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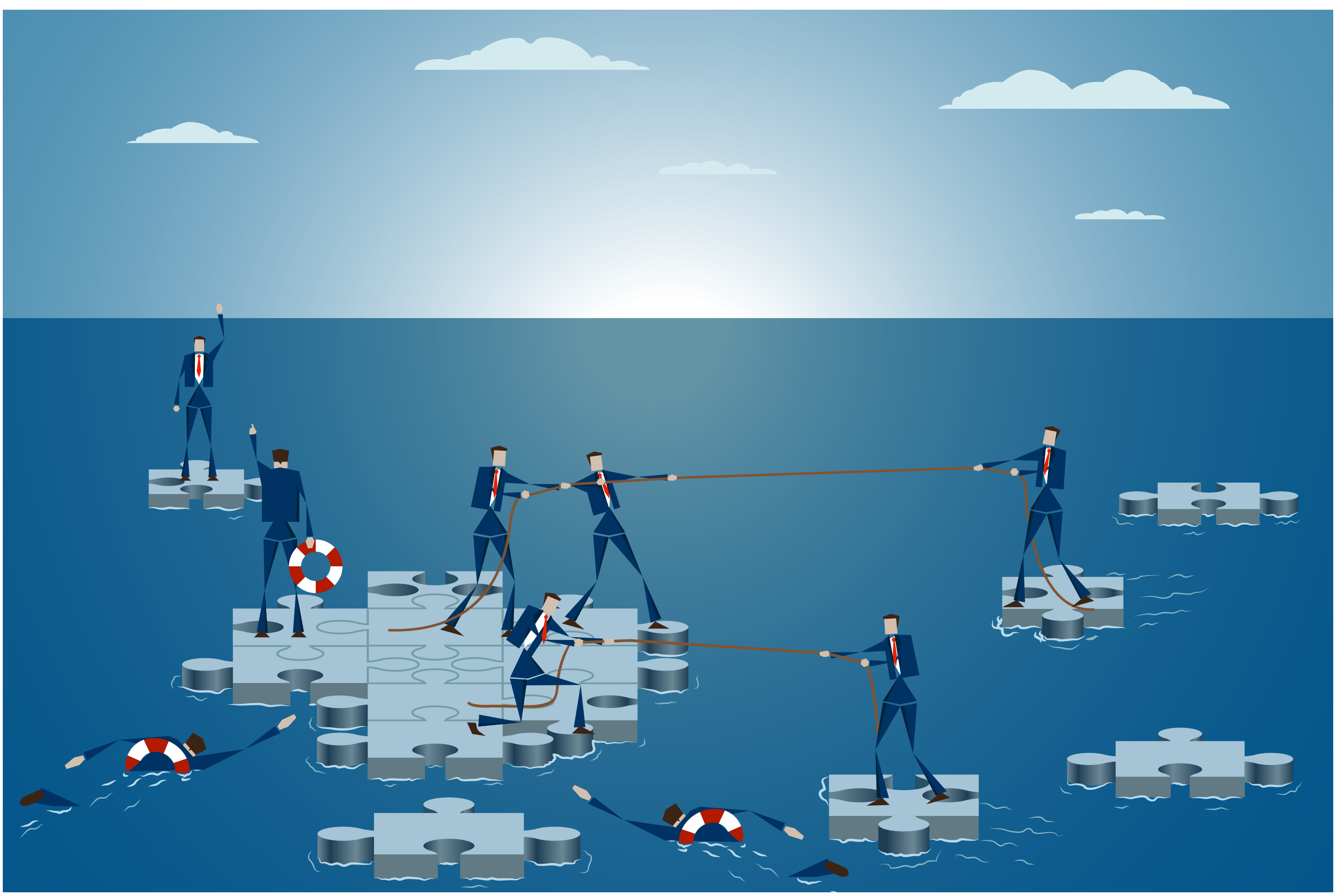
BANKRUPTCY & RESTRUCTURING

Financier Worldwide canvasses the opinions of leading professionals around the world on the latest trends in bankruptcy & restructuring.



