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“Independent Business Review”: key step in the financial restructuring of an LBO

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Shareholders, mezzanine investors, senior bankers, management, and all of the parties involved in the financial restructuring of a business need objective information to fuel their thinking. An independent financial and economic analysis gives them a common basis for negotiation.

Default situations are increasing in the current economic setting

In the current economic environment, even companies with a robust business model are seeing their ability to generate cash flows largely burdened. In the case of a highly leveraged financial structure, debt servicing can quickly prove to be impossible, and restructuring becomes inevitable.

Preserving the economic interests of the various parties involved, inseparable from the sustainability of activity, can require financial efforts ranging from a simple covenant reset (or temporary freeze of debt schedules) to a major recapitalisation that may be accompanied by significant write-offs.

In order to prepare for and agree to participate in the restructuring of a financial holding company, the parties involved need to examine in detail the operational company's ability to reorganise in the medium term and the financial cost associated with this operation. Not everyone has the same knowledge of the assets, and providing an independent analysis is the best way to correct this information asymmetry.

“Independence and pragmatism are essential for analysis”

The information that the parties will find in an independent economic and financial analysis

The analysis of historical performance and the reasons for non-fulfilment of the initial business plan is the first step in analysis. Beyond cyclical slumps in turnover, it should be ensured that the difficulties are not also associated with more structural operational problems (failure of the production tool, fault of key partners, etc.).

At the same time, a review of short-term cash flow forecasts can confirm the urgency of the situation. The nature of the discussions is necessarily different if the horizon of the fault is three or six months.

Lastly, on first analysis, the robustness of the financial control and the quality of the financial information are put to the test: if the cash flow forecasting tools are not adequate, the means for having appropriate indicators must be put into place quickly.

Immediate actions (quick wins) may possibly be undertaken depending on the situation (optimisation of WCR, establishment of factoring, etc.) and incorporated into the modelling of short-term forecasting.

Then the analysis of medium- and long-term outlooks of the company's activity involves a complete analysis assuming:

- An analysis of market prospects and changes in the competitive environment. Depending on the circumstances, this analysis relies on statistical market data, analysis of the competition, and interviews conducted with customers or suppliers.
- An analysis of the need to adapt the production tool or review the scope of activity. Disposal of non-strategic activity, geographic redeployment, and industrial reorganisation are possible solutions for reducing the cost base and the financing needs of the company in a difficult period.
- Modelling of the different scenarios of turnaround financing and assessment of the associated financing requirement. This step is essential because it assesses the needs making it possible to foresee the long-term continued operation of the company. Beyond the short-term financing needs, scenarios at a horizon of two or three years make it possible to size the amount of bearable debt in a deteriorated environment and guide negotiations.
- The indicative valuation of the underlying asset on the basis of current financial aggregates and at the horizon of the turnaround plan. This valuation must also make it possible to assess at what point the investment or credit lines are risky or guide discussions.

The independent analysis can contribute to preserving the value of financial interests in presence

The set of detailed analyses mobilises multiple skills both inside and outside the company and requires approximately six to eight weeks of intense work.

The involvement of the independent expert therefore contributes to coordinating all of these skills in a project mode to meet tight deadlines and reach the initially defined targets.

Often financial difficulties are accompanied by a crisis of confidence among the various parties involved. The involvement of the independent expert permits a detached analysis of the financial and operational data necessary for the formalisation of an objective viewpoint.

For senior bankers, for example, the reports periodically communicated by financed companies may not be enough to decide whether to participate in a restructuring. Faced with a crisis situation, these creditors need ways to get an actual measurement of the difficulties and assess the management's capacities for reaction.

The sometime sudden shift from a growth business plan to a drastic restructuring plan can sometimes be perplexing, and obviously without becoming involved in management, the banker is entitled to understand the reasons for these turnarounds.

The contractual documentation of LBOs also often provides for the performance of these analyses as soon as broken covenants are proven.

Depending on the situations, when it is not possible to find a consensual solution, the analysis can then be guided towards special work for one of the involved parties: search for third-party investors able to propose an alternative solution, preparatory work for disposal of certain business segments, etc.

The involved parties can each benefit from the performance of the independent financial and economic analysis

In a crisis situation, managers are inundated with requests for information while needing to ensure the company's daily operations. They do not always have the tools available to respond to these requests (regularly updated short-term cash forecast, establishment of monthly financial position, etc.). The support of a specialised financial team who helps them conduct these analyses and produce reliable summary documents intended for all involved parties then proves to be valuable.

In a crisis, shareholders want the closest possible monitoring of their investment, beyond the usual reporting documents. But they are not meant to handle the daily management of their investment.

The implementation of independent due diligence measures will therefore enable them to fulfil their role: exercising control over the management in place, approving restructuring or strategic re-direction decisions, and funding additional cash requirements to preserve their investment.

For financial shareholders, the situation is even more complex. With the proliferation of transactions having given rise to a wider syndication of debt, the pool of senior bankers and mezzanine investors can be numerous and quite varied.

Some support the company for years, while others have taken recent positions with access to relatively limited information. The performance of the independent economic and financial analysis will enable them to have information equivalent to the other present parties and assess at what point their line is at risk.

Lastly, it is common for discussions and negotiations between parties to be placed under the auspices of a special representative. As part of a confidential procedure (special mandate/conciliation), the independent review is the cornerstone of the representative's work.

The representative may indeed rely on short-term cash flow forecast work to define the timing of the discussions. The representative then uses fundamental medium-term analyses to propose lasting solutions to be implemented.

A portion of the independent expert's thus shows the debt and liability servicing capacity and, where appropriate, positions the amount of any additional funding requirements over time.

Key points

The independent economic and financial analysis can meet the information needs of the parties involved in a restructuring while allowing management to focus on running the business.

The reviewed financial forecasts will constitute a sound, objective basis allowing shareholders, mezzanine investors, and senior bankers to complete the financial restructuring.

about the authors

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decision-makers: strategy finance law **no. 103**