Stranded in Europe

Getting Debt Restructuring in Europe during the Great Recession

This case study ebook is brought to you by Capital Corp Merchant Banking and Gilles Herard Jr. Merchant Banker

Foreword

This ebook is designed to showcase one of the recent projects that Capital Corp Merchant Banking has had the opportunity to be a part of. In order to comply with signed confidentiality agreements (not to mention that disclosure could negatively impact sales and client relations, revenues, etc), the name of the client will remain be altered, as will the industry in which the client works, though this will have no bearing on the overall analysis of this case. The client will in this ebook be hereto referred as “ABC Co.”.

Though Capital Corp Merchant Banking can talk about the projects on which it works through its press releases and blog articles, readers still miss out on what goes on behind the scenes; how the deals come in, how they are processed, what is the manner in which each individual case develops, and indeed what it takes to get a project from the inquiry stage to getting funded. Hence the development of this first ebook on a recent project that Capital Corp worked on.

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Chapter 1: The Client

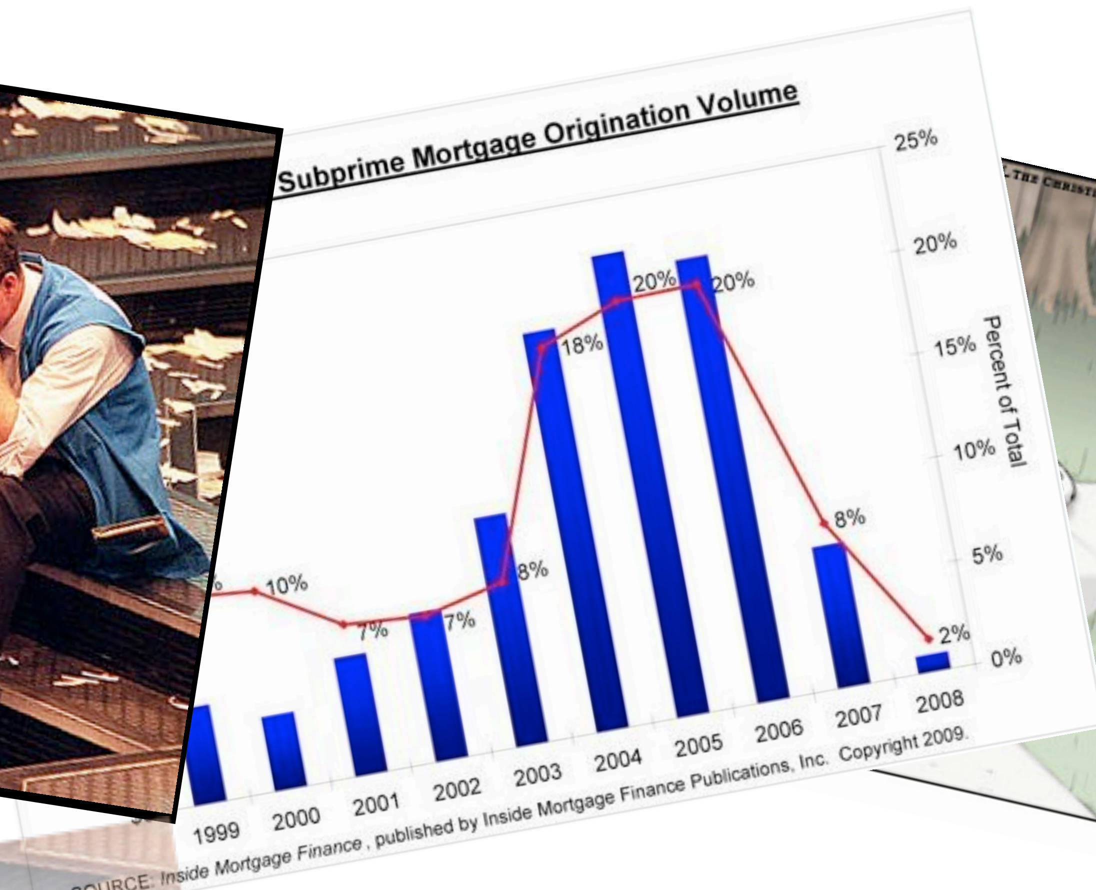
For this case study, we present ABC Co. In short, ABC is a major company working in the commercial refrigeration equipment sector in Europe. ABC came to Capital Corp Merchant Banking in mid-2012 seeking debt restructuring following a downfall due to the 2008 recession, which hit hardest in Europe.

