The Middle East takes a fresh look at restructuring

In the post-Dubai World era, a fresh look at restructuring is required, which should no longer be forced on companies nor carried out behind closed doors. The region has embraced a process akin to that found in the developed economies and managements should recognize, and be ready to embrace, the new regime. Early action is nevertheless strongly recommended: there is much that companies can, and should, do to arrest a deteriorating situation and avoid passing the initiative and control to the banks.

The appointment of Deloitte UK Partner, Aidan Birkett, as the Chief Restructuring Officer (CRO) of Dubai World heralds a new dawn in the way governments and companies in the region handle businesses in financial distress. In a bold move, the Dubai Government has seized the initiative and set in train a process which is certainly recognizable to the international banking community and which is going to become more familiar to banks in the Middle East.

The government simultaneously announced a new legal framework based upon "internationally accepted standards of transparency and creditor protection," providing for an automatic moratorium – an authorization to debtors to postpone payment which comes into effect when a company signals its intention to put forward proposals to creditors for a voluntary arrangement. And where Dubai has gone, other countries in the region will follow.

The old way of dealing with businesses under financial pressure in the Middle East has been anything but transparent, but in the aftermath of the global crisis and in the light of the sheer scale and complexity of the financial issues at Dubai World, a new approach is needed.

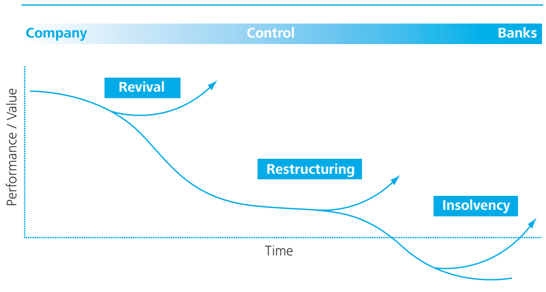
We can now expect lenders in the region to adopt their own approach to customers in distress. Banks have already strengthened their cross-border workout teams and are taking a more active role in the review of highly-leveraged portfolio businesses. They are taking more seriously what might hitherto have been regarded as minor breaches of covenants, they are increasing their fees and the cost of the debt they provide, they are focusing on de-gearing strategies or even exiting from relationships altogether (if they can), and are also demanding that businesses be well-advised. All this will lead to an increase in formal restructuring processes.

Early Warning Signs

Naturally, companies should avoid reaching the stage where restructuring processes are forced upon them so as not to lose initiative and control. They should be able to detect the warning signs.

Early warning signs are usually a combination of market factors and management issues. By way of example, trouble is brewing if sales are dependent on discretionary spend, or if it is not possible to pass on cost increases in price rises to customers; there may be changes in legislation, exchange rates (leading to currency exposures) or permanent shifts in customer buying patterns which call for a fundamental rethink of the business model.

On the management side, an over-stretched and under-resourced team that does not have reliable and up-to-date financial information represents an accident waiting to happen and few administrations in the Middle East region will have any experience in steering a business through a downturn.



(Source: Deloitte)

But for a company heading into turbulent financial waters, early action is critical and can make the difference between revival and insolvency.

We Detect the Signs, Now What?

There are various strategies that companies can adopt in answer to distressing signals.

There must be an unswerving focus on cash management and cash preservation; cash is definitely "king" in these situations.

A thorough and structured review of working capital will usually highlight a number of areas for improvement, whilst attention should also be paid to ensuring the accuracy and reliability of forecasts, particularly 13-week rolling cash flow forecasts.
Every effort should be made to improve operational performance through revenue enhancement, cost reduction initiatives, and a review of capital expenditure. All options should be considered, including the sale of businesses or the closure of unviable ones; there should be no "sacred cows".

Management should also recognize that there are likely to be gaps and shortcomings in their own team, and that they will probably need to draft in people and advisers with experience in operating in distress and in turnarounds.

A company's overriding objective must be to implement internal changes, develop a credible and robust business

plan and demonstrate that the situation is under control. Prompt and regular communication with lenders is paramount: banks hate surprises, so they need to be told the nature and causes of the problems and be given a working plan of how the company intends to deal with these. This should win the banks' confidence and help management keep control.

An early dialogue with lenders will enable a greater range of re-financing options to be considered, which might include the capitalization of unpaid interest, rescheduling repayments, debt write-offs, debt-for-equity swaps, the resetting of covenants or new sources of funding. In contrast, leaving things to the last minute before lending covenants are breached may leave the company in control, but this is likely to be temporary, since banks will be wary and will have the upper hand in negotiations. Banks in these circumstances may demand additional security and higher fees, may place restrictions on, or even reduce, funding lines and may appoint independent accountants to undertake a review. These actions are often the precursor to a restructuring which is forced on the company.

At the other end of the scale, a "head-in-the-sand" approach and a failure to act before a covenant breach is a sure sign of a management that is leading their company towards insolvency.

By **Chris Ward,** CEO, Deloitte Corporate Finance Limited

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