South African Restructuring Outlook Survey Results 2016
“Calm seas don’t make skillful sailors”
- African Proverb
Foreword

The listless economy continues to impact the pace and volume of restructuring in South Africa in an upward direction. Consequently, those of us in the restructuring arena continue to debate and predict when and how the economy will return to health and when we can expect to see substantial growth and renewed investment. At the centre of these discussions has been the restructuring industry which has faced and continues to face the challenge of supporting businesses through these uncertain and unstable times.

Building on the success of the survey over the past 2 years, the Deloitte Restructuring Services team interviewed more than 30 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 similarities and differences across different institutions and industries with regard to restructuring expectations, behaviours and insights. As a result, we hope you agree that this is a valuable set of insights about current thinking and trends in the restructuring environment.

We would like to thank all those who have contributed time and insight into this report. We hope you find this report interesting and look forward to further debates about the future of our restructuring market.

Kind Regards
Nisha Dharamlall and Daniel Terblanche
Executive Summary

What does 2016 hold for the Restructuring Industry?
Political uncertainty, high unemployment rates, slow economic growth and severe drought have left many South Africans under strain. South Africa has experienced a “perfect storm” of economic and political events which have placed significant pressure on the economy.

In order to explore the implications for the restructuring market in 2016, we surveyed a cross-section of key restructuring professionals in South Africa to obtain a better understanding of where the industry is now and what their expectations are for 2016. These respondents were a selected mix of Commercial Banks (40%), Development Finance Institutions (21%), Lawyers (16%), Business Rescue Practitioners (10%) and academia & other key professionals (13%).

Note: When referring to the term “restructuring”, it refers to any process involving a financial and operational restructuring of a company’s affairs which is in financial distress, whether formal or not.

The key themes that emerged from the survey are as follows:
- 39.4% of the respondents expect a recessionary economy driven by political uncertainty and corruption, poor global economic health and depressed commodity prices
- Sectors most at risk to be distressed in the next year are resources, agriculture and construction
- 80.6% of restructuring teams expect an increase in activity in the next 12 months
- Protecting the business still ranked as the #1 priority of a restructuring project
- Early identification of financial distress remains one of the main areas where restructuring professionals believe the local restructuring industry could be improved
- 15.7% of respondents report that “amend & extend the debt” is the most frequently used form of restructuring. This is followed closely by “Exit via sale of business” and “Business Rescue”
- Disappointingly, only 1.9% of respondents highlighted the use of distressed funding as a feasible restructuring option, highlighting the continued infancy of the development of this critical industry
- Existing banks are still the preferred source of distressed funding for the majority of respondents (21.7 %) but existing shareholders are listed as the 2nd most preferred option (16.9%)
- 6% of respondents have had a less than 25% success rate in business rescue, while 38.7% have a success rate of over 75%. Informal restructurings overall have a higher success rate than business rescue
- Success in business rescue is cited as a better return for creditors, AND the business continuing on a solvent and liquid basis
- 54.8% of respondents believe that business rescue practitioners are not adequately skilled or qualified, mainly as a result of their lack of experience and type of qualifications
- Boards of directors are the most likely to place a company in business rescue, and commercial banks (secured creditors) are most likely to oppose a business rescue
- Commercial banks have the highest level of awareness and understanding of business rescue, and creditors have the lowest, according to respondents
- Overall over 64% of respondents still believe that business rescue is effective

2016 will yet again be an interesting year for the Restructuring Industry and we look forward to watching how the events play out.
2016 is forecast to be a milestone year for the Restructuring Industry due to a number of market forces at play
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The highlights

39.4% believe that business rescue practitioners are not adequately skilled or qualified.

54.8% expect increased restructuring activity in the next 12 months.

38.7% have a business rescue success rate of over 75%.

80.6% expect a recession.

Protecting the business ranked #1 priority of a restructuring exercise.

What makes a successful business rescue?
- 37.1% continue on solvent and liquid basis
- 37.1% better return for creditors
- 14.5% preservation employment

Protecting debt and minimising write downs ranked 2nd.

What main restructuring options are used?
- Business rescue
- Amend and extend the debt
- Sale of the business
- Distressed funding

Only 1.9% highlighted the use of distressed funding as an option.

Key to development of the restructuring market.

Sectors at risk of distress:
- Agriculture
- Resources
- Construction

Global economic health:
- Political uncertainty
- Commodity prices
- Economic downturn
- Poor management performance

What causes distress:
- Construction
- Sale of the business
- Amended poor performance

Poor management performance ranked 2nd.

80.6% expect increased restructuring activity in the next 12 months.

14.5% preservation employment ranked 1st.
Gloomy economic prospects lay ahead
The state of the South African economy

**Outlook for the South African Economy**

In 2016, 39.4% of the respondents expect a recessionary economy driven by political uncertainty and corruption, global economic health and commodity prices.

This represents an increase from 2015, where 24.2% of respondents expected a recessionary economy. Interestingly the number of respondents expecting growth (albeit low) remained at 21.2% between 2015 and 2016.

Uncertainty over emerging markets took its toll on the South African economy in 2015 and to date in 2016. This coincided with significant erosion in commodity prices, slowdown in growth from China, a volatile currency, as well as major political uncertainty and decreased investor confidence.

