Guideline

Turnaround Finance

For Small to Medium Sized Businesses on the Brink of Insolvency

Why Is Turnaround Finance So Important?

In a turnaround, resources are extremely scarce. Therefore, there is commonly a requirement for additional finance.

There may also be requirements to raise cash to repay certain creditors who are demanding immediate repayment. For example, the business may be under performing to such a degree that it is potentially insolvent and the company's bankers are demanding repayment. In this scenario, without new and replacement finance the turnaround will fail.

Therefore, "Turnaround Finance" is normally an essential component of most turnarounds.

Outline of This Chapter

The approach taken is to

1. Explain the theory of turnaround finance, and
2. Then set out the practical steps that need to be taken to raise turnaround finance.

Who Should Be Interested in Turnaround Finance

The following chart illustrates the parties who are involved in Turnaround Finance.

Interested Group	Explanation
Management	Turnaround Finance techniques and sources can be used to: Improve existing security Minimise risks, or Facilitate an exit route
New Providers of Turnaround Finance	Providing finance in a turnaround is inherently risky. Appropriate structuring can both minimise risks and maximise returns.
Other Stakeholders	To gain continuing support from key stakeholders - such as suppliers whose confidence may have been shaken - it may be important to be able to demonstrate that the business is well funded. Without this suppliers may require cash in advance of delivery - which may eliminate the company's ability to trade.

Raising Turnaround Finance is Hard!

It is important to understand that raising adequate Turnaround Finance is not easy. Therefore, it is important to understand the realities of the challenge, and adopt a disciplined approach.

The Theory of Turnaround Finance

1 Definition of Turnarounds

Turnarounds involve saving an insolvent or potentially insolvent business from terminal insolvency and returning the business to a stable financial and operational position.

This is achieved at the same time as maximising creditors' interests and, wherever possible, the interests of employees, managers and owners (shareholders).

Turnarounds are achieved by a combination of financial, crisis management, restructuring and insolvency skills and experience.

For the purpose of this article, turnarounds include the turnaround of both under performing businesses that are merely not achieving their full potential, and businesses that are either insolvent or potentially insolvent.

2 Definition of Turnaround Finance

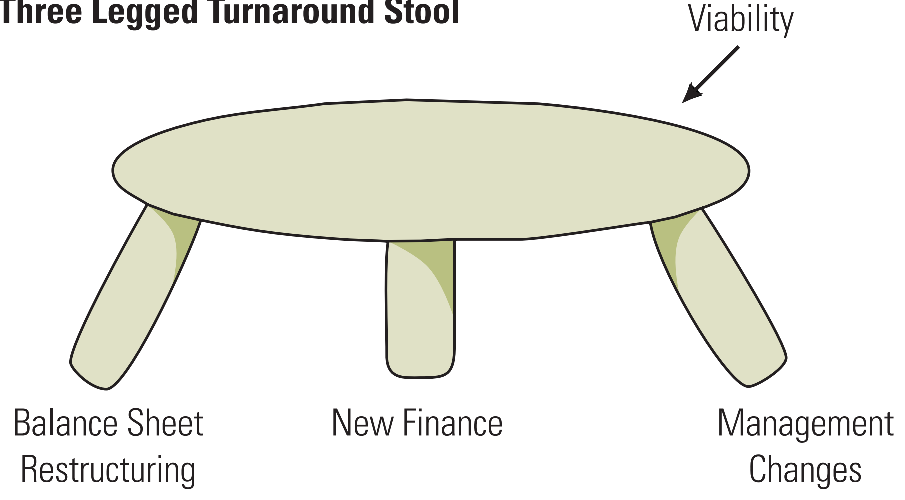
The vast majority of successful turnarounds require new or replacement finance.

Turnaround finance is defined as being any type of finance that is introduced during the turnaround process.

3 Explanation of the Components of a Turnaround

It is very important to stress that although turnaround finance is a fundamentally important component of a turnaround, turnarounds can rarely (if ever) be completed by just injecting additional money. Turnaround finance is therefore a crucial part of the cocktail required to affect a viable and sustainable turnaround.

It is intended to illustrate only the key components of a turnaround by the following simple illustration comparing turnarounds to a three legged stool. Without all three legs being firmly in place it is likely that the stool will collapse - meaning that the turnaround will ultimately fail.



3.1 Immediate Viability

The key issue in (most) turnarounds is that the business must have viability. This means that there must be a clearly structured busi ness plan to achieve commercial viability by generating immediate operating cash flows and positive EBITDA (Earnings Before

Interest, Tax, Depreciation and Amortisation).

Without this basic fundamental requirement it is likely that the turnaround will fail - regardless of how solidly the other components have been completed.

It is perhaps obvious to state that unless viability can be demonstrated or proven it will be extremely unlikely that turnaround finance will be raised.

In addition, a prudent principle of assessing the turnaround is to draw up a "bridge" statement to illustrate how the business can be turned around from its current negative EBITDA to the targeted positive EBITDA. For an illustration of a bridge statement, see Appendix 1 of this article.

3.2 Balance Sheet Restructuring

It is normal to have to restructure the company's balance sheet in a turnaround. The nature of this will vary depending on the characteristics of the turnaround. However, in broad terms this can be done:

3.2.1 informally - meaning without the formalities of the Insolvency Act procedures;

3.2.2 formally - meaning carried out via one of the Insolvency Act procedures.

