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South Africa restructuring outlook survey results 2017

Seeing through the fog

Contents

Foreword

For the fourth year in South Africa, the Deloitte Restructuring Services team interviewed a number of restructuring professionals across all disciplines in order to gain insight into their expectations for the restructuring landscape. This survey has allowed us to highlight the changes that have occurred in our restructuring industry and the wider economy over the last 12 months as well as setting out expectations for the next 12 months. We hope you agree that this is a valuable set of insights.

The increase in political uncertainty is leading to a more volatile economic environment in South Africa. As Albert Einstein once said, "In the midst of every crisis, lies opportunity." During these times, it is important to be able to see through the fog by applying agility and proactivity in order to be able to identify and manage the uncertainties surrounding businesses in South Africa.

We would like to thank all those who have taken the time to contribute their insight into this report. We hope you find the report interesting and we look forward to continuing our discussions with you about the future of our restructuring market.

Kind Regards
Nisha Dharamlall
Head of Restructuring Services
South Africa

Executive summary

What does 2017 hold for the Restructuring Industry?
Given the recent uptick in political uncertainty and subsequent downgrades of South Africa's long-term foreign currency sovereign debt rating by S&P Global Ratings and Fitch Ratings, South Africa now faces the possibility of a deteriorating economic environment over the medium term – the extent and magnitude of which are still to be seen across companies and organisations.

We surveyed a cross-section of restructuring specialists in South Africa to obtain a better understanding of where the industry is now and what their expectations are for the next 12 months. These respondents represented a selected mix of commercial banks (24%), development finance institutions (11%), lawyers (31%), business rescue practitioners (17%), and academia and other key professionals (17%).

Note: *In this report, the term restructuring refers to any process involving a financial and operational restructuring of a company's affairs, whether formal or not, which is in financial distress.*

The key themes that emerged from the survey are as follows:

- 57.1% of respondents expect **growth** in South Africa's economy, driven by an improving global economic environment
- sectors most at risk to be distressed in the next year are **retail**, **agriculture** and **construction**
- 58.1% of survey respondents expect an **increase in activity** in their restructuring teams in the next 12 months, following on from 45.5% over the last 12 months
- **protecting the business** is still ranked as the number one priority of a restructuring project, with the **preservation of employment** becoming increasingly prominent
- **early identification of financial distress** remains one of the main areas where restructuring professionals believe the local restructuring industry could be improved
- 38.8% of respondents report that the **injection of equity finance** (via a sale of the business, non-performing assets or the introduction of new equity) is the most frequently used form of restructuring, followed closely by **business rescue**
- **existing banks** are still the most likely sources of distressed funding for the majority of respondents (30%), but **existing shareholders** are listed as the second most likely option (20%)
- **a lack of available security** was cited as the greatest challenge to distressed companies raising debt finance, closely followed by a **lack of risk appetite** from lenders
- respondents mainly define 'success' in business rescue as the **business continuing on a solvent and liquid basis**, closely followed by a **better return for creditors**
- 81.9% of respondents have had a 50% or higher success rate in **informal restructurings** compared to 63.7% in **business rescue**, pointing to the importance of early identification and the inherent risk of value erosion in business rescue.

Given heightened **political uncertainty** and the impact that this is likely to have on South Africa's economy, 2017 looks set to be another busy year for the restructuring industry.

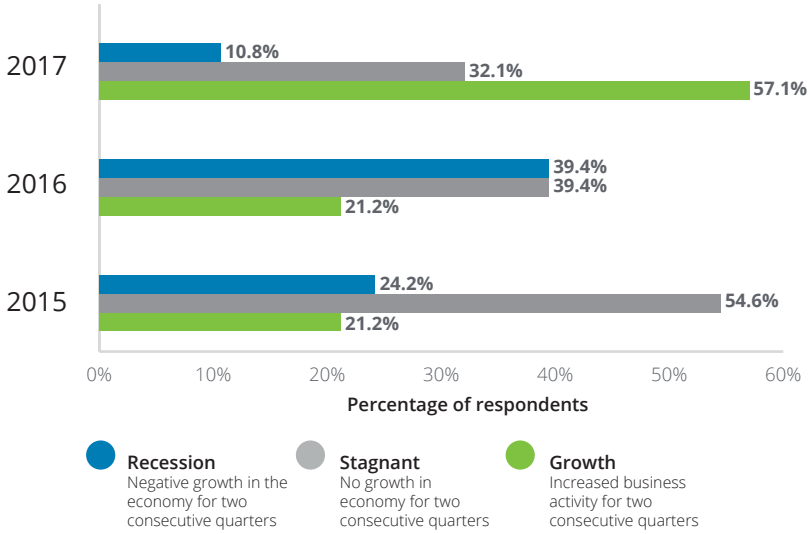
The state of the South African economy

Outlook for the South African economy

The majority (57.1%) of respondents of the latest Deloitte Restructuring Survey expect an improved economic environment in 2017, in line with the wider trend seen across developing economies. However, an important caveat is that this positive sentiment likely weakened slightly in the wake of South Africa's sovereign debt rating downgrades, which occurred shortly after the survey was conducted.

The 2017 outlook represents a significant improvement from 2016, where 39.4% of respondents expected a recessionary economy.

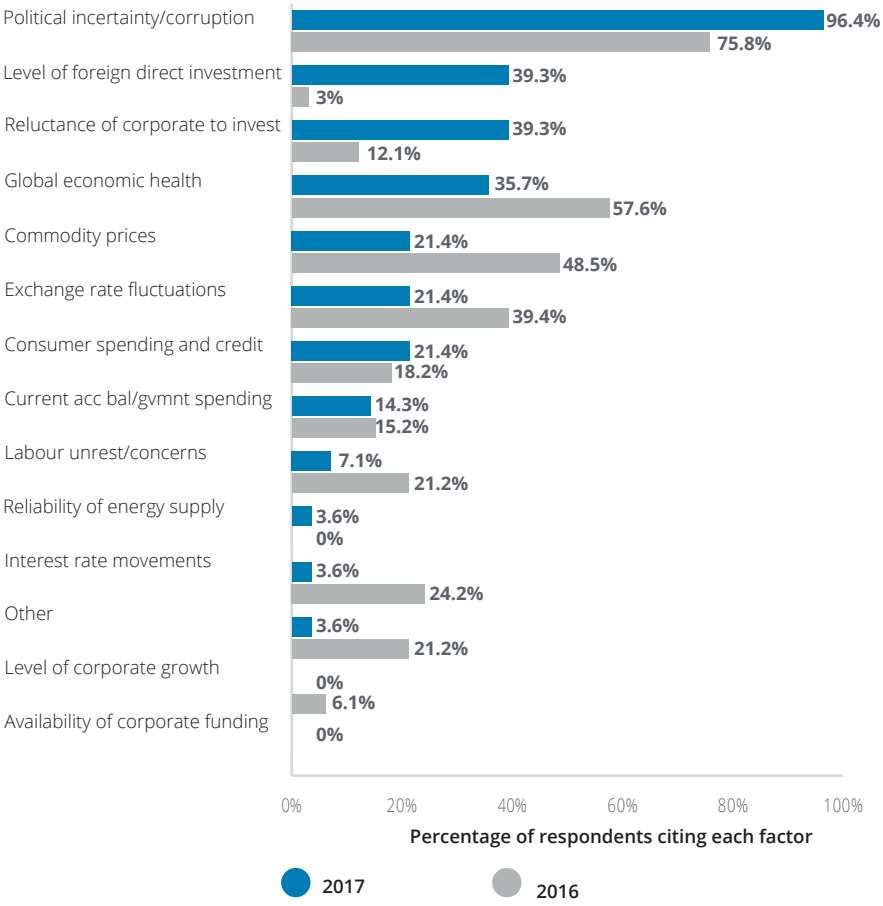
Figure 1: Outlook for the South African economy over the next 12 months



The South African economy expanded by a mere 0.3% in 2016, compared with 1.3% in 2015[1]. Economic growth in 2016, albeit marginal, was driven by the tertiary sector, particularly finance, real estate and business services. Growth in these sectors was offset by a contraction of 5.4% in the primary sector, where mining and agriculture struggled as a result of low international commodity prices and the El Niño drought, respectively.