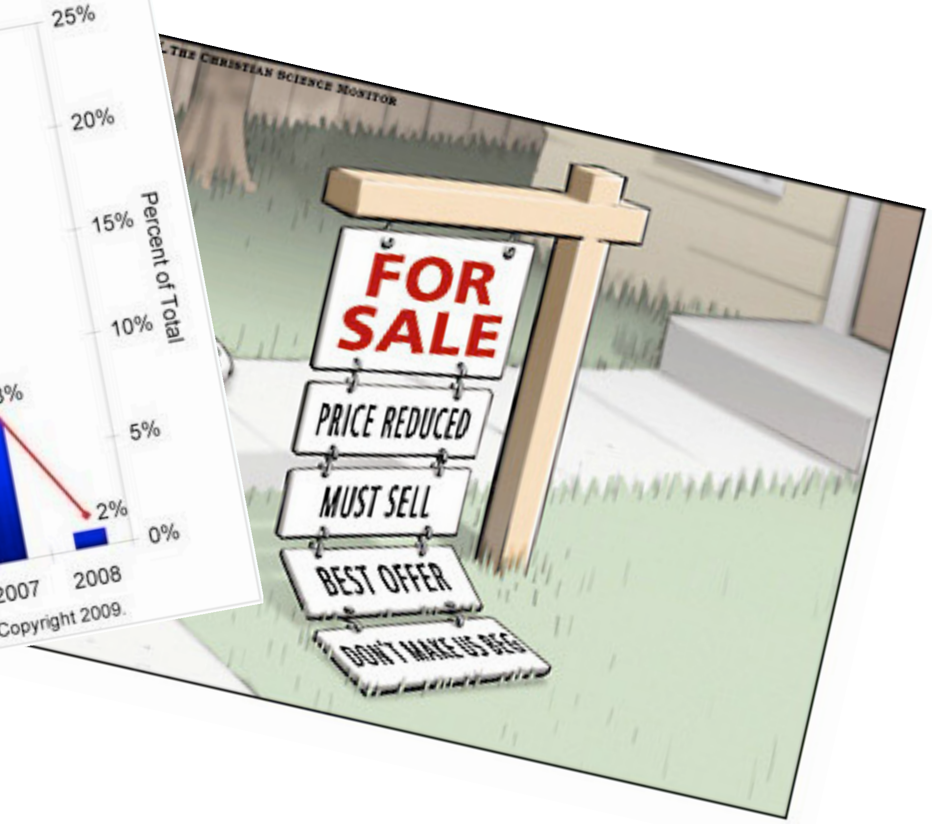
ABC and its subsidiaries have been in business in commercial refrigeration equipment in Europe for over 30 years. It counts among its clients some of the biggest commercial companies in the world. In that time it has expanded into different markets and established itself as a leader in innovation and quality products & solutions for its clients.

With 400 employees spread out over 30 countries, in 2007 ABC was on top of its game.

Chapter 2: The Problem

By the beginning of 2008, what would come to be called the Great Recession was starting to hit. It began as a liquidity crisis in late 2007, followed by the U.S. subprime mortgage crisis (which caused the values of securities and real estate prices to plummet).