The focus of this article is turnarounds and not insolvency.

However, it is stressed that there are many examples of turnarounds that involve insolvency procedures. For example, Canary Wharf went into administration and 10 years on it is a thriving business. The insolvency procedure (administration) was very successfully used to act as a key component of the turnaround.

Whilst it is recognised that insolvency may not mean that the business completely ceases to trade, it is probably fair to say that using an insolvency procedure in a turnaround is (by its very nature) the very last resort.

A brief summary of these procedures is included in Appendix 4 to this chapter. It is however stressed that restructuring has become a very specialised area which is littered with pitfalls for the layman. Therefore, specialist advice should always be sought.

3.3 Turnaround Finance

Turnaround Finance - the topic of this chapter - is a crucial part of turnarounds which are invariably extremely cash hungry.

3.4 Management

The fact that the business has experienced difficulties is (almost always) a result of a flaw in the management team and the business plan. This should be recognised as a "truth". Therefore, initiating the management changes and revolutionising the company's business plan are overwhelming important issues. Without this, raising turnaround finance may be impossible.

3.5 Summary

Anyone considering structuring a turnaround finance deal must both consider the finance in isolation and must focus on the key issues of:

3.5.1 immediate viability;

3.5.2 balance sheet restructuring; and

3.5.3 management changes.

4 Different Character of Turnarounds and Turnaround Finance

Turnarounds will involve different sizes of businesses with different financial and operational problems. Therefore, the type of finance; turnaround advisor and options available will necessarily be very different in each individual turnaround.

This problem is recognised, but this section merely attempts to outline the principles of turnaround finance. The available options and solutions will change depending on the size and nature of the transaction.

5 Different Principles of Turnaround Finance

All providers of finance need to assess the risks of any financial transaction. The normal going concern issues must still be considered in a turn around environment. However, only the additional issues of a turnaround are considered in this chapter.

5.1 Increased Risk

Any turnaround financing attracts considerably higher risk than a going concern financing. This is for the following reasons:

5.1.1 The business has already proven that it is potentially very risky, potentially insolvent or actually insolvent. The degree of severity will depend on the individual circumstances. However, this means that even before the turnaround finance is introduced there is a fundamental problem.

5.1.2 Turnaround finance is generally urgently required. This means that there are very significant time constraints. This causes very real problems for the financier to be able to:

5.1.2.1 identify the possibility and viability of providing finance;

5.1.2.2 complete the necessary due diligence (for the financier to be able to satisfy its own compliance criteria);

5.1.2.3 prepare and negotiate the legal documentation;

5.1.2.4 complete before an outside creditor takes action, or obtain creditor support.

These time constraints are a very important and constraining issue.

5.1.3 The probability, rather than possibility, that a creditor will take action against the company. This will increase risk:

5.1.3.1 before the finance has been injected;

5.1.3.2 after the finance has been injected.

For example, it is possible (in a worst case scenario) to inject unsecured finance only to find the company's bankers (who are secured by a fixed and floating charge) utilise the money to reduce the company's overdraft and then appoint an administrative receiver.

However, it should be noted that in some scenarios the turnaround financier's risk may be substantially reduced by the fact that both actual and contingent creditors may be either eliminated or ring-fenced, depending on the nature and type of restructuring.

There are also fundamentally higher legal risks. For example, it is possible to inject secured finance into a turnaround situation that may end up as insolvency. Therefore, the creation of the security could create voidable security which is in itself a fraud on the company's creditors.

Turnaround financiers (and turnaround specialists) can attract personal risk by acting as directors or shadow directors (either wittingly or unwittingly). In an insolvent situation this can create the possibility that the individual financier can:

- be disqualified as a director; and

- be personally liable for the debts of the company as a result of any wrongful trading (and other legal matters).

Therefore, failure to act correctly in providing turnaround finance can be extremely costly on a personal basis.

Important Note: At the time of writing there are possible legislative changes that may abolish administrative receiverships

In a turnaround scenario, there is considerably greater risk that lack of creditor support could jeopardise the provision of turnaround finance.

A schedule of the risks of key creditor action is included at Appendix 2 to this article.

5.2 Increased Required Rate of Return

Due to the possibility of materially increased risk, providers of turnaround finance will generally require materially higher rates of return.

Therefore, the deals will (generally) be structured to reflect this.

5.3 Increased Funding Requirements

Turnarounds commonly require a greater amount of finance than would be the case in a going concern financing.

The main reasons for this are as follows:

5.3.1 The business' sales performance may be negatively affected during the turnaround restructuring process, as management's attention is diverted.

5.3.2 Trade suppliers are often only willing to supply goods and services on a cash basis, if they have had their outstanding credit balances eliminated, deferred or compromised. This means that if a trading business enjoyed 30 day credit terms prior to the turnaround; the business may have to pay cash or a banker's draft for future trade supplies. This can have a very significant effect on the business' cashflow, depending on the nature of the business. Whilst it is possible that trade suppliers may only require cash payments in the first few months post restructuring, the effect of the lack of trade credit must be carefully examined when structuring the turnaround finance deal.

5.3.3 Caution must also be paid to non-trade creditors withdrawing credit facilities, which may absorb cashflow and increase cash requirements. For example, this would include the company's bankers unilaterally clawing back the company's over draft and (say) telecoms providers requiring deposits prior to continuing supplies.