In terms of the outlook for 2017, 57.1% of respondents believe that the South African economy will return to growth in the coming year, compared with 21.2% seen in both the previous two survey years. As the majority of the surveys were conducted in February and March, we expect that this sentiment will have deteriorated slightly following the sovereign credit rating downgrades by S&P and Fitch to sub-investment grade in early April. This downgrade is likely to bring (i) higher borrowing costs, increasing the risk of fiscal slippage; and (ii) inflationary pressures following the weakening of the rand. Prior to the cabinet reshuffle, the rand had strengthened to a 12-month high. The International Monetary Fund's (IMF) World Economic Outlook in April 2017 forecasts growth rates for South Africa of 0.8% and 1.6% for 2017 and 2018, respectively.

Figure 2: Reasons for concerns in the South African economy over the next 12 months



Note: The methodology for the 2016 data has been revised such that it is comparable to 2017.

The downgrades and associated economic uncertainty are the result of recent political developments, with S&P noting in its press release that the reasons for the unscheduled adjustment included *"heightened political and institutional uncertainties that have arisen from the recent changes in executive leadership"* and Fitch stating that *"recent political events, including a major cabinet reshuffle, will weaken standards of governance and public finances"*. The current levels of political uncertainty and corruption are cited as being a concern to the economic health of South Africa by 96.4% of respondents (2016: 75.8%).

The next two factors that were highlighted as causes for concern in the economy are the reluctance of corporates to invest (selected by 39.3% of respondents; 2016: 12.1%) and the level of foreign direct investment (FDI) (also chosen by 39.3% of respondents; 2016: 3.0%). Both of these factors are strong indicators of business sentiment, which has been adversely impacted by the recent deterioration of the political environment.

Another 35.7% (2016: 57.6%) of respondents note their concerns about the health of the global economy, which also impacts investor sentiment and the outlook for the South African economy.

Political uncertainty and corruption

Unfortunately, the political uncertainty, which was noted as a key area of concern in last year's survey, has increased over the last 12 months. This is reflected in the rise in respondents citing this as being a concern to the health of the economy, up from 75.8% to 96.4%. Factors such as the findings of the Public Protector's State of Capture Report, increasingly frequent motions of no confidence in the South African President being tabled in Parliament, this year's State of the Nation Address, policy uncertainty (including further cabinet reshuffles) and the ongoing corruption charges and legal allegations faced by the President, all lead to decreased foreign and local investor confidence.

> "Low growth is likely until the overall political noise is sorted out."
> - Development Finance Institution

Foreign direct investment

A key factor in respondents' concerns about South Africa's economy is the level of FDI (39.3%; 2016: 3.0%) – itself affected by political uncertainty. However, South Africa has returned to the *FDI Confidence Index* in 2017 for the first time since 2014 and remains the only African country that is included in the top 25 ranked countries.

After 2015 marked the lowest levels of FDI for 10 years, inflows rose by 38% to an estimated US$2.4 billion in 2016. Reasons for this include the country's growing automobile manufacturing industry, which attracted a US$417 million investment by BMW in 2016, and its developed financial and legal industries helping to position South Africa as a gateway to sub-Saharan Africa for international investors.

The impact of the sovereign credit rating downgrade is likely to have a negative impact on FDI, although the impact will be lagged as some investment decisions will already have been committed to.

Reluctance of corporates to invest

39.3% of respondents also raise concerns about the appetite of local corporates to invest (2016: 12.1%). Similar to FDI, local investment too is impacted by an uncertain political environment.

This sentiment is consistent with the RMB/Bureau for Economic Research *Business Confidence Index* which has shown that confidence has been below the neutral 50-point mark for more than two years; hitting a low point in the second quarter of 2016 at 32, before recovering to 40 in the first quarter of 2017. The high level of cash held on the balance sheets of the top companies listed on the JSE supports this view.

Global economic health

The IMF's World Economic Outlook update in April 2017 painted a positive picture for world growth, stating *"With buoyant financial markets and a long-awaited cyclical recovery in manufacturing and trade, world growth is projected to rise from 3.1 percent in 2016 to 3.5 percent in 2017 and 3.6 percent in 2018."*

Respondents echo this increased confidence in the global economy, with a fall in respondents citing it as a reason for concern, from 57.6% in 2016 to 35.7% in 2017.

Commodity prices

The prices of South Africa's most widely exported commodities have been persistently weak over the last 12 months.

The platinum price remains low as a result of demand being adversely affected by the following factors: policy plans to phase out diesel vehicles in European cities; alternate catalyst technologies; and a switch to non-combustion engines. Furthermore, the market remains well supplied and the latest round of wage agreements should avoid any labour disruption. Platinum prices are expected to rise by just 1% in 2017 as a result of stronger industrial demand[2].

The price of gold has continued to be volatile, with the US Federal Reserve's decision to increase interest rates reducing demand, while geopolitical uncertainty in Syria and North Korea has increased demand as investors seek a safe haven. Increasingly low extraction costs continue to increase the supply of gold. Gold prices are expected to decline by 2% in 2017 given the expectation of further US interest rate increases later this year[2].

Agricultural commodity prices have stabilised after the fall from the late-2012 peak. The World Bank forecasts a 1% rise in its *Food Commodity Price Index* for 2017.

Given a mixed bag of developments, overall, commodity prices are widely expected to recover[2], and respondents view commodity prices as a lesser cause for concern in 2017 (21.4%) compared with 2016 (48.5%).

Exchange rate fluctuations

The rand continues to be volatile, as seen by its sharp decline after the political upheaval on 30 March 2017. Despite the political uncertainty, the rand has strengthened markedly over the last 12 months, improving from R15.9/$1 in May 2016 to a peak of R12.4/$1 immediately before the announcements of the national executive changes.

Even after this event shocked the markets, the rand recovered quickly as wider factors continue to prove favourable. These factors include: (i) the narrowing of South Africa's current account deficit due to slowing imports, following a decline in domestic demand, and improving exports, as commodity prices recover; (ii) the more positive growth outlook in developing economies, including South Africa; and (iii) US dollar weakness.

