LatAm Restructurings: The Mañana Complex

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Restructuring professionals are fond of saying that all restructurings are different and that you can't generalize from one to another. While it is undoubtedly true that every case features its own peculiarities and develops in unpredictable ways, there is one theme that cuts across virtually every restructuring process: they start way too late.

Advisors are accustomed to analyzing companies that are nearly certain to require a balance sheet restructuring in the foreseeable future, only to find them deferring the decision to embark on such a process as much as possible. Whether it is motivated by hope that the business will turn around, delusions that the capital markets will bail them out or simply the all-too-human tendency to postpone difficult choices as much as possible, companies almost invariably act (or fail to act) so as to delay the inevitable until the very last minute. At that point, their ability to control the outcome of their restructuring process is greatly compromised as cash balances have declined, vendors are demanding shorter terms and banks have restricted access to credit. We can think of only one case in recent history—American Airlines—where the debtor read the writing on the wall and did something decisive about it well in advance when it still had ample liquidity to shape its destiny.

For those of us who work frequently on Latin American restructurings, it often seems like the tendency to postpone the day of reckoning is taken to an even greater extreme. Whereas a U.S. debtor might wait until three months in advance of a major debt maturity before preparing for a restructuring process, its counterpart in Latin America might wait until three weeks before it runs out of cash prior to making the same decision.

We gathered some empirical data to determine whether there is any merit to the anecdotal evidence of our professional experience. In particular, we hypothesized that if Latin American companies generally wait longer than U.S. companies to launch restructuring processes, their credit profiles are likely to be significantly weaker at such time, and creditor recoveries are likely to be lower. Although it is impossible to use publicly-available data to determine precisely when a company made

the decision to restructure, we used the Chapter 11 petition date (or its Latin American equivalent) as a proxy, under the theory that debtors who take longer to launch restructuring processes are likely to file insolvency proceedings later as well. In addition, to estimate creditor recoveries, we reviewed the bond prices of such companies as of the close of business on the first trading day after their bankruptcy filing, as bond prices should generally correlate with expected bondholder recoveries if bond markets are efficient. We focused our analysis on unsecured bonds only, as there were not enough secured bonds issued by Latin American firms in the sample set for a meaningful comparison.

The results, for companies that filed insolvency proceedings over the past two years and had at least $200 million of liabilities as of their petition date, are shown below:

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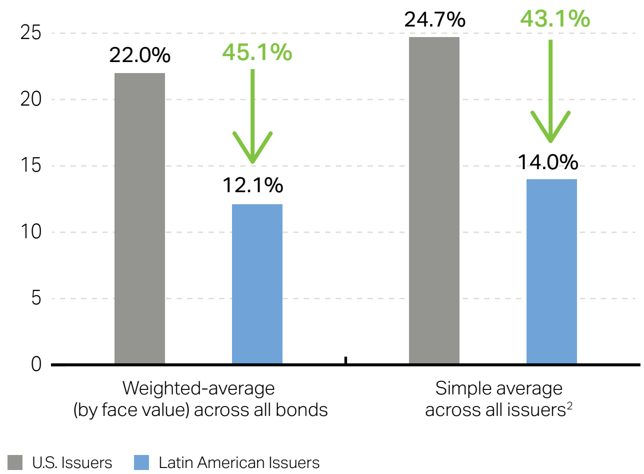
Average price of unsecured bonds as of bankruptcy petition date[1]



Source for bond pricing: ***Bloomberg***

1. Reflects all bankruptcy filings from August 1, 2013 to September 30, 2015 in which the company had at least US$200 million of liabilities as of the petition date. Sample set includes (a) 20 U.S. companies and 49 U.S. unsecured bonds, with an average face value of $399.0 million and (b) 9 Latin American companies and 20 Latin American unsecured bonds, with an average face value of $480.8 million.
2. Calculated by taking the weighted average bond price for each issuer (weighted by face value) and then taking the simple average across all issuers.

As expected, the data shows that, at the time they filed insolvency proceedings, unsecured bond prices of Latin American issuers were dramatically lower—by over 40%, on average—than those of U.S. issuers. The outcome is essentially the same regardless of whether one looks at the weighted average across all bonds (weighted by face value) or the simple average across all issuers (45.1% vs. 43.1%, respectively). Additionally, five of the 20 U.S. issuers in the sample set had unsecured bond prices of 25 cents on the dollar or higher as of the petition date, whereas none of the Latin American issuers had prices at such levels.

The results of our empirical analysis may also be driven by factors other than the timing of when Latin American companies launch restructuring processes. In particular, the relatively lower prices on the petition date of Latin American bonds vs. U.S. bonds may, in part, reflect the differences in insolvency regimes referred to above. Precisely because the reorganization process in Latin America tends to favor debtors and shareholders more so than in the U.S., filing for bankruptcy in Latin America might have

There are multiple reasons why a Latin American company may take longer than a U.S. company to launch its restructuring process:

Family Ownership
Latin American companies are more likely to be family-owned enterprises, with much of the family's net worth (and employment opportunities for relatives) tied up in the business, and might therefore be particularly reluctant to commence a process that could lead to the transfer of equity and/or control to creditors.

Reputation
The stigma of bankruptcy is stronger in Latin American countries than in the U.S., leading to greater reputational consequences for Latin American managers and shareholders (especially in the case of family-owned firms).

Debtor-friendly Legislation
Insolvency regimes in Latin America are generally more debtor- and shareholder-friendly than Chapter 11. Therefore, managers and owners of Latin American firms might be more willing to wait and take their chances in a proceeding rather than try to make concessions out of court.

a more negative effect on expected bondholder recoveries than in the U.S. Additional empirical research is necessary to determine the relative impact of the various factors driving the observed results.

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Regardless of the underlying cause, however, the lesson for bondholders is clear: when investing in Latin American unsecured bonds, bondholders should focus on factors that may cause the issuer to defer restructuring negotiations if their credit quality deteriorates, such as the nature of the shareholder base and the "creditor-friendliness" of the insolvency regime in that company's jurisdiction. In addition, bondholders should pay particular attention to financial maintenance covenants, both when buying bonds in the secondary market and when negotiating indenture terms in a primary issuance. If things eventually go south for the issuer, such covenants can force the company to engage in negotiations with bondholders much earlier than they would otherwise, thereby enhancing bondholders' recovery prospects. Without such "early warning triggers" in place, bondholders will probably only hear from the company regarding its restructuring plans *mañana*—and by that time it will almost certainly be too late. ■

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