In terms of the outlook for 2016, 39.4% (2015: 24.2%; 2014: 18.8%) of respondents believe that the South African economy will either enter a recession or alternatively flat line (39.4%; 2015: 54.5%; 2014: 71.9%) in the coming year, barring any further trigger events (e.g. a rise in interest rates).

**Recession:** Negative growth in the economy for two consecutive quarters  
**Stagnant:** No growth in economy for two consecutive quarters  
**Growth:** Increased business activity for two consecutive quarters
The ongoing economic stagnation is primarily driven by two factors; i.e. the current levels of political uncertainty and corruption (22.1%; 2015: 11.6%) and global economic health (16.8%; 2015: 7%). Interestingly, of the top three factors stated in 2015, both political uncertainty and corruption, and commodity prices featured again in 2016, with reliability of energy supply completely falling off the list in 2016. The combination of these aforementioned factors and their knock-on effect on a number of other factors such as exchange rate fluctuations and interest rate movements, contributed to some of the respondents changing their outlook on the economy to recession.

The impact of the severe drought experienced in recent times was also mentioned as a major factor which added to our current economic “perfect storm”.

“Political situation creates uncertainty for investors, Government is ignoring the rule of law.”
- Lawyer

Interestingly, the number of respondents predicting growth (albeit low) has remained constant from the year 2015 at 21.2%. Lower oil prices and the weakening of the Rand allows for export revenues to increase, and could fuel a modest rebound contributing to the expected marginal growth for South Africa’s economy in 2016, according to these respondents.
The impact of the potential credit downgrade to sub-investment grade status was also a very topical subject, as this event would have a significant impact on government finances and the broader economy, by increasing the cost of credit, reducing investor confidence levels through a flight of capital and reduction in funds available to reinvest into stimulating economic growth.

The weak economic outlook in South Africa has made the fiscal outlook more challenging. As part of the Budget 2016/17, the government announced an adjustment package of expenditure savings for one-third, and tax measures for two-thirds, to reduce the budget deficit from 3.9% of GDP in 2015/16 to 3.0% of GDP in 2017/18 and stabilise the gross debt burden at about 51% of GDP, helping minimise pressures on the sovereign rating.

"The higher sovereign risk results in flight of capital and higher economic uncertainty.”
- Business Rescue Practitioner

Political uncertainty and corruption
Political uncertainty was the biggest concern raised by the respondents this year (2016: 22.1%; 2015: 11.6%), especially considering the number of disconcerting events that took place, e.g., this year’s State of the Nation Address, recent Credit Rating Downgrades, policy uncertainty (including rapid cabinet changes) and the ongoing corruption charges and legal allegations faced by the South African President, which all lead to decreased investor confidence.

This decrease in investor confidence has been reflected in the fact that in the 2014 Foreign Direct Investment Confidence Index, South Africa was the only African country that was listed in the top 25 ranked countries, whereas in 2015 no sub-Saharan African countries made the rankings.

"Our economy is politically driven, which can have a negative impact on the economy.”
- Business Rescue Practitioner

Global economic health
South Africa’s growth is stuck in low gear with real GDP growth estimated at 1.3% in 2015/16 and projected at 0.8% for 2016/17 due to a combination of domestic constraints and external headwinds arising from the fall in commodity prices and slowdown of the Chinese economy. The weak growth performance has been exacerbated by already high unemployment, inequality, and macro vulnerabilities.

Global economic growth has been affected by the slowdown and rebalancing of the Chinese economy, lower commodity prices, and strains in large emerging market economies.

"The global economic outlook sets the context and if RSA wants to play globally, it needs to monitor the global outlook.”
- Business Rescue Practitioner

Commodity prices
Commodity prices overall have declined by over 40% from their peak in US dollars, yet there is no long-term recovery in sight as overproduction still haunts products from steel to oil.

South Africa unfortunately missed the opportunity from the last commodity super cycle. The cycle, which soared because of rising demand from emerging economies, especially China, in the early 2000s, is unlikely to reoccur in this lifetime, according to industry commentators.

South Africa, a net exporter of agricultural products, had the least rainfall last year since records started in 1904, damaging crops and raising food prices. The farmers have been granted as much as R16.6bn in the year through March 2016 to subsidise feed purchases, provide grants and interest-rate subsidies to aid commercial growers in financial distress and help operators pay workers.

Threats of drought in South Africa’s major maize producing regions, extreme shortage of electricity supply and the imminent water crisis could pose a threat to South African commodity prices as approximately 72% of our exports consist of agricultural and mining products (2016: 14.2%, 2015: 16.3%).

Exchange rate fluctuations
The Rand’s weakening is affected by market forces and a myriad of structural problems facing the South African economy. South Africa’s currency lost 26% of its value in the six months after the turmoil that gripped Chinese markets in June 2015.

The Rand is expected to remain under pressure with many analysts predicting that it will fall further in 2016. But the Rand is substantially weaker than it might have been. The sudden reshuffling of the finance ministry was seen as weakening one of the country’s key macroeconomic institutions and continues to undermine market confidence.