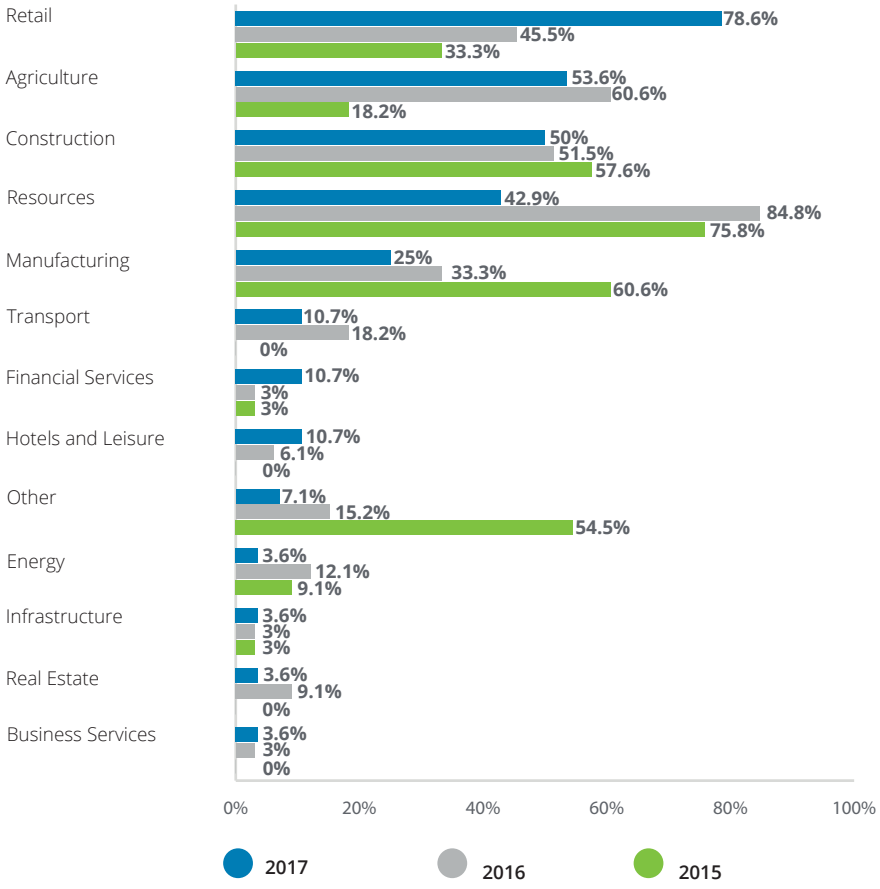
The strengthening of the rand over the last 12 months has led to a reduction in concerns around its volatility by respondents from 39.4% in 2016 to 21.4% in 2017.

Sectors most at risk of becoming distressed

Potentially distressed sectors in the next year include retail, agriculture and construction.

Respondents believe that the retail sector is the most at risk of distress in the next 12 months, followed by the agriculture and construction sectors. This marks a change from previous years when the resources sector was cited as being the most at risk.

Figure 3: Sectors most at risk of being distressed in the next 12 months



Note: The methodology for the 2016 data has been revised such that it is comparable to 2017.

The increased focus on the retail sector, with 78.6% of respondents selecting it (2016: 45.5%), follows the highly publicised restructuring of Edcon in 2016 and the ongoing business rescue of Stuttafords. Low growth, high (imported) inflation caused by the weak rand in 2016, increases in the repurchase rate since 2014 and higher income taxes have reduced the spending power of South African consumers. This, coupled with increased competition from overseas retailers, has made for challenging conditions in this sector.

Agriculture is forecast to be the next most-at-risk sector, having been chosen by 53.6% (2016: 60.6%) of respondents, even after the El Niño drought came to an end in the summer rainfall region. While the rains in this region might have helped growing conditions, the appearance of 'zombie companies' as conditions improve remains a risk. In the winter rainfall region, the water restrictions imposed on the agricultural sector have also adversely impacted output. Some forecasters predict a return of adverse weather patterns in the 2017/18 season, which would cause serious concerns again for this sector.

The construction sector remains one of the sectors most at risk of financial distress in the next year (selected by 50.0% of respondents; 2016: 51.5%), retaining its top-three position for the fourth year running. This can be attributed to the lack of government spending on infrastructure, which consistently falls below the 30% of GDP target as outlined in the National Development Plan. Ongoing tight margins and liquidity challenges for operators in this sector are also contributors to the weak outlook for the construction sector.

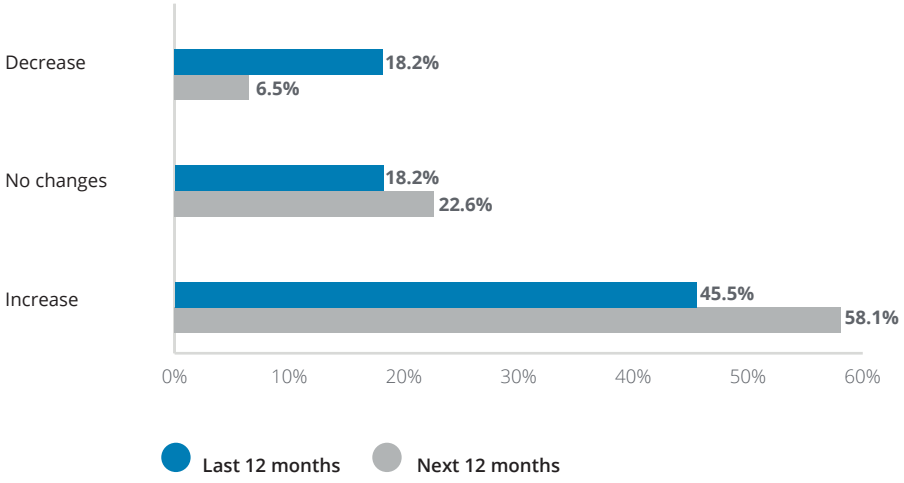
Resources remains a concern for 42.9% of respondents (2016: 84.8%). This is as a result of market prices remaining relatively low compared to the commodity price boom of 2000-2014. The lack of competitiveness in sectors such as the steel sector globally is also a concern in this area.

The restructuring process

Impact of the state of the economy on the restructuring Industry

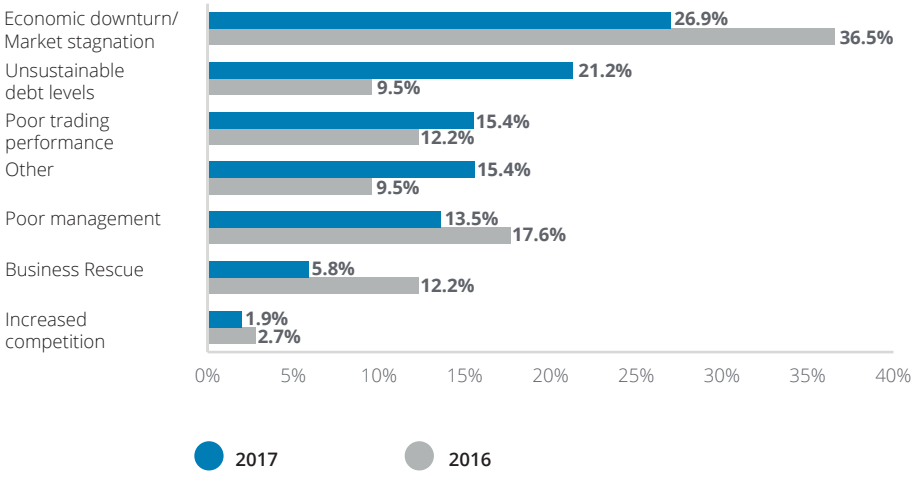
58.1% of restructuring professionals expect an increase in activity in the next 12 months, following on from 45.5% expecting an increase in the last 12 months.

Figure 4: Level of restructuring activity



Given the continuing uncertainty in the economy, 58.1% of restructuring professionals expect an increase in activity in their teams over the next 12 months. This is a continuation of the upward trend reported annually since this survey started in 2014.

Figure 5: Triggers of increased restructuring activity



As in 2016, **economic downturn/market stagnation** is again cited as the primary cause of the increased number of workout and restructuring cases. However, it takes less prominence this year, with some of the focus shifting to **unsustainable debt levels** as the second most given reason. Unsustainable debt levels can arise because of a variety of reasons including an unexpected change in market conditions, a loss of a major contract, a poor lending decision or an increase in interest rates.

