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Opportunities for private equity in business rescue

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On 23 February 2021, the first ever virtual Ansarada DealMakers Annual Awards was broadcast, and two transactions in which Werksmans Inc. ("**Werksmans**") advised on were announced as winners of which was, one in the private equity category and the other in the business rescue category.

The winner of the "Catalyst Private Equity Deal of the Year 2020" was the acquisition by Capitalworks Atlanta GP Proprietary Limited (acting in its capacity as general partner of Project Atlanta Investment Partnership III) of Peregrine Holdings Limited ("**Peregrine**"). Werksmans acted for Peregrine in the approximately R4,2 billion private equity deal.

The winner of the "Business Rescue Transaction of the Year 2020" was the business rescue of Phumelela Gaming and Leisure Limited ("**Phumelela**"). Phumelela entered into business rescue proceedings in May 2020 after deciding against voluntary liquidation. Werksmans acted for the financiers who provided post-commencement finance ("**PCF**") to Phumelela and for the party that will, subject to regulatory approvals, acquire the horse-racing business of Phumelela. Werksmans also acted for the business rescue practitioners of Comair Limited ("**Comair**"), a nominee for the "Business Rescue Transaction of the Year 2020", which also entered into business rescue in May 2020 and where private equity is, in part, aiding in restoring Comair to solvency.

The winning transactions were executed during the continuing onslaught of the Covid-19 pandemic. The successful execution of the transactions says a lot about the value creation brought about, separately, by business rescue proceedings and private equity. Although the transactions are unrelated, this article seeks to briefly explore the playing field for structuring transactions that could be created by the interplay between business rescue proceedings and private equity.

It goes without saying that business rescue in South Africa has created an opportunity for private equity players to participate in business rescue proceedings in one form or another. Chapter 6 of the Companies Act 71 of 2008 ("**Companies Act**") governs South Africa's business rescue regime and when a company becomes financially distressed, it may and often does, initiate business rescue proceedings subject to the Companies Act. On the other hand, the private equity market remains mostly unregulated in South Africa but depending on structures used for private equity funds, the private equity fund managers and/or the bespoke nature of a private transaction, certain legislative frameworks may apply.

It is trite that private equity investments, if done right, can provide genuine value creation for investee companies, shareholders and other stakeholders. Typically private equity investments entail a funding boost and support for the investee company's management team. In a business rescue context, private equity firms may fund financially distressed companies and/or acquire their viable business assets. Private equity investments can take different forms including debt and/or equity funding, asset purchase, leveraged buyouts and/or mezzanine funding. Indeed, private equity players can take up different roles in a company under business rescue proceedings. In addition to bidding, or otherwise trying to acquire, viable business assets private equity players can provide PCF funding to assist the distressed company stay afloat and meet its short and/or long term funding obligations. Such financing is necessary as the distressed company is being restructured.

There are commercial opportunities for private equity players and other investment houses to capitalise on the statutory benefits of offering PCF to a company in financial distress. A detailed review of such statutory benefits in terms of Chapter 6 of the Companies Act is beyond the scope of this article. However, the following overview sets out salient points with regards to the priority afforded to PCF:

1. PCF can be secured by security over the unencumbered assets of the distressed company;
2. putting up PCF funding comes with the benefit that you "jump" the queue (i.e. while you fall behind secured creditors with respect to repayment from the sale of secured assets, such funder gets a jump on unsecured creditors and rank ahead of them);
3. the anti-dilution protections of funders (discussed below) may, subject to competition law constraints, be available to the provider of PCF funding, enabling such funders to "jump the queue" should the business rescue practitioner sell the assets of the distressed company; and
4. the ability of the business rescue practitioner to entirely, partially or conditionally suspend or cancel the Company's obligations during business rescue may assist to make the asset (notwithstanding the financial distress) more appealing.

Private equity players and other investment houses may also purchase the debt of the distressed company at a discount. This is more common in foreign jurisdictions and depends on the mandate of the fund manager, as these are often riskier transactions.

There are also some key issues that business rescue practitioners and distressed companies should take note of when engaging with private equity players (this is not an exhaustive list):

1. firstly, the sourcing of finance by a distressed company may be difficult given the very reasons for the company being under business rescue. Private equity players are able to raise funds from their own investors or sponsors, third parties and/or banks. Private equity players can often leverage their strong position in the marketplace to source better finance deals;
2. secondly, if the private equity firm intends to inject funds in a distressed company by acquiring an equity interest in such a company, such private firm may require anti-dilution protections to protect the value of its equity shareholding. This would be the case in traditional private equity deals in any event. Risk-mitigating strategies for a private equity firm would include pre emptive rights, tag alongs and/or prior consent for any further rights issue by the company as well as the ability to trigger an exit event given private equity firms usually have specific time frames for their investments or portfolios;
3. thirdly, subsequent to providing funding, the private equity firm may at times not be involved in the day-to-day management and operations of the company and may lack control over the underlying businesses of the distressed company. Therefore, to mitigate such risk, the private equity player may request various minority protections and veto rights for key matters on the decisions to be taken by the distressed company. This, of course, also impacts the assessments in regards to competition approvals which may delay a transaction, which is not ideal when dealing with a distressed company. Although, the regulators do permit, in certain circumstances, expedited approvals based on a "failing firm" concept.

Ultimately, with the above being said, private equity players will likely need a clear "exit" strategy in mind subsequent to funding a distressed company. Therefore, there must be a reasonable prospect of rescuing such a company for private equity players to get involved.



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