UNITED KINGDOM

Shearman & Sterling (London) LLP

Respondents

KEVIN HEVERIN
Partner
Shearman & Sterling (London) LLP
+44 (0)20 7655 5764
kevin.heverin@shearman.com

Kevin Heverin is a partner in Shearman & Sterling's financial restructuring and insolvency practice. He has significant experience representing clients in all aspects of complex restructurings, workouts, debt financings, special situations investing and insolvency matters. His experience includes roles advising companies and stakeholders such as banks, funds, noteholders, trustees, directors and insolvency practitioners on a range of complex cross-border restructurings and financings. He is recognised as a 'rising star' lawyer in Legal 500 for corporate restructuring and insolvency, with clients recognising that he "is exceptionally proactive in helping clients get well ahead of anticipated issues and developments".

ALEXANDER WOOD
Of Counsel
Shearman & Sterling (London) LLP
+44 (0)20 7655 5935
alexander.wood@shearman.com

Alexander Wood is of counsel in Shearman & Sterling's financial restructuring and insolvency practice after retiring as a partner with over 25 years' experience. He continues to consult with Shearman & Sterling as well as pursuing other interests, including academic. He is experienced in all aspects of business restructuring and insolvency, and focuses on complex insolvency work and financial services insolvency and restructuring. He has expertise in the design and implementation of complex schemes of arrangement, cross-border restructurings and formal insolvency procedures. He is recognised across the leading legal directories including Chambers UK 2023 and Legal 500 UK 2023.

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Q. How would you describe corporate bankruptcies and insolvencies in the UK over the last 12-18 months? Are you seeing more or fewer business failures in general?

A. Unprecedented government support and robust credit markets, with low-cost debt available on borrower-friendly terms, meant many businesses avoided financial distress during the pandemic. Debtors took the opportunity – up until the end of 2021 when covenant-lite debt volumes peaked – to refinance debt stacks on attractive terms. However, the environment has changed in the last year. Factors including increased energy costs, inflationary pressures and interest rate rises have created a 'perfect storm' of challenges and mean the outlook for business is more uncertain. As businesses face the impact of the removal of coronavirus (COVID-19) era government support and other headwinds including inflationary pressures, supply side restrictions and interest rate increases, not to mention the impact of the Ukraine situation, further insolvencies do appear likely.

Q. In your experience, which sectors seem to be demonstrating structural weaknesses leading to more restructuring efforts?

A. The uptick in restructuring activity is evident across a broad range of sectors. We have seen increased distress across consumer, real estate and energy, to name a few. Industries exposed to consumer spending, now curbed by interest rate increases and the cost-of-living crisis, and the impact of hybrid working will likely continue to face challenges. Higher input costs, including energy, and supply side disruption brought on by post-COVID-19 adjustment and the Ukraine conflict, create more pressure in an uncertain economic environment. Increases in central bank interest rates have also started to impact not just businesses suffering increased loan costs and reduced consumer spending, but the broader financial markets. This includes institutions holding long-term debt where the value of long-term debt has plummeted. This has resulted in stress in the financial sector.

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Q. To what extent are troubled companies able to refinance and renegotiate existing debt structures in the current market?

A. The last few years have seen leverage multiples continue to grow across many sectors. The average debt-to-earnings before interest, taxes, depreciation and amortisation (EBITDA) ratio for new loan issuances in 2022 was the highest level in 20 years. True leverage is likely to be much higher on account of the flexibility permitted in calculating and adjusting EBITDA in recent vintage debt documents. However, we have seen a change in mood and a greater focus on leverage from creditors, including both banks and private capital providers. As a result, it is going to be more difficult for companies with high leverage or facing stress to effect a refinancing of their existing indebtedness. Increased interest rates and tighter documentary terms create further obstacles and mean a straightforward refinancing may not be available. Those companies will need to consider alternatives, such as further equity support or engagement with private capital providers willing to fund a refinancing or restructuring on more

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flexible, albeit potentially also more costly, terms.

