FOREWORD

The global financial crisis has been generated, as is well documented, by an excessive frenzy in the mortgage market in the United States that affected all financial institutions worldwide. Among the main drivers of the crisis, the excessive leverage of many companies can be emphasized, mainly caused by: incorrect assessments of high debt risk; a greater ease, compared to the past, in obtaining debt capital from financial institutions (interest rates at historic lows, covenant lite loans, etc.); the accumulation of acquisition debt resulting from M&A transactions or takeover of the company itself by private equity funds concluded at an excessively high price compared to the real value of the company.

The number of delays in payments and defaults has increased dramatically, threatening the stability of all the major European and American banks, forcing governments and central banks to intervene by “lightening” the budgets from the most toxic positions. Many companies have therefore found themselves at the gates of the crisis with a debt load (and, in general, a capital structure) sustainable only under conditions of constant economic growth and high operating profitability.

As soon as these conditions have disappeared, debt service has become impossible for many companies.

The credit problem is still lingering: the economic and financial crisis that has invested the entire global system for several years is still in progress. In Europe, there are around 1,000 billion NPLs that weigh on banks' balance sheets, 266 billion in Italy alone. The problem of non-performing loans represents a burden for the free circulation of assets; therefore it must be nipped in the bud. Before accumulating a significant amount of non-performing loans certain actions may be considered.

In many cases, debt burdens and a matrix of suspicious creditors can completely obstruct the goals of a once profitable business. Financial restructuring is the most effective way of addressing these stressors, and a complicated apparatus of financial and legal safety nets are available to savvy corporations.

In recent years, there has been an increase in the market for acquisitions of companies struggling within the context of crisis exchange instruments; this phenomenon exists also due to the unequivocal advantages that this kind of interventions presents with respect to a performing acquisition (exemption from the revocatory risk in case of subsequent bankruptcy of the seller, debt relief, purging of expenses, tax advantages, etc.). When a company struggles serving its debt, it will often consolidate and adjust the terms of the debt in a debt restructuring, creating a way to pay off bondholders.

The financial structure of the company must invariably be renegotiated to align it with the needs and capacity of the new business that arises from the implementation of the other key ingredients. A financial restructuring normally becomes necessary in companies where, consequential to many factors, the financial stakeholders' risk/reward balance has been distorted or broken.

The first issue to address is the meaning of restructuring.

Typically, the meaning of restructuring is limited to a restructuring of the debtor's financial obligations in response to a change in economic conditions. A restructuring usually takes the form of rescheduling, a compromise, conversion of debt to equity or a combination of all three. Restructuring should be distinguished from the term "turnaround", which is a more pervasive re-organisation of both the debtor's financial obligations and operational processes.

In emerging markets where creditors' rights are usually impaired, a turnaround is almost unachievable unless there is a willingness by the borrower to do so. However, in jurisdictions where creditors have more developed rights, a turnaround may also be possible.

Whether a restructuring or turnaround process is desired or required will depend upon the individual circumstances of the debtor, the jurisdiction in which it operates and the degree to which the owners or managers of the debtor will support the process.

This book is substantially divided into two parts, each containing two chapters. The first section refers to the explanation of the financial structure and aims to define the signals and costs of financial distress. This part subsequently focuses on financial debt, and more specifically, the financial documentation, the financial covenants and the inception of the NPLs.

The second part of the book deals with the financial restructuring process, identifying the different choices, the issues and the alternatives once the restructuring is implemented.

The last chapter is dedicated to an analysis of a restructuring process case study that enables readers to better understand the reality of this complex process that, if well managed, could be successful.

Mauro Paoloni
Banco Popolare di Milano
Deputy Vice Chairman