Restructuring Series: Experience Matters

THE CONSEQUENCES OF BORROWER UNDERPERFORMANCE

Despite stringent credit selection and partnering with supportive private equity sponsors, some private debt portfolio companies underperform expectations, particularly during a downturn such as the Great Financial Crisis ("GFC"). Restructurings can result from this underperformance, with an increase expected to result from the Covid-19 crisis.

For an investor targeting performing credits, restructurings are certainly not ideal. Restructurings can change the terms of the original loan agreement in a number of ways including; altering debt pricing, extending the debt's legal maturity, altering the capital structure with a new money injection, swapping debt for equity, or even writing off a loan entirely.

GETTING OFF TO A STRONG START

Since inception in 2000, MV Credit has been involved in a few restructuring scenarios, most of which date back to the GFC. Whilst the restructurings had different circumstances and involved a range of key players; experience demonstrated the ways in which a private debt investor can seek to safeguard its investment and enter a restructuring on a solid footing:

- **Identify problems early.** An astute investor is always on the lookout for early signs of underperformance, regardless of the economic environment. Waiting for covenant breaches to indicate a company's deteriorating performance will delay action resulting in the loss of valuable time. MV Credit adopts an approach of "healthy paranoia" towards all its portfolio companies and its monitoring processes aim to pick up on early warning signals of underperformance. A key part of this is its independent Credit Monitoring Team, which systematically monitors each portfolio company alongside the Deal Team, using proprietary non covenant based financial ratios.
- If there are signs of underperformance, it's essential to **start discussions early,** even informally. During the GFC, MV Credit was proactive in reaching out to private equity sponsors when it detected underperformance, and it has rigorously continued with this approach during the Covid-19 crisis. Gaining a sense of the sponsor's next steps is crucial to assessing the future of a company and likelihood of a turnaround.

MAINTAINING PROACTIVITY

Once in a restructuring scenario, MV Credit advice to lenders would be to:

- **Aim for a consensual solution and maintain dialogue.** MV Credit seeks to resolve restructurings through a consensual, out-of-court approach, with an agreement typically based on full consent by the debt lenders, or a majority of lenders. MV Credit is generally reluctant to pursue legal enforcement during a restructuring and believes that working collaboratively is usually the best way to minimise credit losses and ensure that trustworthy relationships are maintained.
    - Only one of **MV Credit's historical restructurings** was ultimately non-consensual, with MV Credit challenging a UK scheme of arrangement.
    - Other investors, such as distressed lenders, can be obstacles to co-operation. In a few instances during the GFC, distressed debt funds challenged MV Credit's position whilst seeking an opportunistic profit. However, future restructurings may see distressed lenders pose fewer challenges; with private equity sponsors seeking to protect their portfolio companies with restrictions on transfers[1] and potentially looking to use cov-lite documentation to resist attempts to seize control of their investments[2].
- **Be active in negotiations.** When investing in subordinated assets, MV Credit will usually be one of a handful of lenders (typically up to three), or even the sole lender in the subordinated tranche. This can ensure a key role in a restructuring and afford the ability to engage in bilateral discussions with the private equity sponsor and other key players. During the GFC, MV Credit frequently adopted a leadership role in restructurings, often playing an important role in formal or informal "Steering Committees", which are led by a group of elected lenders. This gave the firm leverage and a greater platform to put across its views and interests.
    - During the GFC, MV Credit played key roles including coordinating the Mezzanine response as one of the main Mezzanine lenders and representing Mezzanine lenders during negotiations.

HARD-EARNED EXPERIENCE

Given the current economic turbulence, investors are focusing a lot of effort into monitoring their existing portfolios. However, some newer players may be limited by a lack of restructuring experience. MV Credit has gained this experience since its inception in 2000 and puts the lessons learnt at the forefront of its investing. MV Credit's supportive conduct during past restructurings and its excellent relationship with private equity sponsors help provide goodwill and certainty should a restructuring arise. Crucially, most of the senior members of MV Credit joined the firm prior to the GFC, whilst MV Credit's Head of Restructuring is one of the firm's founding Partners. This experienced team can provide invaluable leadership and experience during the potentially turbulent times ahead.

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[1] Source: Laura Benitez, Sarah Husband, and Ruth McGavin, "PE Firms Race to Block The Exits to Ward Off Vulture Funds", Bloomberg, Accessed 2nd November 2020.
[2] Source: Robin Wigglesworth and Sujeet Indap, "Distressed debt investors still await rich pickings from pandemic", The Financial Times, Accessed 2nd November 2020.

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