5.3.4 Where the restructuring deal involves elimination of, deferment of, or compromise with creditors (for example, in an informal compromise or a company voluntary arrangement), the company's working capital can radically increase. The balance sheet instantly improves, and it is possible to assume that the receipts from trade debtors will automatically generate cash, which will therefore provide adequate internal funding. However, there is a timing difference while the debtors convert into cash. Therefore, additional cash is required to fund the "gap" period while debtors convert into cash.

5.3.5 The turnaround can involve significant additional fees and expenses.

The effect of the above may mean that the cash required in a turnaround financing may be greater, at least in the immediate period following the restructuring.

6 Mitigating the Increased Risk of Turnaround Finance

In recognising the increased risk of providing turnaround finance, specialist providers should take steps to mitigate these additional risks.

Each type of finance will require different mitigation steps. However, in general the following can be considered.

6.1 Planning

Due to the abnormal time constraints, planning is absolutely essential. In particular, in the planning of the process and people availability.

6.2 Pre-prepared Procedures and Pre-packaged Deals

For a financier or an advisor who specialises in turnaround finance it is prudent to have pre-prepared procedures in the following areas:

6.2.1 deal investigation and assessment;

6.2.2 deal structures;

6.2.3 due diligence;

6.2.4 legal templates.

The need for pre-packaging is necessitated by the time pressures involved in turnarounds. However, there is a limitation to the extent of pre-packaging as each deal must be specifically tailored to the facts of the deal.

6.3 Quality of Information

In all financing transactions caution should be paid to the quality and reliability of the company's financial information. However, this is particularly important in the case of turnaround finance.

For example, it is common that when a company becomes distressed management are too busy fire-fighting to focus on producing quality financial information. Another extremely common example is where financial reporting is so poor that it may in itself have contributed to the company's financial problems.

Therefore, particular attention should be paid to the company's financial information, and additional due diligence steps should be taken to verify the reliability and accuracy of the information.

After the restructuring it is essential to ensure that quality systems, financial controls and reporting are maintained and/or implemented.

6.4 Additional Risk Assessment for the Turnaround

Additional risk assessment is required over and above a normal going concern investment. This should deal with the additional risk factors outlined at 5.1 above.

6.5 Additional Negotiations

In normal going concern financing it is "normal" only to have to negotiate the finance deal with the directors and the shareholders.

However, in turnarounds the creditors are often more important than the directors/shareholders (although not always). It is therefore extremely important to identify:

6.5.1 Which creditors are likely to take action (as outlined in Appendix 2) and whether that action will have a material affect on the outcome of the turnaround.

For example, this will include identifying:

6.5.1.1 If the company's bankers with a floating charge will continue to support, or will the bankers make a formal demand and appoint an administrative receiver.

6.5.1.2 What outstanding judgements and winding up petitions there are?

6.5.1.3 Whether the landlord will exercise distraint.

6.5.1.4 The level of support of employees.

6.5.2 Which creditors are crucial to the ongoing trading of the business, and whether immediate non-payment will have an adverse impact on the company's ability to trade?

Having established the importance of the relevant creditors it is important to consider them in the structure of the turnaround financing. How the creditors are dealt with will depend on the financial circumstances of the deal, and the quantum and character of the finance available. However, in many turnarounds, either management or independent advisors of the financiers will need to be involved in negotiations with the key creditors. This is peculiar to turnaround finance and is rarely required in normal going concern financing.

It is very important to stress that negotiations may take considerable time. Time is a luxury most turnarounds cannot afford. Therefore, it is essential to consider the negotiation time when structuring the proposed deal.

6.6 Identifying the Cause of the Financial Failure and Implementing Fundamental Commercial Changes

It is absolutely essential to identify the cause of pending financial failure and to implement a workable and realistic plan to prevent the failure recurring.

From the financier's point of view this should be management's responsibility and therefore should be included in the company's business plan.

As it is such an important area, it may be prudent to ensure that failure to implement the agreed changes will result in default of the financing agreements. Therefore, this should be incorporated in the legal documents.

6.7 Maximising the Security and Security Cover

Given the increased risk of turnaround finance, it is important to maximise the security and security cover. This is consistent with the approach taken in going concern financing - however, in turnarounds there are additional issues to consider.

It may be that it is possible to rank ahead of existing secured creditors by creating a Deed of Priority or Inter-creditor Agreement between the new finance and the existing debt providers of the business.

Alternatively, it may be necessary to accept a position ranking pari passu with the existing secured creditor(s).

These positions will only be possible with approval of the secured creditor(s) concerned. This will involve negotiation. Furthermore, the deal clearly must accommodate the interests of the secured creditor(s).

Caution must be paid to ensuring that the taking of security does not create the possibility that the security may be subsequently set aside and declared voidable. The law relating to insolvency is complex and is discussed below. Therefore, specialist legal advice is essential.

Different types of finance may be more able to create full security cover. There are types of finance e.g. debt factoring, which offer security which normal traditional financing does not give.

7 Mitigating the Legal Risks

There are very significant additional legal risks of providing turnaround finance. This is because in a turnaround situation the company is insolvent or potentially insolvent at the time of introducing new finance.

Simply put, the legislation attempts to protect existing creditors from having their interests prejudiced.

The law is extremely complex and it is outside the scope of this chapter to address the detail of the legislation. However, there are broad areas where turnaround financiers should be extremely cautious.