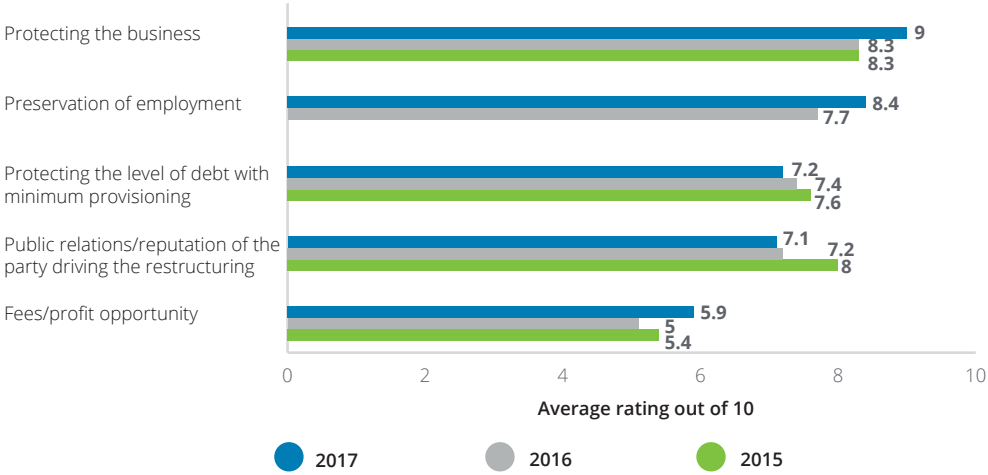
Poor trading performance is also noted as a key trigger of increased restructuring activity, which is often a result of the wider economic challenges but it can also be a factor of poor management. **Poor management** is often given as a reason for business distress or failure.

Objectives at the outset of the restructuring process

Protecting the business is still ranked as the number one priority of a restructuring process.

Respondents indicate that, yet again, **protecting the business** is the most important objective when embarking on a restructuring project. This is often seen as key to achieving some of the other identified objectives, such as the second identified priority of a restructuring – the **preservation of employment.**

Figure 6: Importance of objectives at outset of a restructuring project



The next most important objectives are **protecting the level of debt with minimum provisioning**, often the primary objective of a commercial bank, and **public relations/reputation** of the firm/company involved in the restructuring.

Expected restructuring options

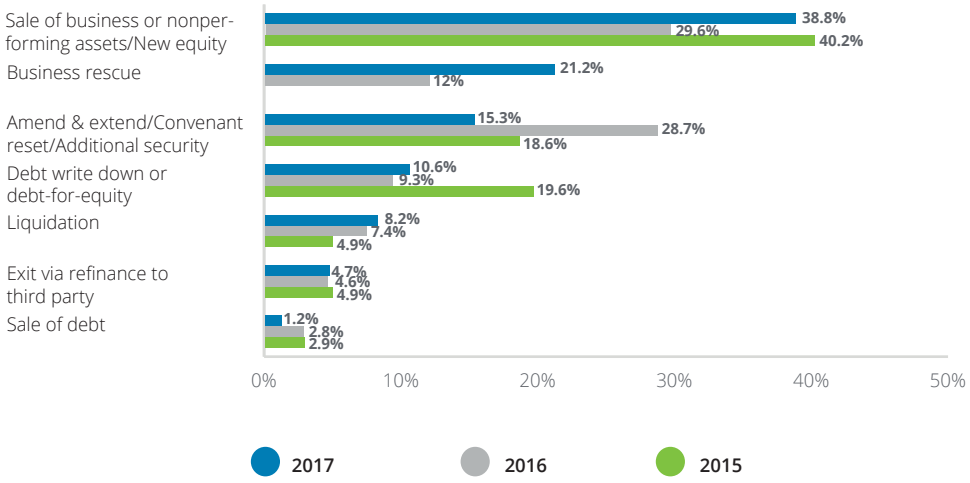
Solvent restructurings are expected to be the most common route to rescuing a company in distress over the next 12 months, with the injection of new equity via the sale of the business, a new equity raise or the sale of nonperforming assets being the preferred route.

Finding a solution for a company in distress that avoids a formal process such as business rescue or liquidation is often the best way to preserve employment and value for creditors. Respondents expect the most prominent restructuring tool over the next 12 months to be the introduction of new equity (38.8%; 2016: 29.6%), either via the sale of the business, sale of non-performing assets, or the introduction of a new equity partner.

Business rescue is expected to be the next most used mechanism (21.2%; 2016: 12.0%). In certain circumstances, this can be a useful way of assisting with the implementation of a transaction involving new equity and provides an opportunity to achieve a better result than liquidation.

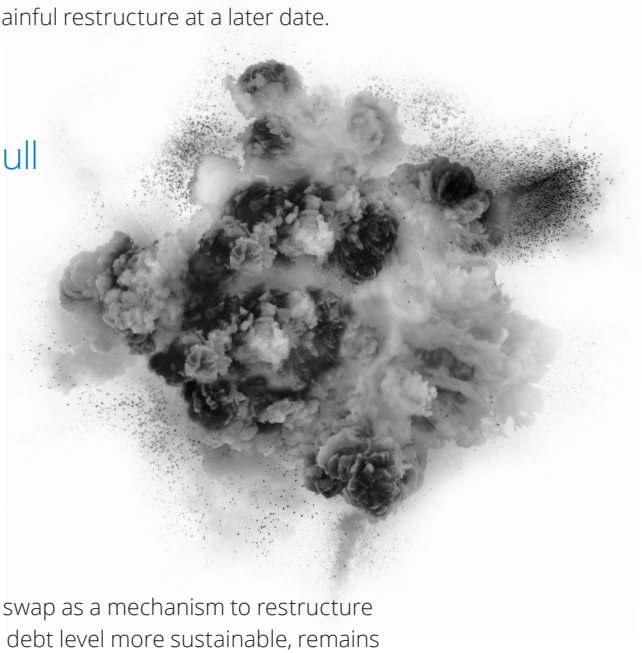
> "Business rescue has contributed to improving the restructuring culture."
> -Commercial Bank

Figure 7: Restructuring options expected to be employed in the next 12 months



Softer solvent restructuring options, such as the amendment and extension of existing facilities, a covenant reset, or the provision of additional security are the next most likely used means of restructuring (28.7%; 2016: 15.3%). This can provide breathing space for a distressed business to implement a turnaround plan, although it should be used carefully by lenders to avoid "kicking the can down the road" and leading to a more painful restructure at a later date.

"Banks are reluctant to pull the trigger, which might be creating a bubble as problems are deferred."
– Lawyer

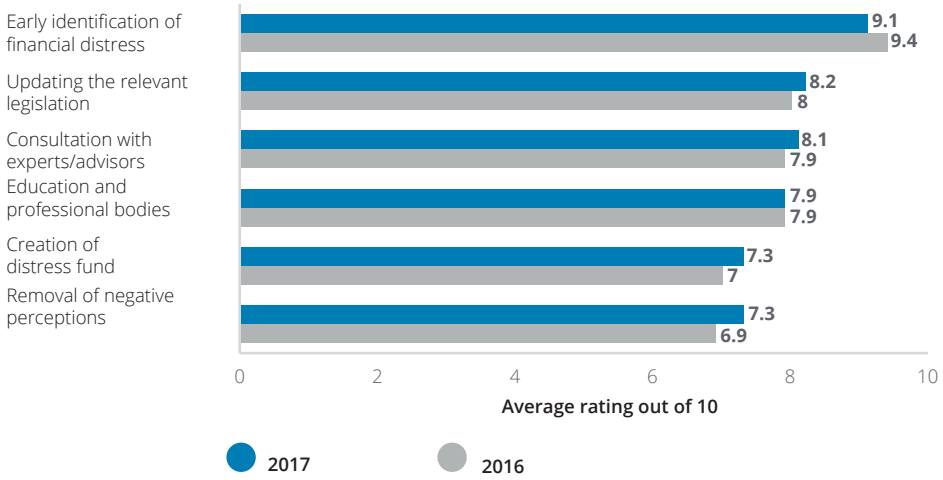


A debt write-down or a debt-for-equity swap as a mechanism to restructure a company's balance sheet to make its debt level more sustainable, remains a less commonly used option to improve the health of a distressed company (10.6%; 2016: 9.3%). This is typically only considered by lenders in situations where the shareholders have also taken some pain as part of the restructuring.

