RESTRUCTURING GUIDELINES
FOR MICRO, SMALL AND MEDIUM-SIZED COMPANIES

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I. INTRODUCTION

The micro, small and medium-sized companies (hereinafter: the SMEs and companies defined by Article 55 of the ZGD-1) are associated with the entrepreneurial activity that plays an important role in the promotion of economic growth and creation of new jobs. In terms of the number, the said companies account for more than 99% of all companies and generate approximately 67% of total revenue, 55% of added value and employ around 70% of all actively working population. In terms of the size structure of the companies, micro companies play an important role in employment and medium-sized companies in the generation of revenues from sales to value added. SMEs are traditionally focused on domestic market as they only generate about 45% of the value from exports; on the other hand, they account for almost 60% of imports of goods.

In terms of organisation and processes, the approach and/or the method of SME restructuring must be adjusted in relation to the restructuring of large corporates, as:

- the process involves fewer creditors, while the number of companies is very large;
- the use of certain tools (e.g. conversion of receivables into capital) is considered less efficient, particularly in view of the relatively small size of these companies, a concentrated ownership structure and the involvement of individuals in the business relationships with the customers and the suppliers (e.g. family undertakings);
- the costs of outsourced experts and administration compared to the revenues of the SME are relatively high, namely regardless of the type of the restructuring procedure (voluntarily or through court);
- as regards the external sources of SME financing, the companies usually depend on the banks to a large degree, since they are mostly uninteresting for the capital market, due to their size;
- pursuant to Article 57 of the ZGD-1, many SMEs are not subject to auditing, which is why the reliability of financial statements is usually poorer and hinders a credible analysis of operations;
- the owner, who is most often also the manager of the company, usually has no appropriate skills and understanding in the area of restructuring (financial and business); furthermore, the operations and the destiny of the company depend on a single person;
- personal guarantees for financial liabilities in SMEs are much more frequent than in large corporates;
- the structure of the business model is usually focused on individual deals rather than continuous operations with several customers; often, short-term activities prevail over long-term ones;
- fluctuations (either positive or negative) in the operation of SMEs are much more frequent than in large corporates.

The guidelines define the approach that should be voluntarily complied with in the overall (ownership, business and financial restructuring) of SMEs. All stakeholders involved in the restructuring of the SMEs' debts must strive to apply the guidelines to the maximum possible extent in the restructuring process, so as to contribute to rapid, efficient and transparent resolution of SME indebtedness.

The guidelines may change through time or they may be supplemented so as to meet the requirements of the business activities and the financial community as efficiently as possible. If necessary, the concepts and the solutions of these guidelines should also apply to the restructuring of large corporates. In any case each restructuring process must take into account the content of the Slovenian principles of corporate debt restructuring adopted by the Supervisory Board of the Bank Association of Slovenia.

II. MANAGING PROCESSES and CLASSIFYING DEBTORS

a. Process management

Timely identification of debtors experiencing business difficulties, identification of the reasons for them and appropriate allocation of debtors into individual organisational units are the key conditions for rapid, efficient and thorough restructuring. In the case of SMEs, the relationship between the bank and the company is most often more personal than in the case of large corporates, which is why the bank should guarantee objective treatment by applying the following guidelines:

1. The bank should define clear and objective criteria for handing over a debtor to the workout and legal support unit, as well as the criteria for returning the client back to the commercial unit for regular management. The commercial unit and the workout and legal support unit must be completely separated in terms of functional, organisational and personnel issues.

2. The following criteria should be applied when transferring a client back to the commercial unit:
    - the client regularly meets all its obligations from the restructuring agreement;
    - at least one year has passed from the beginning of validity of the restructuring and the debtor has repaid at least 10% of the restructured principal in that period;
    - the debtor's indebtedness, measured with the net financial liabilities/EBITDA indicator;
    - the transfer had been approved on the basis of the analysis of the debtor's financial position by the competent committee of the bank.

3. The debtor's problems must be resolved proactively already in the phase when the exposure is still handled by the commercial unit, which is why the bank should guarantee appropriate distribution of know-how and experience between individual organisational units. Timely resolving of the debtor's problems and adopting quick decisions contribute significantly to successful restructuring.

4. The bank regularly reviews the debtors to be able to determine the method of their further treatment; it is recommended that a detailed review be carried out every 6 months. Furthermore, it should establish appropriate IT support for each debtor, depending on the records of overdue receivables and the records of the fulfilment of other conditions.

