



# RESTRUCTURING IN THE SHADOW OF BANKRUPTCY: A PERSPECTIVE ON NORSKE SKOG

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OSLO, JANUARY 23, 2018



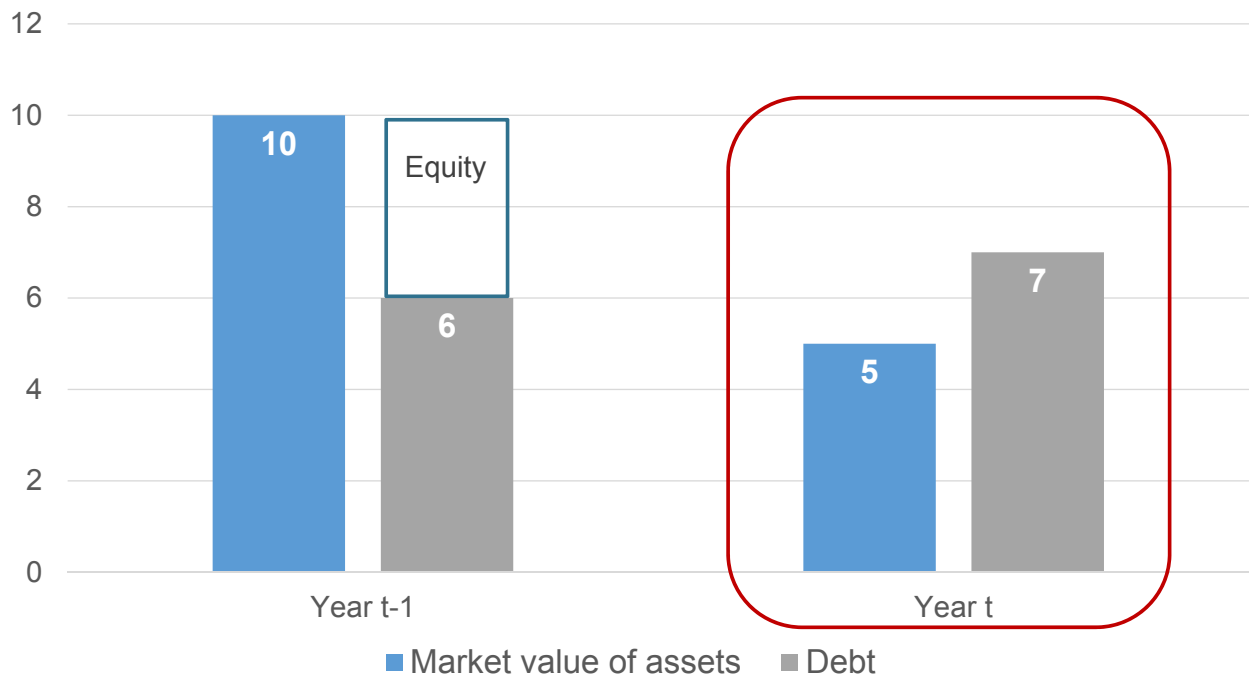
## Economic distress vs. financial distress

	Economic distress	Financial distress
Cause	Broken business	Broken capital structure
Problem	Declining revenues Low operating margins	Too high leverage
Going-concern value	Low	High
Action	Liquidate	Recapitalize - Less debt, more equity

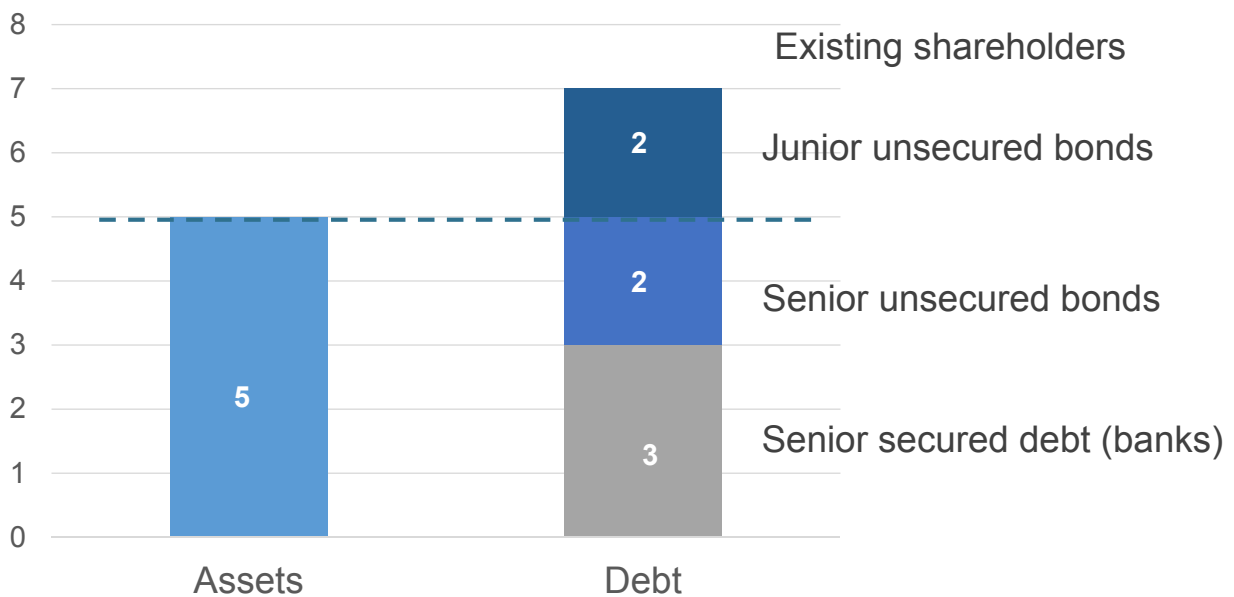
Important to determine the root of the problem!



