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Funding structures in business reorganisations: locating the role of pre-packaging as a restructuring tool

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Abstract

Pre-packaged funding increasingly plays a prominent role in resolving distressed assets under reorganisation laws globally. Based on a qualitative and exploratory analysis, this article examines the actual operations of pre-packs, including the various structures and funding mechanisms used. In many cases, funders and acquirers of distressed assets under reorganisation do not distinguish between pre-pack and post-filing opportunities, but the funding and structuring mechanisms and timing thereof often become the determining factors in the how they are classified.

This study improves our understanding of the financial complexities involved in pre-packaged funding such as the structuring and valuation of transactions, which would be particularly useful to newer entrants to pre-packaging who are considering its application. The analysis of available scientific contents revealed that many of the funding institutions employ a variety of funding mechanisms that often complement one another. It was also found that many of the funding institutions, especially hedge funds, often apply pre-packaged funding as an entry to the acquisition of such distressed assets, usually before the occurrence of the distress event. This study further revealed a correlation between a vibrant distress funding market and sophisticated funding mechanisms, which often charts the course for the establishment of pre-packs.

Key phrases

business reorganisation; business rescue; debt; debt-to-equity; distress investors; equity; funding structures; pre-packaged funding; pre-petition; post-filing; restructuring; secured debt; unsecured debt; valuation methodologies

1. INTRODUCTION

The world has woken up to the realisation that the rehabilitation of insolvent or distressed companies is more beneficial to their economies than outright liquidations, particularly where this can potentially be avoided. With the introduction of business rescue-related legislation to deal with rehabilitations, it has also become necessary for regimes to allow some kind of funding to assist many of these companies undergoing administration or reorganisation or business rescue – the terminology is mainly territorial.

Various funding mechanisms are available to fund companies facing this administration or reorganisation, including post-commencement-funding (PCF), pre-packaged funding and other forms of mergers and acquisition activities specifically related to reorganisations. PCF is found in different wrappings in various regimes, and is usually legislated or otherwise regulated. It refers to funding that occurs post such companies filing for administration or reorganisation, and is used to enable the companies under the administration to pay fees for rehabilitation, carry on trade and pay for fixed costs.

Pre-packaging, on the other hand, mostly involves new or existing funders acquiring an (further) equity in the business or new company formed to acquire the assets of the business. The agreements for the acquisition of shares or assets of the business are concluded prior to companies filing for administration or reorganisation, are concluded soon after filing and once an administrator has been appointed to carry out the sale and conclude the administration process. This usually results in a quick return that saves time for the debtor company, consequently potentially saving jobs, and most importantly providing more and meaningful returns for creditors (Meier & Servaes 2014:11).

Pre-packaged funding appears to be a growing phenomenon throughout the developed world where business rescue or corporate reorganisation is practiced, and could soon find its way into the developing world where business rescue is relatively new. It is defined by the US-based Association of Business Recovery Professionals as an arrangement under which the sale of all or part of a company’s business or assets is negotiated with a purchaser prior to the appointment of an administrator. The administrator puts the transaction into effect, immediately on, or shortly after his or her appointment.

What is behind this growth in pre-packaged funding, and who are the significant parties in this practice? How is it done? In examining distress funding as a whole, Harner (2008:76) argues that the presence of non-traditional lenders in troubled situations changes the dynamics of corporate restructurings.

This article is written as part of a series of articles examining the operating environment of pre-packs in regimes where it is thriving. In particular, this article seeks to examine the actual operations of pre-packs, including who is funding this wheel, why they are continuing to do so, and how they are doing it. In examining these issues, the article has to start by examining the mechanisms used in acquisitions of companies undergoing reorganisations as a whole, before proceeding to isolate the application of pre-packaging in particular. Moeller and Carapeto (2012:2) support an argument proposed by Jensen (1991:15) and further supported by Betton, Eckbo and Thorburn (2008:350-351), that mergers and acquisitions provide an effective means of resolving financial distress. It preserves business rather than companies.

Therefore, and more importantly, this article seeks to investigate potential funding structures for application in business rescue in the South African (SA) context, and whether these are in line with international benchmarks. Given the relative novelty of the business rescue regime in SA, much of the comparisons would be limited to the legislation, being the Companies Act of 71, 2008. The legislation, in fact, does not speak much to sales of businesses or assets during reorganisations or business rescue directly, and is even more silent on pre-packaged sales. This raises questions due to the added benefit of speed and the consequent enhanced chance of saving the distressed company and reducing of potential job losses.

Internationally, much of the literature that is available on the subject focuses on the legal practices and environmental influences. Not as much literature is focused on the financial dynamics of pre-packaged funding and processes, including transaction structuring, capital structures and valuation dynamics. This article attempts to uncover this aspect of pre-packs.

In conducting this study, the authors were limited by the fact that most available literature on the subject is based on the US models, due to the country's long history and high activism in corporate restructurings. Currently, the United States (US) appears to have a more developed market for non-traditional lenders and investors in reorganisations. We therefore examined the US in depth, and included a review of other regimes in this study for purposes of examining any additional factors to be considered. Due to the fact that pre-packaged sales are a form of M&A in a reorganisation context, this study inevitably discusses various other M&A structures.

For purposes of understanding the context of pre-packaging in the US, it is important to understand that it occurs in terms of Section 1126 of the Bankruptcy Code, when a debtor approaches its creditors and proposes a plan of reorganisation in advance. Thereafter, the debtor files for bankruptcy protection with the votes of the plan of reorganisation already been agreed to (Mallon & Waisman 2011:17). Hereafter, a sale of the debtor's assets is then conducted, based on Section 363 of the Bankruptcy Code.

The other regimes that were reviewed include the United Kingdom (UK), Australia and some regimes in Europe with bankruptcy laws. Throughout this article it should be understood that companies in financial distress that do not wish to be liquidated, are given an opportunity to file for bankruptcy in the US, insolvency in the UK, Australia and part of Europe, bankruptcy in other parts of Europe, and business rescue in South Africa (SA). Consequently, the process embarked on is then called reorganisation in the US and Australia, administration in the UK and parts of Europe, bankruptcy in other parts of Europe, and business rescue in SA. As such, the above terminologies are used interchangeably in this article.

2. OVERVIEW OF FUNDING STRUCTURES FOR BUSINESS RESTRUCTURING IN SOUTH AFRICA

South African authorities only introduced reorganisation under business rescue in May 2011, under Chapter 6 of the new Companies Act 71, of 2008. The Act specifically allows for funding to the distressed companies that have filed for business rescue, under section 135 dealing with post-commencement-finance (PCF).