5. The bank should pursue the same approach to all debtors with similar problems, regardless of the account manager in charge of individual case. Consequently, the bank should document the practices in a well-organised manner which should be shared among all account managers.

b. Classification of debtors and assessment of restructuring viability

1. Once the bank has made a quick assessment of restructuring viability, the debtors are appropriately allocated within the units for the management of NPLs regarding the method of treatment (restructuring, collection or bankruptcy, sale of exposures), number of creditors involved, size and complexity of exposure (type of problem, corporate structure, type of collateral, type of exposure etc.). A competent account manager is appointed for each debtor and must take into account the limitations regarding the number of debtors per account manager and whether the bank would coordinate the process.

2. The assessment of restructuring viability should be prepares by the organisational unit or the employees who have previously not been included on the loan approval process, but in cooperation with the commercial unit, in order to provide comprehensive information. During the restructuring process, individual organisational units must closely cooperate in order to successfully complete the process.

3. If it is reasonable to restructure the process, the bank drafts the appropriate action plan and monitors its implementation and effects, and promptly reacts in the case of negative deviations. Should the bank assess that the restructuring of a debtor is no longer reasonable, it shall compile a time schedule for collecting the exposures and setting up the record for monitoring the deadlines for the actual collection and the effects. When drafting the plans for the treatment of individual debtors, the bank must pay attention also to the intensity of their cross-industry and cross-sectoral connections and the impact on the other debtors in the bank's portfolio.

4. When assessing the restructuring viability, the bank should also pay attention to potential frauds and damage suffered by the bank and, if identified, initiate the appropriate legal procedures against such debtor. These events must be reported as loss events.

c. Identification of the reasons

Identification of the reasons for poor financial situation is extremely important for the efficient and effective selection of the method of treating the debtor. In the scope of this activity, the bank should at least check the following:

- has the debtor made investments outside their core activity (i.e. property, real estate or financial assets not needed for the operations) and has the bank been aware of that/has cooperated in the process;
- has the debtor found itself in difficulties because of the ownership consolidation or has it participated in other cases;
- is the debtor experiencing problems because of excessive outflow of cash assets from the company (e.g. participation in profit or payment of capital in the form of financial investments);
- the debtor failed to promptly react to the changes in the macro environment which resulted in inefficient/unadjusted business model;
- has the debtor found itself in difficulties because of concentrated dependence on a single buyer or project (e.g. construction industry) and/or supplier;
- has the debtor found itself in difficulties because of the lack of payment discipline of its customers or their insolvency;

- has the debtor found itself in difficulties because of mismatched maturity between its assets and liabilities (negative net working capital) and inappropriate management of current assets, which significantly affected their liquidity position;
- has the debtor found itself in difficulties because of incompetent management/owner or internal disagreements or disputes;
- has the debtor found itself in difficulties because the organisational structure of the company had not been appropriately adjusted to its growth and development;
- has the debtor found itself in difficulties because of the changes in the broader legal framework (e.g. renewable sources of energy, environmental requirements/permits, adjustments to the EU legislation, etc.).

d. The role of the coordinator

The role of the coordinator should be assumed by the bank with the largest exposure, but the other banks must also be willing to accept it, should the bank with the largest exposure refuse such activities for objective reasons. When appointing the coordinator and setting its powers, the banks shall strive for the following:

- As a rule, a coordinator should be appointed within 1 month.
- The coordinator should be appointed for a certain period (no more than 6 months) with the possibility of renewal (3 months).
- During this mandate term, the coordinator may not withdraw without a grounded reason. If the banks do not renew the coordinator's mandate term 1 month prior to expiry, the restructuring process is completed.
- The coordinator shall be responsible for the assessment of the need to sign a Stand Still Agreement (SSA), the assessment of the need to extend the coordinator's mandate, the assessment of the need for external consultant (financial or legal) and the drafting of the proposed solution for debtor restructuring.
- In the beginning of the process, the coordinator must clearly define the goals, take care of strict compliance of the deadlines, transparent communication and information of all stakeholders and cooperation by agreement
- The coordinator takes care of the minutes of creditor meetings which sum up the decisions and the orientations of the process. In case individual creditors or the debtor constantly change their positions without reason, thereby jeopardising the process, the coordinator transparently informs all creditors and the debtor and is entitled to withdraw as coordinator.
- If an agent is necessary after the completion of the restructuring, this role is usually assumed by the coordinator unless agreed otherwise by the creditors. The coordinator takes over all further communication with the debtor, with the purpose of limiting mutual administrative activities.