The local restructuring industry

Early identification of financial distress remains the most important area for improvement according to restructuring professionals.

Figure 8: Areas to improve in terms of local restructuring industry



Early identification of financial distress remains the area in most need of improvement in the local restructuring industry. One way to address this would be to make private company accounts available to the public through the Companies and Intellectual Properties Commission, similar to the practices in Australia and the United Kingdom. This would enable stakeholders to understand the financial position of a company and it would place more pressure on companies to file on time.

Identifying distress early provides restructuring professionals (including lenders, lawyers and financial advisors) with the opportunity to identify a wider range of options to improve the distressed entity's financial situation. Often, management ignore the warning signs or are reluctant to seek help for fear of losing control of the business or incurring costs.

"The ability to bring companies back to life will be greatly assisted if the denial and hope of our boards of directors is replaced by realism at a far earlier stage."

– Business Rescue Practitioner

The updating of the relevant legislation (with specific reference to Chapter 6 of the Companies Act) to close areas of uncertainty remains important. As this legislation is still relatively new, there is insufficient case law available to bridge the gaps that have been identified. Furthermore, stakeholders are not willing to take risks in areas where these gaps exist for fear of incurring legal fees. This often results in restructuring professionals having to work around these gaps in legislation where possible, which can result in a suboptimal solution. Areas highlighted for review include the regulation over the appointment and removal of business rescue practitioners (BRPs), and greater clarity around the voting rights of creditors.

Consultation with advisers is also identified as an important area for improvement. Related to early identification, with the right advice a formal process can often be averted to deliver a better outcome for all stakeholders.

Improving the education of all stakeholders and the influence of professional bodies in the industry is also deemed to be noteworthy. Common areas identified for improvement include: (i) educating directors about their responsibilities; (ii) having a qualification for BRPs to ensure that each individual has a satisfactory base knowledge; and (iii) giving responsibility to a regulator or professional body with an ability to enforce a set of agreed principles to ensure that the BRPs act professionally.

> "There is a need for a regulator that is proactive."
> – Business Rescue Practitioner

Some respondents stated that the International Association of Restructuring, Insolvency & Bankruptcy Professionals (INSOL) principles are often overlooked in the South African restructuring industry. These principles are designed to assist stakeholders to work together so that they achieve a better outcome for all parties, rather than each party looking after its own interests, which often results in a less successful outcome.

Enthusiasm for the creation of a distressed fund has waned due to the lack of progress made in this area and respondents deciding that alternative solutions, while not always optimal, are satisfactory.

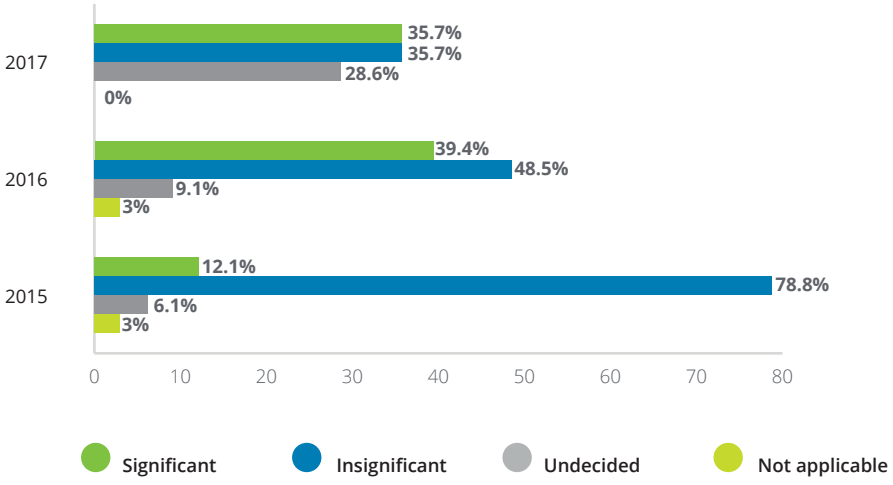
Increasing importance is being placed on removing negative perceptions. Professional bodies might be well-placed to assist in this area through public relations work for their members, as suggested by one respondent.

Distressed funding

State of distressed funding in South Africa

28.6% of respondents are undecided about the level of distressed funding to be advanced in the next year, representing a large increase from the 9.1% stated in 2016.

Figure 9: Expectation of the extent of distressed funding to be provided over the next 12 months



Although the majority of respondents in 2016 (48.5%) indicated that they believe that the level of distressed funding that will be provided in the next 12 months will be insignificant, there has been a shift towards respondents being undecided. Distressed funding (or the lack thereof) remains one of the key challenges in restructurings, and this year a greater proportion of respondents (28.6%) are undecided on their expectations of the extent of distressed funding to be provided over the next 12 months. This is a significant increase from the 9.1% recorded in the 2016 survey, which is a concerning indicator that distressed funding still remains a major challenge in the restructuring industry. Some of the respondents reaffirmed the view that it is easier for larger companies to obtain distressed funding.

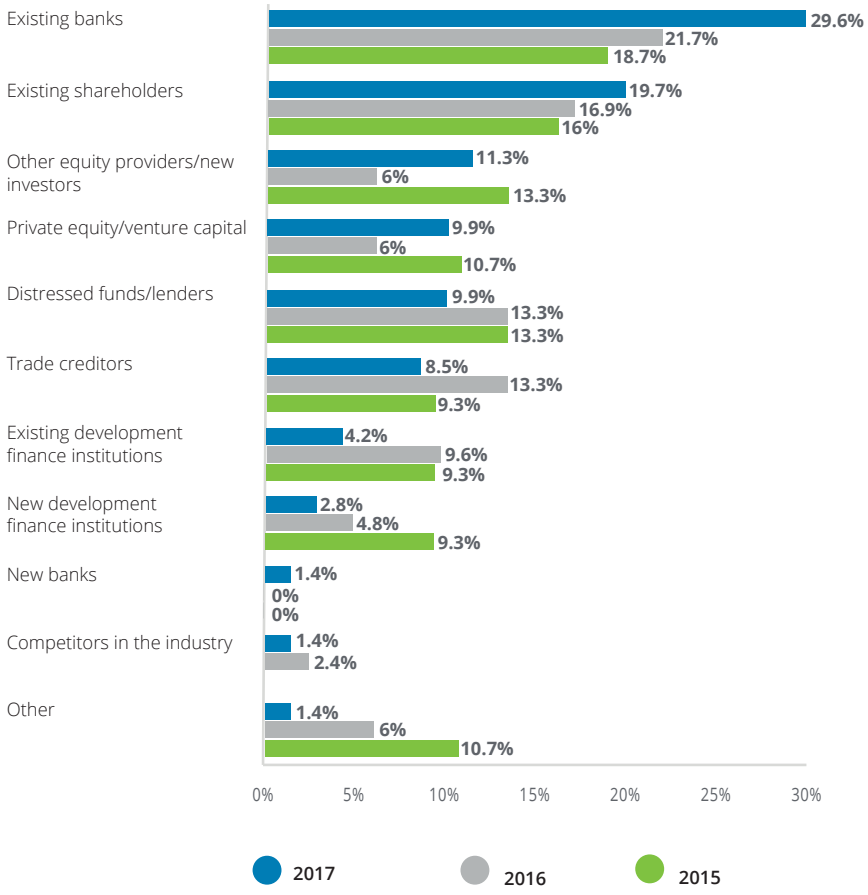
> "Typically companies are already overindebted; can't do much more."
> – Commercial Bank

Interestingly, 32.1% of the respondents (2016: 18.2%; 2015: 9.1%) indicate that there has been an increase in the observed change in the number of distressed funds in South Africa. While the trend is positive, the majority of respondents note that they have seen a few distressed funds being created, even though these were fairly small in terms of fund size. Many respondents mention that they have heard of individuals or firms speak of starting funds, but very few (if any) have materialised as yet.