PCF is a SA version of the US type DIP financing, as it allows financing to be introduced into companies that have filed to enable access to cash flow for aiding normal operations and payments by business rescue practitioners (BRPs). BRPs would have been appointed by the distressed company immediately upon filing for business rescue.

There are no specific provisions in the Act e for sale of a distressed business in whole or parts to third parties or even creditors. The only reference that seems to recognise some sale of assets of the business under rescue is a reference in section 134 dealing with the protection of property interests. This section of the Act specifically allows a distressed company to dispose of property in the ordinary course of business, at arm's length, and for a value approved by the BRP or if it is conducted as part of the business rescue plan.

This reference may be interpreted as a recognition that sales to other parties during business rescue do occur. However, it is not too clear as to what is referred to as property in the Act, since it is not defined. Nevertheless, a glaring omission to regulate how such sales should be conducted may have been a deliberate attempt on the part of the regulators, to allow the market to dictate how they wish to conduct such sales. For that matter, pre-packaged sales are not even mentioned in the Act.

Another important contextual insight relates to the market in SA that in practice, appears slow to adopt sales of distressed businesses or assets. It seems that sales of businesses or assets have only recently begun gaining some momentum, despite there not being any recognisable distress funding markets. Many sales that have taken place have been to industry players, and even fewer seem to be recognised as being concluded on a pre-packaged basis. An investigation into the patterns of these sales, as well as how they have been conducted will be the subject of a future study.

3. PURPOSE OF THE STUDY METHODOLOGY

This study aims to find the pull factors for distress investors to find opportunity and remain in an investment friendly funding market. In particular, the focus is on the attraction for pre-packaged funding mechanisms and tools applied by these investors. This study follows particular funding patterns observable in these environments, and attempted to answer the following:

1. What makes some markets more vibrant for distress investments than others?
2. What are the popular funding mechanisms used, and what value do they bring to the market?

3. Do certain funding practices act as precursors to other more sophisticated models such as pre-packaging?
4. Who are the key players in the distress funding market, especially pre-packaged financiers, and why do they stay in the game?

Table 1 provides a summary of the research design applied in the study.

TABLE 1: Research design applied in the study

Component	Description
Research question/ problem	What is the role, played by pre-packaging in the funding mechanisms of business reorganisations?
Context	Business reorganisations and administrations
Propositions	1. A wide variation of funding mechanisms for distressed acquisitions is found in regimes with an active, vibrant distress-funding market; 2. Pre-packaged financing complements other funding mechanisms in the rehabilitation of distressed businesses; 3. Pre-packaged funding introduces new shareholders with altered capital structures in distressed companies; 4. Third party investments in distressed assets are driven by a perception of good value for money.
Phenomenon investigated	Pre-packaged investment methods, capital structures, timing of investments
Unit of analysis	Internationally available literature; documented practices of the distress funding markets
Logic linking data to propositions	Context, methodologies and motivation of role players, enabling legislation and prevailing practice will inform the use of pre-packs in practice
Criteria for interpreting findings	Types of funding instruments; timing of funding; change in capital structures

Source: Adapted from Yin 2003:21

4. RESEARCH DESIGN

4.1 Research approach

This study is qualitative and exploratory, and is aimed at identifying the various practices used in funding distressed assets, including the valuation methodologies, funding instruments and structures typically employed in such funding. The results obtained were used to map out the possible contribution made by acquisition-based funding of distressed assets, in particular, the role played by pre-packaged funding.

It is understood that the theory base for investments in distressed assets is the developed restructuring regimes that have established some form of distress fund market. Therefore, the studies were drawn from the literature developed on these typical regimes. This is largely a qualitative study intended to create a thematic presentation based on content analysis. Questions raised under the research objectives guided the research.

4.2 Research method

The data collection is guided by the research questions being answered. In following a typical format on the literature review, care was taken to specifically target financially based literature as opposed to legally based journals. Every effort has been made to use recent literature, although where necessary, older literature was used. This would apply in cases where authoritative sources were required or no new literature could be found.

As indicated in the introduction, most of the literature available was authored in the US, and had an inclination to report on US practices. This literature was used to capture the full context of the subject. In other words, the extent of the practices involved in pre-packaged funding. Many of the rest of the regime countries were found to practice some or all of the phenomena applied in the US. European literature was found and used, which applied specifically to European practices. Much of this literature was available in standard search engines.

Secondly, scientific literature on reorganisations, and specifically pre-packaging, was searched to provide detailed understanding of the methodologies applied. The source engines for these searches included Harzing's Publish or Perish and Google Scholar, especially for titles and authors, SABINET, ProQuest and EBSCOHost.

4.3 Research setting

The US, UK and central Europe were identified and studied in-depth to understand their pre-packaged practices developed over recent years. The researcher identified these regimes due to their efforts to attract investments, through their recent efforts to accommodate and assist companies that have faced financial distress. Many of these regimes have been adapting to changes over the years to make it easier for business, and have made an effort to promote transparency for their pre-pack processes.

4.4 Data analysis

Content analysis was largely used to define a theme along the practices of pre-packaging, which have been used to develop insights for the final discussion and conclusion. Whilst only a few regimes could be studied, they could provide sufficient material on the praxis of pre-packaged funding to determine a theme. Furthermore, while there would be slight differences in application of terminology in the different regimes, the business of finance is universal to ensure an ultimate congruence of these concepts. In analysing the results, a universal language of finance was applied.

5. ANALYSIS OF FUNDING STRUCTURES IN REORGANISATION IN THE US, UK, AUSTRALIA AND EUROPE

Most of the literature available for studying the mechanics of investing in distressed assets in reorganisations, and specifically pre-packaged funding, emanate from the US. Even so, fewer journals and articles deal with the financial aspects of the mechanics, including funding instruments used, transaction structuring and pricing. Since this is a qualitative study, great reliance was placed on the reviewed literature for deriving insights and drawing conclusions.

In this review, we examined the nature of the environment that gives rise to pre-packaged funding, the type of institutions involved, their methods of valuation, the financial and transaction structuring involved, as well as their motivation for being active in the field. This is addressed based on the specific countries earmarked for this study, being the US, UK, Australia and Europe in general.

4.1 The United States of America

4.1.1 Background

The US is among the oldest insolvency regimes in the world, and thus, according to Harner (2008:75), the practice of distressed debt investing is not new in the country and is expanding. Accordingly, distressed investors in the US are actively seeking investments in troubled companies, including Chapter 11 debtors, and they have the financial resources to be successful in their pursuits. These distress investors typically look to acquire troubled debt or new equity in distressed companies.