III. DIAGNOSTICS

The principal goal of quick and quality diagnostics is to determine if the debtor's business has good prospects on the long run or not. On this basis the bank establishes how soon (if at all), the company could repay its debt and reach a sustainable level of operation. In this process, the following phases should be applied:

1. The first part of the assessment must comprise the analysis of exposure and the analysis of the rationality of consolidation of exposure, the overview and the assessment of the quality of collaterals, the analysis of the sustainability of the business model and the ability to generate cash flow from the core activity.
2. A considerable number of companies still own large quantities of property not needed for business purposes (most often real estate or financial investments), which is why this part of the assets must first be identified and the scope of potential purchase amount to be used for the repayment of debt must be assessed.
3. Before the final assessment of the manner of handling each debtor the basic scenario of the going concern must be compared with the alternative scenarios, such as the sale of exposure[1], execution, liquidation of collaterals or bankruptcy.

A case suitable for such treatment can be identified based on the signals from the early warning system at the initiative of the account manager from the front office unit or the debtor informing the bank of their problems. Once the case is transferred to the workout and legal support unit, they must use the existing information to select the most suitable method of diagnostics, depending on the size of the company:

a. Micro and small companies

A (partially) standardised approach is suitable for small cases (small and micro companies), i.e. based on a list of key indicators and facts. This allows the bank to quickly identify the problems in the company's operations and the future prospects (permanent sustainability) within a period of up to one month. This reduces the workload and simplifies and accelerates the analytical process.

In the case of small companies and subject to cooperation of the owner or the management, which is trustworthy and provides reliable financial and other information, the use of external

[1] The sale of exposure is reasonable under the following conditions: the bank does not have sufficient capacities for efficient management of exposure, the buyer has positive reference and the buyer is a major specialist in the area of resolving non-performing exposures.

consultants is not efficient in terms of time and costs. In the opposite case, the bank may engage external consultants or demand the audit of the company's financial statements.

The result of efficient diagnostics must be a comprehensive picture of the company's past and future operations and its stakeholders. Standardised (fast) approach should contain the following elements of the audit:

- a focused meeting with the debtor, the goal of which is a clear identification of the reasons for the problems and the assessment of the ability to introduce radical changes into the operations;
- exposure of the banks and all other creditors (related persons, in particular);
- the analysis of the balance sheet structure - the structure of maturity of receivables and operating liabilities, identification of assets suitable for sale and assessment of the value of this property;
- the analysis of the trends of the key indicators of individual categories of financial statements: EBITDA margin[2], net financial /EBITDA, total debt/equity, interest coverage[3], debt service coverage ratio – DSCR[4], net sales revenue/operating receivables, accounts payable/total debt, quick liquidity ratio, cash flow from operations, costs of services[5] etc.
- 3- to 5-year projection of cash flows based on conservative assumptions - the plan of operations must not be a wish list but rather a critical view of the possibilities of the company's development in its branch of industry;
- analysis of the necessary resources for the financing of working capital and investments (capex);
- review of all indemnities (in the case of personal guarantees also an overview and an assessment of the guarantor's property);
- overview of the quality and assessment of the value of collaterals and the calculations of different scenarios (implementation of restructuring or the exit strategy).

b. Medium-sized companies

It is recommended that medium-sized companies (as defined in the ZGD-1) are analysed in more detail, namely, it is reasonable to use a similar approach as in the case of large companies, which means a guided and aligned coordination between the banks and the inclusion of an external consultant to prepare an independent overview of operations, particularly in the following cases, provided that at least one of the following conditions is met:

- at least 3 banks are involved in the process;
- there is doubt about the reliability of financial and other information;
- there is doubt about the fairness and competence of the management;
- a specific activity is involved of which the bank does not have sufficient internal know-how;
- there is great probability that the company will need additional financial assets.

If the bank/coordinator decides on an Independent Business Review (IBR), it should stipulate the exact scope, content and time frame of the project and engage trustworthy external consultants. The final report of the independent review should take into account the following:

[2] EBITDA/total net sales revenues
[3] EBIT/interest cost
[4] (EBITDA - corporate income tax)/(annual payment of principal + annual interest)
[5] in particular, other costs of services

- in addition to the review of the financial position, it must also define possible and viable solutions;
- the assessment of the ability of the owners and potential strategic investors to participate in the capital increase of the company;
- the potential and the future growth of the company, as well as the branches, must be assessed conservatively, and the assumptions must be clearly defined;
- the assessment of the value of the assets, particularly the collaterals and the assets not needed for the operations, must be objective and conservative; when selecting the assessor and the consultant, any situations that could result in a conflict of interest must be excluded;
- the final report must be structured, concise, visually appropriate and easy to read.