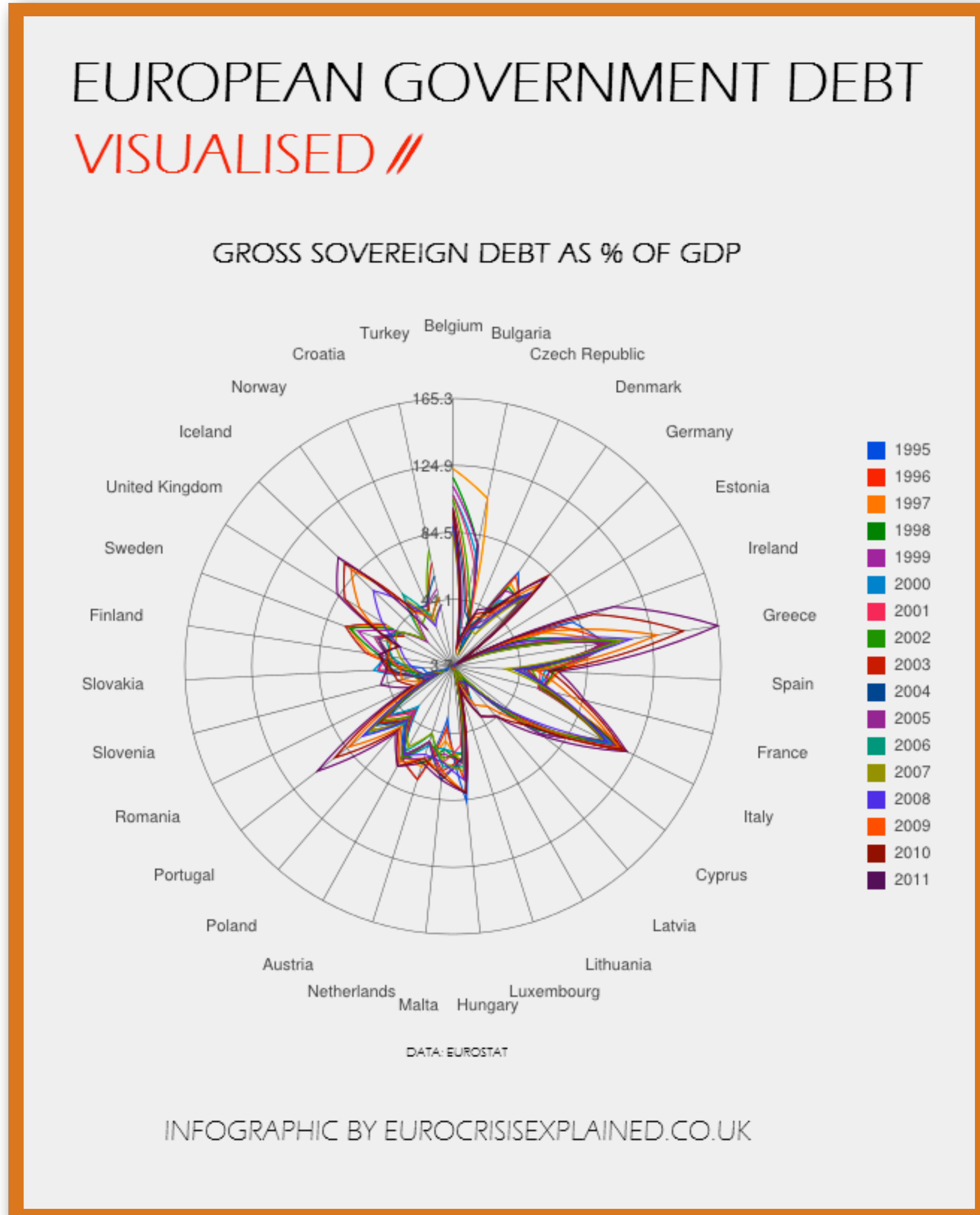




It later the more generalized financial crisis of 2007-2008, which went on to ripple like a tsunami wave across the world, taking all in its path.

One of the most serious side effects of these crises was the European sovereign debt crisis, which affected most deeply some of Europe's strongest countries. Risky credit, public debt creation, and European structural and cohesion funds were mismanaged for decades and when mixed with the U.S. credit crunch, they created the perfect storm.

ABC Co. was not spared despite its good financial standing. Although it had a prestigious global clientele and had full orders (including clients from countries spared from the recession), ABC's bank was severely affected by the recession, and in its panic the bank called in its debts.



ABC was a good corporate client, but the bank pulled the plug anyway.

Chapter 3: Now What?

Almost overnight, ABC was choked by its bank, which began a campaign of imposing on its clients extreme fees and lower margins in order to save itself (which would quickly sink ABC). So in order to get back on its feet from this predicament, ABC needed to do 2 things:

1) Get out from under the bank's chokehold and acquire a long-term debt, and

2) Obtain an equity investment.