# Financial distress puts a stop to value decline



# The waterfall: who should get what?





## Out-of-court negotiation over firm value

- Equity holders control the firm
- Must agree with creditors on how to split the pie
- Creditors' bargaining power depends on their expected payoff in bankruptcy
- This varies across bankruptcy codes
  - The greater the expected payoff in bankruptcy, the greater claim to value in out-of-court restructuring
- Drawn-out negotiations may reduce the value of the pie
  - Management attention on restructuring rather than business
  - Key employees and customers may leave



## US Chapter 11

- Strong protection of the going concern
  - Management stays
  - Debtor-In-Possession (DIP) financing
  - Stop of debt service (interest, principal and collateral)
  - Executory contracts can be terminated
  - Preferential treatment of critical suppliers
- Structured bargaining among creditors
  - Creditors organized into classes
  - Can propose a reorganization plan after 6 months
  - Voting rules (2/3 in amount, 1/2 in numbers) within each class
  - Cram-down if proposed recovery > liquidation recovery
  - Advisors (lawyers, bankers) paid by debtor



## Norwegian bankruptcy

- No protection of the going concern
  - Operations stop immediately
  - Suppliers paid last and stop delivering
  - Secured creditors can seize assets
  - Firms is liquidated piecemeal
- This makes the “pie” implode!
  - Little value left to bargain over
- Distribution of value according to absolute priority (APR)
  - Secured creditors seize most of the value



## Implications for out-of-court bargaining

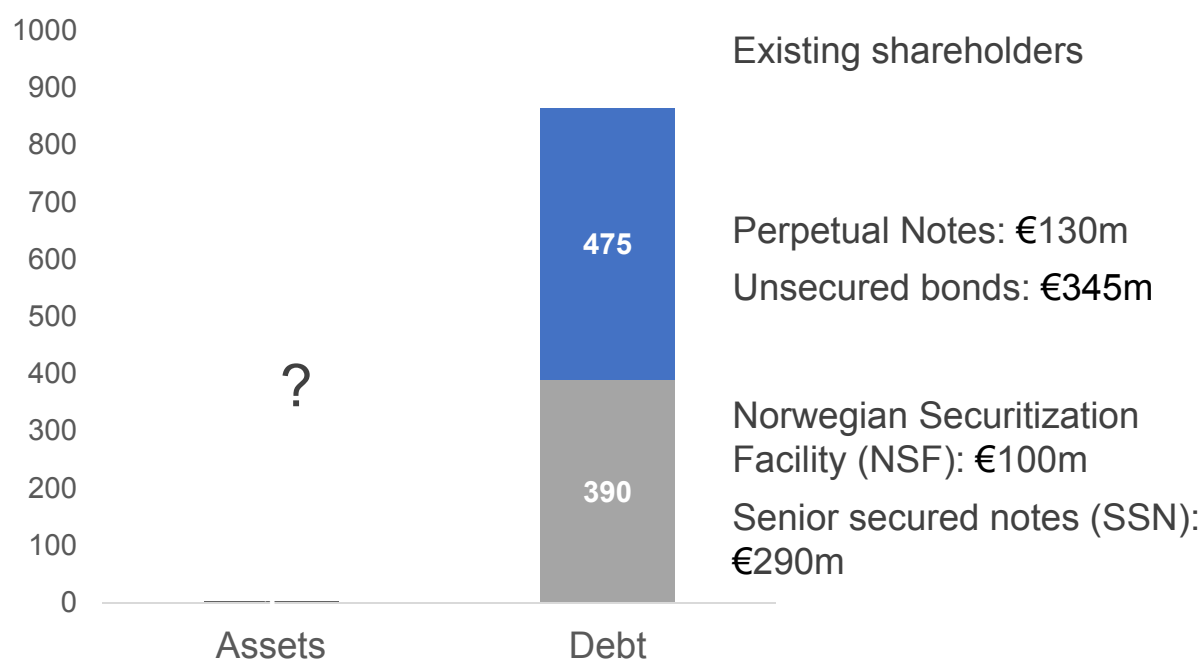
- Junior creditors stand stronger in the US
  - Preservation of going concern value implies a greater pie to split, leaving more for junior creditors in bankruptcy
  - As long as secured creditors get paid in full, juniors creditors can take charge of the renegotiation
  - Equityholders receive very little, if anything, in Chapter 11
- Equityholders have more bargaining power in Norway
  - Secured creditors prefer a negotiated solution to preserve the value of their claims
  - Threat of liquidation, which leaves little for junior creditors, used to pressure junior claimants

