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Chief Restructuring Officers in Asia

Is the appointment of a CRO the way forward for debtor led restructurings?

David Chew discusses the growing trend of appointing a CRO to drive a successful restructuring outcome

We are increasingly seeing the appointment of restructuring professionals in Asia as a Chief Restructuring Officer ("CRO") of stressed and distressed companies to oversee a financial and/or operational restructuring of the company. The CRO concept was first established in the United States ("US") and is now an established feature in both US, United Kingdom ("UK") and European restructurings. The concept is becoming more prevalent in Asia and in this article, we will define the role and key skill sets, the key issues and opportunities for CRO and other interim management appointments.

Defining the role

The primary objective of an appointment of an experienced restructuring professional as a CRO is to provide specialist support to Management and/or the Board.

The appointment frees up Management to focus on business operations and provides "hands-on" support and expertise to the company to handle the unique challenges involved in managing a distressed company and to avoid an insolvency process. The aim is ultimately to ensure that the company is turned around and saved, employees retained and a better return is achieved to creditors and other stakeholders than in an insolvency.

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The title of the appointment is rarely the key discussion point amongst stakeholders. Whether the title is as a CRO, Chief Transformation Officer (used in more sensitive situations), Interim CEO or as a Director to the Board in an executive capacity, the key factor is the functional responsibilities that the CRO will be tasked with.

The CRO has four primary functional responsibilities and these are summarised in Chart 1 on the right.

The CRO will be expected to quickly develop a credible business and restructuring plan, set out a timetable and forge consensus with various stakeholder groups to implement the plan in a consensual manner. The CRO will work in tandem with Management to prioritise tasks, implement the plan and to ensure that business operations continue on a "business-as-usual" basis and that customers, suppliers and employees remain supportive.

Chart 1 - Functional responsibilities

1.1. Cash controls

1.2 Short term cash management (including 13 week short term cash flow forecasts)

1.3 "Quick win" cost reductions and asset sales

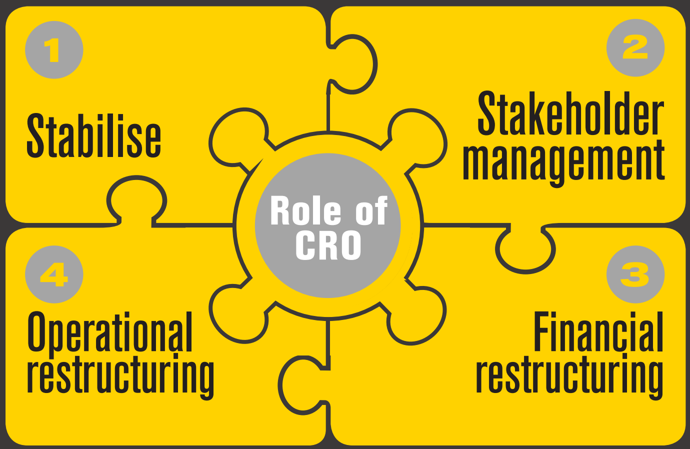
1.4 Diagnostics to identify and correct the root problems

1.5 Business and financial plans

2.1 Understand positions (secured vs. unsecured) and controlling votes

2.2 Communication strategy (when to engage, what to present and when)

2.3 Negotiating strategy



4.1 Improvement initiatives (revenues, costs, asset utilisation, working capital, supply chain, human resources and organisation design)

4.2 Changes to business model and operating strategy

3.1 Determination of appropriate capital structure

3.2 Assess going concern and liquidation value

3.3 Negotiation and communication strategy

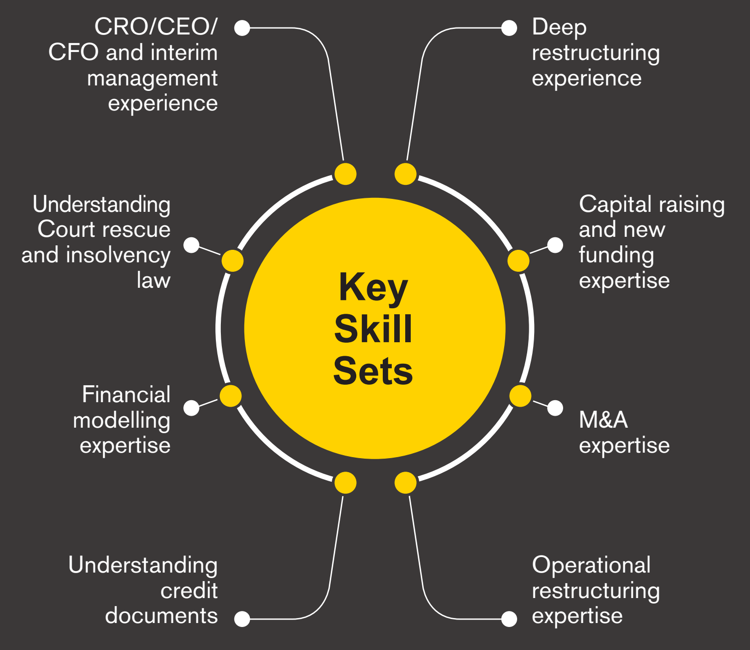
1 **Stabilise:** Focusing on cash, costs and financial rigour on business and financial plans to establish a solid base to make decisions

