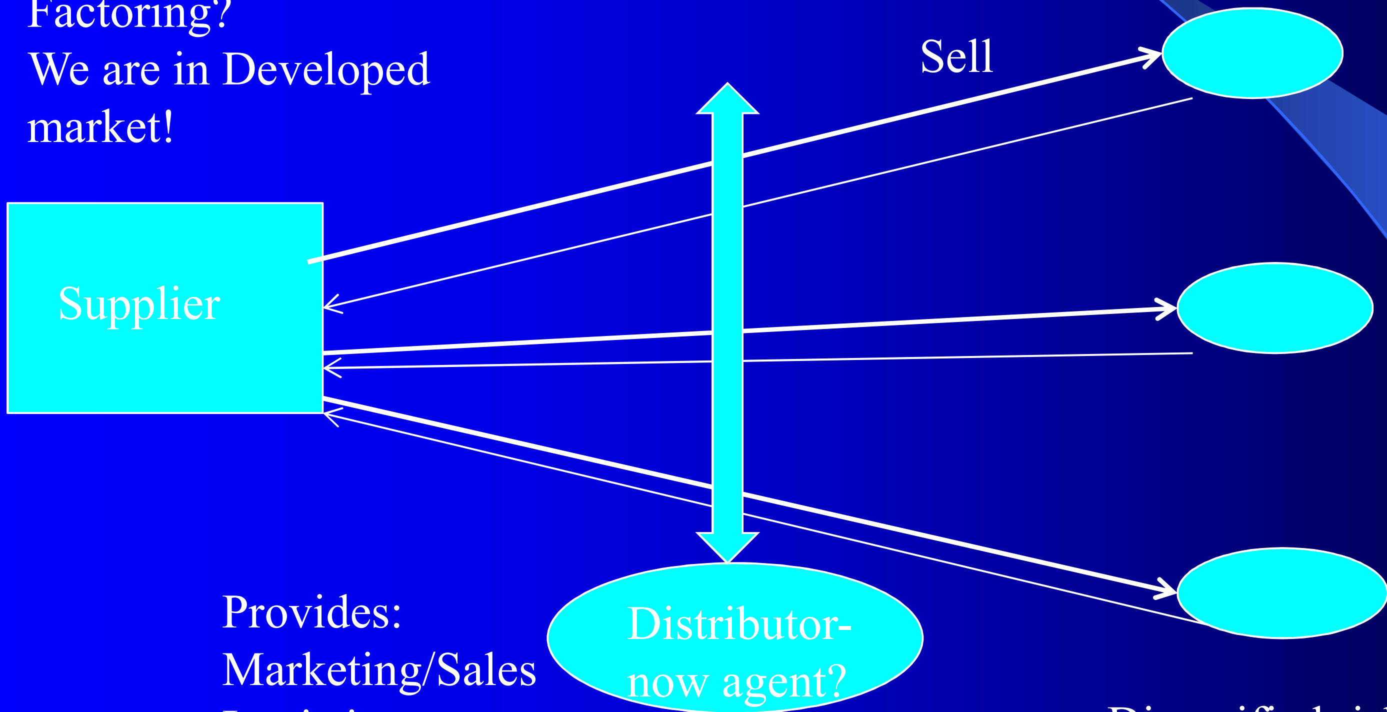
Risks:
Distributor credit risk
This risk may be highly concentrated
Customer credit risk (if distributor has little capital)
Product liability (in any case)

Provides:
Marketing/Sales
Logistics
Service
Working Capital
Finance?
Risk mitigation???

Diversified risk?
Low concentrations?
Single vs. multi tier?
How do you finance receivables in EM?

Distribution example

Credit Insurance - easier to obtain?
Invoice discounting?
Factoring?
We are in Developed market!



Provides:
Marketing/Sales
Logistics
Service
Collections?
Performance risk mitigation?

Low working capital needs!

Diversified risk?
Low concentrations?
Single vs. multi tier?
No need to finance in EM?

Rise of ABL

- Cash flow lending was the main trend in the past. Today, for some businesses EBITDA is much more volatile- not only reducing multiples, but also making cash flow lending unavailable in many areas.
- Lending against assets becoming more used, especially where the value can be clearly determined. And more data can transfer better valuation techniques.
- Illiquid and long term assets are difficult to lend against - shorter term is easier, but requires proper analyses.
- “New Financial Engineering”- how to reduce the risk in transactions
- Unlike cash flow lending, ABL often requires an understanding of operations

Supply Chain and Turnaround Financing

- The supplier (even a highly distressed one) is a lender, providing the next step in the chain (distributor, manufacturer, end user etc.) with credit through payment terms (sometimes they are the only or main source of credit).
- Buyer of the goods can effectively provide money to the seller through reduced payment terms without taking risk (providing that the supplier fulfilled the contract).
- This may provide a workable alternative to DIP (Debtor in Possession) financing, allowing in some cases to provide funds to distressed company without being affected by possible bankruptcy procedures

Key Lessons

- Understand the market
- Do a proper due diligence - do not rely on glossy write ups
- Understand the industry structure and play it right
- Build loyal and competent team
- Ensure stakeholders support
- Redefine and optimise the business
- You do not need to be perfect - just be better than competition

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Thank You and Good Luck!

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