Best sources of distressed funding

Existing bankers of companies in distress are still regarded as the best source of distressed financing.

Figure 10: Best sources of distressed debt funding in a distressed market



The majority of respondents still view **existing banks** as the best source of distressed debt funding in a distressed market (2017: 30.0%; 2016: 21.7%), followed by **existing shareholders** (2017: 20.0%; 2016: 16.9%); **other equity providers and new investors** (2017: 11.4%; 2016: 6.0%); **distressed funds/lenders** (2017: 10.0%; 2016: 13.3%) and **trade creditors** (2017: 8.6%; 2016: 13.3%).

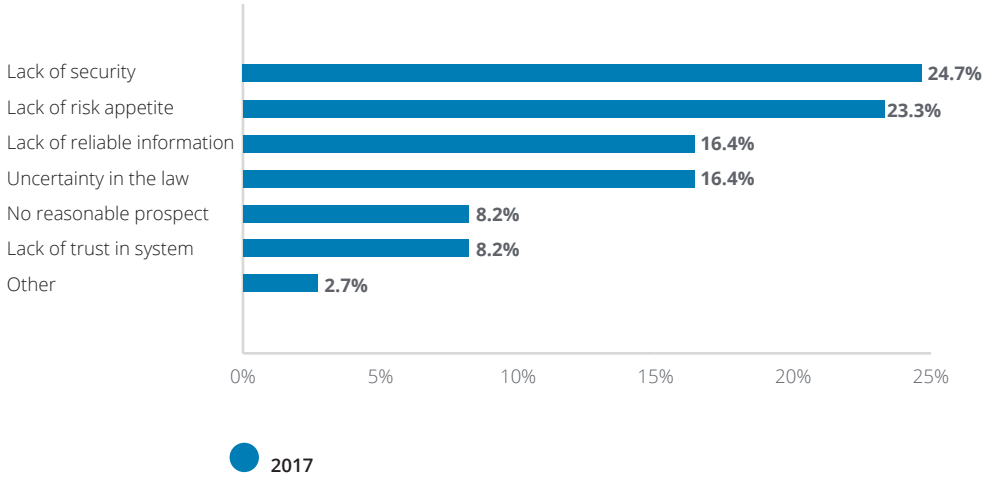
There has been a notable decline in respondents placing their hopes on **distressed funds/lenders**. As mentioned, this is mainly as a result of only a few small distressed funds entering the market.

The nature of distressed funding is mostly through the extension of existing facilities, asset-based lending or new equity.

Major obstacles currently faced by lenders into distressed companies

The main challenges that lenders into distressed companies face in order to stimulate and develop this market, include a lack of security and a lack of risk appetite.

Figure 11: Major obstacles currently faced by lenders to distressed companies



The **lack of security** is ranked by 24.7% of respondents as the main obstacle faced by lenders into distressed companies. Respondents note that while funding is available for deserving companies, those in financial distress are often already over-indebted and lack unencumbered assets.

As a close second obstacle is the **lack of risk appetite** faced by lenders into distressed companies (23.3% of respondents). Any funding advanced to a company in distress carries a higher risk and therefore requires a higher return. Traditional players such as private equity (PE) firms do not appear to be interested in this space. Reasons for this could include the low success rate of business rescue, as well as the fact that the current market does not have the required depth and maturity to comfort potential funders.

The **lack of reliable information** and **uncertainty in the law** are listed jointly as the third major factor. Not enough work is done to determine the exact funding gap of a distressed company, which provides an obstacle according to a number of respondents. This has been further hampered by directors who have not been completely honest and transparent in their disclosures to stakeholders, bringing into question the integrity and trustworthiness of all of the information provided.

Respondents state that the most contentious areas relating to the uncertainty in the law is still the general understanding of the ranking/waterfall of payments. A number of judgements have presided over this matter, with contradicting conclusions and many disagreements raised over these judgements. This has given rise to concerns for potential funders around the certainty of their risk and return. It is evident that the Act did not contemplate all scenarios.

"A general lack of understanding of the distressed market coupled with a relatively small market presents a challenge to lenders into distressed companies."
– Business Rescue Practitioner

Potential of prepacks

Generally, respondents are very positive and supportive towards the use of pre-packs, a restructuring procedure in which a company arranges to sell all or some of its assets to a buyer before appointing a business rescue practitioner to facilitate the sale. This approach has high potential if carried out with complete transparency, however the shortfalls in the legislation to support these procedures is the main reason this has not been used more to date. More needs to be done to inform and educate stakeholders of this option, potentially through the updating of legislation.

> "If done in the right manner and creditors see it as transparent...it can work."
> – Commercial Bank

Business rescue in South Africa

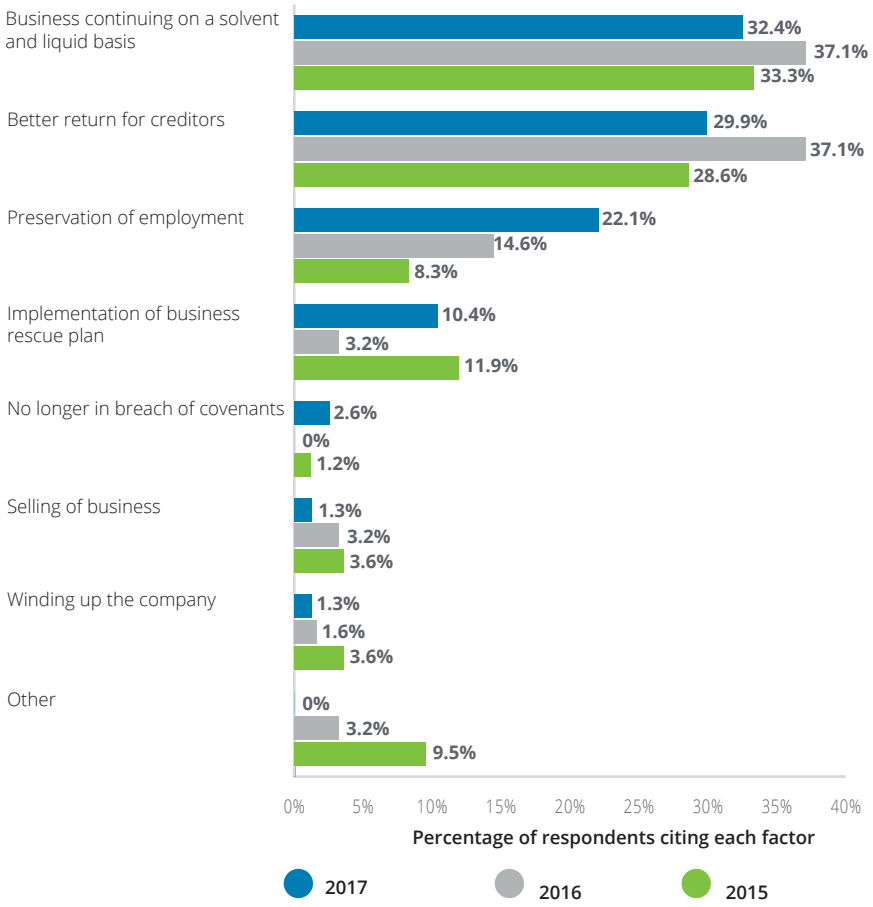
As an alternative to liquidation, business rescue in South Africa is becoming a more structured option for companies in financial distress. There is also a general global move towards business rescue regimes that ensure the preservation of employment. South African legislation makes the provision that companies need to be rescued in a way that balances the interest of all stakeholders.