2 **Stakeholder management:** Focusing on managing multiple stakeholders (customers, financial creditors, trade creditors, employees and shareholders) and restoring trust and confidence with key stakeholders

3 **Financial restructuring:** Focusing on the root problems, value assessment, developing a restructuring solution (potentially involving asset sales or new debt or equity funding) and implementing agreed-upon restructuring actions

4 **Operational restructuring:** Focusing on improvement initiatives and changes to the business model to improve cash generation

Chart 2 - Key skill sets required



The skill set – experience and expertise

The most critical requirement of a CRO is experience in crisis and distressed situations. The CRO will bring deep debt restructuring experience combined with expertise in capital raising, M&A, operational restructuring, understanding of credit documents, financial modelling, an understanding of Court rescue and insolvency laws and experience in senior management running companies.

Another key requirement is the ability to cope with large volumes of information and complexity, synthesise it down to key points and then have the creativity and problem-solving mindset to craft and execute effective solutions using multiple levers all within time-pressured deadlines. This problem-solving mindset is key to be able to provide "real time" advice in meetings or onsite as deliverables are results focused, action orientated and often "report-lite".

The role is suited for experienced restructuring professionals with a track record of successfully completing restructuring transactions and who have the skills and credibility to win the trust and confidence of all stakeholders. The building of trust and confidence is imperative as the CRO is seen as an independent voice and ensures that all stakeholders are getting reliable and accurate information and that agreed-upon decisions are being taken in a timely manner.

Key issues faced

A key issue faced by the CRO is to identify who is the "real" client, who are they reporting to and what is their goal. This is particularly sensitive when the CRO has been appointed as part of a standstill process or as a result of a loan default and financial creditors have had influence over the selection of the CRO.

Ultimately, the CRO's duty of care is to the company and to the Board. The CRO is an "Officer" of the company. The CRO should be appointed as a member of the executive Management team and report directly to the Board (and in certain cases to the CEO). This ensures that the Board receives unobstructed updates from the CRO on key issues facing the company. To be successful, it is imperative that the CRO take the necessary steps to agree clear terms on the role and reporting lines before starting.

A Director appointment will likely involve the director taking an executive function to drive the restructuring on a day-to-day basis. The type of appointment has vastly different implications with respect to personal liability, especially in certain jurisdictions where Directors have personal liability for insolvent trading in and around the zone of insolvency and maintaining good corporate governance practices.

A large number of companies in Asia are family-owned and have historically been reluctant to bring in professional advisors at the early signs of problems (Chart 3) and tend to only bring in professional advisors when there is a liquidity event that is coming due (i.e. interest payments, principal payment on loans or bond maturity or payments to trade creditors). This reactive approach creates challenges as time is lost and results in fewer available options and alternatives for a successful restructuring.

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We are also asked when a company should appoint a CRO. The answer….the earlier the better. The optimal time would be as soon as the company starts to exhibit the early signs of problems (refer to Chart 3). This would give the CRO sufficient lead time to fully evaluate all options, communicate with stakeholders in an orderly manner and to have a liquidity runway that enables the business to operate on a "business-as-usual" basis for a sufficient period of time to complete the restructuring.

Chart 3 - Illustrative early warning signs

1 Profitability

- Profit warning
- Falling sales / margins / profits
- Operating losses
- Loss of key customer

2 Cash flow

- Liquidity and cash flow constraints
- Working capital deterioration
- Significant debt maturing

3 Credit

- Breach / potential breach of bank covenants
- High gearing and leverage / low interest coverage
- Deteriorating relationship with lenders
- Credit rating downgrade
- Bond price fall
- Going concern / auditor qualification

4 Industry

- Share price decline
- Adverse media comment / broker reports
- Market / industry downturn

How effective is the CRO?

