R.I.P. 2020

(and Outlook 2021)

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Alpaha Corporate Finance

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AGENDA

Introduction

European Restructuring and Insolvency Frameworks in Review

Market review : What to expect in 2021 ?

Point of view of a Distressed Investor

Sectorial Review (Retail, Hotels, Travel) and Conclusion

Q&A

Speakers' Introduction

- Gert-Jan Boon / Leiden University
  - Researcher and lecturer at Leiden University (NL), in the field of turnaround, rescue and insolvency
    - He publishes in national and international legal journals, and has been involved in several pan-European projects, including the European Law Institute's Business Rescue project;
  - Leiden University has developed together with EACTP an online turnaround certification program that will be launched in 2021.
    - Based on the TMA US program but tailored for Europe it consists of 3 parts: management, accounting & finance, legal

- Hadrien Salin / Tosca Capital
  - More than 10 years experience in operational private equity and restructuring
  - Experience at PE houses and distressed debt hedge funds such as 3i, the Gores Group Anchorage Capital
  - Set-up Tosca Capital to perform
    - Transactions on Special Situations such as carve-outs and stand-alone turnaround
    - LBOs on European SMEs with an operational angle

- Alain Le Berre / Alpaha
  - 30 years of experience in Turnaround, Restructuring, Stressed and Distressed and Special Situations of any kind;
  - Interim Management, Advisory, Consulting, Board Memberships;
  - Based in Switzerland, active internationally across Europe and the Middle East;
  - Board Member of the recently founded Swiss Chapter of TMA

Introduction

- 2020 : With a few exceptions, most practitioners didn't experience the predicted Tsunami !!

  Due to a combination of :

  - State support (Furlough-Kurzarbeit- Chômage partiel / State guaranteed loans or direct subsidies)

  - Resilience / Reactivity of the players
    - Which burnt most of their cushions in the process;

  - Heartening level of mutual support between the various private stakeholders : creditors, landlords, suppliers, customers…
    - Businesses were not pushed into bankruptcy in droves, and received a level of support which sometimes went far further than could normally have been anticipated;
    - A sense of "We're all in this mess together – let's help each other out".
    - Stakeholders, even when seriously pissed off, have generally kept their heads cool, and tended to avoid knee-jerk reactions, harsh measures / anything that would be perceived as over-reacting;

- Nevertheless : 2020 has seen some of the biggest, most profound reforms in IP Law since decades in several European countries

  - Leyden University's Gerd-Jan van Boon will now present these :

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Restructuring and Insolvency Frameworks in Review (1/3)

Responses to COVID-19 pandemic

Legislative and policy responses in multiple waves. Initially:

1. Step 1: Suspend the duty to file for insolvency proceedings based on over-indebtedness: it was an instant response in e.g., Germany and Switzerland to do so and prevent a heist of insolvencies
2. Step 2: Respond to the illiquidity of businesses

Overall measures to flatten the insolvency curve (tracker):

1. Adjusting tried and tested measures: suspending the duty or right to file/amending existing procedures/
    1. E.g., FA/DE/CH/IT/UK/NL …
2. New proceedings also to handle COVID-19 insolvency
    1. E.g., NL with the WHOA and UK with Corporate Insolvency and Governance Act introducing a Restructuring Plan and Moratorium
3. Non-insolvency measures: the macro economic nature of the crisis requires state measures beyond insolvency and restructuring law

Restructuring and Insolvency Frameworks in Review (2/3)

Outlook 2021: European Preventive Restructuring

2019: EU adopted Preventive Restructuring Directive:

- Minimum harmonization of pre-insolvency regimes across EU, alike US Chapter 11 and UK SoA
- Implementation envisaged in all EU Member States by July 2021, save for extensions.
- Each country will implement independently (tracker).
  - **France** will make some amendments, but generally in line with PRD 2019
  - **Italy**: postponed entry into force of planned legislative reform, will now be amended
  - **Greece**, **Germany (StaRUG) and The Netherlands (WHOA)** introduced new legislation. For cross-border practice the latter two may become particularly interesting with very flexible proceedings, apt to groups of companies and cross-border contexts.
  - **UK** introduced a new Part 26a Restructuring Plan, enabling to bind also dissenting creditors among classes, as well as a moratorium. Clearly aligned to the Directive. Although its application so far has been limited to two cases.

Relevance:

- Increased emphasis on restructuring, in particular to prevent insolvency
- it may be expected to play a key role also once COVID-19 (financial) support measures will be lifted.
- New forms of governance with DIP model restructuring, boost also involvement of turnaround professionals across Europe.

Outlook 2021: new paths (3/3)

New EU initiatives:

- **European Commission announced new legislative initiative to harmonize certain building blocks of national substantive**
  - Commencement of insolvency proceedings
    - When to file? / Who can file? / Duty to file? / Test to file?
  - Avoidance actions
    - Scope and effects
  - Directors' duties
    - Much debated already in preparing 2019 Preventive Restructuring Directive, but ultimately very watered-down compromise in art. 19 PRD 2019
  - Position of secured creditors

Market review : What to expect in 2021 ?

