

Financial Turmoil Management Quoted Companies

November 2008

The current financial turmoil and anticipated recession will give rise to a number of legal issues for quoted companies that require careful management. We have outlined below some of the more important potential challenges and opportunities that may arise. Your own trading platform may be sound, but you need to be prepared for any problems that beset your lenders, key suppliers and trading partners – and to capitalise on the weaknesses of sector peers.

Challenges

Covenant Breaches

- Important to anticipate any issues with financial covenants as far in advance as possible to assess what action can be taken to avoid a breach, e.g. by paying down debt or requesting a waiver.
- If end of year financial covenant test is breached, facilities will need to be reported as a current liability in annual financial statements under IFRS.
- Lenders may lose customary reluctance to enforce on the basis of "technical" events of default so compliance with all undertakings is important.

Director Liabilities?

- Taking professional advice will reduce the risk of personal liability and/or disqualification for wrongful trading.
- Consideration of new companies legislation under Companies Act 2006 is vital – both as regards wider directors' duties and the enhanced conflicts regime.

Working Capital Bank/JV Partner/Supplier is in trouble

- The insolvency of a counterparty could cause funding problems, as we have seen recently in relation to companies who have working capital financing from Icelandic banks.
- Any collapse of a joint venture or trading partner may be problematic. The ability to terminate a contract by reason of insolvency may not help where the company is dependent on continuity of supply or operation.

Disclosure Obligations

- Regulatory requirements may force an announcement of sensitive discussions with bankers much earlier than desired. Through City committees, we are working to seek greater leeway from the FSA – but in the meantime proactive covenant management is recommended.
- Falling share prices may mean transactions trigger class test thresholds, potentially increasing the likelihood of a shareholder approval requirement.

Group Companies placed in Administration

- The collapse of a group company may have serious consequences, for example, cross-defaults and/or guarantee claims.

Practical Management

- Consider financial techniques available, for example, asset based lending and enhanced treasury operations. Ensure management information is current and accessible, with focused KPIs.
- Proactive planning can ensure you, rather than your stakeholders, retain the initiative. Keeping creditors and other counterparties on-side is obvious, but critical.

Beyond the Obvious

- Advice should be sought in other areas: for example, how to manage deferred tax bills and increasing deficits in defined benefit schemes, put rights in JVs, share option restructuring and scrutiny of directors' remuneration.

Travers Smith LLP
10 Snow Hill
London EC1A 2AL
T +44 (0)20 7295 3000
F +44 (0)20 7295 3500
www.traverssmith.com

Opportunities

Distressed Acquisitions (Outside Insolvency)

- Cash is king: corporates with cash reserves or an existing facility they can draw down are well positioned to pick up cheap assets – sector peers or suppliers alike.
- Structure: acquisitions may well be asset purchases rather than share purchases because few, if any, warranties of any substance will be available.
- Stability: the seller may need bank waivers or standstills, and possibly new money, to enable the sale process to be completed.
- Effective control may be obtained in the first instance by buying the bank debt.

Distressed Acquisitions (Insolvent Seller)

- The seller may run out of time or money. A sale by an administrator or a receiver may be unavoidable. Opportunities will be maximised if buyers are ready to move quickly.
- "Pre-packaging" the acquisition through an insolvency process may be needed to avoid challenge to the acquisition on the grounds of undervalue or preference.
- Due diligence should be aimed at identifying issues and negotiating the price accordingly.

Returning Value to Shareholders

- In addition to dividend yields, investor loyalty in the face of general negative market sentiment can be preserved by buy-backs or returning capital to shareholders. Court processes are no longer required for reductions to upstream from UK subsidiaries (unless PLCs).

Alternative Funding

PIPE (Private Investment in Public Equity)

- Opportunities arise for quoted companies to raise funds when equity market confidence is low and debt market unavailable. We have advised on multiple PIPE transactions and are seeing heightened levels of interest in the concept.
- Private Equity may still be a buyer even if market sentiment is a barrier to raising public money.
- Impact of regulatory and listing restrictions may be softened by current market conditions, bringing institutional investors on-side.
- Practical issues for investors such as limited due diligence may be less of a barrier where trading conditions have already required fuller disclosure to the market.

Public to Private (P2P)

- Private investors (e.g. Private Equity) may recognise value and potential at greater multiples than the market, also bringing fresh impetus into managing the business.
- Existing shareholders may be attracted to a cleaner and premium-weighted exit than market trading provides.
- Management may feel that they can meet their business objectives better without market regulation or the need to pander to short-termist fund managers. Now may be the time to think of a buy-out.

Own Debt Purchases

- Can be a way of de-leveraging. In the current market, the chance to buy one's own debt at less than face value may be attractive.
- Facilities agreement needs to be reviewed for constraints on purchase of debt. Banks may object to individual members of the syndicate being prepaid and/or to borrower cash being used for debt buy-back.
- Tax and accounting issues need careful consideration, as will class tests.

For further information about how Travers Smith can help, please contact any of the dedicated team below:



Jeremy Walsh

Head of Banking

jeremy.walsh@traverssmith.com

+44 (0)20 7295 3217



Keith Bordell

Head of Corporate Recovery

keith.bordell@traverssmith.com

+44 (0)20 7295 3234



Richard Spedding

Corporate Partner

richard.spedding@traverssmith.com

+44 (0)20 7295 3284



Spencer Summerfield

Head of Corporate

spencer.summerfield@traverssmith.com

+44 (0)20 7295 3229



Kathleen Russ

Tax Partner

kathleen.russ@traverssmith.com

+44 (0)20 7295 3230



Simon Skinner

Tax Partner

simon.skinner@traverssmith.com

+44 (0)20 7295 3242

Travers Smith LLP

10 Snow Hill

London EC1A 2AL

T +44 (0)20 7295 3000

F +44 (0)20 7295 3500

www.traverssmith.com