May 2015

OUTLOOK

Asia Pacific

Opportunity Knocks: Success in Restructuring

An Outlook on Turnaround and Restructuring in Asia Pacific 2015

Contents

Foreword

Companies in the Asia Pacific region will be restructuring in greater volume and at higher frequency in the next 12 months. That was the general sentiment of respondents to AlixPartners' third annual survey of restructuring and turnaround activity in the advanced economies of Japan and Australia and the various emerging markets in between. The opinion is due in large part to macroeconomic uncertainty globally and is exacerbated by a slowdown in the Chinese economy—in the form of a downward shift in growth that is reverberating across the region.

Choosing the right approach when restructuring very often makes the difference between a successful turnaround and one whose tremendous amounts of invested corporate time, resources, and value get lost. It's challenging, though, to decide which strategy—be it cash management, corporate expansion, overhead optimization, or efforts to enhance revenue—will deliver the desired results.

In addition to gauging respondents' sentiments about trends and market conditions across the Asia Pacific region, this year's survey asked respondents which restructuring strategies would see the widest applications and which would present the most difficulties, because certainly, regional differences between countries give each its intricacies that call for a tailored approach to restructuring.

Our goal in this report—our third collaboration with Mergermarket's events and publications division Remark—is to provide a snapshot of the available options for distressed companies or those considering a restructuring.

As always, we hope you find the report a valuable and insightful read, and we'd welcome the chance to discuss with you in more depth any of the issues raised.

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Executive Summary

The outlook: Anticipation of increasing distress

Some 93% of survey participants anticipate an increase in corporate restructurings in the year ahead. That represents a significant uptick from expectations in 2013 (66% of respondents) and 2014 (70%). The sentiment was led by unease from the slowdown in the Chinese economy, with almost 40% of respondents saying that that downward shift in growth would contribute to increased restructuring activity.

Proactive restructuring still rare

Only 18% of respondents say they take a proactive approach to restructuring—despite widespread realization that early action can give corporate leaders greater control over the process. Restructuring under financial pressures leaves fewer options on the table and makes it more difficult to avoid bankruptcy. Instead, the majority of respondents (69%) say restructuring would commence only after the first signs of distress.

Country and industry forecasts

As in previous years, restructuring activity is expected to increase in varying degrees across the Asia Pacific region. A prolonged recession in Japan means that 97% of respondents anticipate increased restructurings, with distress within the mining sector contributing to downbeat sentiment in Australia and New Zealand (93%). This is followed by South Korea (87%), Greater China (85%), Southeast Asia (75%), and India (74%). Top industries likely to experience upticks in restructuring are financial services (59%) and industrials (58%), followed by automobile manufacturers (50%) and the real estate sector (35%).

Toolbox for restructuring: The strategies for success

Strategies that can be applied to cope with operational and financial changes include mergers and acquisitions (M&A), cash management, overhead optimization, and revenue enhancement. Within each overall strategy, respondents pinpoint particular initiatives they say they believe offer the best chance for a successful restructuring and those they believe would be particularly challenging to implement in their markets.

Strategy #1: Acquiring and divesting

For a company struggling for growth, an acquisition can provide the impetus to reach new markets and explore new product segments. That makes acquisition a popular tool, with 90% of respondents saying acquisition would be a commonly used tool for restructurings in the year ahead. Conversely, when a company is being impeded by a noncore unit or one that is performing poorly, a divestiture might offer the best chance for a successful turnaround. However, with only 43% of respondents seeing it as a likely tactic during a restructuring, divestiture remains a relatively unpopular choice in the Asian region.

Strategy #2: Managing cash flow

The ability to accurately predict cash flow is the most important skill when managing cash flow, according to 70% of respondents. Finding quick resolution to issues between debtor and creditor is seen as the second most-common approach to cash management, an option selected by 62% of respondents. Additional, less popular, cash management tactics include renegotiation of customer terms (53%) and working-capital reductions (48%).

Strategy #3: Overhead optimization

Cutting overhead costs is another important strategy for improving a business's cost competitiveness and growth opportunities. Respondents say employee layoffs would be most common (76%) under this approach, followed by scaling back production (64%). In contrast, outsourcing is seen as a much less likely option, chosen by just 34%.

Strategy #4: Enhancing revenue

Companies trying to develop and secure new sources of revenue or to boost existing revenue streams will do so by exploring new market segments in the year ahead, according to 70% of respondents. Developing new products and services will also be a useful tactic (56%), complemented by pricing more effectively (51%) and negotiating business partnerships (37%).

Postmerger integration: Top challenge, secondary priority?

With acquisition rated as a particularly important tool for turning around an underperforming company, getting the acquisition process right is likely to be decisive in a large number of restructuring situations during the year ahead. A poorly executed integration can have a lasting, negative impact on the future fortunes of a company. Whereas 30% of respondents said postdeal processes represent the most challenging aspect of a deal, 90% said that the most time and the most resources get dedicated to the earlier stages of the transaction. Close to 25% of respondents say postmerger integration deserves more attention than it is being given.

The power of digital

Digital advances offer promising complements to traditional restructuring practices and are ways for companies to gain advantages over their market rivals. However, digital transformations have been slow to take root in Asia. A full 93% of respondents report having heard of digital transformation, but only 50% say it was part of their most recent restructuring. For future turnarounds, 57% of respondents say digital transformation will be a key factor, including 28% that see it is as critical.

Asia's restructuring and turnaround potential

Generally, respondents say the restructuring profession has yet to establish a foothold in Asia comparable to that in North America or Europe. Although regulatory and political developments are paving the way for a smoother restructuring process, 57% of respondents say the region is still less mature than markets in the West. Close to half of respondents also say that executing a corporate restructuring in Asia is more difficult than in North America and Europe.

Corporate Stress in Asia: A Look at 2015

Corporate Asia may be in for another year of turbulence. According to AlixPartners' *Opportunity Knocks: Success in Restructuring*, 93% of market participants in this year's survey anticipate that the number of corporate restructurings and turnaround situations will increase in 2015 (figure 1). That represents a significant increase over responses in our previous annual surveys: in 2013, 66% of participants expected corporate restructurings to increase, followed by 70% in 2014.

Slowing economic growth rates and mounting corporate debt across the region are two of the main drivers of rising distress in Asia Pacific. Those pressures are pushing corporations to close facilities, divest unprofitable business lines, and search for diversification in other industries through mergers or acquisitions.

The ripple effect from the slowdown in the Chinese economy is also being acutely felt regionally. Almost 40% of respondents say impact from China would contribute to increased restructuring activity in the next 12 months.

In addition to the impact of slowing growth rates, more than a quarter of respondents say global macroeconomic uncertainties—such as falling oil prices, Russia's involvement in Ukraine, and continued economic volatility in the Eurozone—would drive restructurings in 2015 (figure 2). Alleviating debt or liquidity issues is another primary concern among respondents this year, as are regulatory or political developments and competitive pressures.

Yet despite the largely negative outlook, companies need not dread the prospects or the process of restructuring. Having a finger on the pulse of the market and on developments in their

Figure 1: Expectations for restructuring/turnaround activity in Asia Pacific in the next 12 months

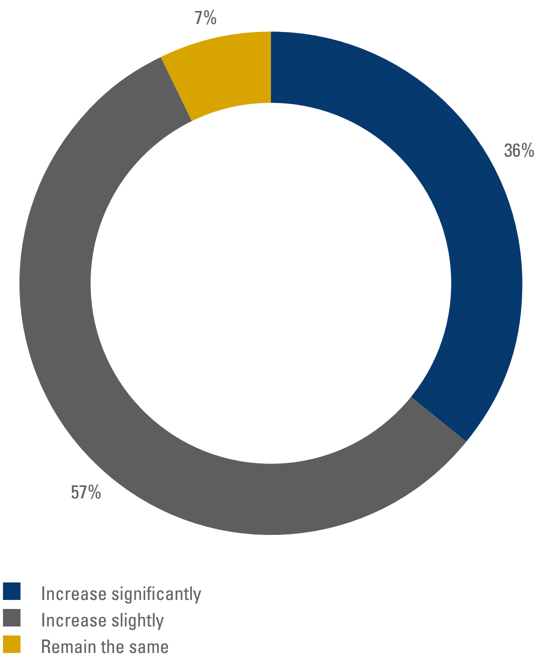


Figure 2: Primary drivers of restructuring in Asia Pacific in the next 12 months

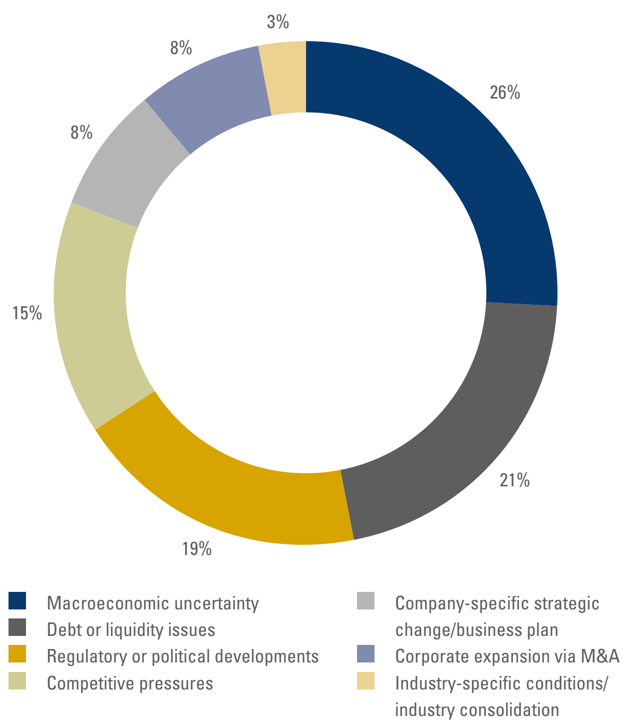


Figure 3: When are restructurings most likely to commence as part of corporate reorganizations in Asia Pacific in the next 12 months?

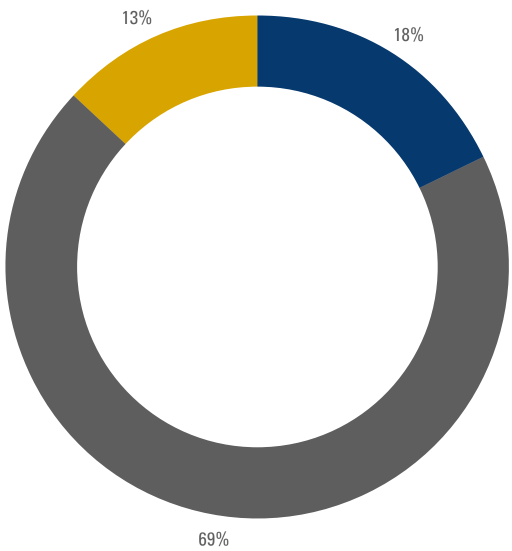
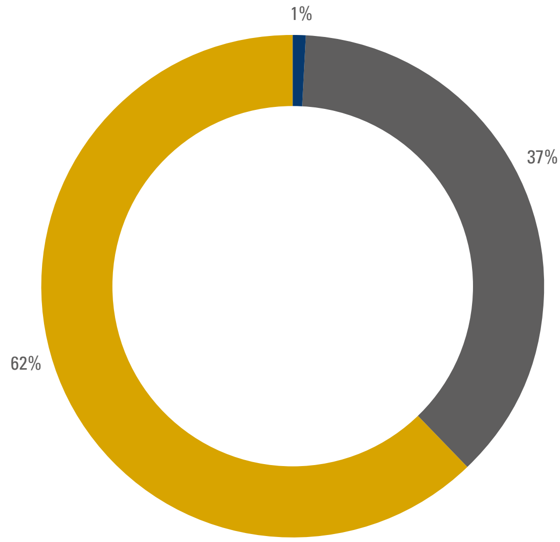


Figure 4: To what extent does the late start of a corporate restructuring affect the success rate of the overall reorganization?



industries will help corporate leaders spot opportunities to restructure their own businesses before value or market share begins to erode. At the very least, acknowledging those signs and taking action can prevent stress levels from rising.

