

New legal framework in Croatia to rescue Agrokor

Simon Rowley and Greg Cross report on retailer Agrokor's financial crisis and subsequent turnaround



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Agrokor is the largest privately-owned group in the Republic of Croatia and one of the Adriatic region's largest vertically integrated companies with distribution markets all across Europe. Agrokor's revenue of EUR 6.1bn is equivalent to 12% of Croatia's GDP.

It operates through several strategic business segments including retail and wholesale, food production and distribution and agriculture. It also owns many diverse businesses outside these core sectors.

Agrokor's financial crisis was caused by external factors and management decisions

During 2016, Agrokor started to suffer as a result of negative macroeconomic trends with increasingly aggressive low-cost

retail competition gaining an increased market share, which reduced Agrokor's revenues and also impacted negatively on profits.

The governance structure whereby many major decisions were made solely by the CEO, Mr Ivica Todorčić also contributed to the increased pressure on the group.

Key pressures created by the group's strategy included the historical M&A "buy and build" model and over-investment in production facilities, which were incapable of producing sufficient return on expenditure.

Furthermore, archaic financing solutions that included bills of exchange, trade loans and cessions provided short term solutions to day to day issues but were inappropriate for the group's size and complexity. This contributed to a "house of cards" effect where

a serious issue in one entity very quickly spread to affect the whole group.

These pressures presented the group with a very challenging liquidity situation and although Agrokor successfully raised EUR 100m of new financing in the first quarter of 2017, it was insufficient to make regular payments to its suppliers, which resulted in reduced or suspended deliveries of goods and services.

The legal framework was developed specifically for this situation

As the government became increasingly aware of the difficulties facing Agrokor, it was concerned that a failure of the business could lead to economic instability in Croatia, as many Croatian suppliers which relied heavily on Agrokor began to find themselves in a difficult financial

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THE GOVERNMENT REVIEWED ITS CURRENT BANKRUPTCY PROCEDURES AND DECIDED THAT THEY WOULD NOT BE SUITABLE FOR AGROKOR



position as a result of Agrokor's liquidity squeeze. Accordingly, at the beginning of 2017, the government, led by Prime Minister Andrej Plenković, but directly managed by Martina Dalić, the Deputy Prime Minister (DPM), reviewed its current bankruptcy laws and decided that the current pre-bankruptcy and bankruptcy procedures would not be suitable for Agrokor's size, complexity and systemic importance and therefore began the development of a third, new reorganisation regime, the Law on the Procedure for Extraordinary Administration of Companies of Systemic Importance for Croatia (the EA Act), which came into force on 6 April 2017.

The EA Act was designed to provide protection from creditors for a period of up to 15 months, allowing the debtor to find a settlement plan (effectively a restructuring proposal), which must be agreed for by either a simple majority in number and value of each creditor class or by 66 2/3% of the total value of creditors.

The commencement of proceedings resulted in the appointment of a new management team for the group

By the end of March 2017, it became clear that Agrokor had insufficient liquidity to continue normal operations, as demands for payments amounting to over EUR 460 million had been filed against the group's companies.

Discussions with the government for a bailout were unsuccessful and ultimately Mr Todorić turned to the courts to seek the protection of the EA Act. On 10 April 2017, Agrokor entered the Extraordinary Administration and Ante Ramljak was appointed as Extraordinary Commissioner (EC).

Immediately following the appointment, Agrokor's senior management team was removed from the holding company board as required under the law. Mr Todorić subsequently left Croatia appearing in London some weeks later, where he still resides. The Croatian state prosecutor

commenced an investigation into events leading up to the filing and issued an international arrest warrant following allegations of fraud in connection with his actions at Agrokor. Extradition proceedings are currently ongoing with an appeal being lodged by Mr Todorić, after the initial hearing in April 2018 determined that Mr Todorić should be returned to Croatia.

Liquidity was an immediate issue with additional capital urgently required

As there was almost no cash available in the group's key operating entities on 10 April 2017, the Extraordinary Administration immediately set about raising new finance, an action permitted under the EA Act.

Within a few days, the Extraordinary Administration was able to secure EUR 80m of funding from local lenders in order to address immediate liquidity challenges. This was designed to allow the businesses to continue operations and undertake some belated preparations for the critical summer tourist season, a period where historically 40% of annual EBITDA is generated. To assist with the systemic challenges facing the country, it was important to ensure this liquidity could quickly find its way to suppliers in order to secure continuity of business and thus, a portion of the funds raised were used to settle certain pre-petition liabilities. A significant portion of these payments were made specifically in respect of "border claims", invoices which were dated prior to the EA commencement, but fell due afterwards.

As it was clear that the initial EUR 80 million would be insufficient for Agrokor's medium term liquidity needs, a more extensive new money process was launched and by June 2017, the Temporary Creditors' Council approved a EUR1.06 billion super-senior facility comprising EUR 530 million of new money (including a refinancing of the

initial EUR 80m) with the remaining EUR 530 million being the refinancing of pre-petition debt and its conversion to a super-senior ranking on a EUR 1 to EUR 1 basis. The refinancing was unsuccessfully challenged by certain creditors who argued that the EA Act did not allow such a move.

This additional liquidity provided Agrokor with sufficient cash to provide a stable platform from which it could start to rebuild trust with suppliers and resume normal operations.

It also expressly provided for a pool of up to EUR 150m, which could be used to pay pre-petition debts of critical suppliers in order to ensure that these businesses could continue operations and support Agrokor's on-going business.