Harner (2008:75) defines a distressed debt investor as an entity that buys the debt of a financially troubled company at a discount to the face value of the debt, to ultimately make a profit. This profit is usually made by reselling the debt, making recoveries of the debt (through restructuring) or converting the debt into an equity position.

The distress funding allows traditional lenders and investors to exit in favour of hedge funds, private equity and other non-traditional lenders. The new investors are generally repeat funders for several troubled companies. How this typically happens is that distressed companies increasingly face demands and pressures from their debt holders, resulting in some restructuring processes, even before the filing of Chapter 11 bankruptcy. Distressed debt investors may have typically entered into contractual covenants or promises of post-bankruptcy financing with traditional creditors, or through other statutory rights. The latter typically happens under Article 9 of the Uniform Commercial Code or Chapter 11 of the Bankruptcy Code or a combination of the previously mentioned.

It appears that many distressed investors in the US do not necessarily distinguish between prearranged (“pre-packaged”) and post-filing, including post-commencement-financing, bankruptcy investments. In either case, it seems much of the investments occur through debt positions taken by distress investors. In explaining the influence on the cost of financial distress by the type of ownership structure on corporate debt, Ivashina, Iverson and Smith

(2016:316) have shown that where ownership of corporate debt is highly concentrated, cases are more likely to be filed as pre-packaged bankruptcies.

In this argument, many of these increases in ownership concentration occur because of consolidation of claims through purchases from trade creditors. Debt markets in the US allow distressed claims trading including bonds, bank debt, trade credit and lease, tax, insurance, and derivative claims. The trading of these claims during bankruptcy occurs through disclosures of Rule 3001(e) transfers, which are made up of trade credit, cancelled leases, and debt instruments not registered with the Securities Exchange Commission (SEC).

4.1.2 Identifying the distress investors

Investors in distressed assets typically include hedge funds, Private Equity firms, investment banks, and also pension funds and other parties. Historically, capital for distress investing has been concentrated in the US. However, many of these funds are actively seeking to invest outside the US (Gilson 2010:18).

Baird and Rasmussen (2010:657) describe distressed debt professionals as holding complicated positions, combining ordinary claims with derivative instruments, and pursuing their own agendas. They are further described as being well informed and close to the process. This sets the stage for new investors in distressed assets. This has been precipitated by claims trading, which took hold in the 1980s, and was further deregulated in 1991. This deregulated market provided an opportunity for firms' control in easier ways than normal equity acquisition could not. This created the entry for hedge funds into the distressed investing market, with several funds currently occupying that space.

Claims trading, it seems, creates a market for those seeking outsized returns. The rationale is simple, it provides easy exit for those that are ill equipped to deal with the bankruptcy process, while allowing the informed distressed investor an opportunity for easy entry and control. For an experienced hedge fund, they are more able to examine a company in full thereby being able to find overlooked value in the debt instruments used by the firm. Furthermore, they would be able to use their knowledge of reorganisations to generate a higher return on the investment than the incumbent creditor. A hedge fund may want to advance the reorganisation plan of a distressed business, ending up with an equity holding (Baird & Rasmussen 2010:670-671).

The first category of investors is hedge funds that specialise in distress investing. According to Jiang, Li and Wang (2012:516), hedge funds have more incentives to pursue high returns, and due to their unique portfolio category are unlikely to experience conflicts of interests with other portfolio firms. Furthermore, hedge funds in the US do not operate according to the prudency rules of other managers such as pension and mutual funds, and can consequently hold risky positions such as concentrated and illiquid securities in distressed firms in order to strengthen their hand in negotiations. Ultimately, their ability to use derivative instruments, combined with minimal disclosure requirements, provides them with additional flexibility to invest in distressed assets.

Jiang *et al.* (2012:513) state that hedge funds participate in bankruptcy investing, in various ways, including investing in debt claims and buying equity stakes in distressed businesses. Furthermore, hedge funds also acquire debts of distressed companies with a view of converting them to equity upon a successful restructuring. According to these authors, evidence suggests that close to 90% of cases in Chapter 11 have an involvement of hedge funds, making them the most active investors in the distressed debt market. The presence of hedge funds in Chapter 11 bankruptcy appears to increase the probability of successful corporate restructurings.

Rosenberg and Riela (2008:1) describe the growth of hedge funds as being in excess of that of mutual funds and the equity market as a whole. Accordingly, distressed companies have increasingly become popular targets for the funds.

Private equity funds also play a large role in distressed investments, albeit with less flexibility due to the prudency rules that apply to them. In an empirical study by Gilson, Hotchkiss and Osborn (2015:1-2) of 350 public firms that filed for Chapter 11 bankruptcy between 2002 and 2011, 75 (21%) of them sold their assets as going concern businesses, of which approximately 40% were sold to financial buyers such as private equity firms. These sales are typically done based on section 363, being essentially a section mostly used under pre-packaged financing. Furthermore, it was found that some sales take place when buyers buy debt in exchange for a controlling stake in the firm undergoing reorganisation, with a similar effect as that of a section 363 sale.

Meier and Servaes (2014:11) argue that firms acquiring distressed or bankrupt assets earn returns greater than when they make regular acquisitions. Gilson *et al*. (2015:6) conclude that mergers and acquisitions (M&A) have become a significant part of the Chapter 11 process, given that when firms face failure they only have two options, either M&A or bankruptcy.

4.1.3 Funding structures for distressed assets

Distress trading occurs in virtually every kind of distressed claim, whether bank loans, bonds, trade payables, private debt placements, asset-backed securities, and real estate mortgages. Investors in these markets follow diverse strategies, such as acquiring debts of firms undergoing Chapter 11 reorganisation, or providing new debt or equity financing, or purchasing assets of distressed firms in bankruptcy courts, or even various combinations of the above (Gilson 2010:17).

As an investor category, hedge funds appear indifferent as to whether they participate in pre-packaged investments or post-filing investments such as debtor-in-possession (DIP) funding. They appear to entertain various avenues of investment in distressed companies available to them. Various strategies are employed by these funds to invest in distressed companies. As sophisticated investors, hedge funds often select distressed firms and positions on the capital structure that offer the best prospects of returns. It is important to note that the Bankruptcy Code (Chapter 11) does not explicitly regulate trading in distressed claims, which therefore leaves the investor at the same level as the original claimants (Gilson 2010:20).