Strike while the iron is hot: Proactive versus reactive restructuring

Deciding when to pull the trigger can make the difference between a successful turnaround and a company liquidation. In an increasingly volatile market, that awareness is key.

However, only a small percentage of respondents (18%) say they take a proactive approach to restructuring (figure 3). Early action can give corporate leaders and turnaround professionals greater control over the process, effectively keeping more doors open as the restructuring unfolds. Corporate restructuring launched under the pressure of financial distress often lacks those options, making it more difficult to avoid bankruptcy or liquidation.

Instead, the majority of respondents (69%) say preemptive restructuring is both uncommon and unlikely and that such efforts to transform a business will commence only after the first signs of distress. The managing director of a private-equity firm in Greater China says that only after signs emerged, such as negative cash flows or declining revenues, did talks of restructuring portfolio companies commence. Other respondents say limited resources prevented them from taking a proactive approach when there were no clear signs the company or its position in the market were in jeopardy.

That's despite respondents' almost unanimous agreement that starting late has an impact on the chances of success (figure 4). And that includes 62% of those surveyed who say a late start would have a significant impact because, as respondents note, delays can have a ripple effect on the company's continued health. Indeed, minor problems at present could spiral out of control, becoming major threats to the company's continued operation.

The managing director of a hedge fund in Greater China illustrates those points by saying, "A late start will definitely alter the outcome and have a long-lasting impact on the business. It increases the likelihood that compromises and internal cuts will be required to rescue the company, leaving it a shell of its former self."

Along with starting in good time, determining exactly what to restructure and knowing how to go about doing so are also critical for a successful restructuring. Here, taking a specific, tailored approach helps increase the odds of success. In the next section, we explore several strategic approaches that can assist companies in navigating distress and that can yield the desired results.

Strategies For Success

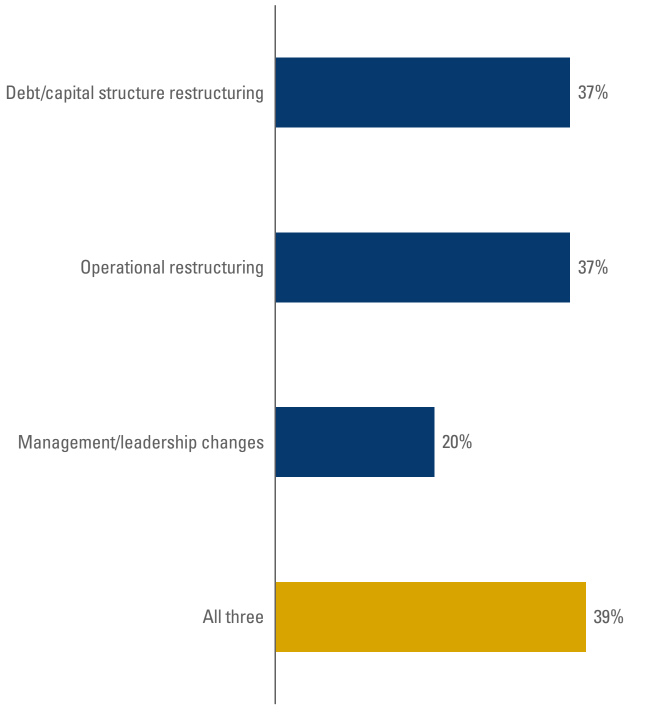
Foremost in the corporate recovery process are (1) the diagnosis of what is negatively affecting the bottom line and (2) the development of solutions to remedy the stress. Addressing those points requires managers to consider the question: What type of restructuring is best suited for our company?

On one hand, if the company is facing financial difficulties, then reducing overall debt will be the main objective. On the other hand, a business unit that needs streamlining and increased efficiency may call for operational changes. And poor leadership or corporate mismanagement may require turnaround professionals to step in as restructuring managers. However, in many situations, a restructuring plan will rely on addressing all three areas—financial, operational, and leadership—by way of a holistic approach.

The holistic turnaround

Respondents agree that a holistic approach will see wider use in the year ahead: more than a third of respondents say that strengthening operational, financial, and leadership would make companies in the Asia Pacific region more resilient and less vulnerable to external shocks (figure 5).

Figure 5: Across Asia Pacific, what will be distressed companies' primary focus during the next 12 months?



In elaborating on that point, a partner at a private-equity firm in Greater China says, "All three are equally important, and distressed firms are likely to need a number of internal changes. Restructuring debt and capital structures would improve balance, and replacing or complementing the management could help provide new, innovative ideas to improve operations and make the business profitable once again."

Yet despite agreement that the holistic approach is the best way of increasing the chances for a successful turnaround, the holistic approach has yet to see widespread application in the market. In terms of management changes, Asian companies have been reluctant to bring in external advisors and turnaround professionals except in the direst of circumstances. And by that time, the level of distress may have reached a point where the opportunity for recovery has been lost.

Indeed, as corporations restructure in the year ahead, internal managers are expected to wield the most influence in driving the process. Respondents say that that responsibility will fall on the board of directors (44%) and the CEO and other C-suite executives (43%) (figure 6). Meanwhile, lender-appointed chief restructuring officers and other external advisors account for only 1% each, which pinpoints the continued reluctance to bring in outside assistance.

Although changes in leadership are often required to jump-start a restructuring or guide a corporate turnaround across the finish line, respondents say that financial and operational restructurings are more likely to be companies' focus this year (both at 37%) rather than enacting management changes (at 20%).

The main tactics for achieving operational and financial changes can be grouped under four overarching strategies (figure 7).

Some 90% of respondents say M&A would be one of the most likely forms of restructuring in the year ahead.

- **Mergers and acquisitions (M&A)** to complete acquisitions or divestitures that will drive the corporate growth agenda and expand operations
- **Overhead optimization** to alleviate cost redundancies across various internal corporate functions in order to reduce the outflow of cash
- **Cash management** to ensure a company's financial stability and solvency
- **Revenue enhancement** to explore and develop new products and services that would maximize profits

The initiatives that underlie these strategies can provide the means to optimize operations, reduce debt, and improve efficiency. For the next 12 months, making an acquisition (90% of respondents) stands out as the anticipated restructuring tool of choice, followed by employee layoffs (76%), cash flow forecasting (70%), and exploring new markets (70%).

Whether focusing on one of those strategies or managing a cross-strategy turnaround, respondents say that those options hold the keys to improving a company's financial condition and turning around a business that may not be operating to its maximum potential. Each approach provides options to alter the current course, reclaim lost market share, and, potentially, create value.

Figure 6: Who will hold the most influence in driving corporate restructuring at companies in Asia Pacific in the next 12 months?

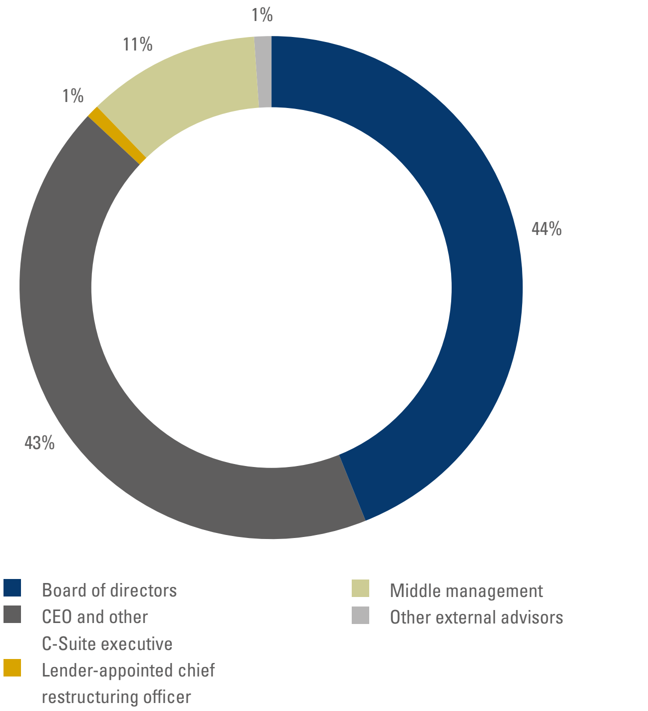
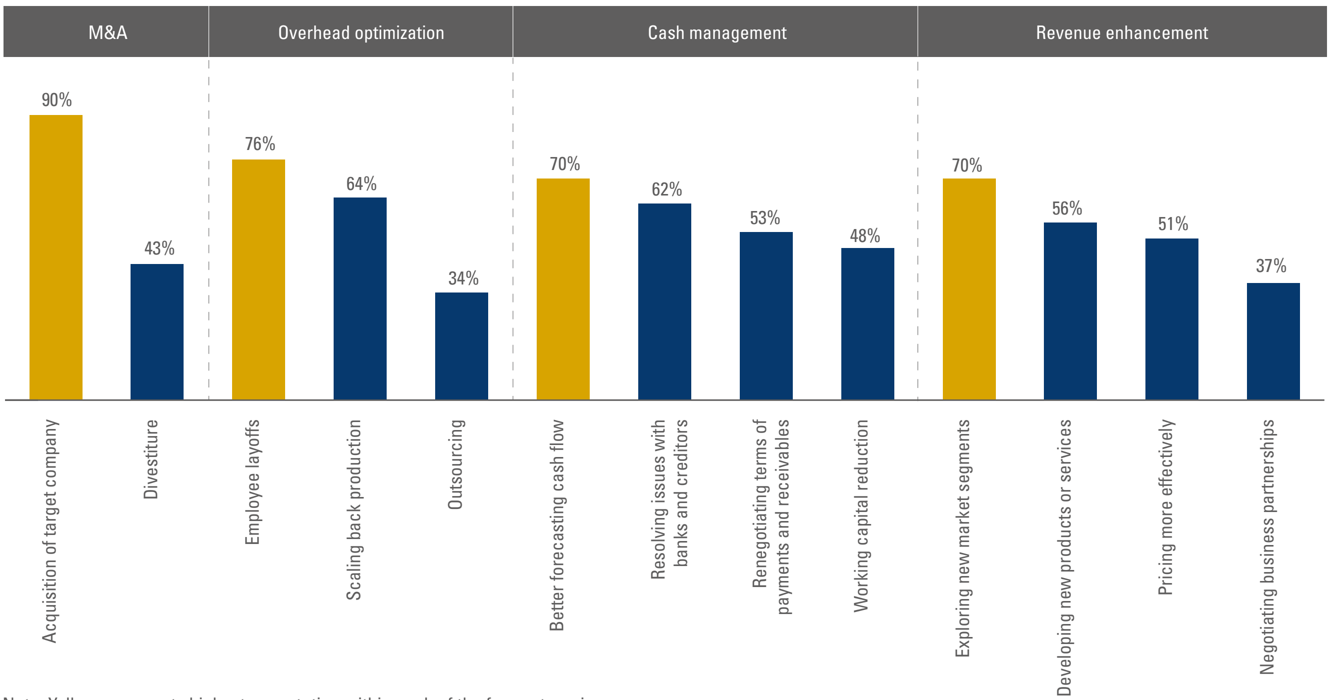


Figure 7: Which of the following restructuring/turnaround strategies will be applied most in the next 12 months?



Note: Yellow represents highest expectation within each of the four categories. Respondents were allowed to choose more than one response.