The financial position of Agrokor was different from what many stakeholders thought

Shortly after the commencement of the proceedings, advisors were engaged to provide an initial view of Agrokor's capital structure, identifying that the group had over EUR 6bn of debt, including EUR 505m in secured debt. Many stakeholders had previously understood that there was minimal, if any, secured debt.

Given these findings, the Extraordinary Commissioner determined that new auditors would be required and PwC was engaged to audit the 2016 financial statements. Once finalised, this resulted in write-downs of EUR 2.9 billion through various adjustments resulting from accounting irregularities and meant that post adjustments liabilities exceeded total assets by EUR 1.9 billion, providing a basis for the Extraordinary Commissioner to bring criminal charges against Mr Todorić for, among other things, falsifying financial reports.

After liquidity was stabilised, a restructuring proposal was developed to address the unsustainable capital structure

As operations eventually began to normalise, an interim governance

structure was put in place whilst the restructuring plan was developed. During this time, Agrokor developed a granular bottom-up business plan for the ongoing operational development and sustainability of the operating business of the group. They indicated that the group was profitable and had the potential to further improve, but that the existing capital structure was not sustainable.

The business plan provided the EA with a robust forecast, from which the creditors' financial recoveries in the settlement plan could be foreseen. The objective of the settlement plan was to maximise returns for the creditors by ensuring that the group continued as a going concern, as opposed to a liquidation or the disposal of some or all of the operations.

The restructuring proposal was published in December 2017 setting out that the creditors would swap impaired debt for equity and other instruments in a deal that would allow them to take full ownership of the group with their shareholdings being based on the estimated returns on an entity by entity basis across the companies included in the EA.

As negotiations progressed, the public and the political pressure resulted in the replacement of both the Extraordinary Commissioner and the Deputy Prime Minister

Agrokor had made front page news since April 2017 and the former CEO had, through a blog he set up, been attacking both the process and the participants for many months. One of the challenges was in relation to the new law and whether it was constitutional; the Court ultimately confirmed it was, but this took time. Other challenges related to the writing of the law, email leaks related to the DPM, the cost of advisers and conflicts of interest. As a result of this pressure, the EC, Ante Ramljak, concluded that his continued involvement was a hindrance to reaching the settlement and resigned in February 2018.

Shortly thereafter, Fabris Peruško was appointed as the new EC of Agrokor, with Irena Weber as his deputy. The DPM, Martina Dalić, also resigned a couple of months later, amid tremendous pressures on the process and on the government.

Mr Peruško picked up from Mr Ramljak in leading the negotiations with the Temporary Creditors' Council and by 10 April 2018, the anniversary of the start of the proceedings, a commercial agreement was reached with creditors and a term sheet published. A three-month extension of the EA process was secured, enabling the finalisation of the documentation and presentation of a settlement plan to creditors. The key elements of the settlement plan remained consistent with the proposal published in December 2017.

Some additional nuances included contingent payment rights for certain creditors, based on future business performance and a solution for the recourse rights, related to bills of exchange.

The plan also allows for the largest secured creditor, Sberbank, to swap its existing minority stake in the Slovenian subsidiary Mercator for an additional stake in the new group structure. This is particularly beneficial as Sberbank had commenced litigation against some of the group's entities in other jurisdictions, where the EA protection was not recognised. In response, Agrokor had challenged Sberbank's claims against the group. Ultimately, value was preserved for all creditors, as agreement on this crucial component of the settlement plan included both the withdrawal of litigation from Sberbank and the acceptance of Sberbank's claim by Agrokor.

Although the EA Act was clearly not initially included in Annex A of the EU Insolvency Regulations, the Croatian government successfully applied to have it added and this occurred on 14 June 2018. The proceedings were recognised in the UK in the course of litigation and a Chapter 15 application was also successfully made to the US Courts. Some of

the other local jurisdictions, notably Slovenia, have not yet recognised the EA Act.

The plan has been approved by creditors and the focus is now on implementing the plan and returning to normal business activity

The final plan was filed at Court on 26 June 2018 and on 4 July 2018, Croatia's largest ever court hearing was convened in the Cibona Basketball Arena in Zagreb, where the plan was approved by an overall majority of 80.2%.

The court confirmed the settlement plan shortly after, on 6 July 2018, triggering a period of 73 days during which depositing challenges would be possible. After satisfactory resolution to the challenges, the plan will be irrevocably confirmed and the process of implementation can commence. The protection of the EA Act will remain in place until the implementation process has been completed.

With a distributable value of EUR 2.8 billion and outstanding claims of EUR 5.6 billion as at that date, the plan was approved, the overall average recovery being of around 50%. This is not a true benchmark of returns to individual creditors, as the complexity of the group's financing structure and the permitted pre-petition payments during the EA process mean that individual creditor recoveries will vary materially.

Overall, the process was a successful restructuring of one of the region's largest companies, maximising returns to creditors, preserving jobs for over 50,000 people and ensuring economic stability in Croatia. Whilst it is clear the law could be further refined, and a mandatory review is likely to highlight areas of improvement, it is an encouraging sign that both the public and the private sectors can move rapidly together to deliver such preventive action – and all in 15 months. Where else could this have been done so quickly? ■



OVERALL, THE PROCESS WAS A SUCCESSFUL RESTRUCTURING OF ONE OF THE REGION'S LARGEST COMPANIES, ENSURING ECONOMIC STABILITY IN CROATIA