Q. Have there been any recent legislative or regulatory developments, including high-profile cases, in the UK that will have a significant effect on bankruptcy and restructuring?

A. Across Europe, we have seen significant legislative developments, with several new restructuring tools available to debtors allowing for the cram down of dissenting hold out creditors subject to certain conditions being satisfied. This is often related to fairness and valuation. However, many of these new tools remain relatively untested so the next wave of restructuring and insolvency activity will be important in understanding how they perform in practice. The availability of the restructuring plan introduced in summer 2020 in the UK is one of the most significant developments in recent years and ensures the UK regime remains at the cutting edge for complex big-ticket restructurings.

Q. What trends are you seeing in the market's appetite to purchase troubled assets? How would you describe recent distressed M&A activity?

A. We expect an increase in appetite for distressed assets and companies in the coming months. Through H2 2022, a combination of uncertainty regarding valuations and the economic outlook generally meant many investors adopted a 'wait and see' approach. However, we are already seeing a greater willingness to engage on live opportunities, as expectations around valuation are adjusted to account for economic headwinds. While financing has become more costly, distressed investors will still have an appetite to explore M&A opportunities where they see businesses with turnaround or growth potential.

Q. What trends are you seeing in cross-border or multijurisdictional insolvencies? What additional challenges do such engagements present?

A. The range of restructuring and insolvency tools available across Europe means debtors have more choice, in terms of processes, than ever before. This means advisers and stakeholders will

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need to consider the optimal restructuring route in any given situation. The fact that there is unlikely to be a 'perfect' solution in every case will give rise to some challenges. In such circumstances, it is imperative advisers in relevant jurisdictions work together in devising a restructuring strategy that is focused on value preservation and on putting the debtor back on a strong footing. Given the availability of capital, even if more likely private capital, and the significant flexibility in debt documentation, we anticipate most restructurings will continue to centre around the provision of shorter-term liquidity and the potential extension of debt maturities as a bridge to a refinancing in the future when debt capital markets are more attractive to borrowers. Stronger borrowers have and may continue to lock in debt extensions now in return for improvement to debt terms as an incentive to lenders. Some with relatively future debt maturities in 2025 have been pushing those out to 2027 or beyond. The flexibility in debt documentation is likely to allow debtors and their sponsors to explore potential options which might avoid a deeper capital restructuring. Some options may be achieved consensually, using consent thresholds under the documentation, or in combination with a legal process using a lower voting threshold to bind minority creditors. In the US, we have seen an increasing number of restructurings voted on by majority creditors which result in equal ranking creditors receiving different outcomes depending on such factors as whether those creditors provide further funding. While some of these are being litigated in the US, it is possible some of these trends will emerge in Europe.

Q. Looking ahead, what developments do you expect to see in restructuring and bankruptcy processes in the coming months?

A. Most restructurings will be predicated on a valuation of the business and identifying which creditors are in the money, partly in the money or out of the money. Valuation is often necessary in terms of enforcing security and will also be relevant in the context of a legal process used to modify creditor rights, either as a comparator to determine voting classes or in the context of using a disenfranchisement or cram-down

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tool. From a debtor perspective, and to mitigate the risk of a challenge, proponent companies and their advisers will need to provide robust valuation evidence as part of any complex cross-border restructuring process. Those seeking to oppose a restructuring on grounds of valuation will need their own expert evidence supporting their views as to valuation and why the company valuation is deficient, and to assess the commercial merits of a challenge. We also anticipate European jurisdictions, including the UK, will seek to make attractive more powerful restructuring tools for small and medium-sized enterprises (SMEs). SMEs are more likely to face greater challenges and have fewer options, so providing a streamlined restructuring regime will be a particular priority in any economic downturn. ❑

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KEVIN HEVERIN Partner
+44 (0)20 7655 5764
kevin.heverin@shearman.com

ALEXANDER WOOD Of Counsel
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