"Dollar based income or offshore investments have become increasingly attractive to hedge the depreciating rand against foreign exchange rates.”
- Business Rescue Practitioner

Sectors most at risk of becoming distressed
Sectors most at risk of being distressed in the next year are resources, agriculture and construction

For the 2016 year, respondents believe that the resources sector is still the sector that is the most at risk of being distressed, followed by the agriculture and construction sectors. These sectors play a vital role in contributing to the national gross domestic product of the country and are therefore important to keep the economic engine running.
Sectors most at risk of being distressed in the next 12 months

Resources remained at the top spot from 2015, which illustrates its ongoing struggle to recover. As described earlier, the main reason for this has been the global commodity prices which have nosedived in recent times.

It must be noted that the mining and steel sectors were cited the most often as being in distress in the resources industry by 24.6% of respondents (2015: 32.4%, 2014: 12.9%). Some of the contributing factors to this are weak commodity prices, the volatile rand, significant labour unrest in the past and the political uncertainty facing the economy.

The agricultural sector is forecast to be the second most at risk of being distressed in the next year by 17.5% of respondents (2015: 6.5%, 2014: 7.5%), mainly due to the drought conditions faced by most farmers.

The construction sector is still viewed by 14.9% of respondents (2015: 19.4%, 2014: 17.2%) as one of the sectors being most at risk of being financially distressed in the next year, retaining its position in the top three for the third year running. This can be attributed to the lack of government spending on infrastructure and the multiple labour strikes experienced in the past.

“Construction has been struggling for a few years and is very cost sensitive.”
- Lawyer
Continued increase in restructuring activity predicted
The restructuring process

Impact of the state of the economy on the Restructuring Industry

More than 75% of restructuring professionals expect the same increase in activity for the next 12 months when compared to the last 12 months.

Level of restructuring activity

- Decrease: 3.0%
- No change: 21.2%
- Increase: 75.8%

According to respondents, the economic downturn is the primary cause of the increased number of workout and restructuring cases. Secondary to this is poor management, which is prevalent in distressed companies, whether the economy is strong or weak. Key management plays a vital role in the success of the business and without this trait, the company will not succeed.

“"The current economic climate has contributed to the increase in restructuring activity.””
- Business Rescue Practitioner

Furthermore the impact of the economic downturn and knock-on effect on the trading performance of businesses, cannot be ignored. More companies are struggling in the tough economic climate, resulting in more distress and an increase in the number of companies requiring assistance to be nurtured back to health.

Similarly, when compared to last year, another big factor resulting in an increased level of restructuring activity is the vast amount of business rescue cases that have been received by restructuring professionals. Business rescue is a relatively new restructuring mechanism in South Africa and the use thereof is expected to continue increasing as a result of the stagnating economy.

“"The market is more knowledgeable about the Business Rescue process and this has increased the confidence in the process.””
- Business Rescue Practitioner

Objectives at the outset of the restructuring process

Protecting the business is still ranked as the #1 priority of a restructuring process

Respondents unanimously concluded that yet again “protecting the business” is the most important objective when embarking on a restructuring project. There has however been a significant increase in the perceived importance of other objectives. The second main priority in a restructuring is “preservation of employment”.

Importance of objectives at outset of a restructuring project

<table>
<thead>
<tr>
<th>Objective</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Protecting the business</td>
<td>9.3</td>
<td>8.3</td>
<td>7.4</td>
</tr>
<tr>
<td>Preserving the level of debt</td>
<td>7.7</td>
<td>8.0</td>
<td>9.1</td>
</tr>
<tr>
<td>Minimising public relations</td>
<td>5.2</td>
<td>5.1</td>
<td>5.1</td>
</tr>
<tr>
<td>Minimising the business</td>
<td>4.0</td>
<td>4.0</td>
<td>4.0</td>
</tr>
<tr>
<td>Minimising the reputation of the party</td>
<td>3.7</td>
<td>3.7</td>
<td>3.7</td>
</tr>
<tr>
<td>1) Priorities</td>
<td>10</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>2) Preservation of employment</td>
<td>9.5</td>
<td>9.5</td>
<td>9.5</td>
</tr>
<tr>
<td>3) Minimising the level of debt</td>
<td>8.3</td>
<td>8.3</td>
<td>8.3</td>
</tr>
<tr>
<td>4) Public relations</td>
<td>7.7</td>
<td>7.7</td>
<td>7.7</td>
</tr>
<tr>
<td>5) Minimising the reputation of the party</td>
<td>6.3</td>
<td>6.3</td>
<td>6.3</td>
</tr>
</tbody>
</table>
This was followed closely by “protecting the level of debt with minimum provisioning” and “public relations/reputation” of the firm/company involved in that restructuring.

“Lenders are very focused on preservation of employment due to the politically sensitive nature of it.”
- Lawyer

**Expected restructuring options**

Exit via sale of business remains one of the frequently used restructuring options together with “Amend & extend the debt”, with “business rescue” featuring as a new popular mechanism being used

In 2016, the types of mechanisms/options used to restructure were a lot more diverse than in previous years. The majority of respondents reported that “Amend and extend the debt” (2016: 15.7%; 2015: 15.7%; 2014: 8.9%) is the top restructuring option most likely to be employed in the next year.