## An example: Norske Skogsindustrier ASA

- Large producer of publication paper
  - Annual sales of €120m and 2,500 employees
  - Seven paper Mills owned through subsidiary Norske Skog AS
- Declining sales and operating profitability
  - Still some going concern value at the core
- Extremely high leverage from acquisition funding
- Situation in Q2-2017 clearly not sustainable
  - Book equity of €-60m vs. €865m of debt
  - CF from operations €23m vs. interest expense of €19m
  - NS defaults on interest payments in June 2017

*Disclaimer: I rely on public information only*

## Total debt of €865m by Q2-2017

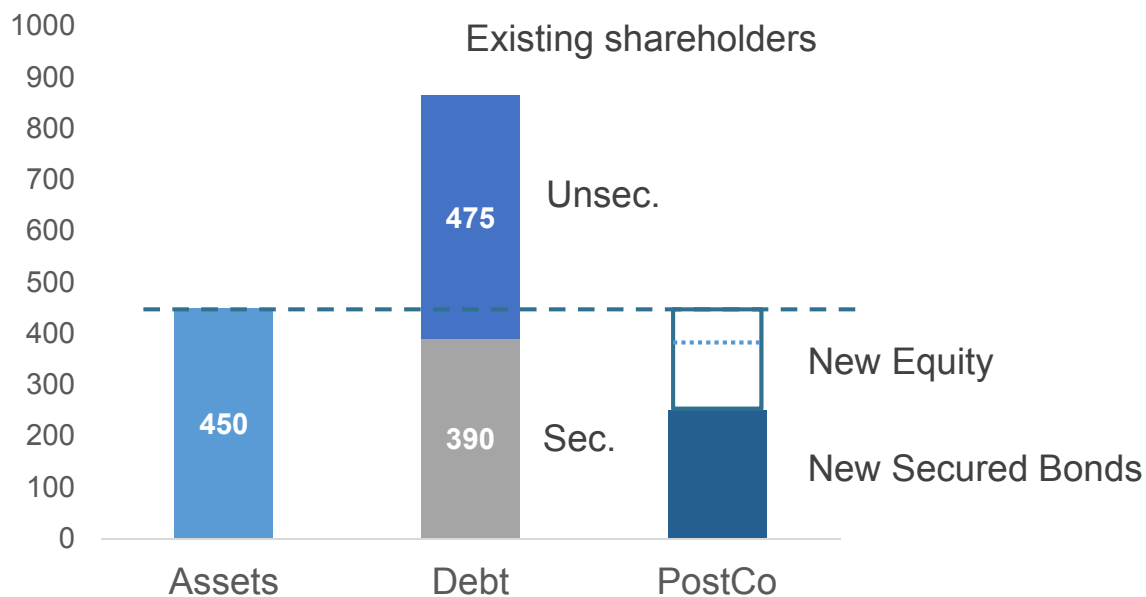




# Asset valuation is key

- Restructuring proposal uses EV of €450m
  - EV/EBITDA multiple of 6x
  - 2017 forecasted EBITDA of €75m
- Key issue: How should this value be divided?
- Several restructuring proposals in 2017
  - June 2 by equityholders (10% of equity to shareholders)
    - Standstill agreement w. creditor
  - July 14 by secured creditors
    - €15 mill liquidity bridge to support operations
    - Secured creditors appoint new board in Norske Skog AS (Sep 12)
  - Sept 18 by equityholders
  - Sept 27 by unsecured creditors
  - Oct 18 by equityholders

## At 6x, most value should go to the secured...



## Proposal of October 18, 2017

- Secured creditors: Secured bond of €250m + 90.75% of equity
- Unsecured creditors: 6.75% of equity
  - New money issue of €30m for 6% of equity
  - Warrants for 6% of fully diluted equity
- Existing shareholders: 2.5% of equity
  - New money issue of €20m for 4% of equity
  - Warrants for 4% of fully diluted equity
- €16m of proceeds from new money issue used to repay liquidity bridge provided by secured creditors
- Warrants expire 6/2019, exercised at EV of €525m (7x EBITDA)