If the bank/coordinator decides not to conduct an Independent Business Review (IBR), it should take into account the standardised approach usually applied to micro and small companies.

Unlike large companies, the audit of a SME must be based on the knowledge of the management, since the company's dependence on the management by a single person increases with the decrease in company size. The bank must strive to learn as much as possible about the management's personal profile and to find out if the cause of the problems is related to its competence, intentional fraud or external objective factors.

IV. SOLUTIONS

Quick and amicable solutions outside the court and insolvency proceedings are always the best option, which is why the bank should try to reach an out-of-court arrangement or solution with the client. As a rule, court and insolvency proceedings should only be used in cases where all other options have been exhausted, where the debtor shows no long-term prospect of successful operations or as a form of additional pressure on an uncooperative debtor that otherwise shows a long-term prospect of successful operations.

When devising the plan of repayments, the bank should also take into account the realistic need of the debtor for investment in fixed assets and development (the so-called capex), which should as a rule equal the level of long-term depreciation and working capital comparable at the branch level. Furthermore, the volume of previously established impairments should not affect significantly the structure/content of restructuring or the final solution.

In view of the findings from the diagnostics, the solutions should be established within the scope of the following options:

1. The company has prospects and a long-term sustainable business model - the repayments are reprogrammed, as a rule over a period of 5 years, or depending on the branch and the business model in the period in which the debtor reaches the sustainable level of indebtedness.
2. The company has marginal prospects - high risks and no possibility to devise a sustainable reprogramme on conservative assumptions. At the same time, the banks' position is weak because of the poor quality of collaterals or high dependence on the owner/management. One of the alternative solutions is selected.

3. The company has no prospects - it is unreasonable to continue with the activity. An exit strategy is devised which may, among other, include sale, collection, collateral liquidation or insolvency proceedings (hereinafter: the measures).

If new information is obtained after deciding on the resolving approach, the bank must re-examine and refresh it. For example, if it turns out that the company had been misleading it with certain information, the approach and the measures must be more aggressive. On the other hand if the debtor puts forward or presents a repayment proposal during the (announced) measures, which would considerably improve the bank's position, the bank may mitigate the measures subject to fulfilment of certain conditions or eliminate them completely. This means that there is a certain flexibility of restructuring measures for the company.

We must be aware of the fact that only the management can put the company on the right track, and not the bank, and that in the case of insufficient competences (usually the lack of financial expertise), it is not appropriate to consider replacement of the management, but rather a way to supplement the missing expertise.

a. A promising company - normal reprogramme of financial obligations

If there is a certain general confidence between the bank and the debtor, if the reasons for the problems are difficult to eliminate, if the future cash flows are sufficient for repayment of the debt until a sustainable level is reached within 5 years or otherwise, depending on the branch and the business model and if all conditions imposed by the bank have been met, the bank will quickly sign an agreement with the debtor, as standardised as possible, in which it will define the new plan and the commitments to be met by the latter.

The typical commitments that can be required by the bank include: personal guarantees of the owners, conversion of the loans raised by the owners and the persons related to them into capital or another subordinate form, capital increase, additional collateral, sale of assets not needed for business operations, achievement of certain levels of financial indicators, etc.

b. A company with little prospects - alternative solutions

If the diagnostics show that although the company is able to reduce its debt (has available cash flow) but is unable to reach a sustainable level of debt within 5 years, such company is considered to have marginal prospects.

When resolving such marginal cases, the banks should consider the following options, which can be reasonably combined, considering the specifics of each situation:

1. Extended period of reprogramming, needed to achieve a sustainable level of indebtedness, i.e. more than 5 years, depending on the industry and the business model, with final repayment in equal instalments or with a bullet[6]/balloon[7] option; however, the maturity may not exceed 10 years, as a rule;

2. Splitting of debt into two parts:

[6] bullet option – the principal and the interest of a loan are paid in full upon maturity
[7] balloon option - interest is paid regularly while the principal is only repaid in small amounts so that the bulk is still outstanding upon the loan maturity

- one part of the debt is repaid in equal instalments (principal and interest), with the maturity of 5 years, as a rule, substantively representing the indebtedness that the debtor is able to repay from the free cash flow;
- the other part of the debt is the excessive debt (which can be subordinated) with several options of repayment (possible splitting into several parts/tranches, non-interest-bearing principal or PIK (payment in kind), 10-year maturity, full repayment of the principal and interest upon maturity, repayment of debt when specific assets are sold or when other conditions are met, etc.);

3. The splitting of the debtor's property into several parts, by founding Special Purpose Vehicles (SPV), which must be executed in a legally admissible manner, usually transferring assets not needed for business operations and the assessed excessive debt.