**Restructuring options expected to be employed in the next 12 months**

<table>
<thead>
<tr>
<th>Option</th>
<th>2016</th>
<th>2015</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amend and Extend the debt</td>
<td>15.7%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exit via sale of business</td>
<td>13.0%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business rescue</td>
<td>12.0%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Introduction of a strategic partner equity</td>
<td>4.9%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sale of nonperforming assets</td>
<td>4.9%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insolvency/Liquidation</td>
<td>7.4%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt for equity</td>
<td>6.5%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Covenant reset</td>
<td>6.5%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Obtain additional security</td>
<td>6.5%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>5.6%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Restructuring via debt write down</td>
<td>2.8%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exit via refinance to third party</td>
<td>2.8%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sale of debt</td>
<td>2.8%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financed by a distressed fund</td>
<td>1.9%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

This is followed closely by “Exit via sale of business” (2016: 13%; 2015: 16.3%; 2014: 18.9 %) and a new option in 2016, the use of “Business Rescue” (2016: 12%, 2015: n/a).

“Restructuring via debt write down” has decreased significantly from 2015 and 2014 levels, potentially demonstrating a reduction in the appetite of using this mechanism (2016: 2.8%; 2015: 13.7%; 2014: 14.4%).

“Financing by a distressed fund” (2016: 1.9%; 2015: 2%; 2014: 14.4%), “Exit via refinancing to a third party” (2016: 2.8%; 2015: 2.9%; 2014: 1.1%), and “Sale of debt” (2016: 2.8%, 2015: 2.9%, 2014: 1.1%) are the least favoured options, due to the lack of a secondary market for debt in the South African financial markets. The least favoured options remain unchanged when compared to last year. This is no surprise as there have been no changes in the secondary market for debt in the last year.

“BR is the new MBA. can make an investment at a huge discount.”
- Commercial Bank

Not surprisingly, respondents shared that the most important aspect in the local restructuring industry is the early identification of financial distress, followed by updating the relevant legislation, education and professional bodies and consultation with experts/advisors.
The local restructuring industry

Early identification of financial distress remains the elusive “silver bullet” for restructuring professionals

Areas to improve in terms of local restructuring industry

One of the key success factors for any business rescue or restructuring, is the ability to identify financial distress early on. Respondents shared that unfortunately management/the board of directors often ignore the triggers and warning signs of distress and it is human nature to try and solve the issues themselves.

“Management often wait too late. They are in denial. They do not understand their roles and responsibilities in terms of the Act.”
- Credit Regulator

If a financially distressed entity requests assistance sooner, more time can be spent on the problem areas of the business, obtaining distressed funding and considering the options for the business, which in turn increases their chances of success.

A factor that has risen to prominence in 2016, is the updating of the relevant legislation (with specific reference to Chapter 6 of the Companies Act), as it is key to address ambiguities identified in the legislation. This is particularly topical in 2016 due to the review of the Companies Act provisions which is currently taking place. The most pertinent areas that need addressing according to respondents are the regulation and removal of BRPs as well as the clarity on the waterfall of payments.

Respondents also shared that there is currently a disconnect between Chapter 6 and Insolvency law which needs to be addressed.

Consultation with experts were also noted as an important consideration, depending on the size and complexity of the client, as well as the stage of distress.

The role of educational and professional bodies were stressed as an important factor. However, respondents are yet to see a tangible impact of the actions of these bodies on the industry. Respondents stressed that they should be more involved in educating non-members, as well as the fact that the Department of Trade & Industry should regulate these bodies and clarify the accreditation of BRPs.

“"The role of Education and professional bodies are seen as less important than they should be."
- Business Rescue Practitioner

Lastly, the creation of a distressed fund (a new option in 2016) was stated as a big opportunity in the local market. Respondents stated that the market is still developing and will probably only mature in approximately 10 years. Interestingly, some respondents stated that too much emphasis is placed on the need for a distressed fund, as they believe that if there was a viable business PCF would be readily available and a distressed fund wouldn’t be needed.
Lack of distressed funding remains a missed opportunity
Distressed funding
State of distressed funding in South Africa

39.4% expect distressed funding to be advanced in the next year, representing a large increase from the 12.1% stated in 2015.

Distressed funding (or the lack thereof) remains to be one of the most topical issues in restructurings and business rescues, as widely held by the respondents. Interestingly in 2016, the majority of respondents (48.5%) indicated that they believe that the level of distressed funding that will be provided in the next 12 months will be insignificant, which has decreased significantly from 78.8% in 2015. This is a very positive indicator that distressed funding is becoming more available for deserving companies.

"Often by the time they need the distressed funding they are too far gone."
- Commercial Bank

Adjacent to this finding, 63.6% of respondents (2015: 84.8%; 2014: 66.7%) have not observed a change in the number of distressed funds being created in South Africa. Some of the respondents noted that it is easier for larger companies to obtain distressed funding. The reason for this is that smaller- to medium-sized entities might struggle with their debt obligations in the long term, as well as the fact that larger companies generally have more resources at their disposal.

Interestingly 18.2% of the respondents (2015: 9.1%; 2014: 13.3%) indicated that there has been an increase in the observed change in number of distressed funds in South Africa. Many respondents mentioned that they have heard of individuals or firms speaking of starting funds, but very few (if any) have materialised to date. However only when the global economy strengthens will a noticeable change be seen in the extent of distressed lending, as currently investors are more risk averse as a result of the state of the economy and are uneasy/unfamiliar with this type of lending category.

