

Can Lenders & Borrowers Align?

To stay in business, Banks must lend and Companies must borrow. How does this happen when Banks are burdened with bad loans and many Companies can't repay? Do we wait for the Asset Management Company to save the day? Eric Stambler of PRI Project Development, explores the possibilities.

Financial sector restructuring and corporate restructuring go hand-in-hand. However, the focus of policy-makers is almost always the macroeconomic picture and not the Real Sector, which produces jobs and growth. Unless the two are being addressed in parallel, we are in for a long slump.

Experiences from many countries indicate that banks and their viable corporate customers cannot afford to wait for the Asset Management Company (AMC) to sweep up the so-called "toxic loans" from the banking system. Delays in the approval and implementation of plans have caused viable businesses to collapse and many jobs lost, since debtors were unable to obtain new and reasonably priced money needed to fund working capital.

In an ideal scenario, such companies would initiate voluntary workouts of their non-performing loans, and their banks would have the capacity to develop sustainable solutions to support these customers and improve their own balance sheets. In the process, "Safe Lending" would have a good chance of becoming the acceptable practice, which is one sure way to enhance the economy.

Unfortunately, there is little experience in workouts and debt restructuring, so the decision-making and approval processes are slow. There is an obvious preference for straightforward debt collection, regardless of how unlikely it is to produce the desired results.

"Safe Lending" involves thorough risk mitigation and due diligence. Companies that are candidates have invested in properly converting their Vision into fully-developed Projects: They can demonstrate that they have developed a clear understanding of the market and competition, and how they can execute their business plan. This is undertaken by utilising the appropriate technology, the required expertise and management, accurate information on costs, timetables and profitability. They produce a clear and complete information package that addresses the questions and concerns regarding the various risks of

the proposed transaction.

Banks must confront their capacity problem head-on, build capacity in workout and risk units and outsource experienced professionals to tackle the difficult task of identifying potentially viable firms within their portfolio and to forecast the future performance of these enterprises based on restructured debt. This will enable them to provide fresh working capital in a structured and secure manner to debt-burdened companies that have the potential to be good customers. That will keep the viable firms alive, hence a much better chance of collecting a higher percentage of their old debts.

At the same time, Companies need to accept that they may have to attract professional management, reduce their workforce, shed unnecessary assets, work harder to collect overdue receivables and take other steps in an effort to stay in business in the new environment. This restructuring will serve to make them a better risk for "Safe Lending." Obviously, the amount of debt a company can sustain is determined by the company's cash flow and the company's cash flow is often determined by the quality and availability of Working Capital. Lenders cannot expect reliable debt service in excess of the company's cash flow.

Our experience shows that debt restructuring can produce a triple-win situation. The banks can ensure themselves of repayment over time; viable companies can complete their projects, or obtain fresh working capital to reach former levels of output, and eventually put themselves on the path to growth; the economy can benefit in a sustainable way.

Lessons from financial crises involving corporate distress over the past two decades in Europe, Asia and Latin America have been reviewed to determine which policies were effective in creating solutions. Obviously, different types of assets require different approaches in terms of asset disposition and restructuring - large corporations, small firms, real estate, etc

In the late 90's we were invited by a consortium of



Candidates for Restructuring
 A number of non-performing Nigerian companies and projects are candidates for restructuring through a workout process. PRI successfully negotiated such a workout in the Steel Industry in Europe.



lenders to work with Skoda, a major industrial company in the Czech Republic. We developed, together with the company's lenders, a structure that enabled Skoda to access fresh capital to fulfill orders from customers of their Steel Plant. The funds came into the company to pay for specific operating expenses to produce a specific set of goods, and the proceeds were applied to repaying the new loans and a portion of the existing debt, before any amount reached the company for other purposes. We assembled a hands-on independent team, with expertise in the industry, giving comfort to creditors that the company was not dissipating its assets, whilst the workout process was underway.

This methodology must be customized on a case-by-case basis, but is generally applicable to "asset light" companies in Nigeria and elsewhere. The downstream oil trading business is clearly a candidate and so is agric. The Banks are exposed, there are several viable



Companies that deserve support, hence the motivation to make the required effort and investment.

WHEN TO CONSIDER A WORKOUT OF PROBLEM LOANS

- The company has a proven market for its products
- It is underperforming and is likely to fail without the support of its creditors
- The owners are willing to bring in new investors and, if necessary, new management and to sell non-core businesses and assets in order to retire part of their debt
- They are also willing to discontinue less profitable or loss-making businesses and to reduce staff and costs where possible
- The company is of strategic importance to the economy
- The prospect of eventual recovery is greater than it would be in liquidation



Creditors are generally not eager (or allowed) to convert debt into equity or convertible bonds. If they were equipped to monitor the operations of priority debtors, these would be effective interim steps. In effect they would “warehouse” the equity until a buyer can be identified to take it over at an improved valuation.

In Nigeria, recoveries from winding up companies are quite low. According to the World Bank, the time to resolve foreclosures in Nigeria is 2 years and the cost is 22% of the total debt being recovered. The recovery rate on claims is 28 cents on the dollar, compared with the OECD average of 68.6 cents. Obviously, to improve it, changes to the legal environment are required. The CBN has endorsed the necessary changes.

It would be wise to follow the suggestions of Olisa Agbakoba (SAN) and others, to streamline Winding Up procedures and unburden the Courts. This would encourage companies to reach solutions with their bankers. Until then a workout is the better option for all parties.

Failure to reform lending practices may prove to be the greatest missed opportunity of the Financial Sector restructuring effort. Regulators must encourage “Safe Lending.” This is the only way to reverse the decline in corporate lending, and to ensure that the cycle does not repeat once liquidity has been restored to the Banking sector.

Eric Stambler, Senior VP PRI Project Development has led the work of international expert teams on PRI’s financial restructuring projects in several countries, and has coordinated negotiations with investors and lenders estambler@priny.com

HOW DID WE GET HERE?

Following the recapitalisation of the banks in 2005 and increased liquidity in the sector, Nigerian corporations borrowed heavily and expanded into many low-margin or loss-making businesses and markets. Later, many otherwise productive firms were severely affected by the general downturn in the economy, either suffering a decline in sales themselves or having customers who were unable to pay their bills. The financial crisis sparked by the fall of the stock markets made it difficult, if not impossible, for these highly leveraged corporations to service their debt, undermining, in turn, the health of the financial institutions that had extended loans to them.

The Nigerian AMC is to issue bonds of up to N500 billion, with the proceeds used to enable the banks to resume their roles of lending and financial intermediation. However, what is being done to prevent the current bad debt cycle from recurring?

The process of getting it started has been slow, and is likely to continue being slow before doing its appointed job. The key to the rescue of viable companies is SPEED. Furthermore, the revival of bank lending to corporates in general is the key to economic growth in any country. Unfortunately, much time has been lost. Standard Chartered Bank research indicates that credit to the private sector has dropped by nearly 12% over the last year.