

Crisis Management in the Automotive Industry due to the Corona Pandemic

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Case study

Berlin, 22 April 2020

I. Introductory Statement

Key points

- ▶ The case study formed here is fictitious and refers to a possible cooperation regarding a restructuring scenario in the current COVID-19 pandemic. The example shown here is based on a specific restructuring procedure that is long-established practice in the US.
- ▶ The case study does not take all possible measures within restructuring proceedings into account and is simplified for better understanding. In this regard, reference is made to the main presentation.
- ▶ Please do not hesitate to contact us if you have any further questions.

II. Case Facts

- A sub-supplier produces plastic parts for installation in cars. It has plants in Germany (headquarters), Czech Republic, Italy and Sweden. Direct customers are manufacturers A and B and suppliers C and D.
- The company has had financial problems for a long time. Losses have been generated in the past two years. The company believes that the losses mainly result from its Czech plant and are categorized as start-up losses, i.e. result from additional costs in the context of new start-ups. The parts supplied belong to customers A and C. The additional costs exist due to the initial investment and the readjustments and small quantities at the start of series production. In addition, its plant in Sweden is running again, but it is only operating at 50% capacity. Customers there are B and D.
- The sub-supplier could not meet certain conditions of the loan commitments from the banks (covenant break) because not sufficient new business has been acquired in recent years and the losses are too high. The banks are authorized to terminate existing loan agreements. The credit lines are also exhausted.
- In the context of the Corona crisis, it is initially not possible to deliver from the Czech plant due to border closures. Then the calls are set to zero for 5 weeks in a period of 8 weeks and all run different again. At the same time, Italy extends the closure of production beyond the 8 weeks period for another 4 weeks. The Italy plant supplies the components in Germany and the Czech Republic and some of it are directly delivered to customers. The Italian sub-components make up 50% of their needed subcomponents. The remaining subcomponents are manufactured in Germany.
- The company registers short-time work in Germany for 8 weeks. However, it notes that due to the lack of receipts of money through the shutdown at the plants of its customers, their liquidity is not sufficient to pay primary material.
- In addition, the failure of the Italian location leads to a 50% undersupply of customers for these parts after restart.
- State aid is not granted.

III. First Stakeholder Meeting

- Sub-Supplier creates a presentation for banks and customers and invites banks and customers to a joint information meeting.
- Procedure and participation:
 - At the beginning of the meeting there is an instruction about the application of antitrust law.
 - The participating companies must take additional safeguarding measures, e.g. by using Chinese Walls or Clean Teams (either participation only through e.g. restructurers, legal and controlling experts or colleagues from the purchasing department who are not operationally involved) ensure that competitive sensitive data is not passed on to people who deal with the sub-supplier on the purchase or sales markets where they are competitors. The participants take the discussion points of the meeting with them and forward them to the decision-making management. They also discuss operational questions with respective departments and, if necessary, initiate examinations e.g. to evaluate the impact of the sub-supplier's proposal and develop own possible solution.
 - Most of the times, there is already an NDA between the sub-supplier and the contractual partners resulting from their general business relationship and/or there will be another one on the case adjusted NDA signed by all stakeholders.
- Please note: The content of the example and points of discussion given in this presentation are not conclusive (see main presentation):
 - The group and owner structure as well as the customer and financial structure will be discussed. The customer structure is in % of sales specified. Customer A: 10%, customer B: 30%, customer C: 20%, customer D: 40% of sales.
 - The financial results in the past and 3-4 years into the future aggregated at group level and for the individual plants.
 - Delivery difficulty due to missing parts from Italy; existing insolvency with regard to the primary material, presentation of the liquidity plan for this year as a cash flow plan. The existing breach of covenants. Loss situation in recent years and an assessment of the causes.
- There is no exchange of information about prices of individual parts and customer-related technical specifications.

IV. Claims of sub-supplier against stakeholders

- In the stakeholder meeting, the company requires the following contributions from the stakeholders:
 - The company expects from the banks the following contributions:
 - A stand still regarding the covenant break and
 - an extension of the credit line.
 - The company expects from the customers:
 - new business for Sweden awarded by customers B and D,
 - start-up losses to be taken over by customers A and C in the Czech Republic.
 - the compensation of the volume loss in the course of the Corona crisis through volume commitments for the next six months or price increases towards all customers;
 - acceptance that only the two main customers B and D are supplied with regard to the parts for which the components from Italy are missing. A and C should not be supplied because their sales were too small. However, the missing part is used by A and C as a component in 80% of all vehicles / parts and the non-delivery actually results in another shut down. Customer A has an alternative sub-supplier for the components.