7.1 Voidability

It is possible that the transaction or security may be voidable, causing monies to be repaid to an insolvent state.

7.2 Personal Liability

It is possible for the turnaround financier as a director (or being deemed to be a shadow director) to become jointly and severally liable for the company's debts.

7.3 Misconduct

A turnaround financier could, as a director or shadow director, be disqualified from acting as a director.

7.4 Litigation

It is possible to act in such a way so as to attract litigation from the directors, the company and/or the company's creditors and shareholders.

It is stressed that all the above concerns can be minimised by the appropriate structuring of the deal. Nevertheless, this is an extremely complex and potentially very risky area and specialist professional advice should be taken.

A checklist is included in Appendix 3 to this chapter, of the issues to consider. However, it is strongly emphasised that the check list is simplified, so as to highlight the issues only, and specialist legal advice should be taken.

8 Types of Turnarounds that Require Turnaround Finance

There are a wide variety of turnarounds that require financing. Examples of these have been included in Appendix 4 to this chapter.

It is important to stress that there are a very wide variety of techniques and the appendix only demonstrates the more common ones.

The illustrative list includes turnarounds that are affected using an insolvency procedure. This may strike some readers as surprising as they may be believe that insolvency equates with "corporate death".

However, there is a very long history of great business being bought out of insolvency and subsequently creating substantial value.

In recent years the insolvency legislation has changed to facilitate turnarounds. So too has the culture of banks and insolvency specialists. It could be validly argued that this change has been too limited. However, the rescue and turnaround culture is becoming far more sophisticated and progressive and it is likely that this will continue. We should expect very radical developments in this field.

9 Types of Turnaround Finance Available

There is a wide range of turnaround finance available. Each provider will have its own requirements, target internal rates of returns (IRRs) and security requirements.

A summary of the types of turnaround finance is attached in Appendix 5 to this chapter.

In addition, this is discussed in full on the section on "Raising Turnaround Finance: The Practical Reality".

Raising Turnaround Finance: The Practical Reality

1 Introduction

1.1 Objective

Having discussed the theory of turnaround finance, the section of this chapter aims to illustrate a practical work programme to assist raising turnaround finance.

It is written from the view point of a turnaround specialist advising a company requiring turnaround finance. However, it is equally applicable for the company's management or existing providers of finance who may be assisting management to obtain additional finance.

1.2 Presumption of Distress

For the purpose of this chapter, it is assumed that the company undertaking the turnaround is actually or potentially financially distressed.

Whilst it is common place it is not the rule. For example, it is possible that an under performing company has excess cash resources, in which case turnaround finance is not an issue.

1.3 The Practical Reality: Raising Turnaround Finance is Hard

Raising turnaround finance is very hard because of the increased risks as set out in paragraph 5.1., and the (normally) very significant time constraints.

However, it is important to stress that with a disciplined and focused approach it is very achievable.

1.4 Raising Debt is Easier Than Equity

In a turnaround; raising debt is considerably easier than raising equity. There are a number of reasons for this.

1.4.1 Since the peak of the UK recession in 1992, there has been an explosion of secondary debt providers who specialise in "asset based lending" (ABL) to SME's.

The way the asset based lenders structure their security means that they focus on:

1.4.1.1 Specific assets such as debtors, stock etc

1.4.1.2 Interest cover rather than repayment as the facilities "revolve".

This means that this type of finance is ideally suited for turnarounds.

An illustration of the growth of asset based finance GE Capital was established in the UK in 1998 with 4 people and no funds applied. By 2001 it had applied £500m of funds, and its employees had grown to 200.

What is especially interesting is the profile of the lending. The typical recipients of G E Capital funds have turnovers of between £10m and £20m and approximately 70% are turnarounds.

This type of financing simply was not available in the early 1990s.

In summary, asset based lending is available for turnarounds and very importantly appropriate for turnarounds.

1.4.2 However, the reverse is true when it comes to turnaround equity - there is very limited turnaround equity available.

The reason for this is that:

1.4.2.1 There are only a handful of equity providers in turnaround situations who are specialists in turnarounds.

Of these providers, the nature of equity provision is that they do a relatively small number of deals every year.

Therefore, a small number of equity providers doing a few deals each year mean that (relative to that demand for turnaround equity) there are a very small number of equity deals done.

It is also crucial to understand that not only is it hard to raise turnaround equity but is hard to get a good deal without material dilution of the opening equity position.

1.4.2.2 There are nevertheless, many business angles, corporate investors and generalist private equity providers who may be keen to do deals.

However, they are often not the best starting point when raising turnaround equity because:

1.4.2.2.1 The distressed nature of the funding requirement can put many would be investors off.

1.4.2.2.2 The short and condensed time requirements are often too pressurised for a non-specialist.

1.4.2.2.3 This means that it is impossible for them to satisfactorily complete the transaction because of the due diligence requirements.

1.4.2.3 There are merits in approaching a financially strong trade competitor. This because a trade competitor can rapidly get into the guts of the business. However, extreme caution should be exercised when approaching a competitor as the competitor may use the distressed position as a "fishing trip" to hijack customers, employees and other key business intangibles.

If a trade competitor is to be approached it is important that it is for sound strategic reasons.

Tactical Approach to Raising Turnaround Finance

Given the above, it is important to have a very structured approach to raising turnaround finance.

