November 2012

Inside Story: de Sede Group

This month's Inside Story is brought to you by Mr Michael Thierhoff and Mrs Renate Müller of **Thierhoff Müller & Partner**, www.tmpartner.de.

Yes, we can: The story of a German pre-pack

1. Background

Across borders, we often hear praise about advantages that insolvency regimes offer. Especially in Germany the focus is on England. One of the English tools frequently featured in restructuring is the so-called "pre-pack".

Pre-pack refers to a process where a buyer for the business is selected by the stakeholders prior to an insolvency filing. A buyer then acquires the business the day the company enters into administration, leaving behind part or all of the indebtedness. One of the key features of this process is that – for the wider public – it is over in a matter of seconds and thus avoids the frictions and likely negative publicity typically surrounding insolvency. Rumour has it that this option is not available in Germany because of the specific legal circumstances.

The following story aims at teaching you different.

2. The business

Swiss-based de Sede AG is a manufacturer of top-notch furniture with a focus on leather seating. Together with German Machalke Polsterwerkstätten GmbH, a German manufac-turer of high quality leather furniture, it was owned by a Swiss private equity fund that had acquired the two businesses together with a number of minor sales companies and offices in various countries in the past decade.

De Sede Group GmbH, the ultimate German-based parent, was a mere holding with no employees. The main business assets of the holding were the shares in the two operating businesses and a marginal bank balance. The other side of the balance sheet was composed of the bank loans, shareholder loans and some minor balances with advisors.

The first financial restructuring in the summer of 2011 only granted short-term relief as at the time the major creditors, a consortium of five German and Swiss banks, were yet unwilling to support a sustainable solution.

The shareholders and especially the private equity owners had, in addition, funded the business with a low three digit million Euro number of shareholder loans in total. Having provided some minor additional financial aid in 2011, the shareholders had clearly signaled that future support of the businesses was not on their agenda.

As prudent directors management had completed an M&A-process to identify parties willing and able to buy and continue the businesses. By mid-June 2012 three potential buyers had been shortlisted and were introduced to

the stakeholders.

3. The case

Our firm had already been involved in the restructuring in 2011. In mid-June 2012, we were again instructed to assist management in a now foreseen ultimate and sustainable financial restructuring of the businesses. Management and their financial advisor had already obtained the consent of the majority of banks and the private equity owner for a sale of the businesses and a comprehensive financial relief. In the first step we organized a meeting of shareholders for the 29th June 2012 to introduce the solution and seek the approval of the shareholders, together with a full waiver of all shareholder receivables. The shareholder meeting proved to be very difficult. While the private equity owners agreed to both the sale and the waiver of their claims, two minority shareholders ultimately dissented. The situation therefore ruled out the financial restructuring of the group, as the banks were clearly unwilling to waive a large part of their comprehensively secured claims if the shareholders could not agree to waive their entire claims which were unsecured and, for the most part, by law subordinated in the insolvency.

In the week following the 29th June shareholders' meeting, we therefore developed a strategy for a pre-pack and assured the backing of the majority shareholder and the major banks involved. By 11 July we had selected a prominent insolvency practitioner from the list of the competent local court and contacted him to discuss the strategy. Following on we arranged for a meeting with the judge on the 13th July to sit down with him in person to introduce the case, to discuss the contemplated strategy and convince him to select the insolvency practitioner of our choice. Prior to that we had agreed a standstill and the support for the plan with the banks. The agreement in essence meant for the banks not to enforce against the operating companies and release their entire security subject to the payment of a pre-defined purchase price. The agreement included the payment of an appropriate portion of the purchase price paid to the estate in order to finance the proceedings.

For the 17th July 2012 we arranged a meeting with the judge and the practitioner of our choice at the court in the small northern Bavarian town of Coburg to submit the insolvency filing for de Sede Group GmbH. The filing requested the appointment of an expert only as in the circumstances, a mere holding, no current operations, no stay and no measures to secure the future estate were necessary. Accordingly a public announcement of the insolvency filing was not required. The court played along with our plan and the appointed expert concurred.

In the four weeks following we negotiated the Sale and Purchase Agreement (SPA) involving the banks and the expert appointed by the court. The groups' auditor was instructed to provide an expert opinion on the fairness of the contemplated purchase prize. The court appointed practitioner prepared his opinion proving the holding company was insolvent and that the estate was sufficient to finance the proceedings.

At exactly 4 p.m. in the afternoon of 16th August 2012 the court followed the motion of the practitioner to open insolvency proceedings for the assets of de Sede Group GmbH. As the order came, following our wishes, very late in the day, a public announcement of the insolvency was delayed until the 17th August.

On the 17th August 2012 at two p.m. the buyers and the appointed insolvency practitioner met to notarize the SPA. As was necessary, the SPA was of course subject to creditor ap-proval, which was granted with the banks

being the dominant creditors supporting the SPA.

Later in the afternoon of the 17th August staff, customer and suppliers were informed at the same time by personal address or e-mail with press releases that had been on the shelf for some days that the two operating businesses had been sold and a new shareholder with a long-term strategy was ensuring the survival of the brand, both production sites and all of the 370 jobs. On the sidelines it was also mentioned that as part of the process the former holding company, de Sede Group GmbH, was without business and would be wound down in an insolvency process.

To complete the story, it was a mere formality that on the 30th August 2012 the creditors meeting approved the SPA unanimously and with payment of the purchase price, the deal was completed on the 5th September 2012.

4. The essence

None of the above story made use of the major revisions of the German insolvency code that were introduced on the 1st March 2012. While the pre-pack German style detailed above has some specific prerequisites, these are not uncommon. The process described does require that the entity filing has no business of its own. This is however a feature frequently encountered, especially in the private equity scene. More importantly, it does require a court and a court-appointed practitioner who play along. Our story is proof that it can be done.

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