

Explore all options but be decisive

Government support and tolerance from financial institutions have cushioned the otherwise significant Covid-19 impact on businesses in many sectors. Some of the worst hit sectors — aviation, travel and hospitality — are beginning to see light at the end of the tunnel as the economy reopens gradually. Boards may now look to reset their long-term strategy, including making tweaks to their business model to address disruptions.

Yet, in the short term, businesses may find it difficult to manage the debt overhang and working capital required to restart operations. As government support can't be extended indefinitely, this may result in some distressed companies looking for options to survive. This includes divesting underperforming assets, and raising equity or debt from turnaround investors.

This article, the final piece in PwC Malaysia's 5-part series on business recovery, highlights some of the mechanisms available to

facilitate the chosen option to achieve strategic outcomes. Such options include transactions via mergers and acquisitions (M&As), rescue mechanisms and other insolvency tools as provided in the Companies Act 2016.

It is important that boards consider all options and mechanisms before making a decision and act decisively after all options have been considered. Boards often take the "wait-and-see" approach when faced with such difficult circumstances; when left till too late, they inevitably lose control. As a consequence, insolvency is left as the only possible way out. As illustrated by the demise and recovery chart (above), options available rapidly reduce over time.

More time, more options

Consider a subsidiary or a portfolio company that has turned loss-making and is expected to drain significant cash and other resources away from other parts of the business. An initial analysis may suggest that the business



model is still viable but may no longer fit strategically within the wider organisation. An exit through the sale of the business appears to be the best option.

Since the warning signs are read early, the board may have time to embark on certain value creation initiatives prior to sale. Financial and operational diagnostics could be performed to determine if there are key levers that may be flexed to rapidly reduce costs without altering the business model or the experience provided to existing customers. If done well, targeted rapid cost reduction and technology adoption will reduce fixed costs, and in some cases, the business can be turned around.

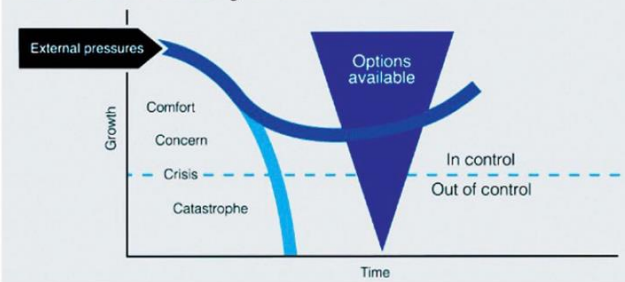
A typical sale process involves the preparation of a great deal of data, management presentations and multiple bidders. It can take between 6 and 12 months, which is often more time than what's available when a business is in distress. Through an accelerated M&A, a solvent business may be sold in a relatively shorter period of time to a trade buyer or turnaround investors. Corporate finance practitioners may collaborate with restructuring advisors, and leverage connections with turnaround investors or distressed fund managers.

The business may be sold as a going concern, which enables the company to continue serving customers, supporting suppliers and retaining employees.

I'm viable, rescue me

Many boards in sectors that saw plummeting demand such as aviation, hospitality and property development found themselves in crisis mode without much warning. They

Demise and recovery chart



were potentially insolvent and without much time left to protect themselves from possible wind-up petitions from creditors.

Rescue mechanisms available within the Companies Act 2016, namely Scheme of Arrangements (SOA), Corporate Voluntary Arrangements (CVA) and Judicial Management (JM), are designed to provide breathing space and a framework for distressed but otherwise viable businesses to work out a plan, in which a compromise or a collective arrangement is proposed to creditors. Once approved, the terms are binding on all stakeholders.

Arriving at the right type of mechanism needs careful consideration, depending on the circumstances. For instance, the SOA is open to all private and public companies and is court-supervised. The CVA, through a relatively quicker out-of-court process, is available for private companies that have no secured debt or any charge over their assets. Of the three rescue mechanisms, the SOA and CVA are debtor-in-possession in that the board retains control throughout the process, unlike a JM where the company will be placed in the hands of a judicial manager.

The proposal to creditors, whether through an SOA, CVA or JM, will typically include cor-

porate transactions. This comprises, among others, the sale of encumbered assets to new fund providers, the emergence of new shareholders through debt to equity conversions, or a potential white knight in the form of a turnaround investor. In doing so, boards will have to consider the terms and conditions proposed for funding and manage the possible competing interests of various stakeholders.

A secured creditor may push for liquidation for an early recovery of their collateral. On the other hand, other creditors or shareholders may advocate for business continuity as potential returns are better compared to a liquidation scenario. To prove otherwise, management must be prepared with robust business plans, including cash-flow projections that will stand up to the scrutiny of stakeholders. An independent party may be appointed to scrutinise the cash-flow projections and the preparation of any liquidation scenario analysis to give credence that business continuity is far better than liquidation. This provides the credibility and trust that is so crucial in managing the various stakeholders.

Proposed changes to the current rescue mechanisms include the introduction of

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Business leaders that responded swiftly to disruptions were able to regain control

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"super-priority rescue financing" which allows courts to give preferential treatment to the security and return of a white knight's funds. This may give rise to a greater number of rescue-related transactions.

Exit, with dignity

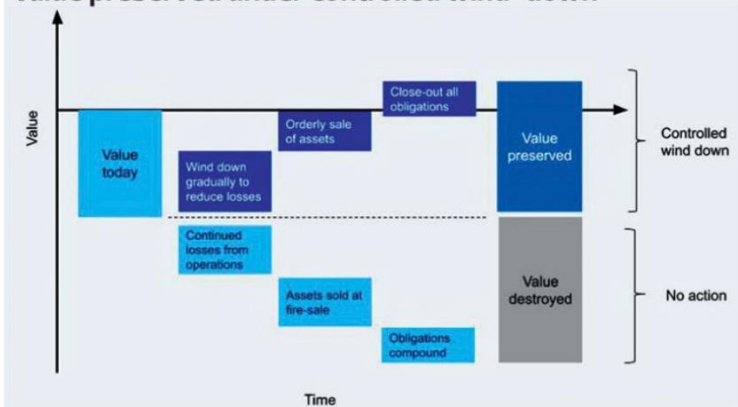
As shared earlier, if businesses are slow to act, they may be left with limited options and spiral down the demise curve, leaving insolvency as the only option.

But all is not lost. For instance, the board of an insolvent business could consider a controlled wind-down through a Creditors' Voluntary Liquidation (CVL). In this case, the board will relinquish control to an appointed Insolvency Practitioner (IP), hence mitigating any further insolvent trading risks from the directors. An IP will take control of assets, stabilise operations including completing existing orders, and take stock of obligations, including employee-related matters. Over time, assets are sold in an orderly fashion and obligations are closed out.

Contrast this with a situation where no action is taken and significant value is destroyed, as illustrated by the chart above.

Under a controlled wind-down, an IP will assess the best course of action in the interests of all stakeholders to maximise recovery. This could possibly include the sale of key operating assets en bloc to a trade buyer

Value preserved under controlled wind-down



through an orderly accelerated M&A process. This way, greater value may be derived from competing buyers rather than assets being sold separately under fire sale to satisfy certain creditors. An IP may collaborate with independent valuers and corporate finance practitioners to plan a smooth and efficient sale process that maximises returns and brings credibility and trust to the process.

Act now to recover

Disruptions are inevitable. Whilst the pos-

sible mechanisms shared in this article are not exhaustive, we have observed how business leaders that responded swiftly to disruptions were able to regain control. However, this hinges on their ability to carefully consider all options and act decisively.

As the saying goes, a stitch in time saves nine.

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