Step #1 Establish what assets are available for asset based lending (ABL)
Step #2 Establish the possibility of raising equity
Step #3 Establish the immediate application of funds
Step #4 Establish the creditors compromise if required

The above approach is illustrated by the examples given below. Before doing so it is important to emphasise

1 Asset Based Lending Depends on Valuations

As discussed above, ABL is based on the premise that the advances will be based on the valuation of the assets in the event of a terminal insolvency.

Each ABL's advance requirements are different and each deal will have its individual complexities so a formula approach is potentially flawed, but the table below is a useful starting point to understanding how an ABL can be structured.

Type of Asset	Valuation Principles	Percentage Advance
Debtors	Recoverable debtors Indisputable proof of delivery Debtor is solvent and can pay debt Exclusions include: Greater than 90-120 days Certain foreign jurisdictions Credit note history Contras with creditors ledger (payables)	75-95%
Commercial Property	Estimated restricted realisation price (ERRP) with 6 month sale period or open market value (OMV)	60-80%
Plant and Equipment	ERRP	60-80%
Stock	ERRP but subject to certain exclusions: Criteria: 1. All stock is assessed in categories 1.1 Finished goods 1.2 Work in progress 1.3 Raw materials Each category will have different ERPP principles and advance rates For example, WIP will rarely be fundable, and Raw Materials are only fundable after deducting potential Retention of Title claims. 2. The value of preferential creditors in the event of terminal insolvency may affect the advance 3. Obsolesce and slow moving stock will be reflected in a lower ERRP valuation	30-50%

2 The Importance of Valuers in Asset Based Lending

Independent valuers are crucially important for asset based lenders. The independent valuers establish the realisable value of the asset - this provides the basis of the advance.

There are 2 types of valuations that are predominantly used in turnaround finance. These are set out by the Royal Institute of Chartered Surveyors.

Valuation Method	Abbreviation	Explanation
Open Market Value	O.M.V.	Rarely used in turnarounds due to risk. However, the OMV reflects the "open market value" of the realisation of assets assuming there is no pressure or urgency for the sale.
Estimated Restricted Realisation Price	E.R.R.P	The most common valuation method in turnarounds due to risk of failure. *ERRP reflects the forced sale value within a specified time period.

* At the time of writing, this position may materially change with the introduction of the Enterprise Bill, crown preferential status may be abolished. This should materially improve stock advance levels

Due to the fact that valuers are so important when raising finance in a turnaround it is (usually) a procedural prerequisite to get valuations. In doing so it is important to ensure that the independent valuer is either on the proposed lenders panel or is acceptable to the lender.

It is common to get valuations prior to contacting lenders to establish the shape and structure of the deal. This is demonstrated in the illustration below.

For clarity, valuers should only be used in the valuation of physical assets or property.

The ABL will assess the recoverable value of debtors themselves. However, valuers are occasionally used to value intangibles such as goodwill. It is submitted that chartered surveyors are not the most appropriate professionals to do this. Invariably the best people to provide business valuations are professional accountants or corporate finance houses who specialise in this area. In addition, very few (if any) asset based lenders will provide funds using goodwill as security.

Finally, to re-emphasise it is the (professionally and independently assessed) realisation valuation that is crucial. The accounting net book values have no relevance at all in asset based funding.

3 Illustrative Case Study

To demonstrate the practical approach, a refinancing is set out below - using 2 different valuations. This illustrates the impact on the amount of funds raised and ultimately the impact on creditors.

		Scenario #1 High Valuation		Scenario #2 Low Valuation	
Asset Based Lending					
Category	**Advance percentage**	**Valuation £000s**	**Advance £000s**	**Valuation £000s**	**Advance £000s**
Debtors	85%	2,000	1,700	1,500	1,275
Plant and Equipment	80%	1,000	800	500	400
Stock	50%	3,000	1,500	1,500	750
Property	70%	2,000	1,400	1,800	1,260
			5,400		3,685
Equity Advance			500		500
			5,900		4,185
Immediate application of funds					
Repay existing bankers			(4,000)		(4,000)
			1,900		185
Required to bring all creditors up to date			(1,200)		(1,200)
Additional/[shortfall in] working capital			**700**		**(1,015)**

This is illustrative of the impact of valuations as it very materially affects the level of advance.

This ultimately affects whether or not the turnaround can be financed without a compromise of the creditors position as illustrated in appendix 4.

Additionally, if asset based lending is used then the lender takes over the existing lenders security.

Unless there are unusual circumstances, the existing secured lender is normally repaid.

4 Satisfying the Turnaround Financiers Requirements

To obtain adequate turnaround finance, it is important to structure the deals to ensure that the turnaround financier's requirements are satisfied.

Clearly, there are no rules that can be set out but the table below attempts to summarise the principal issues that will count for each type of financier.

Criteria of Focus	Traditional Bank Debt Provider	Asset Based Lender	Turnaround Equity Provider
Security cover	Yes	Yes	Yes
Interest cover	Yes	Yes	Yes
Ability to repay	Yes	n/a	Yes
Revolving facility	Maybe	Yes	n/a
Bridge statement/viability	Yes	Yes	Yes
Management changes	Yes	Yes	Yes
Cheap entry point for equity	n/a	n/a	Yes
Attainable exit route	n/a	n/a	Yes

There are clear differences between all possible funding sources, but it is clear equity providers are the most demanding.
To illustrate this:

- Equity providers will normally provide their "equity" as a combination of debt and equity. The debt portion will (normally) be subrogated in repayment and security to the primary debt lender. However, the equity provider will still consider the possible security in assessing the risk/return issues.