"Financiers don’t understand PCE, not much appetite."
- Lawyer
Banks remain the preferred and most prevalent source of distressed funding
Best sources of distressed funding
Existing bankers of companies in distress are still regarded as the best source of distressed financing

Best sources of distressed debt funding

<table>
<thead>
<tr>
<th>Source</th>
<th>2016</th>
<th>2015</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Existing banks</td>
<td>21.7%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Existing shareholders</td>
<td>16.9%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Distressed funds/lenders</td>
<td>13.3%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade creditors</td>
<td>13.3%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Existing DFIs</td>
<td>9.6%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private equity/venture capital</td>
<td>6.0%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other equity providers/new investors</td>
<td>6.0%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>6.0%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>New DFIs</td>
<td>6.0%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Competitors in the industry</td>
<td>2.4%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>New banks</td>
<td>0%</td>
<td></td>
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</tbody>
</table>

Major obstacles currently faced by distressed lenders
Respondents were asked whether a lack of local funding increased the propensity of financial distress. Respondents confirmed that there was an abundance of funding available for deserving companies, and that those in financial distress were often already over-indebted.

Therefore in order to obtain an understanding of the main obstacles that distressed lenders face to entering the market, respondents were asked to rank and list the key challenges that need to be overcome in order to stimulate and develop this market.


A slight increase has been noted in respondents placing their hopes on “Distressed funds/Lenders”, however it’s still safe to say even though the local restructuring industry is ready and has an interest in distressed players entering the market, few have taken up this opportunity.

Following closely after is “Existing development finance institutions” ("DFIs") (2016: 9.6%, 2015: 8.4%, 2014: 11.1%), as these organisations are expected to assist organisations in distress through their social and development mandate (i.e. preservation of jobs).

Interestingly, a number of respondents mentioned that institutional investors (e.g. asset managers) are ideally placed to enter this market, emulating similar trends in the USA and UK markets.

Lastly, the nature of distressed funding is mostly through the extension of an overdraft facility, some form of asset based lending or new equity.
In terms of the factors listed, the **uncertainty regarding key aspects of the law** was ranked by 22.3% of respondents as the main obstacle faced by distressed lenders. Respondents stated that the most contentious of areas on this matter 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 to these judgements, which raise concerns for potential funders around the certainty of their risk and return. It is evident that the Act did not contemplate all scenarios.

The second most prevalent factor raised was the **lack of risk appetite** for this nature of funding in the local market. Due to the fact that the company is in distress, any funding advanced to them is at a higher risk and therefore requires a higher return. Traditional players such as Private Equity 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.

Thirdly, the **lack of reliable information** available to lenders to obtain comfort about the nature and extent of funding required by the company, was listed as a major factor. A number of respondents also listed enough work being done early on in determining the exact funding gap as a factor. This has been further hampered by directors who have not been more honest and transparent in their disclosures to stakeholders. Therefore the integrity of the information comes into question, leaving lenders concerned about the trustworthiness thereof.

Furthermore, the **lack of available security** (due to the fact that the current security has already been encumbered), **lack of trust in the system** (mainly due to concerns regarding the skill levels and reputation of the business rescue practitioners and a lack of trust in the existing management) and **no reasonable prospect** (the wrong businesses are filing and all are filing too late) also remain major obstacles to the provision of distressed funding.

> "Availability of funding will increase, but the longer diligence processes required will inhibit the advancing of funding."
> - Business Rescue Practitioner

### 5.3.1. Potential of prepacks

A new question in the 2016 survey explored the potential of **prepacks** in the local market. Generally respondents were very positive and supportive towards the use of this mechanism. Respondents stated that this approach was often followed during informal restructurings and builds trust in the process. It also increases the level of transparency and accountability. The main reason this has not been used more to date is the lack of awareness of this tool. More needs to be done to inform and educate stakeholders of this option, potentially through the update of the legislation.

> "Prepacks are indispensable in SA…it is critical to success."
> - Commercial Bank
Business Rescue has increased in prominence in recent times
Business Rescue in South Africa

Business Rescue in South Africa is still a relative newcomer to the South African legal system. The restructuring of companies in financial distress is on the increase globally and has been common practice in many overseas jurisdictions for some time. It is evident that the use thereof is increasing locally. However, a number of shortcomings are still prevalent. Survey respondents indicated very passionately what is working and what is not in the field, and provided some suggestions to ensure the sustainability of the industry going forward.

**Extent of cases constituting business rescue**

*60% of respondents deal with less than 25% business rescue cases*

Survey participants were asked how many of the cases they deal with were business rescue cases, as well as what the success rate of those who entered business rescue were.

The results revealed that for 60% (2015: 45.5%; 2014: 62.1%) of the respondents, business rescue only constitutes less than 25% of all cases dealt with, which represents a decrease from 2015 levels. 20% (2015: 15.2%; 2014: 3.4%) of the respondents reported that more than 75% of the cases they dealt with entered business rescue, which is a slight increase from 2015.

**Percentage of cases dealt with that have entered business rescue**

![Graph showing percentage of cases dealt with that have entered business rescue](image)

**Measure of success of business rescue**

Most respondents defined success in business rescue as the business continuing on a solvent basis AND a better return for creditors giving each equal importance for the first time.