## Implied payoff at EV of €450m (6x multiple)

(MEUR)	Face value	Accr. Int. <sup>1</sup>	Total claim	New equity <sup>2</sup>	New senior debt	New equity frac.	New equity value	Total net payoff	Rec. rate
Secured	390	23	413		250	72%	179	429	104%
Unsec.	475	29	504	30		18%	45	15	3%
Exist. Shareh.				20		0	26	6	
Total	865	52	917	50	250	100%	250	450	52%

<sup>1</sup> Assumes interest expense of 1% per month for 6 months

<sup>2</sup> Assumes full subscription to equity offering and ignores any value of warrants



## Deviations from absolute priority

- Secured creditors get full recovery—if not more
- Existing shareholders get one-third of the remainder, despite unsecured creditors not being paid in full
- Why do shareholders get so much?
  - Can force NS into bankruptcy
  - In Norwegian bankruptcy, assets would be liquidated and unsecured creditors receive close to nothing
  - In Ch. 11, unsecured creditors would stand much stronger
- As time passes, secured creditors accrue interest (1% per month), increasing their total claim
  - Erodes the claim of the unsecured creditors





## But recovery depends on asset valuation

	EV @ 5x multiple			EV @ 6x multiple			EV @ 7x multiple		
	Equity value	Net payout	Rec. rate	Equity value	Net payout	Rec. rate	Equity value	Net payout	Rec. rate
Secured	125	375	91%	179	429	104%	233	483	117%
Unsec.	31	1	0%	45	15	3%	58	28	6%
Exist. Shareh.	18	-2		26	6		34	14	
Total	175	375	41%	250	450	52%	325	525	57%

<sup>1</sup> Assumed interest expense of 1% per month for 6 months

<sup>2</sup> Assumes full subscription of equity offering and ignores any value of warrants



## Oct. 18 proposal fails to receive support

- Shareholders and unsecured creditors agree to the proposed plan
- But Blackstone, holding 75% of NFS (through its subsidiary GSO), surprisingly holds back its approval...

### Nov 23, 2017

- Q3 results released: EBITDA for Q3 of €14m (c.f. €19m Q3-2016), and €49m YTD 2017 (€83m YTD 2016)
  - Makes 2017F EBITDA of €75m less likely
- Oceanwood Capital Management (OCM) announces it has acquired the NFS from Blackstone
  - OCM already owns a majority of the SSN
- Aker and OCM will form a joint company and bid for Norske Skog AS



## December 2017

- Dec 13: Secured creditors move ahead with auction
  - Norske Skog AS appoints Evercore to act as financial adviser in a sale of Norske Skog
  - Together with Citibank, the agent bank for the secured creditors, Evercore will arrange an auction for Norske Skog
- Dec 19: Norske Skogsindustrier ASA files for bankruptcy
  - Norske Skog AS, the operating company, stays outside of bankruptcy
  - HQ is transferred to NS AS and operations continue with “business as usual”
  - Shareholders acknowledge that their investment is lost



## The auction of Norske Skog AS

- How much is the highest valuation bidder willing to pay?
  - Depends on competition and going concern value
  - Are strategic bidders financially constrained?
  - Are Norske Skog’s assets interesting to PE?
- Today, the total secured claim (including accrued interest) must be at least €420m
  - €390m of face value + €30m of accrued interest
- If highest bid < €420m, all proceeds will go to the secured creditors
  - At EBITDA of €70m and 6x multiple, NS valued at €420m
  - If worth more, unsecured creditors have an incentive to bid in order to push up the price

## Key takeaways

- Norwegian bankruptcy is harsh and incentivizes creditors to negotiate out-of-court
- By controlling the fate of the firm, equityholders get more bargaining power than in other bankruptcy regimes
- Banks are secured and stand strong in the negotiations
  - But have little willingness to take equity due to high risk-weights
- Unsecured creditors get squeezed in the middle
  - Deviations from APR
- Distressed investors, such as hedge funds, facilitate the restructuring by consolidating claims
- Auctions often provide an efficient and speedy resolution

## It ain't over yet...

Dagens Næringsliv | Tirsdag 23. januar 2018

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# Har mottatt bud fra flere selskaper

Fristen for å melde seg på i budkampen om Norske Skogs papirfabrikker har nå gått ut. Det meldes om «robust» interesse og flere selskaper har levert inn indikative bud.

### INDUSTRI

Christian Bjerknes  
Oslo

Tirsdag morgen gjennomføres første skiftesamling i konkursboet Norske Skogindustrier asa. Der børsnoterte papirkonsernet slo seg selv konkurs den 19. desember etter at en langvarig kamp for å finne en refinansieringsløsning for det gjeldstyngede konsernet