In other words, ABC needed to restructure its corporate debt and get a cash injection.

But how to do that? Where to get it?

Chapter 4: Finding the Right Help the Right Way

Help came in the way of a broker, who brought ABC's quandary to Capital Corp's attention during the summer of 2012. At Capital Corp Merchant Banking, we a merchant banking group that provides middle-market clients with tailor-made solutions and funding packages by way of equity funding and debt financing. Also, we provide corporate debt restructuring services to our clients.

In this case, ABC had need of the latter.

Chapter 5: What is debt restructuring?

The need for a corporate debt restructuring often arises when a company is going through financial hardship and is having difficulty meeting its obligations.

Capital Corp Merchant Banking offers clients financial relief through the refinancing of existing mortgages; in doing so, the outstanding amounts can be increased so that working capital can be injected into the troubled company. The bonus is that when refinancing a business mortgage, it becomes possible to combine to that funding any outstanding equipment finance loans or leases, which then creates automatic working capital for the company.

Restructuring business debt can also improve cashflow by one of 2 ways:

1) refinancing and consolidating the existing debt, which will grant the company a longer amortization period; and/or

2) by injecting equity, which is equal to giving the company a blood transfusion, taking in consideration its actual financial situation and its development for the next 3-5 years.

For more information about Capital Corp's corporate financial reorganization services, click here.

Chapter 6: Re-Evaluating Value

Now that we have established a proper understanding of what corporate debt restructuring is, we can delve some more into ABC's problem.

So ABC came to Capital Corp Merchant Banking seeking to reorganize its finances, get out from under its bank, and obtain an equity investment in the mix. But could it obtain access to funds for an equity stake without going through a re-evaluation? This point is particularly important because it is such a crucial part of the terms of refinancing.

In order for a company to obtain equity funding, it must first prove its value so that the equity injected can have its value properly assessed versus the certified value of the company. For example, if you are looking to invest $1 million into a company, you need to know what that company is worth in order to understand what your investment represents and what percentage of the company you now hold.

In other words, how far will that $1 million go?

But what happens to a company that has just been hit by a major recession despite its good standing? There is an adage that says that 'a rising tide lifts all boats'. The opposite is true as well. So as markets came crashing down, housing bubbles burst, and real estate values plummeted, so ABC's value was diminished as well.

ABC had been de-valued.

On paper, ABC had lost a severe amount of its value. Because of that, refinancing at this stage was nearly impossible.

Who would touch this deal?

Who would want to rescue a de-valued company stuck in the middle of a perfect storm?

Chapter 7: All Hands on Deck!

As expected, not many people wanted to touch this deal, nevermind go near it. But we knew at Capital Corp that something could be done there; it would be tough going and would require all our negotiations expertise, but ABC could be saved.

First things first: ABC submitted itself to a new evaluation in order to assess its value as it now stood (also known as ‘as-is-where-is’). This would help not only ABC and Capital Corp understand the value of its assets, but also give an indication as to the value of the 25% share ABC was willing to cede in order to obtain the equity investment it needed.

At this point it needs to be said that ABC did not want to lose control of its operations to new investors. This was a sticking point in the negotiations. So the compromise achieved here was that ABC Co. would let go of a 25% stake in the company in exchange for a cash injection (or equity investment) equal to that 25%. This is part of the reason why understanding the new value of the company was so crucial – so that Capital Corp could figure out how much cash exactly that would come out to.

While not all of ABC's debts were able to be paid, Capital Corp helped ABC navigate which debts to pay and which to negotiate and refinance. Capital Corp also went ahead and talked to ABC's remaining lenders about the re-organization the company was undergoing, and it obtained from each of them a signed statement that they would not flee at the last minute but remain with ABC and stick with them through this re-organization, provided that Capital Corp helmed the restructuring process.

The point of this, aside from the obvious, was to give ABC some breathing room and to stop the lenders' pressure tactics. An example of a similar situation would be if you accrued high debts on your credit cards and the credit card companies started hounding you about getting paid, calling you every day to pressure you into paying them. This creates a highly stressful situation and can put so much pressure that you can't think clearly. It did much the same for ABC Co.