**How would you define “success” in terms of a business rescue?**

![Graph showing measure of success of business rescue](image)
An important question posed to respondents are what they see as “success” in business rescue. The top success indicator was shared by two measures i.e. where the business continues on a solvent and liquid basis was selected by 37.1% (2015: 33.3%; 2014: 30%) of respondents as well as 37.1% (2015: 28.6%; 2014: 28.9%) of respondents indicating that a better return for creditors is an equally successful outcome. This is the first time in the three years of the survey that the business continuing has not ranked ahead of the better return for creditors, potentially indicating a shift in the view of how stakeholders view business rescue.

In 2016, preservation of employment also rose to significance ahead of other measures, as all stakeholders appear to have become much more sensitive and attuned to this critical aspect of success in a business rescue.

Interestingly, 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 employee’s jobs will largely be secured. Hence it is interesting to note that this measure is losing ground in the opinion of respondents.

“Better return for creditors in a business rescue than there would be in a liquidation is the preferred definition. The improved position for staff (preservation of jobs)…in a business rescue is better than there would be in a liquidation.”
- Business Rescue Practitioner

Success rate of business rescue and informal restructuring
Furthermore, of these business rescue cases dealt with, 35.5% (2015: 30.3%; 2014: 41.4%) of the cases have a less than 25% chance of success – in fact, the real success rate is seen to be closer to 10%.

Compared to 2015, more respondents (2016: 54.8%; 2015: 39.4%) reported a success rate of more than 50%. Interestingly, the success rate level of over 75% has increased significantly, moving from 24.2% in 2015 to 38.7% in 2016. Overall more respondents reported higher success rates in 2016 compared to 2015. This potentially points to the fact that more of the right businesses are entering business rescue at the right time.

In 2016, respondents were also asked what the success rate was for informal restructurings, with the results being significantly better overall compared to business rescue. 71% of respondents recorded a greater than 50% success rate and 38.7% of respondents recorded a greater than 75% success rate.

Success rate of informal restructurings

Another new question was posed in 2016 regarding pre-assessment. Many have stated that it is critical to increase the success rate of a business rescue or restructuring and respondents were asked what they believe the key factors to consider are.
A number of factors were described, with the following key aspects being stressed:

- **Is there a business**: Does the company have a product, market, good margins? Is the business viable?
- **Identifying the cause of distress**: Identify the fundamental reasons (i.e. root causes) for the distress? Can these be addressed?
- **Liquidity and cash flow position of company**: Understand the financial state of the company with specific focus on the liquidity and the availability of cash in the business.
- **Availability of PCF**: Is PCF available to support the business during a BR?
- **Management capability**: Assess the quality of management and whether the necessary controls and governance structures are in place to manage them. This would include whether they have the required skills, integrity and willingness to support.
- **Other factors**: These would include:
  - Availability of restructuring options for the business
  - Understanding whether there was fraud in the business
  - Determining if financial information is reliable and credible
  - Valuation of the business (going concern versus liquidation)
  - Nature, outlook and structure of the industry

**Critical pre-assessment considerations**

- Is there a business
- Identifying the cause of distress
- Liquidity and cash flow position
- Availability of PCF
- Management capability

**Parties placing companies into business rescue vs opposing a business rescue**

Respondents were asked who the parties are who most often would place a company into business rescue, and unanimously the board of directors took the top spot in this question again.

It was noted that a reason why affected parties (i.e. employees, trade unions, creditors and shareholders) have not done so more often, is due to the more onerous and costly burden of proof on them to prove financial distress, reasonable prospect and place the company into business rescue through the court.

On the flipside, respondents indicated that the party who is most likely to oppose a business rescue is the commercial banks. However, this has decreased from 43.5% in 2015 to 31.8% in 2016.

Shareholders and Creditors increased in prominence in 2016 as the 2nd most likely party to oppose a business rescue. The main reason stated for this is that these parties have the most to lose during this process.

**Groups most active in placing a company business rescue**

![Groups most active in placing a company business rescue](chart1)

**Groups most likely to oppose business rescue**

![Groups most likely to oppose business rescue](chart2)
Business Rescue Practitioners (“BRP”)  
54.8% of the respondents believe that business rescue practitioners are not adequately skilled or qualified, which represents an improvement from 2015.

54.8% (2015: 100%; 2014: 78.8%) of the respondents felt that the BRPs were not adequately skilled or qualified to perform their duties, in contrast to all of the respondents in 2015. This is a significant decrease in the belief that BRPs are not qualified to perform their duties. The reason for the change is mainly due to the fact that more respondents indicated that they have had more positive experiences recently with a small number of respected and valued BRPs, but that the remainder of the body was below standard.

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

A Business Rescue Practitioner has full management control over the company. He or she may delegate certain functions to a director on the board of the company or to a person who was part of the pre-existing management of the company – thus highlighting the importance that the BRP must be adequately skilled and qualified.

Although the majority of respondents believe that the current body of BRPs are not adequately skilled and qualified, it is worth noting that many believe that a BRP needs practical, relevant working experience in turning around a company and some respondents have only worked with a handful of competent BRPs.

Reasons for lack of faith in BRPs

When respondents were asked for the reasons why they do not believe BRPs are adequately skilled and qualified, they were asked to rank which of the following aspects contributed most to their view of BRPs. The experience level and nature of qualifications were listed as the top two contributing factors.