Recent restructurings of listed companies in Asia that have appointed a CRO include PT Berlian Laju Tanker Tbk ("BLT") and Noble Group Limited ("Noble"). BLT was successfully restructured with recognition in Indonesia, Singapore and the US (under Chapter 15). Noble's restructuring is ongoing at the time of publication of this article and involved the appointment of an Executive Chairman on the Board. South African based, dual listed international retail company with operations in Asia, Steinhoff International Holdings N.V. appointed a CRO to lead its restructuring exercise following the discovery of accounting irregularities. An earlier case, Singapore listed, First Engineering Limited involved the appointment of an Interim Chairman and CEO to successfully push through a restructuring.

We are also aware anecdotally of a number of small and mid-sized private companies in the region that have appointed a CRO to successfully restructure in a timely manner.

However, not all cases involving the appointment of a CRO have resulted in successful outcomes. Most notably, Singapore listed, China Fishery Group Limited is a case in point.

The cases above show that the appointment of a CRO can be a key driver in successfully turning around distressed companies. The concept is, however, in the early stages in Asia and time will tell if the appointment of a CRO will become mainstream or just an ad-hoc role depending on the situation at hand.

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Opportunities

We see a number of emerging trends in the insolvency and restructuring landscape in Asia. Firstly, there has been a shift away from banks and other secured creditors directly placing the company into an insolvency process (except in cases of fraud or mismanagement), to companies directly appointing consultants and working with the banks and other stakeholders to right size their businesses. This trend started in US and UK restructurings. Australia followed this lead post the Global Financial Crisis and now more recently we are seeing this shift in Asia. Secondly, capital structures have become much more complicated with multiple lenders across multiple layers of debt tranches becoming the norm. Thirdly, there is a large (and ever increasing) amount of capital that is focused on investing in distressed situations and this availability of capital has opened up a range of options for all stakeholders. This can range from banks exiting via a secondary debt sale to new investors who may ultimately wish to own the business to companies raising new capital to support working capital or a turnaround of the business. With these developments, we expect to see an increasing number of CRO appointments in "out of Court" restructurings as Boards with the support of its stakeholders explore all options to rescue a company as opposed to simply placing the company into a value destructive insolvency process. The value add that a CRO brings to the table fits perfectly with this debtor-led approach – objective analysis, addition of specialist skills to the Management team thus freeing up internal resources, ability to manage multiple stakeholders and the different stakeholder agendas and ability to play the role of an "honest broker" to identify and attract new capital.

We also expect to see an increasing trend in Court-led restructurings, which involve the appointment of a CRO as the Singapore Companies (Amendment) Act 2017, which came into effect on 23 May 2017 introduced significant new legislative tools to support debtor-led rescues for Singapore and regional companies. The big game changers are an automatic and strengthened extra territorial moratorium, super priority rescue financing or DIP financing and cram down and pre-packs to fast track pre-negotiated schemes.

About DHC Capital

DHC Capital is an investment banking and financial advisory firm specialising in developing differentiated and innovative liquidity solutions for clients facing stress, distress or an event driven special situation.

DHC Capital provides independent and conflict-free advice on financial and operational restructuring to corporates, creditors, investors and other stakeholders, both in and out of Court. DHC Capital also advises clients on structuring and executing bespoke capital raising and accelerated M&A transactions in stressed, distressed and special situations. DHC Capital will further provide directors or executives into corporates, which are entering into a restructuring process, being restructured, exiting a restructuring process or on behalf of creditors and investors to monitor and protect their investments.

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About David Chew

David is a Partner and Founder of DHC Capital.

David has over 20 years of experience in restructuring, turnaround and special situations having worked as an advisor with Ernst & Young and Arthur Andersen, investment banker with Morgan Stanley, in senior management as a CRO, CFO and interim CFO and Board advisor to distressed companies.

David has advised private and publicly listed corporates, creditors, private equity and debt funds and investors across the full range of the restructuring transaction cycle, including crisis stabilisation, business and strategic reviews, strategic option analysis including planning and implementing in and out of Court solutions, operational turnaround, debt restructuring / schemes of arrangement, distressed M&A, rescue financing and refinancing. He is also a specialist in advising corporates requiring urgent financing during periods of market and sector specific dislocation or financial stress.

David has Board experience having been appointed as a Director of a private equity backed company operating in Indonesia that is undergoing a high-profile debt restructuring. He also has direct CRO experience having been appointed as CRO to advise on restructuring and turnaround programs for a US based multi-national corporation's Asian operations and to advise a Singapore company on restructuring and sale of business and assets. He also has previous experience as interim CFO and in interim management advisory roles.

As an investment banker, David was involved in the sourcing, structuring and execution of high yield, stressed and distressed investment opportunities across Asia Pacific for Morgan Stanley prop books.