Three broad roles for hedge fund involvement in distressed companies are described as creditors, equity holders, and loan-to-own participation (Jiang *et al.* 2012:513). According to their empirical studies, pre-packaged Chapter 11 financing is directly correlated to hedge funds' loan-to-own strategy of investing. Interestingly, the higher ratio of secured debt to total debt in distressed companies is negatively correlated to the loan-to-own strategies of hedge funds. Conversion of debt to equity in a loan-to-own structure is usually, naturally precipitated by high debt leverage, and combined with a low ratio of secured debt (Jiang *et al.* 2012:533). Evidence suggests that loan-to-own strategies are done by first investing in unsecured debt, which often experience higher recovery rates under pre-packaged bankruptcies. In general, hedge funds seem to enter the distress investment market through investing in debt, and most often unsecured creditors, where most end up as equity holders post filing (Rosenberg & Riela 2008:5; Jiang *et al.* 2012:514, 516).

Hedge funds invest in distressed companies, in either pre-filing or post-filing for bankruptcy, and these include the following (Rosenberg & Riela 2008:4-8):

- *DIP loans* – these normally allow funders entry and access to confidential information, as well as super-priority status among the creditors. In addition, the position allows them to have influence over the reorganisation process and an advantage in negotiations with debtors.
- *Pre-petition secured loans* – the nature of secured debt allows hedge funds the underlying benefits such as significant leverage in negotiating the distressed company's reorganisation plan and their use of cash collaterals, protection of their interest in the company's property and ability to bid in assets sales.
- *Pre-petition unsecured debt* – due to the status of the unsecured debt, hedge funds are able to acquire these at significant discounts. Hedge funds will typically pursue unsecured debt if they believe that the reorganisation will yield much higher returns than their cost of the debt acquisition, and that the reorganisation will be consummated quickly enough to justify their costs of holding the asset. Hedge funds mainly rely on their use of investment professionals who understand bankruptcy, and in their ability to adequately analyse the distressed businesses to project the true value of the debt.
- *Pre-petition equity* – Hedge funds' investment in distressed equities carries a higher risk and lower priority than in debt. Investing in distressed equity is premised on a successful outcome of the reorganisation plan, backed by negotiations with creditors, litigation or both. Some such cases are known to yield returns for investors that are more than a hundred times over the initial investment.
- *Asset acquisitions* – a further popular way of equity investing in distressed businesses is through the acquisition of the distressed firm's assets with the court's approval in terms of Section 363 (Gilson 2010:23).
- *Funding the plan* – this involves acquiring new shares issued under the distressed firm's reorganisation plan, with proceeds either used to finance cash distributions to pre-petition claimants or retained in the company in order to support the business post-bankruptcy (Gilson 2010:22).

- *Post-emergence equity investments* – in some cases, hedge funds seek to play a role as post-emergence investors by making equity investments in companies that have just emerged from Chapter 11 reorganisation. This investment is made on the basis that the infusion of new capital reduces the leverage of the emerged company and increases distributions to both unsecured creditors and shareholders. Thus, these investments provide hedge funds with the opportunity to obtain significant discounts to values estimated in the reorganisation plan, allowing potential long-term capital profits, whilst allowing them negotiation leverage concerning the plan of reorganisation. Furthermore, the funds often earn large commitment fees on such transactions.
- *Credit swaps* – another way is to engage in credit default swaps, which are contracts in which creditors buy credit risk protection from hedge funds who in turn sell the protection for a fee. In this arrangement, the seller of the credit risk undertakes to pay the buyer (creditor) a stated amount upon the occurrence of a credit event such as bankruptcy.
- *Other investments* – one other way of participation in distressed investments is by selling short the unsecured debt while buying long the secured credit positions. This is based on betting that in the event of the company filing for bankruptcy, the unsecured debt would likely fall in value, making a profit for the short positions. On the other hand, the hedge funds might be able to extract concessions from the debtor in the event of covenants required. Furthermore, an investor can consider a "loan-to-own" strategy, which is defined by Gilson (2010:25) as providing equity at the same time as providing a secured loan outside of Chapter 11 bankruptcy, with the expectation that the secured debt would convert into controlling equity once the firm files for bankruptcy.

The primary aim thus is for hedge funds to influence the restructuring process of the distressed firm. Hence, a strong activist bias is key to successful hedge funds investment in a distressed firm. They do this through their participation in relevant committees during the restructuring process, such as the creditors' committee, or the equities committee where applicable. Overall, hedge funds seem to have a relatively long-term investment horizon. Through their empirical studies, Jiang *et al.* (2012:546) show that hedge funds' participation is associated with returns that are more favourable to shareholders of the distressed companies.

A popular view in the US is that the active participation of hedge funds in the bankruptcy process gives them an unfair advantage because of the access to confidential information. Consequently, various measures are being developed to regulate them accordingly (Sharfman & Warner 2014:61).

4.1.4 Valuation methodologies

For hedge funds in the loan-to-own structure, a good investment selection is the starting point in entering a transaction at an optimal value. In making this selection, it is important to find that "fulcrum" in the capital structure where the enterprise value is unable to fully cover the claims. This point is usually fulfilled by unsecured debt due to its upside potential (Jiang *et al.* 2012:533). Thus, the low secured ratio is a key element in the valuation process for a hedge fund, but it is the potential for reorganisation and emergence, attracting more hedge funds. In general, hedge funds tend to pick firms with good fundamentals but bad balance sheets, meaning that although they suffer from financial distress they would have a strong operating performance (Jiang *et al.* 2012:514).

Due to the potential upside upon emergence, it is advantageous for a hedge fund to push for a lower valuation, even once converted to equity. Rosenberg and Riela (2008:1) report that hedge funds provide substantial returns to investors even in tight markets, with some of these returns pertaining to investments in distressed assets.

For equity investments, the valuation methodologies are generally similar to typical M&A valuations, except that the state of the organisation has to be taken into account. In comparing pre-pack practice and legislation in the US and UK, Theunisse (2014:24) argues that valuation is always marked by uncertainty, even in non-distress situations, and are accentuated during financial distress. This is due to the market being heavily influenced by the problems financially distressed businesses face, and that multiple valuations are usually required during bankruptcy. The main driver of valuations is the behaviour of firms, management, creditors and investors, who are then greatly impacted by bankruptcy proceedings.

Theunisse (2014:26-27) identifies three methods of valuation as being available for distressed companies:

- *Company/market comparison* – which provides an interpretation of financial performance as measured against other comparable measurements in the market. EBITDA is one such market comparison.
- *Comparable transaction* – this looks instead at similar acquisition transactions undertaken in the market, and the prices paid for them.
- *Discounted cash flow* – which analyses past cash flows, adjusts them for projections using investors' expected returns (typically, Weighted Average Cost of Capital), and the results adjusted with a perpetual growth value.

