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Business Restructuring & Insolvency Report

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Restructuring is here to stay

by Peter Wolterman and Koos Beke, PwC Netherlands

We strongly believe that the restructuring market has changed over the last few years. Megatrends create a continuous flow of restructuring cases, independent of cyclical downturn. The economic outlook provides a further basis to expect a continued high number of restructurings in 2015 as low growth is expected and certain industries have depleted their buffers.

INTRODUCTION

We expect that the number of restructuring cases will remain high for 2015 and years thereafter. This view is shared by the special credit departments in The Netherlands. In this article we touch on four important aspects that will impact the Dutch restructuring market in 2015 and onwards:

1. Megatrends;
2. Sale of (non-)performing loans;
3. Insolvency law reforms; and
4. General economic outlook.

Megatrends cause business models to change continuously and rapidly. Tomorrow's financial advisor has to have more extensive strategic knowledge and capabilities to assess the impact of megatrends. In addition, we expect demand for operational restructuring to increase, as companies will want to shift to new business models and become more flexible. Upcoming insolvency law changes in the Netherlands offer two new restructuring tools, focused on business preservation (via debtor-in-possession restructuring) instead of liquidation: a Dutch Pre-pack and a Dutch Scheme of arrangement. Both regimes are still under construction, but an informal pre-pack is already put to practice. We expect the megatrends and insolvency law reforms to impact *how* financial advisors help clients to solve their problems.

IMPACT MEGATRENDS ON RESTRUCTURING MARKET

Megatrends are global trends that affect how economies and

companies operate. Examples of today's megatrends are resource scarcity, technological breakthroughs, shifts in economic power, accelerating urbanisation and rapid changing business models. The latter is reinforced by (disruptive) technological breakthroughs and digitalisation that significantly shorten the life cycle of business models. The shorter life cycle is illustrated by the numerous restructuring cases related to retailers. They have to tailor their business model, decide on clicks *vs.* bricks and develop an 'omnichannel' strategy to stay competitive. Example of large bankruptcies of retailers are Halfords (130 stores), Harendse Smid (33 stores), Free Record shop (141 stores), Schoenenreus (140 stores) and Mexx (315 stores). Each large Dutch retailers who were unable to timely adapt its business model affected by the megatrend digitalisation and internationalisation.

Resource scarcity and related shift to renewable energy is another megatrend that affects restructuring cases. Governments heavily subsidised wind/solar energy. In addition, shale gas and the economic downturn lower prices for energy. Energy companies will have to revisit their strategy and business model. Traditional energy plants in the EU have difficulties generating profits especially. As energy prices from renewables cannot be matched (due to subsidy and zero marginal cost) and renewables fill-in large parts of the energy peak demand (which was a cash-machine for traditional plants), energy companies

have no other option but to operationally restructure their plants and adjust the cost base to remain profitable. In the long run we expect them to change their business models. E.on has already initiated a first step by separating renewables and traditional energy production.

We expect that the megatrend of rapid changing business models to create a continuous flow of restructuring cases, despite economic recovery, and also to change the nature of the restructuring cases. Focus will shift from distressed balance sheet restructuring to operational restructuring (adapt the business model) and changing of the debt structure accordingly. The newly developed business models have to be flexible to allow for changes driven by megatrends. Obviously, this trend also affects the required capabilities and focus of a restructuring advisor. He/she will have to combine both strong strategic and strong financial capabilities with the ability to effectuate a turnaround in an organisation.

SALE OF (NON-)PERFORMING LOANS

Basel III and Solvency II have caused Dutch financial institutions to buy and sell (non-)performing loans to optimise their balance sheet. In recent years the asking price showed a gap vis-à-vis the price offered for loan portfolios. However, the price gap has reduced/ been closed due to a number of reasons. Therefore we expect increased loan portfolios transactions in The Netherlands for 2015-2016. Important reasons are:

1. In 2014 the asset quality reviews (AQR) did not only provide insight to the financial institutions into their asset portfolio, but also increased the level of financial provisions (mainly related to real estate, e.g. Rabobank provisioned c. €0.5bn on its real estate portfolio in 1H14). (Additional) financial provisions have contributed to closing the gap;

2. On demand side we see credit funds with increasing liquidity and also leverage becoming available for portfolio transactions. Funds consider (non-)performing loans as an interesting investment opportunity given the high anticipated risk premium on their investment. Over the last years, return on investment in European countries such as UK, Ireland and Spain has decreased due to

increased demand from (i.e. competition amongst) investors. As a result, investors have started a search for higher return on investments in other territories, such as the Netherlands.

The entire EU market for loan portfolios has shown a significant increase of traded portfolios (€67bn in the first 9 months of 2014) and is trading above expectations. The Netherlands is no exception with an estimated €3.9bn in the first 9 months of 2014. We anticipate a further increase in 2015 as (non-)performing loan portfolios of Dutch financial institutions are brought to market to improve their balance sheet. In the Dutch market, the traded debt mainly relates to real estate (as opposed to corporate debt).