- In 2021, Governments' support will be even more in the spotlight and under critical scrutiny :
  - Claims of bureaucracy and inefficiency of the various State support programs –
  - Likely to be increasingly the case, if not enough is done to address the various critic points;
  - UK : HMRC now reinstated as a preferential creditor : Surprising timing
    - Has been blamed as one of the reasons behind one of the biggest retail failures in Europe (downfall of Arcadia);
    - Will put pressure on industry as well as retail;
    - Will make ABL difficult as secured creditors are too high;
  - Continued regulatory uncertainty is also detrimental, e.g. :
    - E.g., Austria : First 80% Turnover compensation in Nov – then 50% in Dec – then compensation of Fixed Costs (not defined !) – then limited to 800k€ by company – then what ??
    - E.g., D : Nov + Dec 75% of prior year's turnover – then from January 90% of fixed costs until June (rental costs + financing costs)
    - Moral hazard : preventing the failure of sound companies vs. preventing the rational sanction of fundamentally flawed business models and management shortfalls;
- 2021 : Landlords will really be in trouble :
  - Turnover-based variable Rent, Grace Periods, Exits…;
- 2021 = Year 1 of the Post-Brexit era : X-Border automatic recognitions of procedures are no more !
  - Lugano provisions or other tools to be explored by creative lawyers;
  - Will other European venues replace London as the go-to place for X-border restructurings ?
    - Amsterdam ? Frankfurt ??

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Market review : What to expect in 2021 ?

- We start the year with a much more fragilized economic tissue – new lockdowns are likely to push many businesses over the line :
  - Increased Debt, VAT liabilities, rents in arrears…
  - Both creditors' patience and debtors' resilience are starting to run thin !
  - Many sectors need to get fit for purpose again – more about this in a moment with a particular focus on some Retail / Hospitality and Travel Sectors trends;

- More and more businesses have a valid reason to exist, great customers and great order books – but no cash whatsoever and no unmortgaged assets left !
  - Insolvencies will be unavoidable – but as we all know they typically destroy a lot of value;
  - How will courts look at Valuation issues in this context ?
  - How will Tax liabilities considered in the UK, now that HMRC is a preferred creditor again ?
  - How do you do proper DD in this context ? How do you appraise assets ?

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The Point of view of a Distressed Investor (1/3)

Timing / Market:

- Things typically do not move much when in the eye of the storm, when everybody is like a dear caught in a headlight
- If we compare to 07-08 which was a liquidity crisis, pipeline then froze during the mist of the crisis, before moving fast and deep in the two years after the crisis into an economic crisis and then a sovereign crisis which impacted everything and including central banks policies providing free money
- **Liquidity as in lack of potential financing source is not an issue today: Government back-ups / markets as high, lots of dry-powder, accommodative central banks**
- Covid is different as it impacts both balance sheets and business models significantly and brings so much uncertainty.
  I would distinguish three different situations:
  - Deals have already happened in some segments which were already in trouble because of an existing major market shift happening such as retail transitioning to digital, oil run economy stuffs
    - For these, Covid is an accelerator and transactions must happen very fast and be paid at a very significantly discount
  - Impact on balance sheets are already here but don't become live situations as maturities have been extended / debt could be refinanced
    - In 2-3 years, we will realise their leverage is simply not sustainable, only then will a refinancing or a restructuring be on the cards
  - Business models are already disrupted but it is hard to see where businesses and their respective markets will land.
    - Management teams know everything will be different but still hope for a come-back to pre-Covid
    - There will be significant moves in different directions for short period of times
    - Difficult to navigate this uncertainty
    - And that is the main difference with 07-08 when we kind of came back to the same normal after the economic crisis

The Point of view of a Distressed Investor (2/3)

Timing / Market (c'td) :

- For most segments of the market, things should be moving in second half of 21 as
  - It is difficult to execute on transactions at the moment
  - Companies are not forced to move because of government support
  - Shareholders do their best to avoid selling at discounted valuations

- At that point there will be a polarisation of the market between the winners and the troubled assets.
  Investors will need to differentiate between businesses:
  - Who still have a reason to exist and had to "suspend" activity for a year.
    - In these instances, the approach will mostly be a balance sheet restructuring exercise or finding new financing structures
    - Example: Guy Degrenne retail, in June, it had a clean balance sheet, in the Summer, no-one wanted to finance them any longer !
  - For which the fundamental operating model has been structurally shaken by Covid.
    - In these cases, resizing the balance sheet won't be enough
    - There will also be a need for an operational answer to resize and reposition the business, merge
    - Example in supply-chain management / Industrials (relocalisation, optimisation, increased digitalisation…)

→There is a good chance we will see many situations in need of both solutions

The Point of view of a Special Situation Investor (3/3)

Macro-economic trends :

- Economies will show healthy growth numbers but still the impact of the last year massive crash will be felt for a long period. Cleaning the mess is going to take time
- There has been massive destruction of value of the past year, significant unemployment or if unemployment growth limited by Governments schemes, unemployment rates will go up when we are out of the storm
- At the same time, massive amount of savings which only asks to be spent → consumption might be up
- In the longer term, how will government backed loans be refinanced considering their advantageous conditions?