V. Formation of a bank group and bank proposal

- The banks form a stakeholder group. Part of the group are the banks of the pool contract and two financiers with individual loan agreements.
- They choose a representative body consisting of three bank representatives, a chairman and a joint economic and legal consultant.
- There are several meetings that take place, in which the position of the entire group is negotiated.
- Bank proposal:
 - A new loan is rejected.
 - The banks agree to a stand still
- Requirements:
 - Payment of a significantly higher interest rate
 - Previously unsecured claims shall be secured.
 - The liquidity should be provided by the customers.
 - Another prerequisite is that the economic effects from the required customer contributions will be 100% effective. The banks do not care whether this will be fulfilled in the way requested.
 - In addition, they require the transfer of the company to a sales trust and the sale of the sub-suppliers.

VI. Formation of a customer group

- The customers form a customer group. Customer A immediately rejects participation and uses the notice of non-delivery to terminate the part in Germany and subtracts the scope. Customer A remains a customer in the Czech Republic.
- The group selects customer D, being the largest customer, as their representative. The group agrees that the position of the customer group will be developed jointly, which the representative will then defend in the negotiations with the other stakeholder groups. The outcome of these negotiations will be again discussed within the group. Every customer is free to accept the negotiation results, or is free to exit the customer group.
- In the discussion, the customers question the sub-supplier's analysis and decide to have the situation examined by themselves.
- For this purpose, the customers mandate a common economic consultant for the customer group, who deals with the economic issues of the customer group as a whole and with individual customers.
- Furthermore, the economic consultant is installed as a general antitrust clearing officer, who also acts on the compliance with antitrust regulations within meetings of the group, to guarantee that, in particular, no competition-sensitive information is exchanged. The clearing officer shall also examine individual parts prices and other antitrust-critical issues and process them into aggregated data.
- The consultant examines the plants on site and comes to the following conclusion:
 - Italy is in excellent condition if it weren't for the Corona shutdown.
 - The Czech Republic has a holistic quality problem in production, which increases returns and thus production costs. In addition, the Czech Republic is burdened by high levies from the German parent plant.
 - The main German plant has a far too large indirect area that is not appropriate for its size. The plant also pays above the pay scale.
 - The plant in Sweden is using only 50% of its capacity. The sub-supplier never cared to win over other customers and hoped that B and D will fulfil capacity utilization rates fully.

VII. Content of customer proposal (1)

- The customers discuss the results of the study by their own business consultant in the presence of the business consultant / clearing point in several customer meetings.
- The participants in the customer meetings are still the same participants that were selected according to Clean Team rules.
- They take the results of the respective state of discussion with them and coordinate them with the management in their respective companies. They also forward queries to own operational departments and, if necessary, have examinations e.g. to the effects of the various proposed solutions.
- Content of the customer proposal:
 - C refuses to take over any start-up costs. The start-up costs are not increased.
 - C and B send respective production and quality specialists together, who together with the plant management in the Czech Republic and who shall solve quality problems at the Czech plant for all customers. The specialists are not linked to employees that were or are, not will be responsible for price negotiations and technical developments in their respective companies. They are instructed about the need for the implementation of Chinese Walls. This is to solve the operational problems and to improve the earning situation.
- All customers demand that remedial measures are also initiated at the main plant in Germany. This includes reducing employee costs. For example, the indirect area could be downsized and brought to the industry standard and the above the pay scale payment would be terminated. In no case, however, customers would cross-subsidize this situation through levies from the other plants. For Sweden, customers refuse to award new business. The sub-supplier should acquire other customers in order to decrease the dependency on B and D.
- Regarding the capacity reduction to 50% due to missing sub-components from Italy the customers agree that the capacity between B, C and D shall be shared according to the proportionality of the calls that were placed before the start of the Corona crisis.