REGULATORY CHANGE: INSOLVENCY REFORMS

Dutch insolvency law is under reform. Two important proposed legislative changes are the (secret/silent) appointment of an administrator before bankruptcy ('WCO I', similar to UK Pre-pack) and the introduction of out-of-court creditor agreement ('WCO II', similar to UK Scheme of Arrangements).

WCO I offers the possibility to prepare the sale of a distressed company prior to insolvency. The administrator is (secretly) involved before bankruptcy and can therefore approve the deal as soon as bankruptcy is declared (the so called 'silent administrator'). This offers the opportunity to realise higher proceeds compared to an uncontrolled bankruptcy and to save jobs as the business can be sold instead of merely the assets. Currently, TUPE rules are not applicable (i.e. no obligatory transfer of personnel to buyer), which makes it a very powerful restructuring tool. Whether or not TUPE *should* apply is currently under discussion. Anticipating the new legislation, some of the Dutch courts already facilitate informal pre-packs. As not all Dutch courts approve the appointment of a silent administrator prior to bankruptcy, forum shopping within the Netherlands has started.

Recent cases in which the company was sold through insolvency to a related party (e.g. Estro) or in which the company was given a new start but implemented significant salary cuts (e.g. Heiploeg) have made the general public more sceptical about the Dutch pre-pack. Interviews learn that stakeholders (e.g. administrators, courts etc.) have become more reserved to co-operate with the pre-pack. These developments illustrate the need for transparency and 'proof' that the right decision was made. In our opinion, proof is provided if the market is sufficiently tested (to create a market price for the company) and if option analyses are available to clearly show that the pre-pack has a more favourable outcome for creditors compared to the liquidation scenario. Because Dutch courts only appoint silent administrator before bankruptcy for a very limited time (1-2 weeks), proper preparation before the appointment of a silent administrator is key. Research has shown that there is still a lot to gain on this crucial point. If WCO I becomes law, we anticipate an increase in distressed M&A processes and restructuring professionals will have a strong tool to implement a turnaround.

WCO II introduces an out-of-court, debtor-in-possession restructuring tool. It allows the debtor to propose a restructuring plan and to cram-down dissenting creditors (if appropriate majorities vote in favour of the plan). The Dutch legislator has taken the US Chapter 11 and UK Scheme of Arrangements as starting point for the new regulation. Current draft bill looks promising and adds an important, missing, restructuring tool to the Dutch restructuring arena. We expect an increase in financial restructuring cases (and decrease in insolvencies) following the passing of the bill, as it becomes less burdensome to come to an agreement with relevant stakeholders (majority instead of unanimity is required). Although The Netherlands has quite a good track record in informal restructuring processes, sometimes out-of-court restructuring plans are difficult to realise due to (minority) creditors or shareholders who exploit their nuisance value. We anticipate that valuations will play an important role in the WCO II process to determine if the minority can be bound to the plan via a cram-down. The draft bill will be further developed and discussed in 2015.

If both WCO I and II are introduced, we will have two new and strong restructuring tools available in the Netherlands, finally aligning our jurisdiction with that of other European countries. Please refer to the contribution of Loyens & Loeff in this book for information on the legal aspects of the proposed legislative changes.

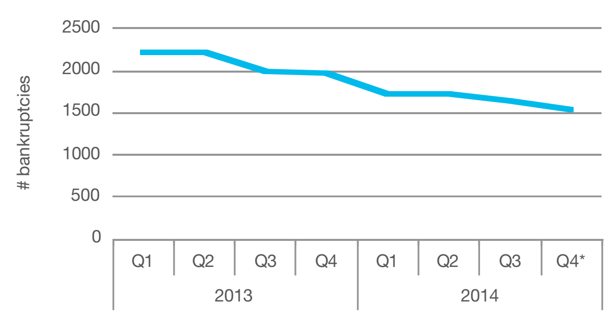
ECONOMIC OUTLOOK DUTCH ECONOMY

The Netherlands has an open economy and is therefore dependent on global and EU economic developments. 2015 economic outlook shows signs of economic recovery with limited 1.5% GDP growth, resulting from, amongst others, increased consumer spending and +4% export. The depreciation of the euro should further improve our competitive position. Insolvencies are at an historical high level, however over the last quarters the number of insolvencies has shown a steady decline, expected to continue in 2015 (-0.3%). On top of that, employment is expected to decrease from 6.75% to 6.50%, which is earlier than expected. Inflation is estimated at 1%. Latest geopolitical developments (e.g. Swiss Franc, Russia, ECB measures, Greece) will impact abovementioned outlook.

Despite the (slow) economic recovery and the declining number of insolvencies, we do not expect the restructuring market to cool down in 2015. Not only because of the earlier mentioned megatrends, but also because the crisis has taken too long. Company buffers have depleted and the hunger for top line has deteriorated margins, for instance in the building and construction sector. Lending institutions are still cautious to provide new funding and seek (independent) comfort regarding feasibility of the business plan developed by the company.

Other sectors we expect to continue to have issues are retail (mainly fashion and electronics), oil & gas and healthcare. The latter is still struggling with the shift from a government regulated market to a competitive, unregulated market.

CHART 1 - BANKRUPTCIES IN THE NETHERLANDS



* Preliminary numbers
Source: Centraal Bureau voor de Statistiek

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