→ **The impacts will need to be analysed sector by sector and uncertainty will still be hard to navigate.**

Valuation issues :

- Today the situation is completely different from the previous crisis in 07-08 when liquidity was scarce and financing conditions tighter because of regulation
  - And also very different from the period in-between, an environment in which money was free and competition fierce, which was also difficult to navigate in the quest for value-generating deals, as distressed situations managed to refinance themselves too easily !
- Today there is massive dry powder as fundraising has been going strong, and it's difficult to deploy capital during the crisis
  - Money will remain cheap, and some dodgy assets might be able to refinance instead of going bust;
  - There will still be an avalanche of opportunities but funds bandwidth is limited, and there will be a fly to relative quality
  - There will be plenty of other assets to acquire that no one will have time to look at.
  - **It will be a feast for bottom fishers !**

What to expect in 2021 ?
Focus on Property / Retail (1/2)

- Commercial property will get hit :
  - One study says 83% of businesses are looking at reducing office space for the long-term !
- Transfer from Bricks-and-Mortar to EComm :
  - 6 Years of f EComm growth forecasted achieved in 6 months !
    - E.g., UK : From 20% of all retail sales, to 40% according to Gordon Brothers
    - B&Q, an UK DIY chain, reported +164% in Click-and-Collect
  - .. But not all rosy and positive :
    - Fixed Costs remain while Variable Costs take the elevator
    - Every 1% turnover transitioned can bring along a 7% margin hit !!
- Shattered brand loyalties :
  - McKinsey says 75% of US adults have changed their brand habits
  - Not everyone is negatively affected : those with job and income security have actually bolstered savings (no commuting costs, no holidays abroad, no restaurants, no theatres…);
  - Winners trade up, losers and younger folks trade down – the “mid-range” brands are the losers !

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What to expect in 2021 ?
Focus on Retail (2/2)

- Increased polarity between “Retail losers”… :
    - One poll showed 58% of population avoids travelling on public transportation whenever possible
    - This plus WFH mean City centres stores hit by a significantly reduced footfall;
        - With long-term consequences on business models : should sales clerks be present on-site Mo-Fri 9 to 7 ??

- … Vs. “Retail winners” :
    - Gordon Brothers saw 70% increase in convenience stores sales – with cheaper rents this opens great opportunities;
    - Also 55% grew stronger bonds to community – likely to outlast the pandemics;
    - Increased price-sensitivity mean opportunities galore for budget retail
        - Furloughed, ruined business owners…
        - Uncertainties for the future
    - Conscious Consumerism drive some incredible success stories :
        - Gordon Brothers forecasts +300% in 3 years for the Circular economy (Clothing, furniture…)
        - With 64% consumers polled saying they will make it a purchasing criteria

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What to expect in 2021 ?
Leisure & Hospitality : Focus on Hotels

- Can't be migrated to virtual !
  - Occupancies in high teens, for break-evens much higher than this !

- M&A market essentially stopped in its tracks :
  - Tough to make sound valuations
  - Tough to find bank financing for deals

- Whilst there are clear Losers…:
  - Business hotels, Airports and City Centres hotels;
  - Luxury hotels (no oversea visitors)

- … There also are clear Winners :
  - Staycation hotels,
  - Leisure hotels in coastal locations,
  - Serviced appts for WFH, isolation and limitation of interactions

- Increased reconversions into Residential property, Student accommodation, Coworking Spaces, Retirement Villages !

- "Safe haven characteristic will eventually attract equity as well as debt investors" (Shaun Roy, Knight Frank);

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What to expect in 2021 ? :
Focus on the demise of Business Travel

- Significance :
  - Travel & leisure = one study says it accounts for 14% of all jobs WW (directly and indirectly)
  - Pre-Pandemic : Business travel was 30% of airlines' revenues (up to 75% on some international routes) !
    - Also 70% of revenues for hotel chains such as Marriott.

- Leisure travel will come back :
  - Initially at least there will be a marked pent-up demand effect which will be very helpful;
  - Although financial difficulties and environmental concerns may durably damp customers' appetites;

- But Business Travel won't come back that easily :
  - Zoom reports a turnover up 500% yoy from companies above 10 employees
  - How many companies (or individuals), will chose to rule out traveling post-pandemic ?
    - Some experts say –30%, others say -50%... But the impact on profitability throughout the sector will be massive !
    - Environmental concerns will also be used to justify travel restrictions which in fact will mostly be driven by a desire to slash costs !
    - Nestlé, Deloitte, PwC have already made announcements in this respect.

- Further sobering warning :
  - Business Travel took 5 years to recover after the GFC of 2008-2010 (McK).

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What to expect in 2021 ? Conclusion

- There are a number of good news : Liquidity is buoyant, M&A also, syndication market too
  - Value deterioration to be balanced by long-term prospects…
  - … And by historic opportunity to enter markets with previously limited access or supply

- All about accelerated change :
  - Resetting the sails when you can't change the wind !
  - The winds are changing – and they will continue to change
    - The winds will also be fierce !
  - Everyone will need to be brave, flexible, and nimble !

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