The problem with these valuations, and arguably the reasons for the uncertainties surrounding valuations of distressed companies, is the choice of variables for input, given the uncertainty of the company's trading environment. It is important to note that the valuation argument advanced above is specifically aimed towards pre-packaged financing solutions.

In comparing market values of firms that reorganise in bankruptcy, with value estimates that are based on management's published cash flow information, Moyer, Martin and Martin (2000:48-54) corroborate two of the three above valuation methods by Theunisse (2014:26-27), with the exception of the comparable transaction methodology. Their study, however, focuses on valuation errors resulting from their comparisons. This seems to confirm the valuation uncertainty argument advanced by Theunisse (2014:24).

An additional element that usually drives valuations, even in non-distress situations, is negotiations with stakeholders. In the case of distress, creditors become an additional and very important stakeholder to deal with. Thus, Moeller and Carapeto (2012:10) confirm Hotchkiss & Mooradian (1998:240-262) that negotiations with creditors add complexity to the overall negotiations, as they also involve different classes of claimant, and often become a key determinant of the price paid for the business.

Despite the valuation methodologies and the investment strategy pursued, it appears one of the most important value creating strategies involves restructuring of equity and assets post-restructuring. Gilson (2010:473) explains restructuring of equity as changing how the firm's residual cash flows are distributed among the firm's shareholders, with the goal of increasing the overall market value of the firm's share equity. Accordingly, the commonly used techniques for equity restructuring include corporate spin-offs, equity carve-outs, and tracking stock (shares). With a spin-off, the company issues shares to existing shareholders in a new subsidiary created to house the new business free of liens, whilst the parent company remains with claims against remaining assets. An equity carve-out on the other hand, involves the selling off, of some equity for cash, usually in a public offering, with the cash available for liquidity in the firm.

Lastly, tracking stock involves isolating a claim against the profits of a particular division, without creating it into a subsidiary. It in effect creates the same equity structure as a spin-off without changing the firm's corporate and organisational structure.

4.2 The United Kingdom

The UK does not operate a typical DIP as provided by the US' Chapter 11 for companies facing distress. What is in place instead is a super-priority lending, which essentially allows new and existing creditors to lend the distressed company further debt in order to fund its administration. Typically, such new debt receives a super-priority status. However, the idea of super-priority finance in administration seems not to have garnered enough support to make it a popular option and seems instead to have paved the way for a more popular sale of assets or business (Aruoriwo 2014:12-14).

Using the Company Voluntary Arrangement (CVA) and administration, an administrator is appointed to manage the distressed company. As part of this administration, the administrator can reach an agreement with creditors, either before or after filing, to sell the company or its assets to either third parties or management. Where this agreement is made before filing and the sale is concluded shortly after filing this process is called pre-pack administration (Payne 2016:5-6).

Currently, the administrator is responsible for setting the sale price and terms of the sale in pre-pack administration, and negotiating with the potential buyers (Crouch & Amirbeaggi 2011:32). It is unclear what this valuation should look like, except that according to the guidelines by Statement of Insolvency Practice (SIP) 16 (2009), the administrator should ensure that a fair value is obtained for the sale (Conway 2015:3-4). Since this step is meant to address transparency issues and satisfy creditors as to the fairness of the process, it can be presumed that the fairness of the value is to the benefit of creditors.

Windsor and Jarvis (2011:3) state the various steps that the administrator needs to take in ensuring fair value are obtained. This entails firstly looking at recent attempts to sell the company, failing which the administrator may seek to have the company marketed. Should the latter not be practical, the administrator is expected to obtain desktop valuations from independent valuers and obtain expert advice on recent mergers and acquisition activities in the sector, to be satisfied with the reasonableness of the price offered.

Recently, the Secretary of State in the UK commissioned a review of the corporate insolvency framework, through which a reform of the insolvency laws is proposed in the UK (Insolvency Service May 2016:5). An important recommendation in the framework affecting this research is the recommendation concerning valuations for companies under distress. In terms of this recommendation, government is considering legislating for the use of a minimum liquidation valuation, which would essentially be a liquidation value, whenever a company or assets of a company is sold to an investor in a restructuring situation.

The idea is to ensure that creditors are not off worse than under liquidation, while providing guidance for rescue finance providers regarding the remaining value that can be secured as part of the plan. The point made is that the latter should not be paying for potential future earnings they would be party to creating. Government is currently reviewing the recommendations, following consultation with stakeholders. Interestingly, it seems many of the stakeholders in the UK have rejected the proposed changes regarding valuation, on the basis that there is a sufficient market for distress investing and thus, no need for further incentives (Insolvency Service September 2016:10). It remains to be seen what the implementation of the overall recommendations will look like.

The purchaser of the distressed company's business may be new to the company or a competitor, and may even be the existing management of the company. A typical structure of such acquisition is that a new company is formed to acquire the business or assets of the company under administration. According to Conway (2015:2) in 2011, the Insolvency Service (an insolvency agency) estimated that 25% of companies that entered into administration in that year used the pre-pack procedure.

Conway (2015:2) further mentions that the survey also revealed that nearly 80% (or over 70% according to Windsor & Jarvis 2011:4) of the pre-pack sales are to purchasers with existing links to the business being sold, such as current and past management or shareholders. The balance of sales are, accordingly, to competitors and specialist investors, sometimes even secured creditors who have formed special purpose vehicles (SPVs) to acquire such assets (Windsor & Jarvis 2011:4).

4.3 Australia

The Australian rescue regime does not formally address the sale of businesses under distress, leaving it to market forces. There are however, guidelines regulating the behaviour of members of the Insolvency Practitioners Association to behave ethically while dealing with matters of sales of distressed businesses, in particular with pre-pack sales (Crouch & Amirbeaggi 2011:32). Using the Corporations Act and Voluntary Administration, distressed companies are able to embark on a process of reorganisation by claiming insolvency.

The companies can negotiate with potential buyers for the sale of the business or assets to a newco prior to filing for a Deed of Company Arrangement (DOCA). Thereafter the debtor company then appoints an Insolvency Practitioner whose responsibility is to review the sale terms and ratify the sale. To show independence of value, the directors also have to appoint a reputable valuer, who often is an independent audit firm, to conduct a valuation, upon which the sale is concluded (O'Brien-Palmer 2012:2). Similar to the UK, there does not seem to be any pre-pack sale activity on the credit side in Australia.

4.4 Europe

Within Europe, the European Commission embarked on an initiative to ensure that all member states have in place adequate mechanisms to deal with distressed but viable businesses (Payne 2016:13).