Strategy #1: M&A

The race to build a stronger, better organization amid a rising tide of competition led respondents to select acquisitions as their top choice when restructuring in the year ahead (table 1). For a company struggling for growth, M&A can increase exposure to new markets, add new product lines, or bolster talent and therefore serve as a springboard for a resurgence in performance. Conversely, divesting a noncore business enables companies to offload distressed or nonperforming assets so as to create a leaner, more efficient company (figures 8 and 9).

Table 1: M&A (by respondent expectations)

90%
Acquisition of target company

43%
Divestiture

Acquisition of a target company

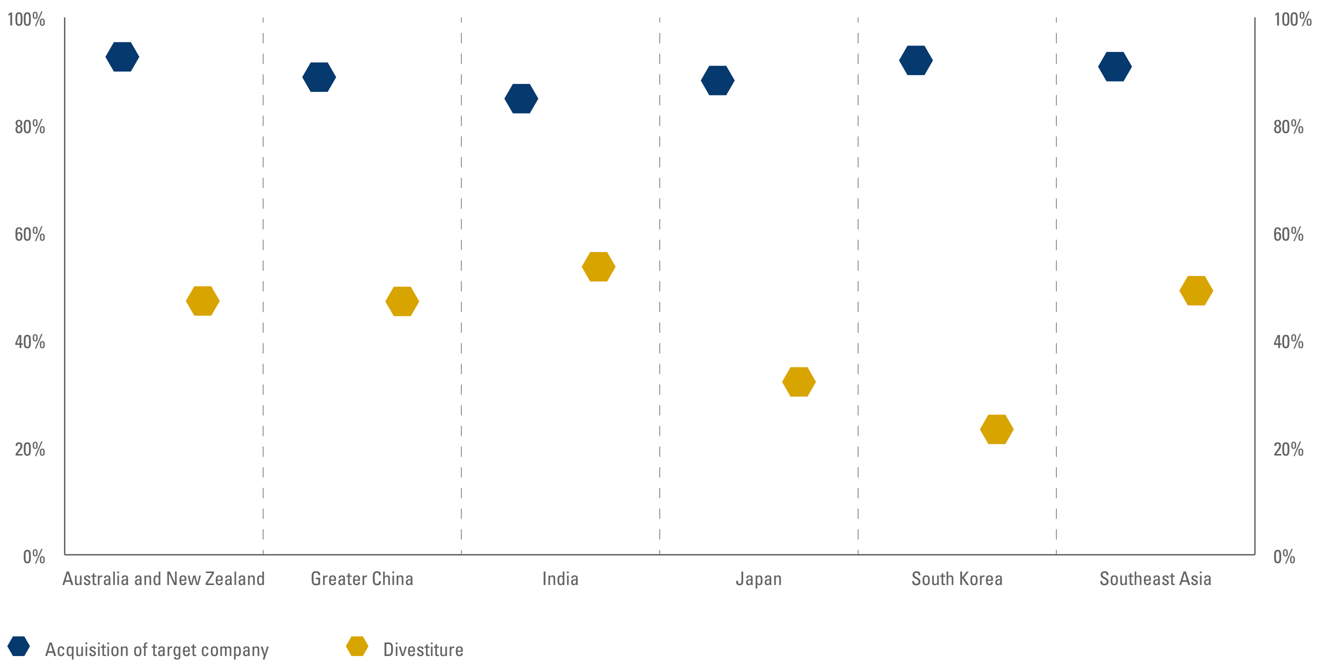
In the past 12 months, the level of acquisitions across Asia Pacific reached new records as regional and international corporations completed transactions as part of expansion and restructuring agendas. In 2014, approximately 3,760 deals were completed, an increase of 21% over the previous year, according to data from Mergermarket. A large part of that activity was driven by government-mandated industry consolidations, particularly in the steel processing industry. Increasingly, however, corporations in Asia are using M&A as a way to break out of their local and regional markets and into the global arena.

In Japan, corporations are following the acquisition trail in search of new points for growth amid shrinking market shares as the country's population declines. Chinese corporations are likewise looking to M&A to rebrand themselves and their operations in order to join the ranks of multinational corporations.

The views of a partner at a Japanese private-equity firm echo that sentiment: "Acquiring a target company, especially a smaller one, can add value to the parent company and act as a catalyst to boost revenue, enter new market segments, and add talent and expertise." Such add-ons in turn can help transform a company's approach to doing business, potentially opening up new avenues for growth that had been unavailable previously.

Although for a struggling company the rewards from acquisitions can be significant, a company must first make an honest

Figure 8: Anticipated use of M&A as a restructuring strategy, by geography



assessment of its current financial and operational standing. The costs in time and resources may put such a process out of reach for companies suffering high levels of distress, as opposed to those that are pursuing M&A under much less pressure.

Equally, the acquisition process has many inherent challenges. Foremost among them is the selection of the right target to acquire. In M&A, a "good-enough" fit can spell disaster. Prospective acquirers must adhere to a strictly enforced selection process to find a target that will create long-term value.

Respondents also say that due diligence poses a significant hurdle in completing a transaction, particularly during a cross-border acquisition. As well as investigating the internal operations of the target, an acquirer must become familiar with the local legal and regulatory frameworks.

The work done after a deal is signed is likely to be even more intensive and is often underestimated, with time and resources instead devoted to the early and midstages of the transaction. See **Joined-up thinking: The challenges of integration** on page 12 for more.

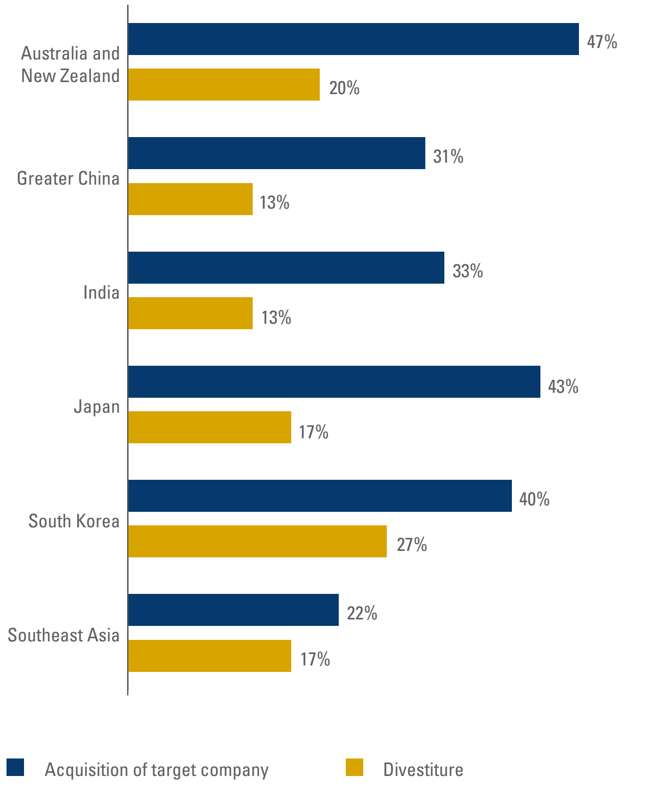
Divestiture

When an organization's overall performance is being hampered by a noncore or underperforming unit, a divestiture may be needed to get on with growth. Such divestiture could involve the sale of manufacturing plants, business divisions, or entire subsidiaries of the larger corporation. As 43% of respondents point out, divestiture plays an important role in the restructuring of a corporate portfolio and would be a common approach during a reorganization.

Divestiture of a noncore or underperforming unit can put funds to work to further other aspects of the restructuring process, including growth initiatives. That point is emphasized by the managing partner of a law firm in Greater China: "The decision to sell a noncore or nonperforming asset is only one part of a divestiture. Before the sale is complete, business leaders must also have a plan for how cash from the sale will be used postdivestiture. Exploring new market segments is one option, but a company must seriously consider how proceeds can best be used to reposition itself as a leader against the competition."

Once the asset is divested, a corporation can also refocus time and resources on core operations. Japanese electronics giant Sony used that rationale when announcing plans to spin off its audio and video division in early 2015—a move that will free Sony to focus on higher-growth sectors—in the areas of movies, music, video games, and image sensors.[1]

Figure 9: Which of these approaches to M&A will be most challenging in your primary region of focus?



A relatively low number of respondents say a divestiture would be a particularly challenging part of any restructuring process. Across Asia Pacific, the highest percentage of such respondents is in South Korea, where the country's chaebol (business conglomerates) are often hesitant to divest assets—even those that impede growth. The reason is the sense of loyalty the chaebol have toward companies in their portfolios: one that often dissuades parting with assets—even those that have nothing to do with the core business.

Divesting an asset when the company is stable is usually only a matter of finding a buyer and reaching an agreeable valuation. However, that process gets compounded if the parent business or the asset being sold is distressed or underperforming. In such unfavorable conditions, yielding the best possible return from the sale will be unlikely and valuations may be weak.

Even amid rising stress levels, a corporate divestment must be executed following a well-defined strategy with clear objectives. That includes having a price in mind for the asset being sold. Following that course—even when divesting in unfavorable circumstances—can help maximize a sale and contribute toward the company's recovery or redirected business strategy.

1 Eric Pfanner and Takashi Mokizuki, "Sony to spin off its audio and video business." Wall Street Journal, February 18, 2015.

Joined-up thinking: The challenges of integration

Determining where to commit time and resources during an acquisition will affect the amount of value created or synergies realized. In our survey, participants say that time and resources are usually dedicated largely to the early stages of the transaction, with more than 90% saying the focus is on activities completed before the deal is closed (figure 10).

Respondents suggest that the importance of deal sourcing and due diligence means that those steps dominate the process. But 30% of respondents say the most challenging part of the transaction occurs once the deal is closed and integration begins. Given the complexities associated with the merging of workforces, the integration of IT functions, and the reallocation of resources, it's necessary to designate sufficient resources at this stage. That step requires the right amount of time, proper attention, and genuine commitment from management.

Close to a quarter of respondents say postmerger integration deserves more attention than it is given. Those respondents hold that the resources allotted were insufficient to meet the heavy demands of the process. Postmerger integration can be daunting, especially amid a wider restructuring that may require management to handle multiple tasks at once. But it is critical because a delayed or poorly planned integration can erode value at both the target and parent companies.

Poorly executed integrations often negatively affect a company's future fortunes. Nearly all respondents agree that weaknesses during the postmerger integration stage can have a major impact on the overall restructuring (figure 11). The reasons integrations fail are complex and varied, and significant differences emerge between deals intraregional within Asia and deals between an Asia-based acquirer and a target located abroad (figure 12). Cultural issues, involving both national differences and the corporate cultures of the buyer and seller, stood out as the greatest obstacles to the merging of business entities (at 73%), especially during a cross-border, intraregional transaction. The language barrier can likewise stand in the way of what could otherwise be a smooth integration.

Overcoming obstacles and increasing the likelihood of a successful integration require a comprehensive plan be in place ahead of signing. The plan must clearly define objectives and delegate responsibilities. An experienced integration team comprising management at the target firm and professionals who oversee the transition is also paramount to successfully merging two businesses—a point several respondents remark on. During cross-border acquisitions, utilizing local experts with ground-level insights can prove invaluable for first-time buyers in a new market.

Figure 10: During the acquisition process, which task is given the most time and resources, and which is most challenging as it pertains to restructuring?

Figure 11: What impact can a failed or weak PMI have on the recently restructured organization?