- The equity provider will therefore want to earn interest on the debt.

- The equity provider will want the debt to be repaid.

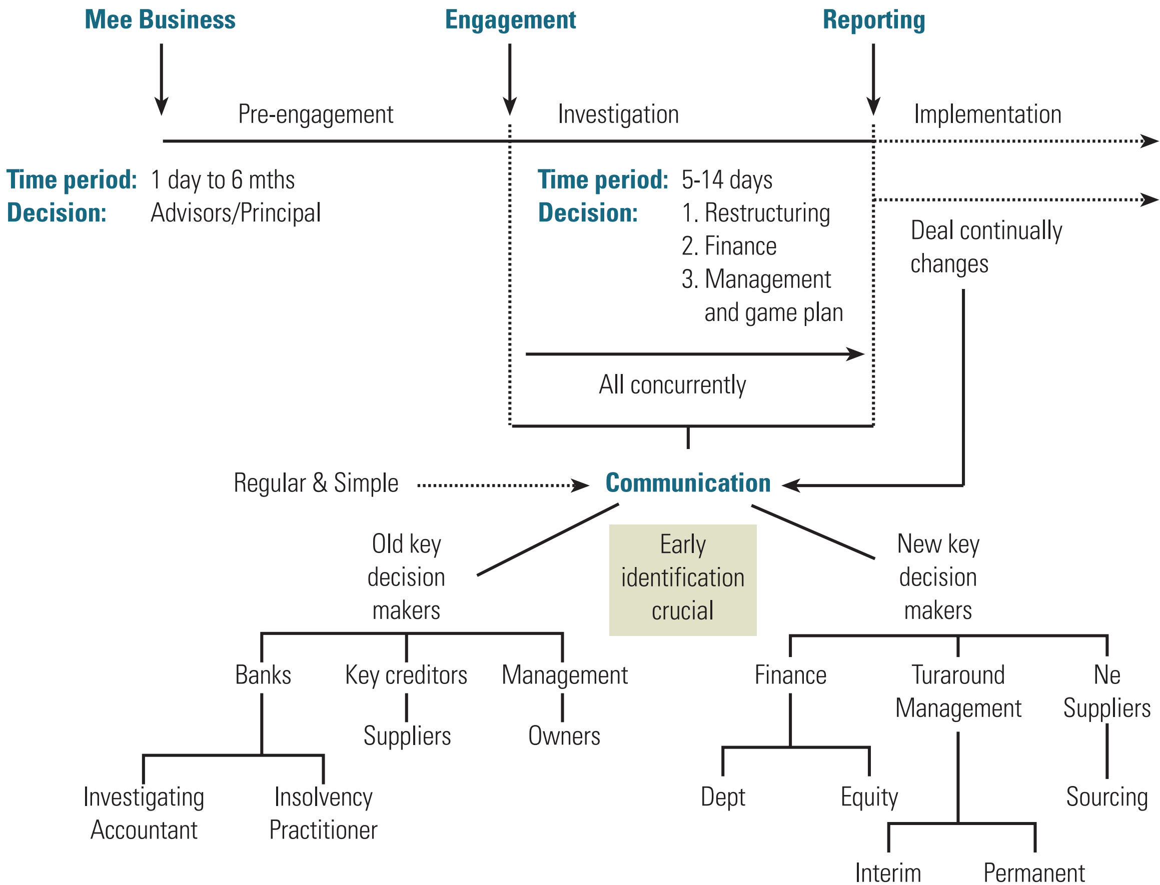
- The equity provider will search for a cheap equity entry point as well as a realistic and attainable exit. Therefore, there are lots of additional hurdles to jump through to satisfy equity providers. But the most fundamental issue is to communicate and satisfy all types of providers that:

- The business is viable and that the turnaround can be demonstrated in substance. This is commonly done by using a "bridge statement" (see appendix 1).

- The required management changes will be implemented. This is a huge area that can not be covered by this article. It is essential to emphasise that financiers require these changes to be addressed and implemented concurrently to providing more cash. The difficulty is communicating this to them within the time frame required.

5 Getting Turnaround Finance Deals Done: Structured Approach in a Very Short Time Period

The chart below illustrates the type of work flow that is required by both the company's management and the professional advisor to get a turnaround finance deal done, bearing in mind the very real time pressures.



In explanation of the above chart, here are a number of points worth making.

The pre-action or pre-engagement period can be both very short or quite long before initiating action. Some assignments only get going after many (often tortured) meetings. Others spring into action as a result of an urgent phone call on a Sunday evening.

Although this chapter focuses on turnaround finance, it is axiomatic that the refinancing can only be meaningful if it is done concurrently with the management changes and new game plan, and (if appropriate) the restructuring of creditors.

It is a great mistake to work on one aspect only - the finance follows the management changes (not the other way round).

Communication in these deals is everything. Many deals go badly wrong due to poor communication. The chart above illustrated the key players that must be communicated with in a turnaround finance deal. The relative importance of each player will vary on each deal. However, the key is to identify their relative importance at an early stage and structure the work and communication focus accordingly.

Turnaround finance deals constantly change. This makes it difficult at times but all parties need to be as flexible as possible to get these deals done.