According to Clowry (2010:51), there has been a resurgence of debt-for-equity swaps as a corporate rescue tool throughout Europe. This is characterised by creditors receiving equity interest in exchange for a reduction in debt claims against the debtor company. These are generally used by classes of secured creditors and debenture holders. For these creditors, the strategy offers a streamlined process of acquiring the business while eliminating the structural risks of competitive bidding in a sale process (Goldberger 2010:97). Debt-for-equity swaps usually occur because of a bankruptcy filing. However, it can also be applied prior to debtors filing for bankruptcy or reorganisation, thereby lending themselves as part of pre-packaged arrangements. For instance in Germany, a debtor company can negotiate an insolvency plan that includes a debt-for-equity swap prior to petitioning for insolvency, in a manner similar to the UK pre-pack administration.

The fundamental issue with debt-for-equity structures is determining the value of the business or assets of the debtor. A fulcrum needs to be reached where the enterprise value of the debtor company can no longer fully cover the creditor claims. At that point, out-of-the-money junior creditors may be disenfranchised to the point where they have no economic interest. This leaves room for courts to assess the valuations because of inter-creditor disputes that arise (Clowry 2010:56).

In certain jurisdictions, when debt-for-equity swaps cannot be implemented due to lack of consensus, the alternative may be an enforcement of share security, which requires the enforcement of a security interest over that of the existing shareholders. This is done by creating a holding structure, Bidco, over the debtor company, structured in a similar manner to the newco structure in the UK. Creditors agree on the participation of existing lenders in the debt and equity of the new Bidco structure in advance of any bid.

In essence, the creditors agree to release their claims against the debtor company/borrower in consideration for the transfer of the secured shares to Bidco. As part of the consideration, cash may also be required for the shares. Such a structure could be formulated on a pre-pack basis, with terms of the acquisition transaction agreed in advance of an enforcement of the sale of the debtor company or its assets into Bidco. In common law jurisdictions, such a sale would be completed by a Receiver who has been appointed by a trustee, under a sale and purchase agreement without the need for a public auction. The receiver will be responsible for undertaking the valuation of the shares to ensure reasonability.

The French regime seems to have favourably adopted the European Commission's initiatives, and have introduced reforms that have made it easier to finance companies facing bankruptcy. The most relevant development is the introduction of the Order of 18 December 2008, which allows the conversion of debt into equity by minority creditors, without having to go through approvals of creditor classes. This debt to equity conversion essentially allows loan-to-own structures to be implemented, as many creditors ultimately insure their debtors' books or sell them in a securitised form to third parties.

The injection of new funds into the market created by the arrival of non-bank lenders, institutional investors such as pension and hedge funds, has also encouraged this practice.

As in the US with a vibrant investor market, new debt instruments have now been introduced, such as collateralised debt obligations (CDOs) or collateralised loan obligations (CLOs). The selling of loans to the secondary market through syndication and securitisation has been among the by-products of these new reforms. Furthermore, derivative instruments are being introduced into the market such as credit default swaps (CDS), with these essentially used as a form of “pre-packaging” by buyers of the debt instruments (Vermeille & Pietrancosta 2010:5).

Nevertheless, the prevailing method of investment in distressed businesses in many parts of Europe is mainly based on direct equity acquisitions. Sweden operates an auction bankruptcy system, which requires an immediate sale of the distressed company in order to reduce the period of bankruptcy process and increase chances of survival. On average, auction sales are resolved within two months. Once filed, a trustee is appointed, whose task is to oversee the sale of the business in an auction process, in a piecemeal or company as a whole.

Valuation for this auction is based on a liquidated piecemeal value calculated by industry experts. This break-up value can be improved on by bidders willing to put a premium to the liquidation value (Eckbo & Thorburn 2009:40). A pre-packaged sale is conducted by debtor companies negotiating a sale before filing, which needs to be approved by the trustee. Sweden further does not have provision for negotiating secured debt claims, with the result that no debt sales occur.

The Dutch have recently introduced pre-packs as part of the process of dealing with bankruptcies. The draft Act on the Continuity of Companies I allows for the appointment of a silent trustee to oversee the pre-pack proceedings, leading to a sale of the distressed company’s assets to a buyer, who then continues the business by offering key personnel new employment contracts (Verwey 2014:35). This structuring seems similar to the UK and Australian pre-pack structuring. Because valuation methods and practical experience have mostly been developed in the US, Theunisse (2014:26-27) argues that the UK and Dutch seem to apply the same principles, in many respects.

6. DISCUSSION

Many countries have adopted different practices for funding distressed businesses, in line with what they deem suitable for their circumstances. In turn, the suitability of the laws and regulations has served to dictate the pace of advancement of the distressed funding market in each regime. Consequently, certain countries such as the US and, to some extent, France, have developed sophisticated distressed funding markets, whilst Sweden seems to operate a singular model of funding. Many of the distress funding mechanisms straddle either or both sides of the filing process, thus either used as pre-packaged funding or after the filing process commenced (post-filing). The table below specifically illustrates the available pre-pack funding structures and models, observed in the literature.

In broad terms, the focus of pre-packaged funding models appears to be classifiable into two major categories, namely debt and equity. Equity funding models appear to be more widely used throughout the advanced reorganisation regimes, and range from simple acquisitions by special-purpose-vehicles (SPV) setup for purposes of acquiring the distressed assets, to the more imposing enforcement of share security by affected creditors. In the case of the former, industry buyers, or existing management, or even unrelated institutional investors such as hedge funds and private equity firms take up these positions after negotiations with management/shareholders. These are discussions taking place before the distressed debtor company files for reorganisation or business rescue. Sometimes, even secured creditors participate in pre-petition equity.

Pre-petition equity seems to be the model of choice for pre-packaged funding in the UK, Australia and Netherlands. The acquired assets are then usually priced at going concern valuations, although adjusted for the effects of insolvency (Theunisse 2014:26-28). These valuations include a Discounted Cash Flow (DCF), market comparisons using earnings multiples, and comparable transactions. The mechanisms that are put in place to regulate the reasonability of these valuations include, stalking horse bid (in the US), the use of an administrator for valuations in the UK, and the appointment of an independent valuer in Australia, among others. Sweden applies an auction process to facilitate the transaction, although a generally accepted valuation there is a liquidated piecemeal value. The idea therein is that buyers should not be left worse off than if the company had been liquidated

(Eckbo & Thorburn 2009:40). This is probably the most conservative valuation in reorganisations.

Debt funding models appear even more complex than equity models, mainly because many of them are designed much prior to a known event of bankruptcy or distress. By their definition, pre-packaged debt funding instruments are credit instruments purchased in anticipation of a distress event or insolvency. Universal law dictates that a creditor who is being owed by a debtor assumes ownership of the debtor’s assets in the event of payment default. This is especially true for secured creditors who would have specifically secured their loans against specific assets of the debtor.