Experience

The lack of practical and relevant experience in turning around a business was raised as the biggest concern among respondents. Respondents noted that they have worked with very few BRPs who have sufficient knowledge and experience and the downfall was as a result of too complex transactions, a vast amount of cases that had been taken on, and not focusing on the issue at hand. It was noted that an ideal BRP profile candidate should be an “ex-CEO”, who has a commercial mindset, and is strategic and forward looking in their decision-making.

Many agree that other critical skills that are required during a rescue include being a good negotiator, having the ability to motivate all parties, being a good communicator, possessing a strong ability to analyse and understand a business and most importantly have the necessary experience to turn a business around.

Qualifications

Many different views were shared in terms of the type of qualifications and education a BRP needs, with many believing that merely having a financial, legal or management degree is not sufficient.

A strong view was shared that liquidators are not the appropriate candidates for BRPs as they have a liquidation mindset, instead of a solvency one, and their main aim may not be to rescue the business. The liquidators are converted insolvency practitioners, who do not necessarily have the appropriate skills or experience to take the business forward.

“There are a lot of liquidators who have become BRPs without reskilling.”
- Lawyer

Remaining factors

Ethics and integrity was listed as the 3rd most important factor, with respondents stating a number of abusive practices observed of certain BRPs e.g. taking on a business rescue where there is no reasonable prospect, manipulation of the liquidation valuation etc.

Regulation and accreditation was also stressed as critical, in order to address all the concerns raised to date regarding the conduct of BRPs. If an effective regulator is appointed, BRPs will have to adhere to professional standards and will need to comply with a disciplinary code.

“We are not attracting the right people.”
- Business Rescue Practitioner
Other considerations in business rescue
SARS and the Courts are having an impact on business rescue matters

Respondents were asked whether they have encountered any tax related issues during a business rescue, to which 48.1% responded yes (2015: 54.5%). Similar to 2015, the main reasons stated for this was that SARS is unresponsive in business rescues, or can at times be obstructive to the process. Having said that, many have noticed an increased level of activism and organisation from certain SARS regions regarding their understanding of business rescue and raising some interesting legal points.

If you have been involved in Business Rescue, have you encountered any tax/SARS related issues?

![Bar chart showing the percentage of respondents who encountered tax/SARS related issues in 2016 and 2015.]

Courts
Similarly, respondents were asked about their experience with the courts in dealing with business rescue matters, where they indicated that 47.6% have experienced challenges when dealing with the courts (2015: 71.9%). This represents a big improvement from 2015.

Similar to 2015, these include long delays in dealing with the courts, inconsistent judgements, heavy burden of proof required and significant costs associated with the courts. A key recommendation was raised again to institute dedicated business rescue courts to address these type of cases.

Are you aware of any court challenges with administering business rescue?

![Bar chart showing the percentage of respondents who encountered court challenges in 2016 and 2015.]

Level of awareness of business rescue
Commercial Banks have the best knowledge of business rescue, with creditors ranking the worst

The level of awareness of business rescue amongst typical stakeholders varied greatly amongst respondents, with Commercial Banks coming out tops again in 2016, followed closely by Lawyers (new category) and BRPs (new category). The parties with the lowest awareness levels remained creditors and employees/trade unions. This indicates that little has been achieved in terms of educating all stakeholders on their rights and responsibilities in business rescue.

Trade unions have a fantastic opportunity to enquire as to the prospects of an entity filing for business rescue, as they are one of the few parties who can request access to the company’s financial statements. Raising awareness and education of this stakeholder group is key.
Concerning is the low level of awareness of business rescue of boards of directors, who according to 78.8% (2015: 83.9%) of respondents, confirm that directors are not aware of their responsibility to consider business rescue when the company is financially distressed. This is crucial as they stand to be personally liable in terms of the Companies Act if they do not fulfil their fiduciary duty in this regard. It must be noted that this is a slight improvement from 2015.

Are Directors of financially distressed companies aware of their responsibilities in terms of business rescue?
Effectiveness of Business Rescue

Respondents were asked whether they believed that Business Rescue is effective, and what the factors were that drove this. Interestingly, aside from the many areas of concern that were raised, 64.5% of respondents still felt that Business Rescue was effective.

Many stated 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 provides a better dividend for creditors, the process is more efficient, more jobs are saved and there is generally more value for all stakeholders. Respondents believe that it provides a second chance for a deserving company. However, it does not solve all problems for all companies.

Do you think business rescue is currently effective?

64.5% Yes 35.5% No

“Business Rescue adds value to the economy, things would be worse in the absence of this tool.”
- Development Finance Institution

“Any rescues are better than none. There is, however, room for improvement.”
- Academia

Respondents also stated that it is becoming more effective but a number of factors are still creating obstacles, i.e. ambiguity in the Act, used as a delaying tactic, waiting too long to file etc. Business rescue has not yet reached its full potential, but the intention is noble.