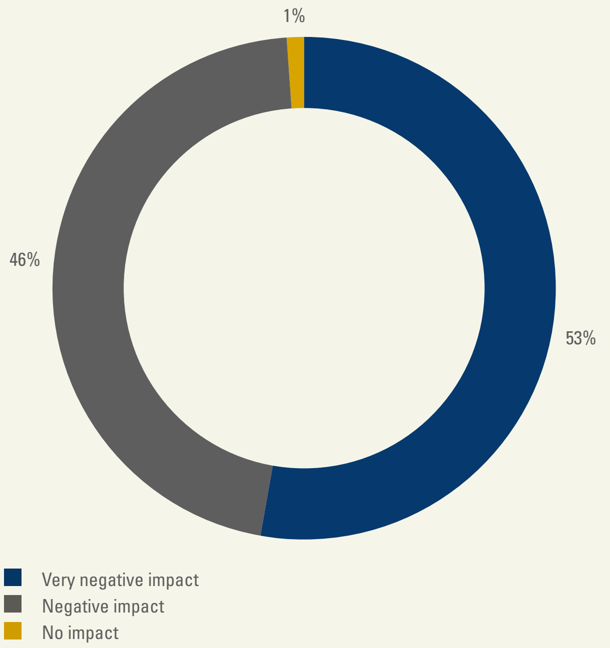
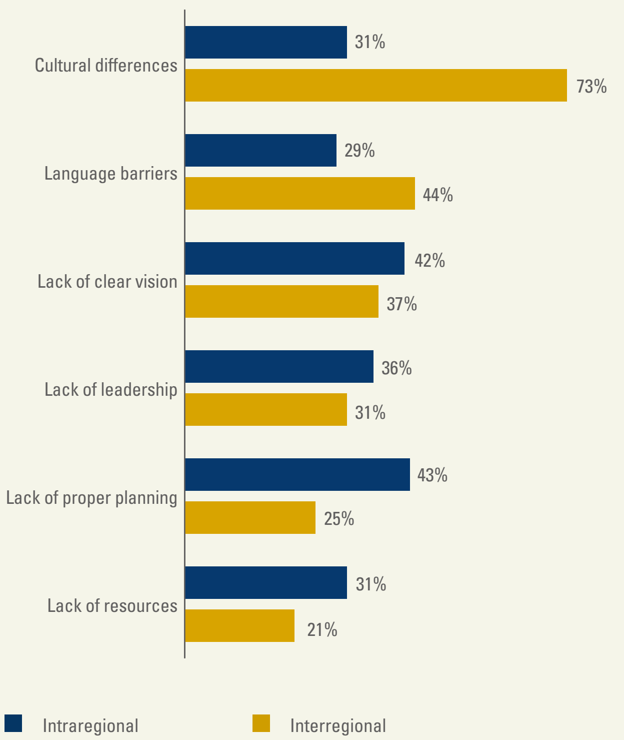


Figure 12: What are the key obstacles that have an impact on PMI, by M&A deal type?



Strategy #2: Cash management

Cash management is likely to be a central component in any restructuring process; the availability of cash can often determine the options a company has for improving underlying operations. Companies that generate or manage cash supplies effectively are more likely to find solutions that alleviate distress, with respondents pointing out the importance of accurate forecasts alongside the resolution of issues with banks and creditors as particularly key steps in this process.

Better forecasting cash flow

The ability to create accurate cash flow forecasts stood out in most territories across Asia Pacific as the most important tactic when a company is looking to improve cash management (figure 13). Some 70% of respondents say that creating those projections and communicating effectively with lenders and other investors would be major parts of restructuring processes in the year ahead (table 2).

"Cash flow forecasting is important because it enables leaders to plan the restructuring and examine the associated costs while also gaining trust from creditors. Knowing exactly how much cash is available also opens more options during the restructuring process," says the CEO of a Japanese investment bank.

Given the macroenvironment and local and regional volatilities, the difficulty of making projections was noted by respondents in varying degrees across the region (figure 14). This is true for as much as 60% of respondents in India, where the underlying economic environment is especially unpredictable amid a deceleration in growth.

According to the director of investment at a Japanese investment bank, "Cash flow forecasting is challenging because market dynamics are shifting, and those shifts make it incredibly difficult to make accurate projections. Similarly, demographic changes are adding to the layers of complexity in creating an appropriate financial model for the future of the business."

Resolving issues with banks and creditors

Finding a quick resolution to issues between debtor and creditor is seen as the second most-common approach to cash management, an option selected by 62% of respondents. As a partner at an Australian law firm points out, negotiating with creditors to establish more-agreeable repayment terms would be essential to financial restructuring in the year ahead. According to that respondent, "Effectively managing relationships with creditors will help clear the air and should help overcome misconceptions or confusion about the health of the company."

Table 2: Cash management (by respondent expectations)

Better forecasting cash flow
70%

Renegotiating customer terms of payment and receivables
53%

Resolving issues with banks and creditors
62%

Working-capital reductions
48%

A dialogue with creditors that is characterized by openness and trust, wherein information is shared to assess a company's financial condition, can result in better results for both parties. Creditors are more likely to realize a return on their investments, and debtors can overcome short-term turbulence.

The debtor-creditor relationship is one of the many intricacies that differentiate restructuring in Asia from restructuring in jurisdictions in North America and Europe. In the United States, for example, reputable legal frameworks exist that allow for a debtor-friendly restructuring. However, such frameworks are much less prevalent in Asia Pacific, and resolving issues with banks and creditors stood out as the most challenging cash management tactic in most Asia Pacific geographies.

That perspective is echoed by the director of investment at a Japanese investment bank: "Resolving issues with the bank and creditors will be the most challenging because of the regulatory environment and a strict credit regime, which means there's less opportunity to negotiate for a better agreement or payment mode."

Renegotiating terms of repayments and receivables
Revisiting payment schemes with clients and customers is another proven tactic for cash management. Requesting

Figure 13: Anticipated use of cash management as a restructuring strategy, by geography

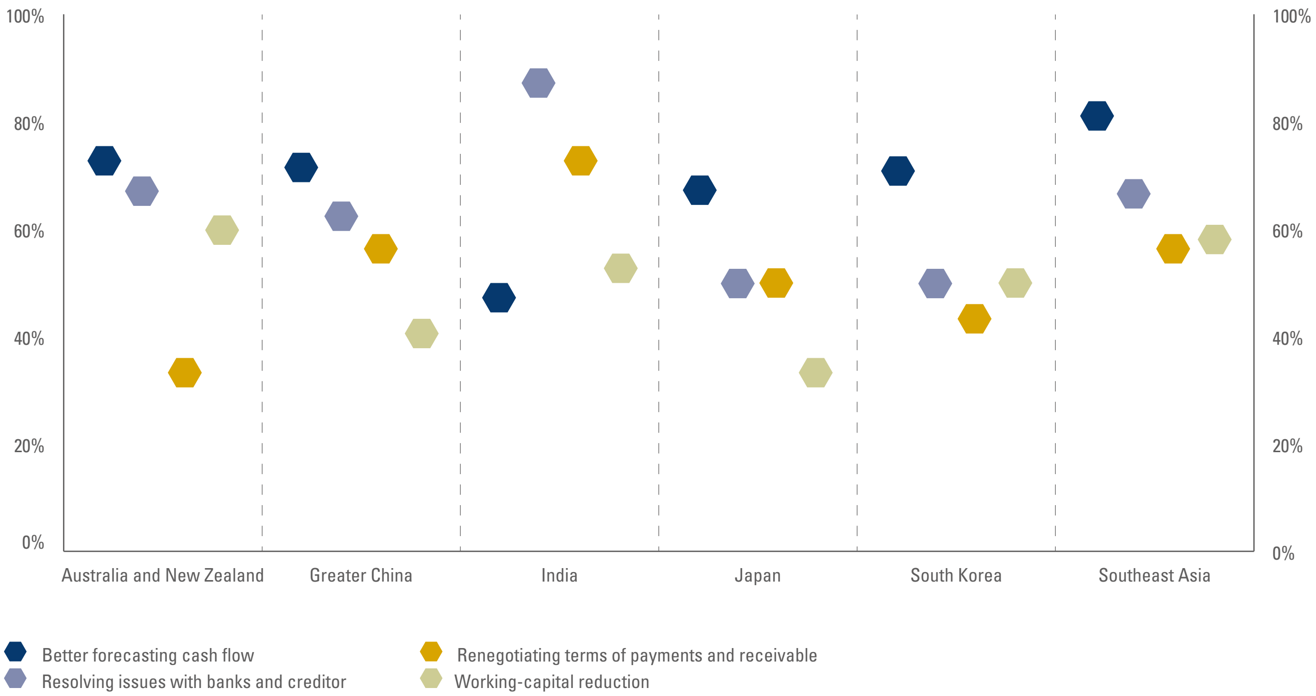
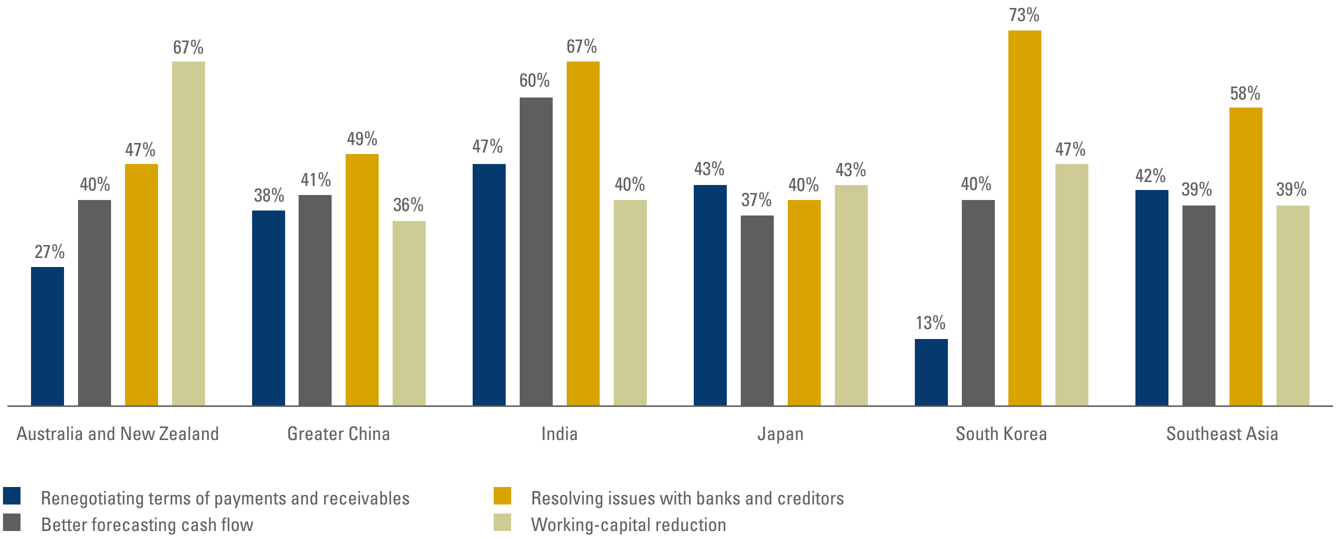


Figure 14: Which of these approaches to cash management will be most challenging in your primary region of focus?



early payment from customers or improving the consistency of payments can give those companies strapped for cash an advantage as they restructure, an opinion shared by 53% of respondents.

"Renegotiating terms of payments and receivables will increase flexibility," suggests the chief investment officer at a hedge fund in Greater China. "Asking customers to pay their bills on time or early facilitates more options when investing in new businesses and also helps in renegotiating payment terms with banks and other creditors."

Renegotiating terms of payment with a company's customers can also help a company recognize "best customers" from the rest, in effect identifying those customers that are profitable and able to pay on time and those that should be avoided. This can be a particularly important if a company is facing financial difficulties and must rely on those payments to meet its debt or financial obligations. Similarly, setting new terms can encourage customers to pay on time or repay existing balances; inconsistent or late payments from customers can be seen by creditors and lenders as a risk to the company's bottom line.