The concept also applies to unsecured creditors, albeit that they are only entitled to residual assets of the debtor after allocation to secured creditors. In either case, their claims supersede those of shareholders, rendering them default shareholders. The transactions involve mostly hedge funds, who look to invest in loans to debtors, by either out-rightly buying the debt from the creditors (in a factoring transaction), or selling insurance on the loans against default. In either case, there will be no further action from the hedge funds if no default event happens.

Secondly, they tend to involve more sophisticated instruments and complex valuations. Even a simple pre-petition debt requires a seasoned investment professional from a hedge fund, who also understands credit, to determine the valuation, which happens upfront before an event of default may or may not occur. A debt-for-equity transaction occurs either pre- or post-filing of bankruptcy. In the event of pre-filing, the pre-pack transaction is conducted in a similar manner as an equity funding structure, i.e. once there is a view that the company would file but prior to filing.

The buyer, usually a hedge or a pension fund, would rely on the expectation that they would be influential in the development of the business plan of the reorganised debtor company. The valuation here is more complex and uncertain, as it involves the buyer finding a fulcrum at which to determine the price they would be willing to pay. This fulcrum value has to be reached in order for the transaction to make commercial sense for the buyer.

A credit default swap (CDS) appears to be the most complex instrument, as it involves credit derivative instruments, which can only be actuarially valued, way before the possibility of a default event. CDS' are prevalent in the US, with its sophisticated distress fund market, with some countries in Europe beginning to open up to them, particularly France. The CDS involves a hedging process over the investment instruments, in this case, different classes of creditors. As can be expected, only hedge funds would have an appetite for and ability to execute on such transactions. Debt funding models enable the investor to have access to inside information during insolvency proceedings, which gives them leverage to influence the resulting business (rescue) plan.

A summation of the funding models applied globally is provided in Table 2.

TABLE 2: Pre-pack funding models' summary

Funding type	Typical funders	Transaction structure	Typical countries	Suitable valuations	Valuation custodian	Instrument/ method
Pre-petition equity	Hedge funds (US), Private equity, Management, Industry buyers	Newco SPV; Bidco	US, UK, Australia, Netherlands	Going concern (adjusted)	Independent valuer (Australia); (UK)	Cash acquisition
Pre-petition debt	Hedge funds	Form of insurance	US, France	N/A	Hedge fund professionals (done upfront)	Debt instruments
Auctions bankruptcy	Banks prohibited	SPV, existing comp.	Sweden	Liquidated piecemeal value	Industry expert	Cash acquisition
Debt-for-equity	Hedge funds, Pension Funds	N/A	US, Europe	Fulcrum debt value	Hedge fund professionals, Courts (in disputes)	Debt instruments

Funding type	Typical funders	Transaction structure	Typical countries	Suitable valuations	Valuation custodian	Instrument/ method
Credit default swaps	Hedge Funds	Insurance transaction	US, France	N/A	Actuarial (done upfront)	Fixed income derivatives
Enforcement of share security	Creditors	Bidco SPV	Europe	Going concern	Receiver (trustee appointed)	New issue of shares for credit

Source: Own compilation

6.1 Variation of funding mechanisms found in vibrant distress funding markets

The countries that have been studied for the purposes of this research, being the US, UK, Australia and Europe in general, have fairly established reorganisation regimes, and have been applying pre-packaged funding for varying periods. Many of the newer regimes among them have applied some of the principles observed in the other more established ones, thus together giving a more rounded impression. Generally, all regimes that have adopted reorganisations or business rescue in their insolvency provisions recognise the need for financial assistance for such distressed companies. The financial assistance legislated for, differs in each country, as does the number of ways this assistance is usually provided.

There is a great variety of ways in which this funding is provided, including using either equity or debt instruments, whether post-filing or pre-filing of bankruptcy. Countries that apply a variety of these investment methods into distressed companies, like the US and France, seem to have an established market for such funding variations. Hedge funds in both countries seem to play a dominant role in funding or buying up distressed businesses in both countries. These funds seem to have developed a reputation for venturing into riskier transactions with a penchant for higher returns. They are furthermore not burdened with similar prudency rules that regulate private equity firms. What seems to be clear though is that where hedge funds are active in the market for funding distressed assets, the market does appear vibrant.

On the other hand, while countries such as the UK, Australia, and the rest of Europe do seem to have enough options in securing buyers for distressed assets, many of these seem to prefer equity related asset acquisitions such as post- and pre-equity funding. With the exception of the US, hedge funds do not seem to be dominating the market.

It is not too clear whether the variety of funding mechanisms is a result of this established market for funding of distressed assets, or whether the latter influenced the former. However, there seems to be some positive correlation between the wide variety of funding mechanisms and the vibrancy of the distress funding market. About funding mechanisms, the study confirmed the proposition as follows:

Proposition 1: A wide variation of funding mechanisms for distressed acquisitions is found in regimes with an active, vibrant distress funding market.

6.2 Pre-packaging as complementary funding to other funding mechanisms

Furthermore, many of the equity related investment products are in principle, applicable during pre- and post-bankruptcy filing. It seems that funders often apply pre-packaged funding because it gives them some advantages, but would also fund or acquire assets after they have filed for bankruptcy. Hedge funds are known to straddle both lanes with ease, as they are also active in the debt related funding or acquisition market. For such funders, acquisition of distressed assets is the primary goal, with both pre-packaging and post-filing used as complementary methodologies.

Debt related instruments for funding or acquiring distressed assets are mostly used in pre-packaged funding mechanisms. These are usually arranged way before the known occurrence of such an event of insolvency. Countries that do not apply equity funding instruments often do not apply debt instruments as well. In other words, debt instruments, which are mainly pre-packaged funding instruments, seem to exist only when post-filing equity instruments are already in place in distressed acquisitions, thus complementing them.

It therefore appears that where pre-packaging occurs, it often complements other funding mechanisms. This study thus proposes as follows:

Proposition 2: Pre-packaged financing often complements existing traditional funding mechanisms in the rehabilitation of distressed businesses.

6.3 Introduction of new shareholders with altered capital structures in pre-packaging

The thesis of pre-packaged funding is that it is an acquisition of assets or a whole business of a distressed company. Consequently, it introduces new capital into the structure and thereby alters it with new equity either replacing debt or as an addition to the existing debt, which in itself alters the debt-to-equity ratio. One can further argue that the debt structure will be further altered down the line as the new capital repays it.