VII. Content of customer proposal (2)

- The prerequisite for these customer contributions is:
 - That the owner of the company makes a commitment to bear the remaining losses.
 - The banks do not receive any interest rate and grant the restructuring loan, which may earn interest, but on normal terms.
 - No additional security for the banks.
 - Customers reject a sales escrow. They want to continue working with the owner and if the company is sold, only if the owner wants it. In this case, customers want to be involved from an early stage on. They want the obligation of the owner not to sell to an investor to whom the customer cannot award business due to internal regulations.
 - All concessions are subject to the condition that a restructuring plan is drawn up with a milestone plan and that all customers (also outside of the customer group) contribute relatively in the same way. The clearing point will review this.

VIII. Further stakeholder meetings

- In a joint stakeholder meeting, the company informs banks, trade unions and the customer group and customer A, that the willingness of customers and their terms and conditions do not align with the position of the banks and their prerequisites. It also informs that there has been no willingness of the respective union yet to agree to a collective restructuring agreement and to shorten employee numbers.
- A direct negotiation starts between the representatives of the banks and the customers, as well as the union.
- The negotiations are carried out by the respective representatives of the stakeholder groups and their respective clearing points. The results of the negotiations are presented in the stakeholder groups and each groups agree on a position.
- The individual contributions are discussed. Part price increases at individual component level are not discussed, but only the total sum per customer. The same applies to other contributions.
- The representatives take this back to the individual stakeholder groups and provide information about the status of the negotiations and proposals. This is coordinated with the members of the individual stakeholder group. They jointly develop a new proposal. The overall proposal and the impact of contributions from individual members of the group will be done by the clearing officer.
- When it comes to contributions from individuals in a negotiation round between the stakeholder groups, the respective individual company joins the negotiations.
- In the final rounds of negotiations, one representative of each member of a group is involved, to shorten the decision-making process.
- Each member of the group is free to reject the result.

IX. Agreement between the stakeholders (1)

- Employee contributions:
 - A collective restructuring agreement for the German plant is concluded and an employee reduction is approved. In return, there is a 5-year job guarantee.
- Customer contributions:
 - As shown above. Additionally:
 - C grants a percentage increase in car parts prices in the Czech Republic for three months, on the condition that A also grants a comparable increase in car parts prices. A agrees. In return, C receives the same amount via a first rank of a claim for a possible M&A sale in case the sale of the supplier takes place.
 - For the plant in Sweden, B and D grant a last call for new business. A normal market inquiry takes place. After the last round of negotiations, the sub-supplier will be communicated in which categories he is not competitive. He has the right to bid in this category.
 - Regarding the effects of Corona, customers are willing to switch to instant payment. In addition, customers are willing to purchase quantities as much as possible to build up stock, which is then gradually dismantled.
- Owner contributions:
 - The company is not sold to investors who either do not take on the contracts in the form in which they currently exist or who reject customers for other essential reasons. The criteria will be defined.
 - The owner takes over a loss transfer guarantee.
 - The company will not be transferred to a sales trust, but if refinancing does not succeed within two years, the owner agrees towards the banks for sale. The customers still do not expect this under these conditions.

IX. Agreement between the stakeholders (2)

- Contributions of banks
 - The banks grant a transitional loan. However, this does not have to be as high as originally requested by the sub-supplier, as customers are willing to switch to immediate payment. This is granted at a normal interest rate.
 - There is no subsequent securing. The interest on the old loan is deferred.

- The contributions are ranked as follows with regard to participation in a possible M&A proceeds:
 - First place: demand from C and the bridging loan from the banks,
 - Second place: newly made loss assumptions by the owners
 - Third place: old claims of the banks
 - Forth rank: old claims of the owners.

X. Implementation of the Agreement

- Banks, customers, owners and companies sign a joint framework agreement in which the content of the agreement outlined above is entailed. This is signed by everyone involved. There is no group representation.
- This framework contract contains the description of the contributions per contracting party on a general basis, or the distribution and calculation models to be applied and regulates, what happens if the contribution obligation is violated or parts of the restructuring plan.
- The specific individual contributions per contractual partner are exclusively bilateral agreed on between the supplier and each stakeholder concerned in a separate contract. The implementation of the framework contract is checked by the respective clearing officer. Banks can have pool contracts as an implementation contract.