

Financial Turmoil Management

Private Companies

October 2008

The current financial turmoil and anticipated recession will give rise to a number of issues for private companies that require careful management. We have outlined below some of the more important potential risks and opportunities that may arise.

Risks

Practical Management

- Consider financial techniques available, for example, asset based lending and enhanced treasury operations.
- Keep creditors and other counterparties onside.

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.
- Facilities agreement should be reviewed to see whether it allows an equity cure and on what terms.
- If accounts prepared on an IFRS basis additional complication for end of year financial covenant test.
- Distressed lenders may lose customary reluctance to enforce on the basis of "technical" events of default so compliance with all undertakings is important.
- Market practice regarding "standstill" agreements, equity cures etc. is evolving and methods of dealing with breaches are being developed.
- Consider what help (if any) is needed from shareholders.

Director Liabilities

- Directors need to manage conflicts of interest.
- 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 (effective 1 October 2008) is vital.

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 finance from Icelandic banks.
- Any collapse of a Joint Venture, partner or supplier 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.

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Opportunities

Distressed M&A Deals (Outside Insolvency)

- Acquisitions may well be asset purchases rather than share purchases because few, if any, warranties of any substance will be available. Due diligence and pricing are keys to success.
- The Seller may need bank waivers or standstills, and possibly new money, to enable the sale process to be completed.
- Control might be obtained in the first instance by buying the bank debt.

Distressed M&A Deals (Insolvent Seller)

- A Buyer will need to move quickly as the Seller may run out of time or money. A sale by an administrator or receiver may be unavoidable.
- "Pre-packing" 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 and retentions accordingly.
- If a company is placed in administration that may present opportunity for management to obtain private equity backing to buy back the business.

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 buyback.
- Tax and accounting issues need careful consideration.



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