6 Sources of Turnaround Finance

As this is a relatively specialised area, newcomers to turnaround finance may not know who to approach.

The various categories of finance providers are included in the web-site **www.turnaroundfinance.com**

Appendix 1 - Illustrative Bridge Statement

	£000s	Timetable
Current negative EBITDA	(600)	
Increase in margin by Price increase by 3%	250	1 month
Improved purchases by 2%	150	2 months
Vacate regional warehouse	150	3 months
Redundancies Reduced salary/wages bill	400	Immediate
One off redundancy payments	(120)	Immediate
Reduce head office costs and management charges	200	Immediate
Target positive EBITDA	**430**	**3 months**

Notes

It is important to stress that the key principles of a bridge statement (usually) are that the "bridge":

- Should not require an increase in sales
- Should be based on as many certainties as possible
- Should be immediately implemented on an achievable timetable

Appendix 2 - Risk of key creditor action

Class of Creditor	Type of Action that can be taken
Secured creditor with a floating charge	Can appoint an Administrative Receiver.
Secured creditor with a fixed charge (including a mortgagee)	Can enforce by taking possession over charged assets and/or appointing a fixed charge receiver (or taking possession as mortgagee).
Judgement creditors	Can: Petition to wind the company up Execute judgement - e.g. attachment of an asset or garnishee
Landlords	Rights of distraint, re-entry and forfeiture for default of conditions and non-payment of rent.
Creditors with retention of title	Have retention of title (ROT) over unpaid goods (if ROT valid), therefore can reclaim relevant goods.
Creditors with liens (this would include solicitors' liens, stockbrokers' liens, accountants' liens, bankers' liens, repairers' liens, shippers and carriers' liens, and any contractual, equitable or statutory liens.)	Have liens over goods for unpaid bills. For example, a garage may have a repairers liens over a repaired vehicle until work is paid for.
Trade creditor	Trade creditors can often put themselves in a very powerful position by refusing to supply goods (at worst) or only supply goods on a cash basis. This can make trading in a turnaround impossible.
Inland Revenue, Customs and Excise and Rating Authorities	Have powers of distraint for unpaid PAYE, NIC, VAT and rate.

Appendix 3 - Legal Risks in Turnaround Finance

Important notice: This schedule is merely an indicative schedule of the additional legal issues of turnaround finance. It is illustrative only, and is not intended to be comprehensive. Specialist legal advice should be taken as part of all turnaround finance transactions.

Legal Issue	Legislation (ref below) IA - Insolvency Act CA - Companies Act And common law	Potential Risk (Y/N)				
		Explanation of circumstances giving rise to concern in Turnaround Finance	Transaction voidable	Personal liability for directors and shadow directors	Misconduct resulting in directors disqualification	Litigation against finance provider
Transaction at an Undervalue	s238 IA 86	Transaction creates a gift or undervalues consideration.	Y	N	Y	Y
Preference	s239 IA 86	Transaction puts one creditor in preferential position.	Y	N	Y	Y
Extortionate credit transactions	s244 IA 86	Transaction requires grossly exorbitant payments or grossly contravenes ordinary principles of fair dealing.	Y	N	Y	Y
Avoidance of floating charge	s245 IA 86	If floating charge registered after new monies introduced, floating charge could be voidable.	Y	N	N	N
Transactions defrauding creditors	s423 IA 86	Transaction creates a gift or undervalues consideration and transaction puts assets beyond reach of creditors and/or prejudices the interests of creditors.	Y	N	Y	Y
Substantial property transactions	s320 CA 85	Transactions with directors (and connected parties) of greater than 10% of the company's net asset value and/or £50,000 require approval of a general meeting of a company.	Y	Y	Y	Y
Fraudulent trading	s213 IA 86	Trading carried on with intent to defraud creditors.	Y	Y	Y	Y
Wrongful trading	s214 IA 86	Directors allow company to continue trading while (knowingly) insolvent.	N	Y	Y	Y
Restriction of re-use of business name	s216 IA 86	Transaction facilitates new company re-using a restricted business name of liquidated company.	N	Y	Y	Y
Fraud and deception	s206-s211 IA 86	Transaction creates fraud and/or deception.	N	N	Y	Y
Sale to a connected party	Statement of Insolvency Practice 13 (SIP 13)	Transaction funds a buy out of the business and assets to a connected party that does not comply with SIP 13.	?	?	?	Y
Misfeasance and breach of duty	Common law and s212 IA 86	Committing an act of misfeasance or breach of fiduciary duty or a breach of some other duty, including breach of the above listed sections.	Y	Y	Y	Y

Appendix 4 - Explanation of the Types of Turnarounds and Insolvency Procedures that may require Turnaround Finance