Measure of success of business rescue

Most respondents define success in business rescue as the **business continuing on a solvent basis**. It is, however, interesting to note that the importance of preserving employment has been growing steadily since the inception of business rescue. This is not surprising as **preserving employment** is cited as the second most important objective by respondents when starting with a restructuring project. This could be attributed to the increased focus on the country's socioeconomic challenges – including the triple dilemma of a high level of unemployment, a high poverty rate and inequality.

When a business continues on a solvent and liquid basis, the viability of the business appears more promising and, more likely than not, the business will carry on as a going concern in the foreseeable future. When this takes place, creditors will be repaid, stakeholders should be more at ease and employees' jobs will largely be secured.

Figure 12: How would you define "success" in terms of a business rescue?

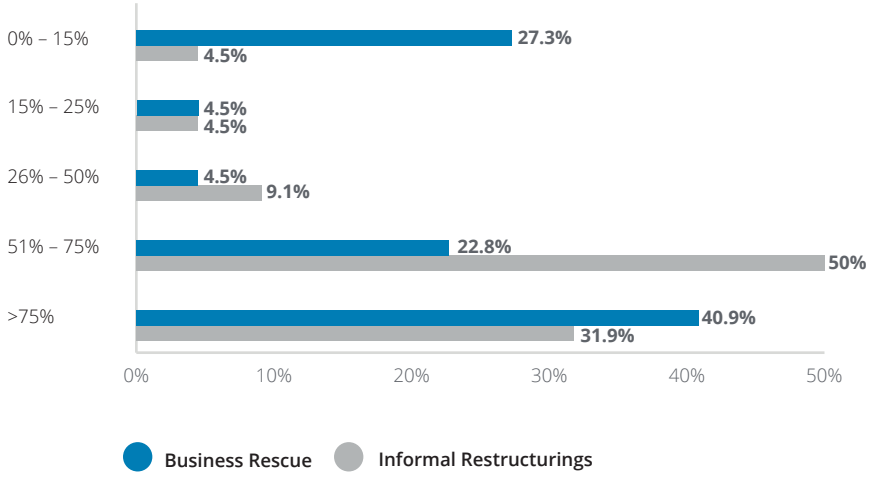


Success rate of business rescue and informal restructuring

An interesting finding is that 27.3% (2016: 37.9%) of respondents have experienced a success rate of less than 15% in business rescue cases, compared to 4.5% (2016: 3.8%) for informal restructurings. 81.9% (2016: 84.6%) of respondents had experienced success in more than 50% of the informal restructurings that they have been involved in, compared to 63.7% (2016: 58.6%) of business rescue cases.

The results highlight both the importance of identifying distress early and the risks of value erosion that business rescue can bring if not managed carefully, such as the discontinuation of supplies into a business or higher employee attrition rates.

Figure 13: Success rate of cases dealt with in the last 12 months



Note: Results for this figure exclude respondents with no business rescue or informal restructuring experience, by removing respondents that replied with "not applicable".

Regarding pre-assessments, respondents describe a number of factors, with the following key aspects stressed as critical to ensure an increase in the success rate of business rescue or restructuring opportunities:

- **Is there a business:** Does the company have a product, market, good margins? Is the business viable?
- **Identifying the cause of distress:** Identifying the fundamental reasons (i.e. root causes) for the distress. Can these be addressed?
- **Liquidity and cash flow position of the company:** What is the financial state of the company with specific focus on the liquidity and the availability of cash in the business?
- **Availability of post commencement finance (PCF):** Is PCF available to support the business during a business rescue?
- **Management capability:** The need to assess the quality of management and whether the necessary controls and governance structures are in place. This would include an assessment on whether management has the required skills, integrity and willingness to support the distressed company.
- **Other factors including:**
  - confidence among stakeholders in the business rescue practitioner
  - ability of the BRP in selling a required concept to the affected parties
  - determining if financial information is reliable and credible
  - valuation of the business (going concern versus liquidation)
  - the ability of the practitioner, including their skill in communicating with all of the stakeholders effectively
  - the quality of the information at the BRP's disposal.

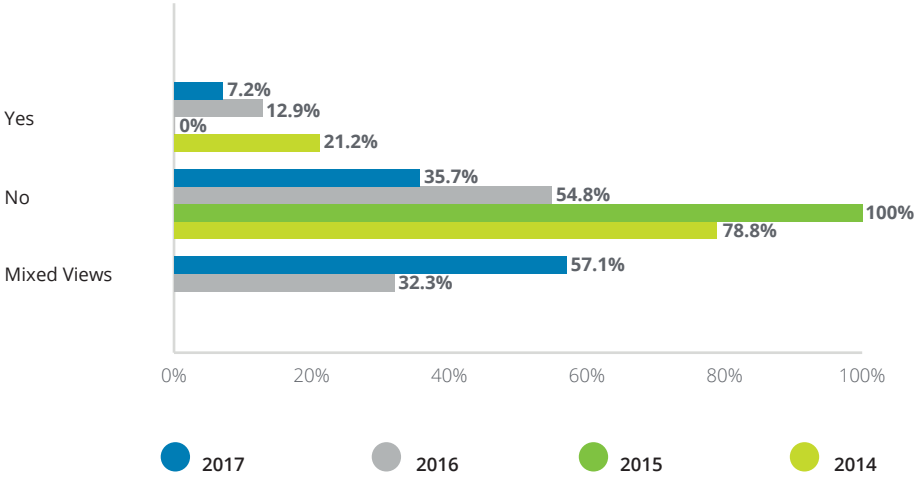
Figure 14: Key factors for dealing with pre-assessments

Business rescue practitioners (BRPs)

35.7% of the respondents believe that BRPs are not adequately skilled or qualified – a reduction from 54.8% recorded in 2016.

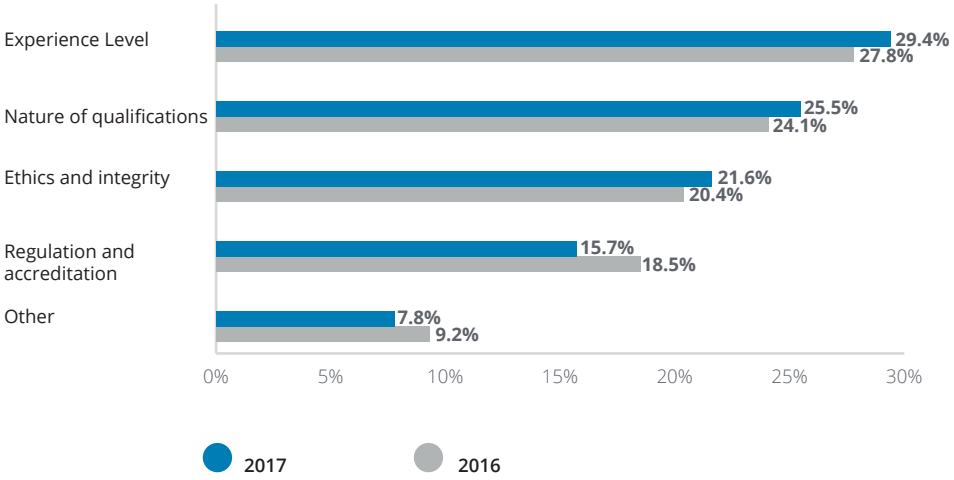
57.1% (2016: 32.3%) of respondents have **mixed views** when asked whether they felt that the current body of BRPs are adequately skilled or qualified to perform their duties. Only 7.2% of respondents regard the 321 practitioners registered with the Companies and Intellectual Properties Commission as at 13 December 2016 as having a **high level of competence**. There has, however, been a move by respondents towards selecting **mixed views** rather than having a **lack of confidence in BRPs**. The latter is down from 54.8% to 35.7% year-on-year.