Working-capital reductions

Freeing up working capital—such as that directed toward maintenance and managing inventory—lets a company quickly generate value and cash flow. Cash that has been freed up by reducing working capital can be applied to pay off debt and attend to financial obligations. It can also be reinvested in the company to boost performance. This can be done in a relatively short amount of time and with relatively little effort, which makes this is a valuable approach to cash management for companies going through painful restructurings. However, only 48% of respondents say that that initiative will be a key step taken when addressing cash concerns during restructuring in the year ahead. It may be because savings from working-capital reductions often go overlooked due to an absence of metrics to quantify those savings. "Working-capital reductions are challenging because management teams first have to accurately assess where those costs are being incurred in order to reduce them," says the director of investment at a Japanese bank.

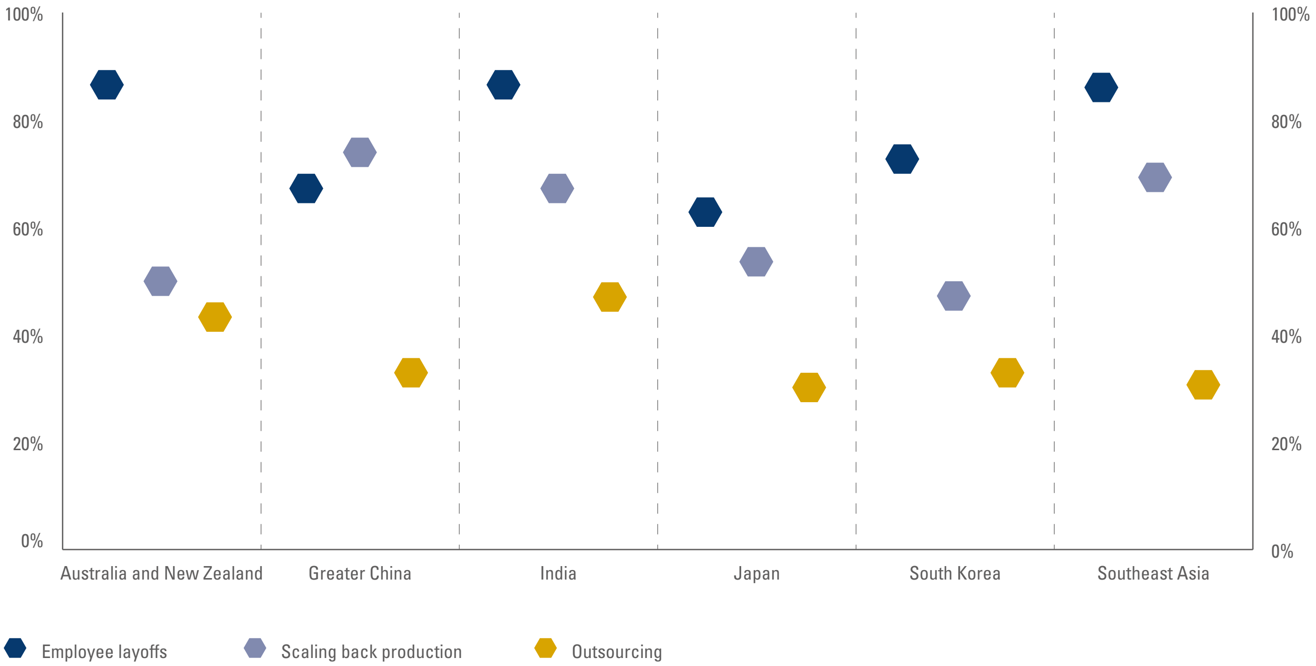
Strategy #3: Overhead optimization

Choosing the right approach to cut overhead costs is another very important step toward improving a business's cost competitiveness and growth opportunities. Although the exact size and composition of overhead costs vary among industries and although geographically specific hurdles sometimes pose challenges, respondents identify several initiatives that will likely be deployed in the year ahead (figure 15).

Employee layoffs

In our survey, 76% of respondents agree that employee layoffs often represented the quickest and most likely option during restructuring in times of distress (table 3). Although this is never a popular tactic, employee layoffs offer the benefit of reducing redundant positions and creating a leaner, more effective workforce.

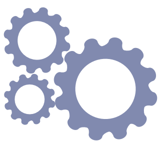
Figure 15: Anticipated use of overhead optimization as a restructuring strategy, by geography



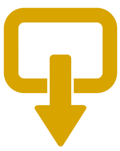
By reducing head count proactively, management can develop an effective plan to retain top talent that will assist with the company's growth. In contrast, waiting until the company is distressed can cause valued employees to jump ship, particularly in the absence of an effective communications plan around any downsizing program.

Table 3: Overhead optimization (by respondent expectations)

76%
Employee layoffs



64%
Scaling back production



34%
Outsourcing

Although downsizing the current workforce has the potential to make the organization more efficient and more competitive from a cost perspective, a slash-and-burn approach to reducing the size of the workforce could have a deleterious effect on company performance. Possible negative consequences include reductions in employee morale, selling efforts, and client relationships, all of which could have a spillover effect on revenue. Meanwhile, in knowledge-based companies, cutting staff can result in a loss to the company's competitive edge in innovation. As such, respondents agreed that establishing a downsizing plan proactively would be much more likely to reap overall benefits.

It's worth noting that mass layoffs are often prevented by employment laws and labor unions across Asia Pacific. Those employment laws and the overall complexity of human resources' management of the downsizing of a workforce led respondents to choose employee layoffs as one of the top challenges in restructuring in the year ahead—most notably, in India and Southeast Asia.

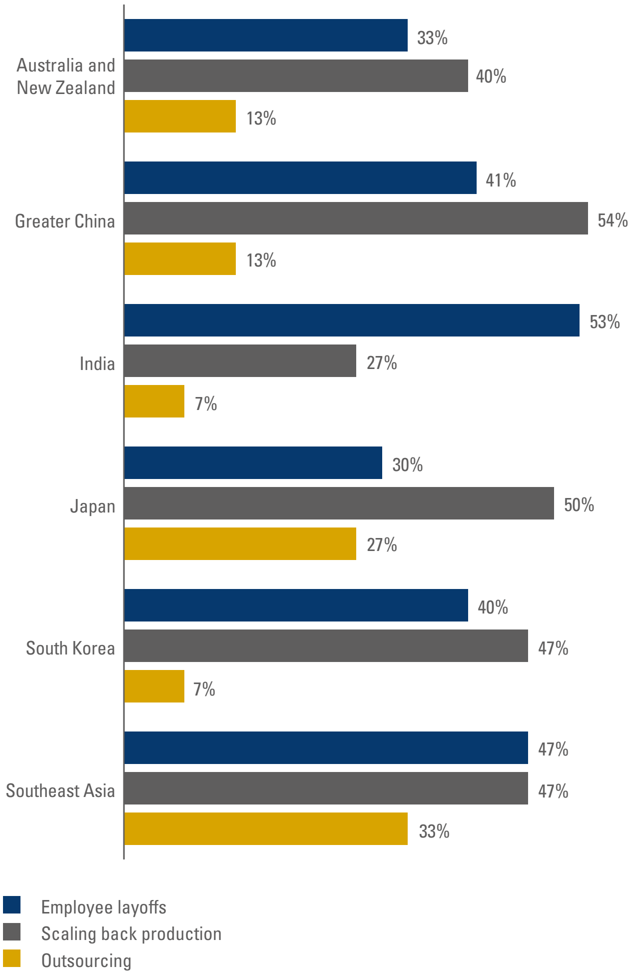
Scaling back production

Scaling back production to limit overcapacity or prevent excess inventory is recognized by 64% of respondents as a likely optimization initiative for the year ahead, with respondents suggesting that cutting output in line with weakening demand and market developments is a necessary part of restructuring (figure 16).

Cuts in production were notable parts of Japanese automakers' restructurings when revising their China strategies in recent years. Amid political tensions and shifts in demand, many shuttered factory operations. Similar closures have also been common in Asia's steel industry, where overcapacity continues to plague the sector.

The managing director of a Southeast Asian private-equity firm says that whereas scaling back production can save on operational costs, disruption to normal production schedules and operations can cause "unanticipated costs to accumulate." Equally, companies looking to downsize operations must carefully select which production sites to close. Whether it's a far-reaching restructuring plan to shutter multiple facilities or a more surgical approach to close an underperforming plant, business leaders must also bear in mind the costs associated

Figure 16: Which of these approaches to overhead optimization will be most challenging in your primary region of focus?



with such shutdowns. For companies in distress, a financial drain at an inopportune moment could further accelerate an already potentially steep downward spiral.

Outsourcing

Although only 34% of respondents chose outsourcing as a possible approach for the year ahead, those who did praised its cost-effectiveness. Allocating certain business processes or units to external service providers places a minimal burden on internal operations and carries low risk relative to other approaches.

Outsourcing business activities after a thorough analysis of the potential business provider will help companies keep costs under control and even assist with cutbacks and scaling down production," says the managing director of an Australian hedge fund.

Still, business leaders should not act too hastily to outsource operations without considering certain threats. Outsourcing can create quality control issues when products or services are designated to an external manufacturer or service provider. Hidden and unanticipated costs from vendor selection and work handover can also arise. Likewise, language barriers and incompatibilities between IT systems can hinder the process at a time when a smooth transition is vital for a successful restructuring.

Strategy #4: Revenue enhancement

With economic growth rates declining across Asia Pacific, companies that once enjoyed buoyant sales are now trying to develop and secure new sources of revenue or to boost current revenue streams to remain profitable. As companies face the prospect of lower growth amid dwindling consumer spending in China and across the region, many have had to rethink their business strategies, with a focus on offering the right products to take market share from competitors.

Exploring new market segments

During a restructuring, a company is likely to focus on finding the fastest way of generating additional revenue. For distressed companies, that focus usually involves reexamining current product and service offerings, as opposed to developing new ones. It can also involve selling the current lineup of offerings to new classes of customers. In contrast, companies taking a proactive approach can conduct a wider strategic review to examine the possibility of new applications for existing products and the development of derivative products.

Regardless of the health of a business, 70% of respondents say that most restructuring in terms of revenue enhancement

Table 4: Revenue enhancement (by respondent expectations)

Exploring new market segments
70%

Pricing more effectively
51%

Developing new products and services
56%

Negotiating business partnerships
37%

in the year ahead would revolve around the exploration of new market segments (table 4). Respondents in Greater China say the exploration of new markets would be particularly prevalent due to strong competition and depressed consumer spending (figure 17). However, gaining entry to a new market segment is also seen as the greatest challenge for respondents from Greater China in terms of revenue enhancement strategies in the year ahead (figure 18).

In Japan, a declining population has led to a shrinking consumer market, whereas increasing competition from domestic and international corporations has led to market share decreases. The result has seen Japanese corporates diversify within the market and attempt to gain entry to international markets via outbound acquisitions.

Developing new products and services

In our survey, 56% of respondents say that developing new products and services would be the most likely way of generating new revenue streams in the year ahead.