Now, having appeased the lenders, ABC and Capital Corp were able to clearly map out the re-structuring process.

Chapter 8: The Process

A financial re-organization on the scale of ABC Co. is complex, not the least because companies of that size have Boards of Directors and they need to be on board with the plan put forth. In this case, Capital Corp Merchant Banking's plan needed to get those votes in order to go forward into the process of actually funding the debt restructuring of ABC Co. Once that was achieved, through much back-and-forth, late-night and early-morning conference calls, and hundreds of email exchanges, ABC Co. was ready to go through Capital Corp's funding procedure.

The funding process begins with the Due Diligence. A Due Diligence is the process of evaluating a business and identifying the risks in owning the business and/or the assets from a legal, business and financial standpoint. This way an investor can make an informed business decision about whether to proceed with the transaction on the proposed deal terms. In other words, it's the identification of the potential "Deal Killers."

In ABC Co.'s case, while the 'deal killers' had been addressed during the restructuring negotiations, the Due Diligence still needed to be done and was carried out, well, diligently.

The rest of the funding process includes signing a Term Sheet and the Investment Proposal, both of which have been done, to the sum of €42.8 million. At this point, provided that all conditions are met, the funding is on its way.

Chapter 9: The Method to the Madness

If you look up the definition of 'corporate debt restructuring' on Google, you will find 9.38 million results. 'Financial reorganization' will get you 12 million results. Investopedia, Wikipedia, the Business Journal, and many more will provide dry definitions of the word with maybe a side commentary on how the process is carried out. But rare is the time when a true case is presented about how a company dug itself out of a tight spot by restructuring its debt.

The method behind the 'madness' of writing this case study ebook is that we at Capital Corp Merchant Banking want to extend our outreach beyond our blog and beyond the press releases that we send out where we talk about the projects we embark on. Our blog has been meant to give people an insight into the world of investors; the jargon, the financial instruments, do's and don'ts, tips and tricks, etc. But it only goes so far and Capital Corp has wanted for years to talk about the *process* (we know it's been a popular word in this ebook, and that's the point, really) of funding a project.

It’s not always about whether a client gets funding or not; sometimes the lessons lie in how far a project goes and what steps were taken to make it progress. Why keep it shrouded in secrecy? So people will take you seriously? The Big Guys in corporate finance like the sense of importance they get from being in their glass towers and big conference rooms. They believe that if they keep the sense of mysticism behind project financing alive, then others will believe they really are as good as they say they are. And sometimes they are that good. Mostly, though, it’s just a way to impress people and charge higher fees.

We at Capital Corp Merchant Banking believe that project financing should not be something to fear or whisper about. The process can be not only exciting but full of learning opportunities as well. And we wish to share those learning opportunities, thus our first ebook about ABC Co. and its debt restructuring needs. As the European debt crisis is an ongoing situation, we feel that this case study is particular relevant as a starting point.

If you have any comments or questions about this case study, we would love to hear from you. Please feel free to leave us a comment in our corresponding blog page that will talk about this case study only. We look forward to hearing from you!

About
Capital Corp Merchant Banking

Capital Corp Merchant Banking is part of a group that was formed 25 years ago to meet the growing needs of companies, clients and promoters looking for funding and professional assistance in a diversity of projects.

On the premise that a single firm can combine funding and professional consulting, Capital Corp Merchant Banking can stimulate optimal performance for its clients. Since then, Capital Corp's success has come from its culture, which strives to foster the same values that help any business succeed: Hard Work, Common Sense and Integrity.

Throughout this time, Capital Corp Merchant Banking has always stayed true to its original vision: to provide our middle-market clients tailored solutions and funding packages in international project financing by way of equity funding and debt financing.

Capital Corp's fundamental philosophy is epitomized by the principle that *our word is our bond*. This makes Capital Corp an ideal partner in the types of relationships fostered in project financing and corporate debt restructuring. In addition to these attributes, Capital Corp is creative, solution-oriented, and known for being THE most flexible funding source on the market in creating handcrafted investment structures that meet the needs of the different constituent groups in each individual transaction.