Name of Procedure	Formal/Informal in terms of Insolvency Act 1986	Brief Explanation of Procedure	Types of Turnaround Finance Required
Workout with additional finance with no formal insolvency procedure	Informal	1. Informal deal (usually) with a limited number of key creditors, with additional finance introduced. 2. Normally only appropriate if company has short term cash flow difficulties (rather than being technically insolvent) and company viable.	1. Any appropriate finance to provide working and development capital. 2. Buy out creditors (usually banks).
London Approach	Informal	1. Informal procedure driven by consensual approach by lenders and senior debt creditors, working together to maximise returns while keeping the company alive. 2. Only appropriate for large multi-banked companies.	1. Additional finance to provide working capital during stand still. 2. Buy out lenders and senior debt providers.
Contractual compositions	Informal	1. Informal deal (usually) with a limited number of key creditors, with additional finance introduced. 2. The difference in this scenario is the "deal" with individual creditors is contractually binding as a result of a composition that is drawn up in a legal contract, to which the creditor agrees. 3. Normally only appropriate in cases where small number of key high value creditors who are willing to agree to the compromise and support the turnaround.	1. Any appropriate finance to provide working and development capital. 2. Buy out creditors (usually banks)
Debt/equity swaps	Commonly informal (but can also be included in a formal arrangement in a CVA or Administration)	1. Deal (usually) with limited number of key creditors, with additional finance introduced. 2. In this scenario individual creditors convert their "debt" into "equity". 3. Usually only manageable where small number of key high value creditors who are willing to agree to the debt / equity swap and support the turnaround. 4. Procedure is commonly used in conjunction with other procedures listed on this schedule.	1. Any appropriate finance to provide working and development capital. 2. Buy out creditors (usually banks).
Company Voluntary Arrangements (CVAs)	Formal	1. Deal between insolvent company and its creditors which is supervised by an insolvency practitioner. 2. Generally only appropriate for SMEs that have an established business.	1. Provide additional working and development capital. 2. Buy out secured creditors 3. Buy out creditors bound by the CVA
Administrations	Formal	1. Company obtains an administration order which creates a moratorium. An Insolvency Practitioner appointed as Administrator to achieve set "purposes". 2. Appropriate in a variety of circumstances.	1. Fund the trading of the administration. 2. Fund buy out from the Administrator and working capital of newco. 3. Buy out creditors.
Administrative Receiverships	Formal	1. Secured creditor with a floating charge (commonly a clearing bank) appoints an Administrative Receiver to recover its lendings. The Administrative Receiver administers the company until he recovers the lenders funds. 2. Generally only occurs where bank has no other alternative (after considering risk) of recovering funds.	1. Provide funding for receivership trading. 2. Provide funding for receivership buy out, 3. Provide funding to buy out secured lender and discharge receivership.
Fixed Charge Receiverships (and mortgages)	Formal	1. Secured creditor with a fixed charge appoints a Fixed Charge Receiver to recover its lendings. The Fixed Charge Receiver has limited powers and only controls the charged asset. 2. Generally appropriate on simple recoveries where a particular asset can recover lenders exposure. It does not necessarily affect the remaining business.	Provide funding to acquire assets and/or buy out secured creditor.
Liquidations (all types)	Formal	1. Company wound up, Liquidator realises assets and distributes realisations in a set priority. 2. Generally applies to terminal insolvencies, although in some circumstances appropriate in turnarounds.	1. Provide funding for liquidation buy out of assets and goodwill. 2. Provide working capital and development capital for newco.

Important Note: at the time of writing there are possible legislative changes that may abolish administrative receivership

Appendix 5 - Types of Available Turnaround Finance

Type of Finance	Explanation	Advantages	Disadvantages
Private equity (Venture Capital) funds specialising in turnarounds	1. Provide equity and debt financing for working capital and development capital. 2. Provide buy outs of existing lenders and creditors. Due to due diligence requirements, only limited number who can genuinely transact within the required time frame.	1. Appropriate for most types of businesses. 2. Provide working and development capital. 3. Provide management skills. 4. Deals can be very flexible and creative.	1. Generally very selective. 2. Can be expensive. 3. Very limited number of providers for turnarounds.
Factors and invoice discounting	1. Provide funds based on percentage value of debtors, which are assigned to factors. 2. Invoice discounting is rarely provided in turnarounds 3. Focuses solely on debtors	1. Focuses principally on debtors and not total balance sheet. 2. Simple. 3. Allows for growth. 4. Can be implemented rapidly. 5. Significant number of factors willing to finance turnarounds.	1. Can be expensive. 2. Not available to all types of business. 3. May provide inadequate funds for whole turnaround. 4. Source of finance usually already obtained/explored prior to financial crisis.
Stock financing	Provide financing on stock holdings	1. Simple. 2. Focuses solely on stock. 3. Allows for growth of business. 4. Can be implemented rapidly.	1. Not available for all businesses. 2. May provide inadequate finance for the whole turnaround. 3. Source of finance usually already obtained/explored prior to financial crisis.
Asset financing	1. Specific assets are financed by HP/leases/loans. 2. In turnarounds sale and subsequent lease back is a useful option	1. Simple. 2. Focuses on one asset.	1. Not available for all types of business. 2. May provide inadequate finance for the whole turnaround. 3. Source of finance usually obtained/explored prior to financial crisis.
Bank finance	Secured loans	1. Relatively simple. 2. Can finance total business.	1. Source of finance has almost certainly been obtained or explored prior to financial crisis. 2. Banks are (normally) unwilling to fund turnarounds unless they are already materially exposed.
Corporate capital	A very important source of turnaround capital is Corporate Capital. This is where a trading business invests is a turnaround for strategic reasons - such as to provide a new customer base and/or technologies.	1. Appropriate for most types of business. 2. Provides working and development capital. 3. Provide management skills. 4. Can be flexible and creative. 5. May provide strategic benefits. 6. May require lower returns than pivotal equity providers.	1. May lack necessary skills in Turnaround Finance. 2. Source of finance usually already explored prior to financial crisis. 3. Acquiring management may not be able to transact quickly enough.