Expanding on those expectations, the director of a Chinese sovereign wealth fund suggests that "Developing new products and exploring new market segments will be the most-applied strategy in our domestic market as well as the overall Asia Pacific region, given the large number of opportunities and the fact that

Figure 17: Anticipated use of revenue enhancement as a restructuring strategy, by geography

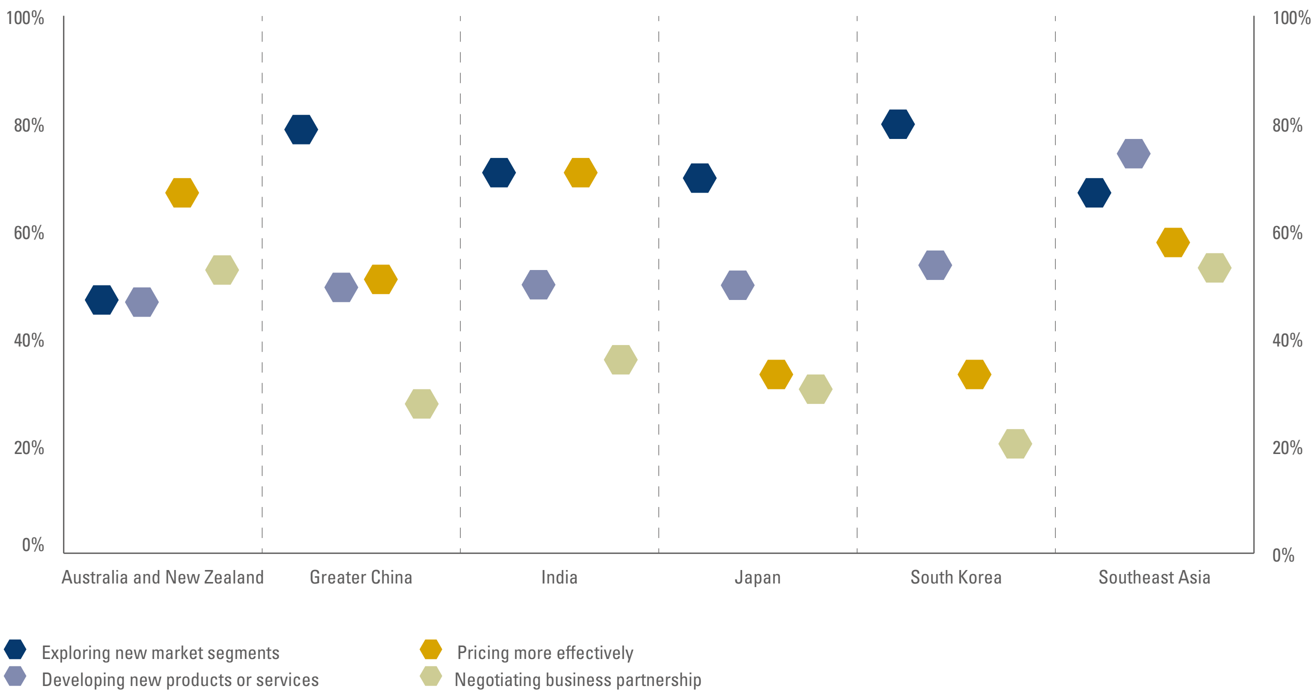
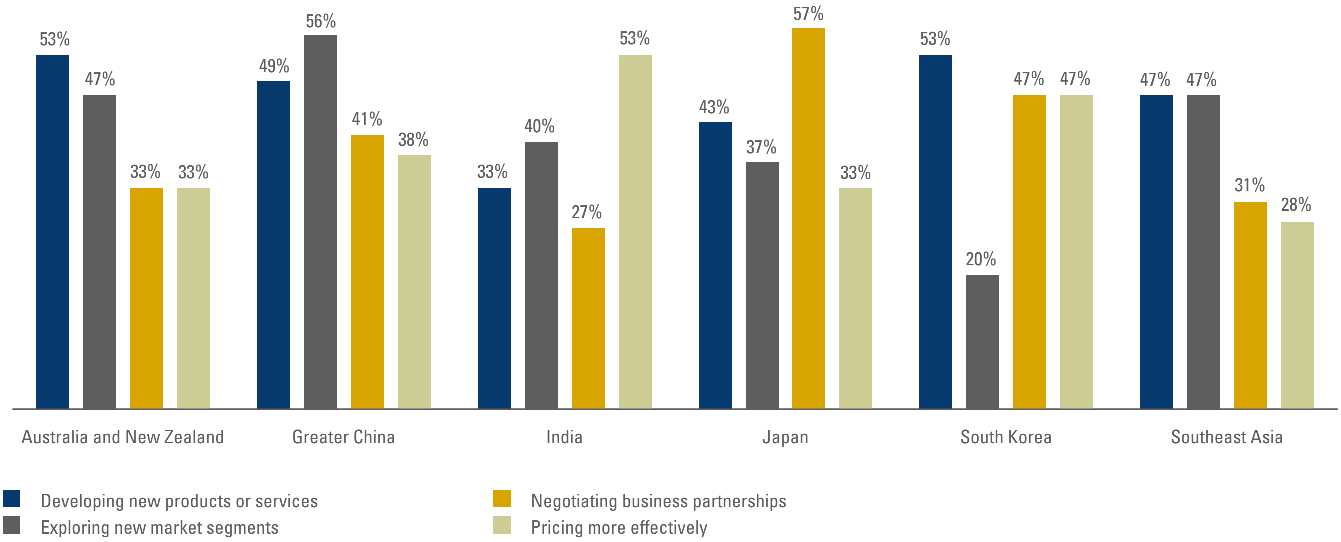


Figure 18: Which of these approaches to revenue enhancement will be most challenging in your primary region of focus?



many companies are considering exploiting synergies within market segments and product classes."

Respondents say that this tactic would most likely be applied in Southeast Asia, given the rise of a burgeoning middle class with changing tastes and growing demands for consumer goods. However, given the diversity of that market, developing new products and services is also seen as one of the most challenging initiatives when restructuring to enhance revenue. As the managing director of a Chinese private-equity firm says, "Developing new products will be challenging because market trends are highly unpredictable and it's hard to tell what the actual demand for a product or service will be."

Pricing more effectively

Pricing more effectively will be a significant part of restructuring in the year ahead, according to 51% of respondents. That strategy is most likely to be used in Australia and New Zealand and India, where many respondents point to competitive pressure to match or slash prices.

"Pricing more effectively will be an important strategy in our market as opportunities in India shrink and domestic companies look for ways of maintaining their competitive edge over other companies in their market segments," a partner at an Indian private-equity firm says.

Respondents in India also say that pricing will be the most challenging revenue enhancement tactic in the year ahead. Lowering prices could lead to a costly price war with competitors, especially in an overcrowded market. That could result in prices' dipping so low that although a company would retain customers, it would do so at the expense of the company's bottom line. As the respondent from India notes, "Reducing prices tends to favor customers and doesn't always work in a business's favor. The risks tend to be high because customers can always change their minds and buy a different product."

Negotiating business partnerships

Establishing new business partnerships or restructuring current ones is seen by 37% of respondents as a likely strategy in the year ahead. Although expected to occur relatively infrequently, creating and reviewing partnerships can heavily affect a company's success when entering a new market or expanding within an existing one.

Across Asia Pacific, joint ventures are often necessities due either to unfamiliarity with the target market or to government-mandated matchups. Although a large number of joint ventures succeed in their intent, misaligned interests or lack of understanding between the parties can cause the partnership to flounder. Fixing the partnership structure is often the first move, but if an agreement cannot be reached, those involved must reconsider their positions in the relationship and turn to exit strategies to mitigate risk and manage potential costs or losses from the investment.

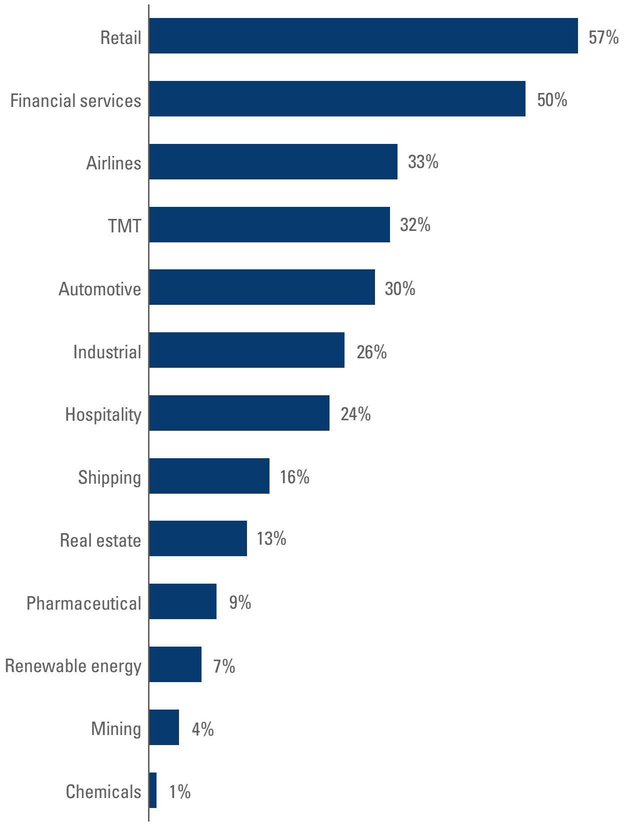
Regionally, particularly in Asia Pacific's emerging markets, negotiating business partnerships is not seen as a significant challenge to restructuring. However, in Japan and South Korea, challenges are noted due to language barriers and cultural differences that make such business tie-ups difficult to execute and cumbersome to maintain.

Transforming For a Digital World

Companies that are adaptable, agile, and resilient are the ones likely to reap the most business success. The strategies set forth in the previous section can put companies on the right course, but companies that embrace modern advances and adopt current business processes by incorporating digital technology into their operations can see even better results.

The power of digital has become the great equalizer in business. Companies that take advantage of digital advances, especially in the increasingly competitive environment of Asia Pacific in the fields of data management, mobile application, analytics, and social media often reap the rewards of closer customer engagement, improved performance, and enhanced overall reach. Yet as respondents in our survey point out, digital transformation has been slow to take root in Asia. A full 93% of respondents say they had heard of digital transformation prior to taking this survey, but only 50% say digital transformation was part of their most recent corporate restructuring.

Figure 19: Which industries could benefit most from digital transformation?



What is digital transformation?

It is a dramatic change in the way a company is configured—due to the adoption of new technologies and new business models—so it can engage and deliver to digital consumers.

Respondents who had not implemented digital initiatives say they lacked resources because the focus was on developing other core areas of the business. However, many say that although digital transformation was not a part of recent efforts, it would be considered in future restructurings.

Those who had rolled out digital transformation strategies did so for a variety of reasons. The director of investing at a Japanese bank says that when his firm wanted to compete with larger firms, it used digital transformation as a stepping-stone that would enhance a culture of excellence and position his firm as a top participant in the market. Reducing costs is the main concern of the managing partner of a Chinese hedge fund, who says his firm consolidated most of its business units and developed new digital frameworks to streamline operations while also extending online services for clients.

That sentiment is echoed by the director of an Australian bank: "We aimed at transforming physical data into digital data to make it accessible across platforms and locations and to improve outreach and client relationship management."

Only 50% of respondents say digital transformation was part of their most recent corporate restructuring.

Applying technology across industries

All industries can upgrade existing technology in the move toward a more digitized business, but respondents say several sectors in particular stand to benefit the most from such change (figure 19). Specifically, retail and financial services are expected to see the most improvement or most value add if digital technologies get incorporated into restructuring or turnaround efforts.

In the retail space, respondents point to the growth in e-commerce and the potential for digital transformation to help retailers of all sizes scale their operations to capture larger pieces of the consumer market. "Retail has been very active in the e-commerce space—especially in consumer electronics, apparel, home, and lifestyle—so digital transformations will be extremely important for companies in that sector, because they can establish closer relations with customers and increase their shares in the market at relatively low cost," says a director at a South Korean bank.

In financial services, respondents say, the retail banking segment will benefit the most from digital transformation because consumers increasingly use digital services for making online payments, for conducting transactions, and for doing their personal banking. Several respondents note the importance of improving the user experience in digital transformations and restructuring. Customer service can be enhanced significantly by expanding digital services and capabilities. And establishing a presence on social media and mobile platforms can make it easier for customers to access products and services.