Figure 15: Belief that the current body of Business Rescue Practitioners are adequately skilled and qualified to perform their duties



Respondents reason that BRPs are not adequately skilled and qualified given a **lack of experience** and the **nature of their qualifications**. These two contributing factors also ranked top two in 2016.

Figure 16: Reasons for lack of confidence in BRPs



Experience level

The lack of practical and relevant experience in turning around a business is raised as the biggest concern among respondents. Respondents note that they have worked with very few BRPs who have sufficient knowledge and experience. Contributing factors are complex transactions, numerous cases being taken on at the same time, and not focusing on the key issues at hand. A number of respondents indicate that too many BRPs have a strong legal background with insufficient business acumen to support the process.

Nature of qualifications

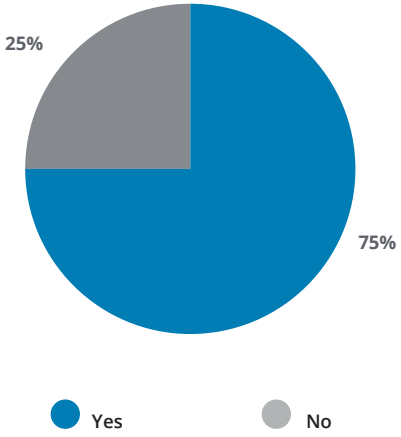
There are varying views in terms of the type of qualifications and education a BRP should have. However, there is clearly a need for a more regulated industry with prospective BRPs successfully completing an accredited business rescue course/certification as a minimum criterion. A number of candidates within the business rescue industry are already gaining experience working alongside experienced business rescue practitioners that will stand the industry in good stead in the future.

Effectiveness of business rescue

When asked whether they believe that business rescue is effective, and what the factors are that drove this, aside from the many areas of concern raised, 75% of respondents still feel that business rescue is effective.

This represents a marked increase of 10.5 percentage points from 2016. Many respondents state that they believe there is a place for business rescue, but it is often not used appropriately. Business rescue is seen as a much better intervention than liquidation, as it will often provide a better return for creditors. Furthermore, the process is more efficient, preservation of employment is more likely and there is generally more value for all stakeholders. Respondents believe that it provides a second chance in the right situations.

Figure 17: Do you think business rescue is currently effective?



Respondents' reasons in support of the improved effectiveness of business rescue include:

- improved legal advice prior to commencing with the business rescue process
- companies entering business rescue earlier, providing a better opportunity for the business to be saved
- an increase in the number of assignments that commenced the process for the right reasons and where there was a clear understanding of the shift in the roles of the board of directors and the BRP.

Although seen as becoming more effective, respondents note a number of factors that are still creating obstacles. These include ambiguity in the Act, and when the moratorium that business rescue provides is abused by directors.

> "If a business rescue can produce a better result for stakeholders than liquidation, then it has been a success"
> – Academic

Business rescue is now entering its sixth year since the implementation of the Act in May 2011. The industry is starting to reach new levels of sophistication and is gradually becoming more robust and effective. Respondents were asked to take stock of business rescue six years down the line and share what they believe the top opportunities and challenges in the industry are. The key themes are summarised below.

> "Business rescue can facilitate deals to save businesses."
> – Development Finance Institution

Opportunities

- using experience to date to improve the legislation and effectively regulate the business rescue profession
- protection of jobs and a better outcome for creditors
- opportunity to save a business that wouldn't otherwise be possible
- the use of pre-packs within business rescue
- growth of a broader skilled group of BRPs
- chance for investors to acquire businesses at a discount
- sharing more success stories

Challenges

- inappropriate use of business rescue due to the lack of proper pre-assessments
- lack of adequately skilled BRPs and an industry-wide accreditation
- lack of appetite for investing in distressed companies
- negative perception created through the low success rate
- lack of a dedicated business rescue court

> "Taking responsibility for the narrative of the successful restructurings is a joint responsibility of those in the industry."
> – Commercial Bank

"Companies are put into business rescue when there is no reasonable prospect. There should be a formalised pre-assessment requirement."
– Commercial Bank

Business rescue is a growing industry. Respondents have seen an increase in both the number of cases and success thereof. Evidently, this will create increased awareness of the tool for stakeholders and lenders and allow them to utilise it appropriately.

Respondents also clearly note that in order for the industry to grow further, the flaws in the Act need to be corrected, and a regulatory body appointed.

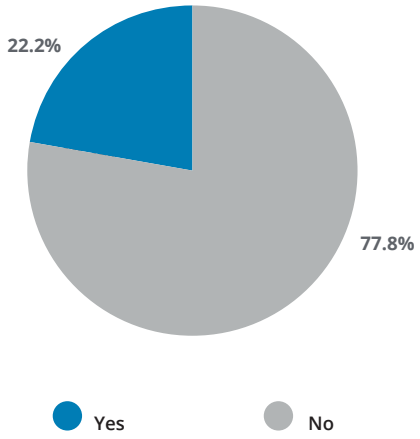
"Directors not filing for business rescue early enough is a problem that is not helped by account filings being kept private."
– Business Rescue Practitioner

What does the future hold?

Once again, it has been an interesting and exciting past year for the restructuring industry. However, change in the form of legislative amendments, progression and development of processes, as well as learnings relating to past successes and failures – have been slower than many expected.

As this survey results report reflects, we still have a long way to go to improve as an industry, considering that 77.8% of respondents believe we do not have a rescue culture. On the larger syndicated restructurings, rescues appear to be orderly and effective. However, on the smaller restructurings, the environment is still very much creditor-driven and liquidation-friendly according to respondents. It is evident that informal restructurings have become increasingly more popular and successful over the past 12 months, in comparison to business rescue.

Figure 18: Do you believe we have a rescue culture in SA?



"The industry is continuing to evolve and the progress can be seen in the success of some of the larger restructurings completed recently."
– Commercial Bank

With the recent uptick in political uncertainty and the consequential downgrade of the South African sovereign credit rating, both adding to the already uncertain economic environment, an increase in volatility can be expected across the South African economy. While the potential of increased volatility can be daunting for companies and organisations alike, it most notably calls for a renewed focus, agility and proactivity by all stakeholders in order to be able to identify, address and manage the uncertainties surrounding businesses in South Africa. The ability to identify distress early by management and boards of directors, accompanied with the imperative need for restructuring practices, both informal and formal, to develop and become more dynamic, is more critical now than ever before.

While South Africans may be in for a turbulent flight ahead, this turbulence will more than likely act as a catalyst for change in the restructuring industry, and as restructuring professionals, it will undoubtedly be an exciting time for us all.

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Endnotes

[1] Statistics South Africa Economic Growth Update April 2017: www.statssa.gov.za/?cat=30

[2] World Bank Commodities Prices Outlook April 2017: http://pubdocs.worldbank.org/en/174381493046968144/CMO-April-2017-Full-Report.pdf

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