

# Why the distressed sector is floundering to recover



Anyone outside the distressed investment sector would think that a bunch of distressed investment professionals attending the recent 'Distressed Investing Europe' conference would be looking in on one big party. It would seem that the hard-nosed expression, 'it would be a shame to waste a good recession', just doesn't cut it in this market place, according to **Graham Smedley**, a serial interim FD/MD specialising in distressed situations who shares his observations from the conference and sheds some light on what is holding back distressed businesses from recovery.

The keynote speech over a satellite link from Wilbur Ross and a later overview by the Linklater team addressing the Lehman Bros failure, touched upon the stratospheric events of the past 18 months. The majority of us attending, ranging from professional investors, Pan-European corporate lawyers, insolvency practitioners and turnaround and restructuring advisors, were all in search of some answers as to why distressed and restructuring deal flow was not getting fed through the ranks. This was of particular interest to an interim such as myself. Why were more companies not calling out for interim restructuring help? Certain points were made during the various sessions that resonated strongly with me. I've highlighted them here for you.

## **No new bank money**

The increased volume of rights issues and financial restructuring activity is a reflection of the unwillingness of banks to put new money into corporations. However, debt rescheduling and moratoria are open for debate. Bluntly speaking there is no new bank money for big corporations seeking restructuring support finance. Small cap/SMEs might fair slightly better. And while bridging finance to support a corporate disposal strategy can be found, it will be granted at high premiums. And while recent improvements in the FTSE-100 index would seem to reflect relief that banks and the financial system are in safer waters, it is expected that in the intervening period banks will write off more bad debt (corporate & personal); more businesses will fail and unemployment will rise.

## **Liquidity in an illiquid marketplace**

An unwelcome consequence of the destruction of enterprise value and the inability or unwillingness of investors to introduce additional equity has been that senior debt (usually from banks) has in fact been faced with liquidation (in an illiquid marketplace) or debt/equity swaps.

## **More casualties for retail sector will create new ventures**

Anyone investing in the retail sector will be living on a knife edge (excluding essential foodstuff supermarkets as exchange rates and commodity prices are generating margin pressure. As restocking for Christmas commences around September, more failures should be expected, exacerbated by credit insurance removal. Whilst gaps will appear in the High Street this will allow winning business models to extend themselves and new ventures to appear. Landlords' headline rents and lease periods/break clauses will come under increasing pressure. Resistance by landlords will accelerate good retail brands to accelerate and expand their e-commerce activities.

### **Automotive sector still in dire straits**

Any investors servicing or investing in any area of the automotive industry will be feeling a negative impact as the industry is in dire trouble. The balance sheet of Fiat lacks the strength to take over and restructure Chrysler without US government support under pressure to save jobs. GM will require significant restructuring, which can only be done under Chapter 11 Court protection. The implications within Europe are clouded in uncertainty – significant job losses throughout the supply chain seem inevitable.

### **Spanish banks in denial**

Spain is distressed. If you had heard the revelations of the panel from Spain you would have offered them pain free euthanasia to put them out of their misery – 17% unemployment rising towards 20%. A large volume of developments are still unsold and left unfinished. Banks are in denial on property values and in holding mode – however they don't have the liquidity to do so – which is why investors are giving it a pass until the penny and the prices drop.

### **Hands-off for Russian distressed investing**

Russia/CIS was perceived as having exciting opportunities, however there were several warnings:

- a) Not advisable to contemplate ex Government owned businesses
- b) Select partners very carefully
- c) Commercial deals are often done on a wider personal network basis, not necessarily as in Western Europe
- d) Avoid distressed investing – court and commercial law seriously under-developed
- e) Selling an investment and taking profit/cash out of Russia could be difficult for the foreseeable future

### **Private Equity in fence sitting mode**

Private equity and corporates with 'war chests' are, in the main, fence sitting in expectation of better bargain basement investments and greater confidence that a commercial 'bottom' has been reached and a recovery timeframe is emerging that they can believe in.

Considering the above it would be easy to fall into a 'gloom & doom' mentality. However, the corollary implications suggest exciting opportunities that must emerge, albeit not necessarily from the normal channels of recent years. Sectors will see winners and losers and as a result new business models will emerge. Supply chain priorities will be re-evaluated and consolidation will be driven by revised funding logic.

**Graham Smedley** is an Interim MD/FD with 20 years' experience of being brought into stressed/distressed situations. He has completed successful assignments which have won him the confidence of stakeholders (including private equity and banks) in sectors including aerospace, financial services, FMCG, wholesale distribution, e-commerce, property development & management, manufacturing and engineering.

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