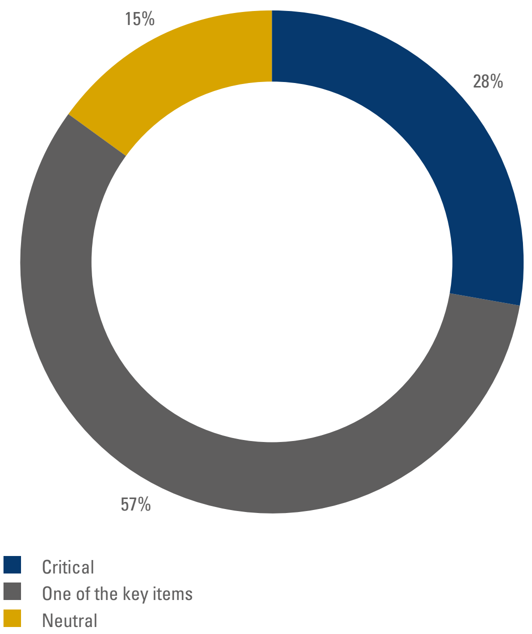
A trend of growing importance

Looking ahead, the majority of respondents say digital transformation opportunities will be involved in restructuring, with 28% saying digital transformation will be a critical factor and 57% saying it will be at least a key item (figure 20). As the director of investment at a Japanese investment bank says, "Digital transformation is critical because businesses will compete not only for better opportunities but also for retention of customers. Businesses will need to take an interest in adapting to ongoing technological changes to develop a greater scope for their products."

Unless financing options are not available, investing in technology usually presents no obstacle. The true challenge to digital transformation is in the transformation itself—that is, rewriting internal rules and business models that may have governed the workings of the company for years, if not decades.

Even though those strategies may hold the key to increasing sources of revenue or improving customer relations, companies that are already struggling may not have the financial capacity to implement digital change on an organizational scale. When such constraints exist, digital restructuring is likely to remain an afterthought, with businesses instead focused on fixing core operations or managing their debt. "Those areas require improving first; then digital aspects can be addressed," suggests the managing director of a Chinese private-equity firm.

Figure 20: How important do you think digital transformation will be to restructuring plans in the next 12 months?



Restructuring Asia: Market Forecast and Comparison

For each jurisdiction in the Asia Pacific region, respondents predict varying degrees of distress, with the number of restructurings expected to increase. That prediction reflects a recognition that the restructuring and turnaround market in Asia Pacific—although not yet at the level of that in North America or Europe—is indeed maturing.

Country forecasts

As in previous years, restructuring activity is expected to increase in Japan, with 97% of respondents expecting an increase, up from 76% in 2014 (figure 21). The opinion stems largely from the recession in the Japanese economy through much of 2014, a slowdown that has yet to fully abate.

The end of the mining boom and its ripple effect on the overall Australian economy are casting doubts in that market, a trend that has seen respondent expectations anticipate an increasing need for restructuring in the past few years (figure 22). The same was likewise true in the emerging markets of Southeast Asia, where the ripple effect from China's slowdown is being felt across industries. In South Korea, currency fluctuations and the strength of the South Korean won are currently major burdens as developments that have seen respondents predicting increasing restructuring activity in that country since 2014.

Government-mandated industry consolidations and plummeting consumption habits are driving restructurings in Greater China. Private-equity firms that entered the Chinese market with high-growth-investment theses are having to consider restructuring portfolio companies amid the country's economic slowdown.

India is the only market in which the percentage of respondents expecting an increase in restructuring activity fell from the previous year. A turnaround in the Indian economy—the result of monetary policy stimulus and economic reforms by Narendra Modi's government—has positioned the country to be one of the best-performing emerging markets in 2015.

Industry forecasts

Similar to expectations in 2014, respondents say that rising stress levels in the financial services and industrial sectors will lead to further restructurings in the year ahead (figure 23).

Figure 21: What do you expect to happen to the level of restructuring activity within each of the following geographies in the next 12 months?

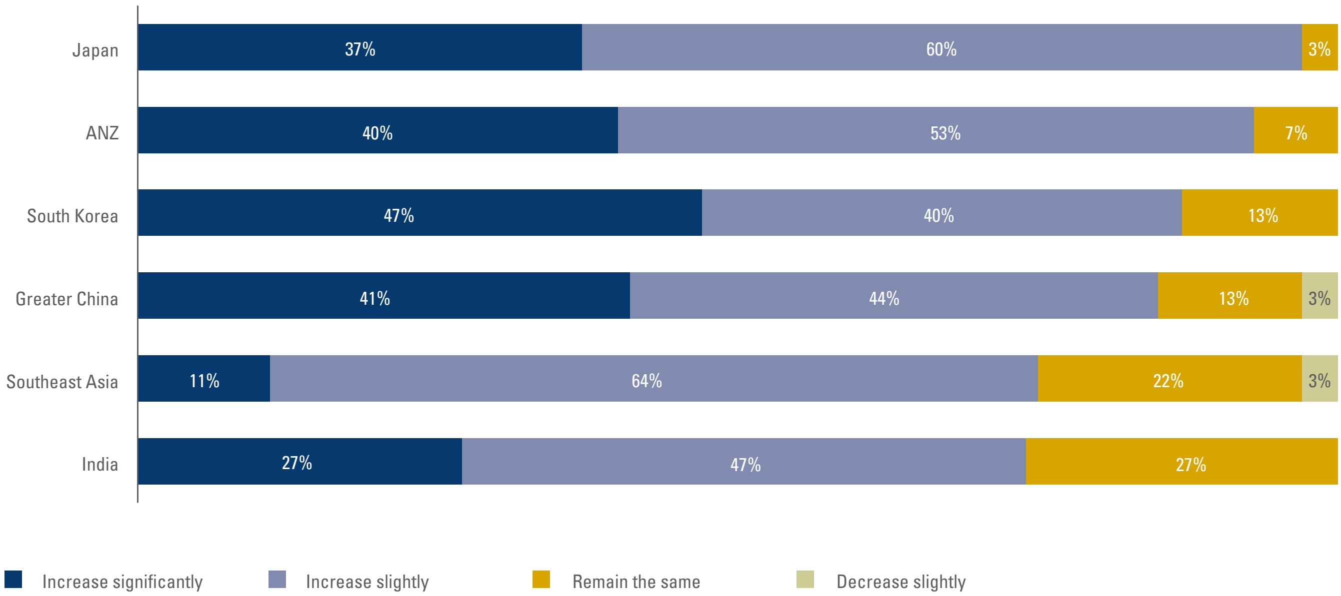


Figure 22: Expected increases in restructuring activity across Asia Pacific

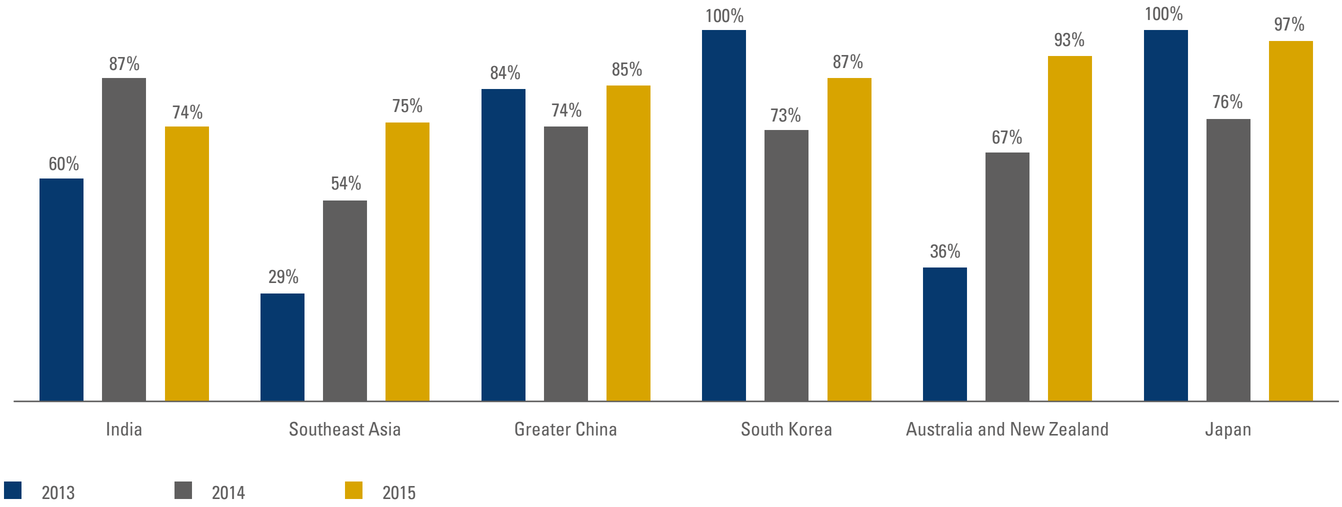
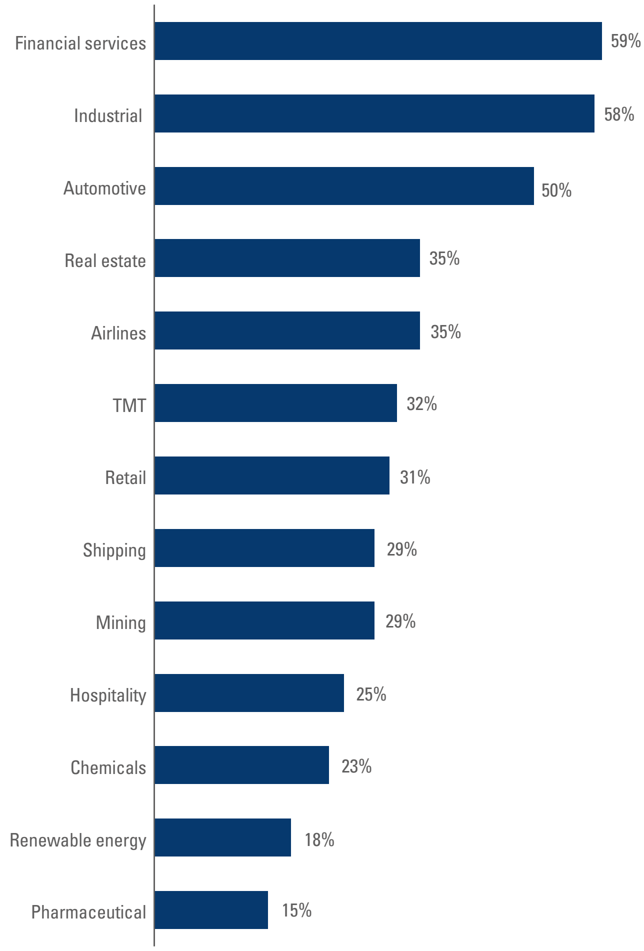


Figure 23: Which industries will see the most restructuring activity across Asia Pacific in the year ahead?



Nonperforming loans continue to burden the region's banks, and lower oil prices and sinking demand in the West have become challenges for industrial manufacturers. The automotive sector is also anticipated to experience large restructuring volumes as new competitors to the market force their rivals to cut back production or change operational strategies.

Restructuring environment comparison

Slowly but steadily, an openness toward corporate restructuring is taking hold among Asia Pacific business leaders. The potential impact such reorganization can have on a company is being recognized, but the market's overall maturity has yet to reach a level on par with that in North America and Europe.

Although regulatory and political developments are paving the way for a smoother restructuring process, 57% of respondents say the region is still either slightly or significantly less mature than markets in the West (figure 24). Respondents point to lack of sophistication and lack of understanding of the restructuring process.