As seen in Table 2, in all the cases where pre-packaging is introduced, there are new shareholders that come along with it. In many of the cases, the new shareholders are completely new to the business being financed, including Hedge funds, private equity firms, industry players, and management in some cases. Where creditors come in as new shareholders, these may be existing creditors such as in the enforcement share security or pre-petition debt, or new creditors altogether such as in CDS and debt-for-equity transactions. In the end, the following is proposed:

Proposition 3: Pre-packaged funding often introduces new shareholders and altered capital structures in distressed companies.

6.4 Perception of good value for money as a driver of third party investments

Valuation plays a key role in investment decisions of investors in distressed assets. According to Harner’s (2008:75) definition, a distressed debt investor is an entity that buys the debt of a troubled business at a discount to its face value in order to ultimately profit from it. In order to increase the chances of profitability, the entity has to ensure that the entry price is set favourably from the onset of the transaction. This issue applies to both equity and debt driven acquisitions.

There, however, does not seem to be any uniformity in the valuations offered around the world regarding distressed acquisitions. On the equity side, valuations vary from one extreme in Sweden's auction bankruptcy of a piecemeal liquidation value, to a going concern value in the enforcement of share security in other parts of Europe. A pre-petition equity offers some middle ground with an adjustment being allowed to the going concern value.

From an acquisition through debt perspective, actuarial calculations have to be done by seasoned investment professionals employed by hedge funds in order to ensure optimal values for the instruments. Knowledge of the creditors' market backed by an understanding of bankruptcy is a useful skill in conducting proper valuations, especially since many have to be conducted way before the occurrence of the default event. In addition to that, a fulcrum also has to be determined during the event of default. A further tool in the shed for acquisitions through debt instruments is the negotiations with creditors. A good negotiation can always assist to achieve a good valuation. This study concludes therefore that:

Proposition 4: Third party pre-packaged investments in distressed assets are driven by a perception of good value for money.

In conclusion, to agree with Meier and Servaes (2015:22), investors (in a prepack) only invest once their valuation calculations point to a profit befitting the risk incurred in acquiring the distressed asset, as opposed to regular mergers and acquisitions.

7. MANAGERIAL IMPLICATIONS

Pre-packaged financing is in essence the acquisition of the business (as a whole) or assets (in whole or parts) of a company in financial distress. It normally takes place where acquisitions of such assets are permitted, either legally or by practice, after filing for bankruptcy. In those environments, pre-packaging occurs as a complementary and possibly even more effective method of acquisition of such assets. The advantages of pre-packaged financing are numerous, including the speed of execution, avoidance of reputational damage for the distressed company, and preservation of key employees.

Earlier studies indicate that pre-packaging is a market driven phenomenon. When one understands that pre-packaging is another mechanism of acquiring distressed assets, and often follows when the post-filing mechanism is in place, it becomes easier to predict that as post-filing acquisitions occur, pre-packaging is also possible down the line. Once the funding market becomes used to acquiring assets post-filing for bankruptcy, they will find it easier to start implementing pre-packs. With the global investment market at our disposal, hedge funds as major participants in the distress funding market will begin to find new avenues and markets. A further study needs to be undertaken to understand what attracts experienced international hedge funds to new markets for distress funding, including SA. A further study for SA is to understand the extent of post-filing acquisitions, as well as whether they may influence or facilitate the entry into pre-packaged acquisitions.

The market for debt-based acquisition instruments encompasses relatively complex models, but they can easily be exported to countries where opportunities exist. This is a glaring opportunity for business, especially financial services companies in new business rescue or reorganisation environments. There is no doubt that this is a growing market.

Previous studies have been used to discuss the prevalence of pre-packaged financing throughout the world, especially in countries with established practices. In this study, the complexities of investing in distressed companies were explored, especially regarding the financial complexities. Much of the research that has been completed thus far specifically details the legal environment and complexities accompanying them. This study, however, is pivoted on an improved understanding of financial structures and valuations applied in these different structures, including the profile of participants in distress funding. Ultimately, once the legal complexities have been dealt with, the financial intricacies will determine pre-packaging to be practical, or not.

Regimes that are aware of pre-packaging and likely to implement it, in perspective, might not be ready either from a regulatory perspective, or from a financial sophistication to handle the myriad of transactions. As can be realised from the study, the investment into distressed assets offers many avenues of entry in either equity or debt. Even using those avenues requires different skills from the investor markets. A country such as the UK, with a more established insolvency (reorganisation) regime, has not yet ventured much into debt instruments for investment in distressed assets. One cannot, however discount the possibility of this sophistication creeping in over the years in the UK, as well as in countries new to reorganisations, such as SA. In fact, a guideline in this regard could be that once investors become very active in a market, there may be openings for new ideas and therefore diverse financing products.

For SA, the hedge fund market has not yet developed well enough to enter the distress funding market, whereas it is the biggest participant for distressed investments in the US. A further study may need to investigate the constraints of hedge funds in entering this market in SA.

8. CONCLUSION

In search of directives for South African application, this study focused on the financial intricacies of restructuring based on global models. Specifically the research intended to isolate pre-package funding models in terms of valuation and transaction structuring. It is clear from the findings, firstly, that while pre-packaged funding is used extensively in many regimes, it is often applied alongside post-bankruptcy filing (post-filing) funding mechanisms by active participants in the distress funding market. Thus, most established distress funders use pre-packaging inter-changeably with other post-filing mechanisms. With the development of the M&A market in the distress environment in SA and the applicable equity instruments, a course may be chartered for the future development of pre-packs.

Secondly, it can be established conclusively that sophisticated funding mechanisms are used in both pre-packaged and post-filing funding. Most notably, pre-packaged funding strategies, structures and valuation methods tend to be more sophisticated due to the very early timing of the process and the related greater uncertainty and risks. In adopting pre-packaging, newer regimes like SA need to be cognisant of the required resources, including the highly developed analytical and negotiation skills.

Thirdly, while it may not be clear whether a variety of funding mechanisms influence the vibrancy of the distress funding market or vice versa, it is clear that there is often a correlation between the two. The role of hedge funds in developing a vibrant distress market in a regime such as SA would then need to be established, given the dominant role these play in more developed markets.

Specifically in the SA context, pre-packaging is not yet officially documented. However, post-filing acquisitions appear to be taking place, albeit in isolated cases. An empirical study into the nature of these acquisitions, the participants thereof, as well as whether the benefits are being reaped, needs to be undertaken. Furthermore, whether such post-filing acquisitions could be a precursor to pre-packaged funding should also be conclusively researched.

The role of hedge funds (or absence thereof) in the future of pre-packaged funding needs to be investigated for SA, as well as in other potential global markets. In other words, what are the antecedents to a hedge fund driven vibrant distress funding market?

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