4. In extreme cases, conditional write-off of receivables is one of the more effective approaches to the restructuring of companies with marginal prospects. In this way, the bank encourages the existing owners to make an additional financial contribution and to ensure maximum harmonisation of interests between the bank and the debtor in terms of motivation, particularly in cases when the net present value of the company (taking into account all collaterals and the potential cash flow) is lower than the total exposure (excessive debt). In this framework, the bank can adopt different approaches, such as:

   - Partial write-off of receivables in the framework of the debtor's capital increase (through cash contributions) by the owners, namely in all cases where the owners have not assumed the role of the guarantors or guarantors of a bill.
   - Partial write-off of receivables in the framework of the debtor's capital increase (through cash contributions) by third-party investors, namely in all cases where they have not assumed the role of the guarantors or guarantors of a bill.
   - Partial conditional write-off of receivables in the case of extremely successful business restructuring that materially deviates from the operating plan, which served as the basis for the implementation of the financial restructuring of receivables.
   - Partial conditional write-off is used in all cases when above-average successful engagement of the existing owners (e.g. successful sale of assets not needed for business operations) guarantees a higher level of repayment of the banks.

5. Receivables can also be written-off if the collaterals have no economic value and if such a measure ensures the continuation of a company's operations and it is evident that the owner had already invested the entire property in the company and lost it, if the debtor possesses a significant "know-how", if the bank has confidence in the management or if the cause for the problems came from objective external factors.

6. As a rule, debt to equity swap is appropriate for medium-sized companies according to the ZGD-1 and reasonable when taking into account other conditions, such as the fact that the company can be sold, has a niche product/service, has material reference or know-how, has a significant market share, etc.

7. Debt to Assets Swap can be an efficient tool, especially in the cases of stranded real estate projects, provided that the real estate is in good condition and that it can be economically

viably managed in the future, and that the transaction is not legally disputable, considering the provisions of the insolvency and liability legislation. This tool can also be used for other real estate cases, equity stakes and securities with determinable market value.

The bank should strive to find a solution even in marginal cases. A temporary solution might sometimes be suitable. The bank may adopt a decision to monitor the client in stages (particularly recommendable in small SMEs) with one-year extensions of the restructuring agreement. In such manner, the debtor will be monitored on a case by case basis and will be under more pressure to succeed than in the case of a long-term solution with more loose supervision.

c. A company without a future - execution or insolvency proceedings

In spite of a clear priority that the bank pursue the goal of preserving the going concern, this might not always be economically viable. In such cases, the bank has the following options:

1. Execution proceedings
2. Measures under the insolvency legislation

d. Sale of redundant property

The owners of SMEs are quite strongly attached to property and fail to carry out the required activities in spite of clear contractual commitments on the sale within a certain time interval, or they present a better-than-actual state to the bank. Facing the fact that the market price is lower than expected is the most problematic.

In the event of sale, the bank must demand reasonably short deadlines be met by the debtor and may not leave them to their own devices. It is recommended that the bank obtain a notarised power of attorney from the debtor, allowing it to activate the the sales procedures in the event of excessive negative deviations in the sales procedure. It is recommended that the bank have sufficient competent human resources in the area of real estate market, who can actively accelerate the sales procedures.

e. Monitoring the restructuring process

The approval of the restructuring agreement is only a part of the process of resolving, since the bank must continue to monitor the debtor to ensure timely reprogramming of payments and meeting of commitments. If reasons exist on the part of the debtor to deviate from the agreement that are reasonable and objectively justifiable, the bank may approve a waiver of commitment. In the event of material unjustified deviations, the bank must impose additional requirements, penalty interest, termination of agreement, blocking of the transaction account, execution, etc.

The control over the fulfilment of all commitments and timely payments must be ensured by the bank by setting up appropriate IT and organisational support. If there is no confidence in the management, the bank should strive to involve an external consultant or authorised person to periodically monitor the company's operations on behalf of the bank.

For SMEs, a short quarterly review is the most cost-efficient manner, namely in the form of meetings with the key staff and inspecting the documentation, analysing the financial statements in order to obtain an overview of a realistic business and financial situation of the debtor.