For the most part, the region's corporates lack "practical exposure to the restructuring process, not to mention the challenges inherent in a corporate turnaround," suggests the director of corporate development at a corporate and commercial bank in Greater China. Continuing that thought, a partner at a law firm in Greater China says, "Conducting restructuring is more difficult in Asia Pacific because those in management usually lack adequate knowledge and expertise to run the process themselves. As such, they rely mostly on external agencies for support."

Another common thread among respondents is a lack of financing in Asia Pacific compared with Western corporate peers. However, participation by private-equity firms and other investors has been increasing in Asia. According to a partner at a law firm in Greater China, "These financiers provide capital, expertise, and convenient terms at a time when banks are reluctant to lend."

Figure 24: How would you describe the restructuring environment in Asia Pacific compared to North America and EMEA?

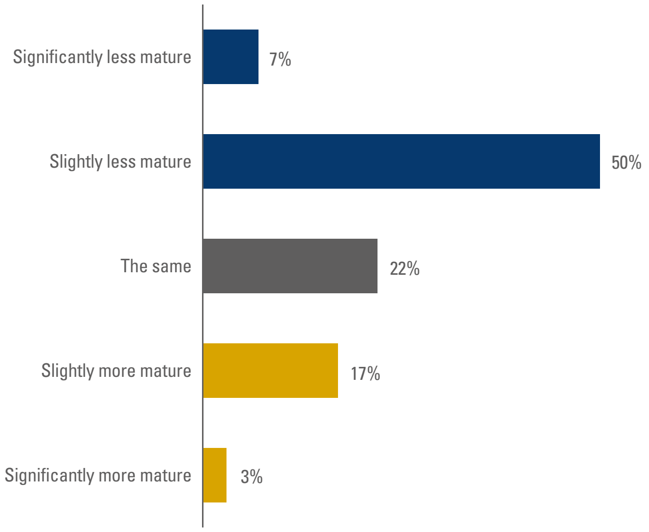


Figure 25: How does executing restructuring in Asia Pacific compare to similar activity in North America and EMEA?

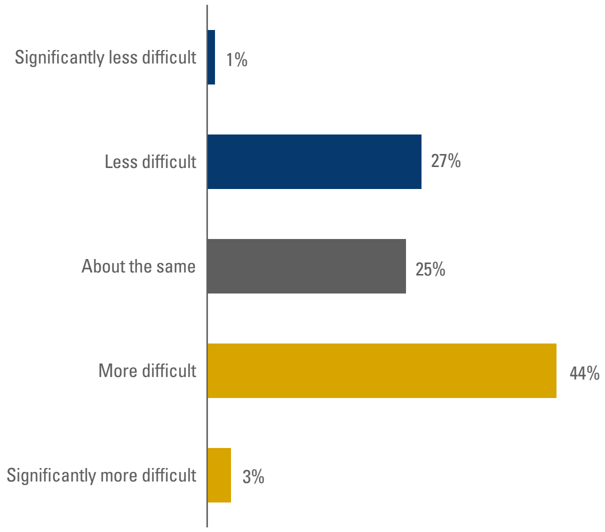
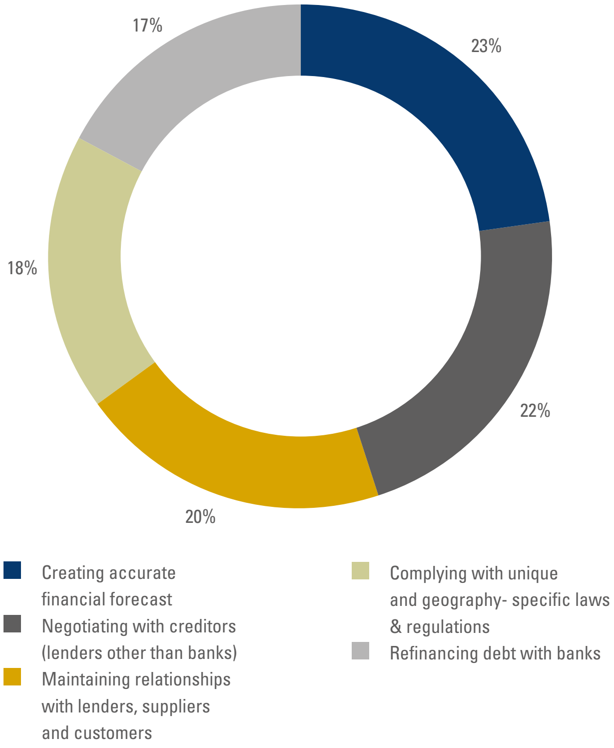


Figure 26: Which of the following will pose the greatest challenge to corporate restructuring over the next 12 months?



For those reasons, a high number of respondents (47%) say that executing a corporate restructuring in Asia is more difficult than doing so in North America and Europe (figure 25).

Challenges in 2015

The level of uncertainty in the market has made the creation of accurate financial forecasts the top challenge to restructuring activity in the year ahead (figure 26). Indeed, the economic situations brewing in North America and Europe (25% say those situations will have a significant impact on Asia Pacific) and the slowdown in China (39% say it will have a significant impact on the region) have contributed to that sentiment. Likewise, negotiating with creditors is expected to prove challenging.

Conclusion

There is clearly no single right solution for restructuring or for trying to emerge from distress. However, the options respondents name in our survey paint an interesting picture of attitudes in Asia Pacific toward finding solutions to alleviate financial and operational ailments.

In general, the responses suggest a growing sophistication about the restructuring process, as exemplified by respondents' choice of acquisition—a complex time- and resource-intensive process—as the most popular route for restructuring. By way of contrast, in previous years, respondent sentiment tilted toward less-complicated procedures such as working-capital reductions and the sale of an underperforming business.

Equally, the acknowledgment of digital and its incorporation into the restructuring process to transform a business demonstrates an understanding of the full range of tools now on offer to corporates undergoing reorganization. As respondents noted, digitally transforming the business in tandem with one of the four main strategies can hold the key to unlocking the door to the next level in a company's growth and development.

Perhaps most important is a growing recognition of the importance of timing for a successful corporate reorganization. Although most companies are waiting until signs of distress are apparent, there are signs that that approach is changing, with market participants readily admitting that delay is very likely to have a detrimental effect on the likelihood of success.

Our survey reveals several major findings corporate leaders must consider.

- **Restructure in good time.**
  Waiting until stress becomes apparent or worsens may not leave sufficient time to prepare and execute an effective turnaround strategy. Instead, consider a proactive approach that takes current market conditions and rivals' activities into consideration.

- **Consider which strategy is best for your organization.**
  The restructuring initiatives presented in our survey provide a wide range of options, but a company's business leaders should develop a thorough internal analysis of the company's current strengths and weaknesses to determine which approach is best. Likewise, to maximize results, they should consider a cross-strategy attack that combines elements of M&A, cash management, overhead optimization, and revenue enhancement.

- **Know when to call for help.**
  The complexity of a restructuring can leave even the most-experienced and most-resilient corporate leaders at a loss. Knowing when to bring in external support and advice is vital to managing losses at a declining company and ensuring the turnaround achieves the desired results before further distress erodes corporate value.

As the Asian restructuring market continues to mature, a rising volume of activity is highly likely. Even though our survey shows that progress is being made in understanding the full range of restructuring strategies and the role of turnaround professionals, the Asia Pacific region still has considerable scope for further development. AlixPartners looks forward to following that progress and contributing to the advancement of understanding of the role that restructuring can play in building successful businesses.

Methodology

From November 2014 to January 2015, Remark, publishing division of Mergermarket, surveyed 150 lawyers, banks, and fund managers across Asia Pacific who had completed a turnaround or a restructuring. There were 30 respondents from law firms, 24 from investment banks, 30 from corporate and commercial banks, 39 from private-equity funds, 15 from hedge funds, 6 from sovereign wealth funds, and 6 from government bodies and others.

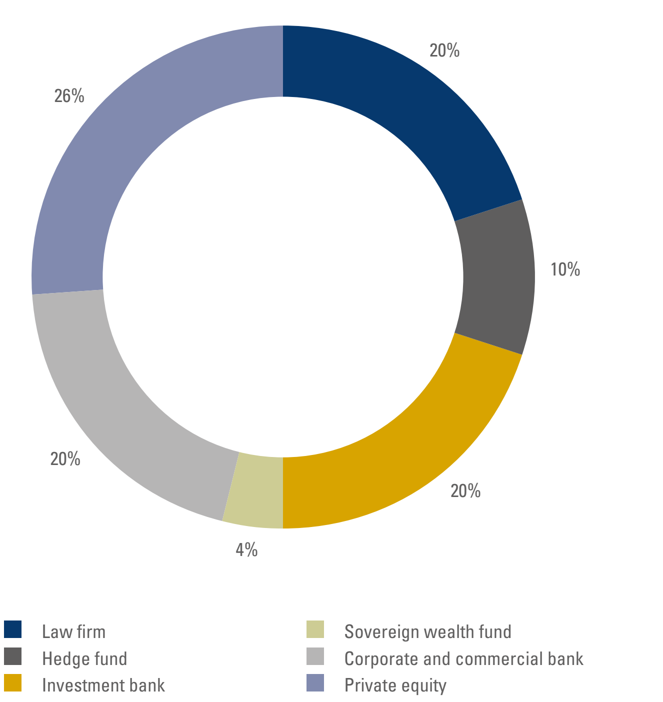
Within the survey results and graphs, when figures add up to more than 100%, respondents were allowed to choose more than one answer. And when percents sum to more or less than 100, it is because of rounding.

All dollar symbols ($) refer to US dollars unless otherwise stated.

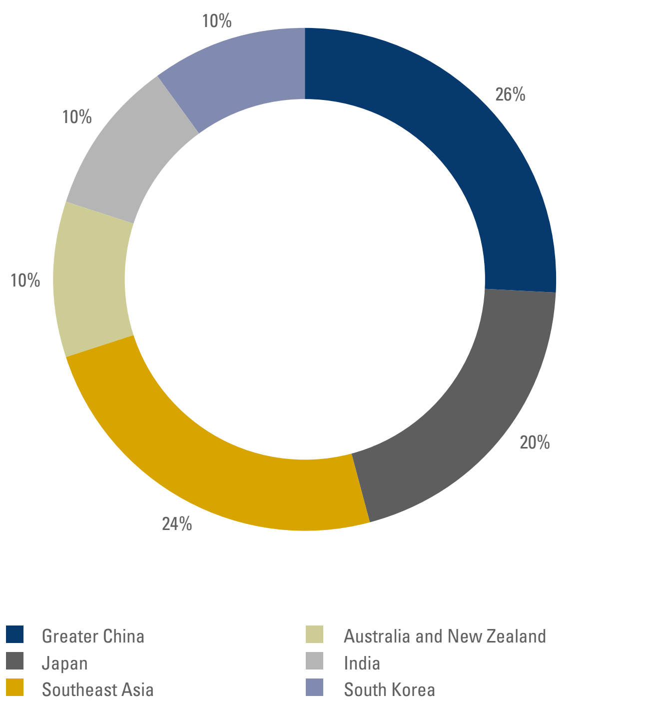
Greater China in all references consists of mainland China, Taiwan, Hong Kong, and Macao.

All data quoted is proprietary Mergermarket or AlixPartners data unless otherwise stated.

Respondent professional practice



Respondent base in Asia



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About Remark

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The firm's expertise covers a wide range of businesses and industries, whether they are healthy, challenged, or distressed. Since 1981, we have taken a unique, small-team, action-oriented approach to helping corporate boards and management, law firms, investment banks, and investors to respond to crucial business issues. For more information, visit alixpartners.com.

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