Challenges

- Poor legislation, which will become robust overtime through case law.”
  - Business Rescue Practitioner

- No judicial oversight, BRPs have free reign.”
  - Commercial Bank

Opportunities

- Regulation of the industry and accreditation of BRPs
- Creation of a distressed fund to make PCF available
- Education and awareness (specifically of directors)
- Positive marketing of BR
- Review and update of Chapter 6
- Proactive use of BR
- Needs national championship through Parliament
- Use of prepacks
- Investors buying companies at a discount
- Build a body of knowledge
- Innovation and collaboration
- Joint appointments and transfer of skills

Challenges

- Lack of regulation of the industry
- BRPs lack of skills and experience
- Lack of availability of PCF
- Low levels of education and awareness of all stakeholders
- Negative publicity and no success stories
- Lack of legal clarity and no specialised courts
- Not using BR early enough
- Credibility of the process

Opportunities

“Cost effective tool for discerning distressed companies”
- Lawyer

“Educating business on restructuring opportunities presented through BR.”
- Commercial Bank

Business Rescue is now entering its fifth year since implementation of the Act in May 2011. The industry is starting to reach levels of sophistication not yet seen before and is gradually becoming more robust and effective. Respondents were asked to take stock of Business Rescue five years down the line and share what they believe the top opportunities and challenges in the industry are. The key themes are summarised below:
Conclusion

Overall respondents commented that 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 tap into an untapped market in the near future.

Respondents have clearly noted that in order for the industry to grow further it needs to correct the flaws in the Act and appoint a regulatory body.
The way forward...
What does the future hold?

Looking back over the past few years, it is easy to miss how much has changed and evolved. One thing is certain, it has been an interesting and exciting time for the restructuring industry, and one that has been crucial for the wellbeing of our country. However this report clearly reflects that we still have some way to go. Especially considering the fact that when respondents were asked whether they believe we have a rescue culture, 78.1% said no. Many respondents stated that this is changing slowly but we are still very creditor driven and liquidation friendly.

Do you believe we have a rescue culture in SA?

![Pie chart showing 78.1% no, 21.9% yes]

When asked what they believe the future holds for restructuring and business rescue, the following themes emerged from respondents:

Respondents stated that this is still a new industry, which will continue to go from strength to strength and eventually become the norm. As more success stories are shared and celebrated and stakeholders become more educated, the use of the tool will increase and the industry will become more professional. The industry will become more credible and will attract international interest. Many believe that it is making a positive difference in our economy. However this will only take place if the following matters are addressed:

- Accreditation and regulation of BRPs which will weed out non-performance
- Fixing the gaps in Chapter 6 of the Companies Act
- Creation of a distressed fund
- Business rescue used earlier in the timeline of distress
- Celebration of success stories and increasing eminence and profile
- Specialised business rescue courts

If the above matters are not addressed, business rescue will go the way of judicial management and stakeholders will lean more towards the use of informal restructuring.

“Restructuring industry prospects are good if the right foundations are laid now… then the industry will become mature, meaningful and substantial.”
- Business Rescue Practitioner

In conclusion, most respondents still believe that this industry has a growing and bright future. Restructuring (and more specifically business rescue) is becoming increasingly sophisticated and more dynamic than ever before. We look forward to capturing the developments in the industry through future surveys.
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Deloitte Restructuring Services

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Deloitte South Africa core restructuring and turnaround skills

<table>
<thead>
<tr>
<th>Service Type</th>
<th>Description</th>
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<tbody>
<tr>
<td>Independent Business Reviews</td>
<td>In the current economic environment there are an increasing number of businesses experiencing financial difficulties. This represents a high level of risk to lenders who face potential non-payment of some or all of the outstanding capital and interest balances owed by the business. Deloitte can assist both the business and lenders in addressing their key concerns such as short-term liquidity, reasonableness of business plans, future market prospects and business sustainability and restructuring options.</td>
</tr>
<tr>
<td>Going concern and liquidation valuations</td>
<td>We perform valuations of business enterprises, ordinary and preference shares as well as tangible and intangible assets. We also provide support with going-concern reviews, as well as solvency and liquidity reviews. We are able to assist with liquidation valuations. We can also provide modelling services for different options being considered by business rescue practitioners as well as modelling the impact of the restructuring of the debt using free cash flow to equity models.</td>
</tr>
<tr>
<td>Fast Track M&amp;A</td>
<td>We assist clients on both sell side and buy side mandates to maximise value, providing a tailored service depending on your needs and experience in stressed and distressed transactions.</td>
</tr>
<tr>
<td>Debt Restructuring</td>
<td>Funding requirements are invariably a major feature of any transaction and the Deloitte Debt Advisory team enables clients to take control of this vital process, to access a much wider spectrum of funders, to pitch competitively and to execute the most effective deal. We provide completely objective advice, remaining independent from prospective funders. Debt Advisory assists corporates with new debt financing, refinancing maturing debt and re-structuring existing debt.</td>
</tr>
<tr>
<td>Accounting support &amp; resource placement</td>
<td>Our Accounting and Financial Advisory (“AFA”) offering supports our clients while they are building capacity in new geographies across Africa by working alongside them to provide financial management solutions, financial and accounting outsourcing and resource placement. In addition have provided services to some of your Africa partners on projects like CIEL and BBM Due Diligence.</td>
</tr>
<tr>
<td>Business rescue practitioner appointment</td>
<td>Our Restructuring Team assists financially distressed companies to find the best possible solutions while considering the rights and interests of all stakeholders and this is done in a balanced manner. Instructions are received from the companies in distress or its affected persons.</td>
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Deloitte Restructuring Services – Global Footprint

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<td>EMEA</td>
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<td>Asia-Pacific</td>
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EMEA: People 552
Asia-Pacific: People 532
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