Navigating Through Financial Distress

Introduction to EY Debt Restructuring Services

March 2024

EY Parthenon

Building a better working world

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Executive Summary

Foreword

Just as economies around the world slowly recovered from the doldrums of the pandemic inflicted hibernation, the prospect of a global recession coupled with escalating geopolitical tensions and a protracted supply chain disruptions have unwittingly appeared on the horizon. Such concoction of malaise is only certain to bring about a race to safety and a forced shift towards shorter term returns and sustainability, inevitably zapping out financial and capital liquidity, and depriving the so many businesses which are still in the process of reconstructing their post-pandemic existence as well as reconfiguring their sustainable value propositions, of the much-required financing lifeline.

Domestically, the Indonesian Government, through the monetary levers as mechanized by the Central Bank of Indonesia has implemented various anticipatory policies in order to safeguard the resilience of the Indonesian business sector. Responsive and proactive monetary interventions have to date kept inflationary pressures at check, stabilized the exchange rates and managed capital outflow, while injecting sufficient liquidity to spur economic activities and to ensure effective roll-out of fiscal programs, as aligned to the government's post-pandemic National Economic Recovery Program (Program PEN).

Nevertheless, softening and likely deteriorations in the quality of cash-flows across the business segments should be expected under a tighter liquidity environment, thus, heightening insolvency risks. It is encumbered on businesses to avoid financial distress by proactively identifying the likely pitfalls of a liquidity crunch. Business going concern should be framed through a proper risk management plan, equipping the executives with the tools for early detection of business risks, for practical mitigation against external shocks, for unlocking values through risk mitigation, and very importantly for avoiding or practically dealing with financial distress.

Furthermore, beyond external shocks, potential insolvency could also have arisen due to non-optimal capital structure, liquidity mismatch, operational challenges, and sub-optimal capital deployment. Businesses need to seek alternative solutions to the dynamically evolving financial conditions, particularly in terms of fulfilling financial commitments and covenants.

Navigating through financial distress is a challenging task. Effective and practically implementable debt restructuring, and insolvency mitigation programs should be carefully considered to provide a solution to the liquidity driven funding and financing challenges , and to ensure that valuable time and resources do not go to waste. With a well-prepared strategy and sound execution, a successful turnaround from insolvency is highly achievable.

Macroeconomic Outlook

Brewing geopolitical tensions and supply chain disruption proves calamitous to the post-covid economic recovery

Having gravely suffered from the destructive impacts of the COVID-19 pandemic, economies around the world stepped up their push towards recovery in 2021. This resulted in an impressive hike of 5.7% in the global GDP growth, up from a negative 3.3% in 2020. The spirit of revival inspired markets globally to not only reopen and re-embrace various business sectors, but also gradually build, and eventually establish, a much-needed economic resilience, largely by leveraging technologies and embracing business flexibilities.

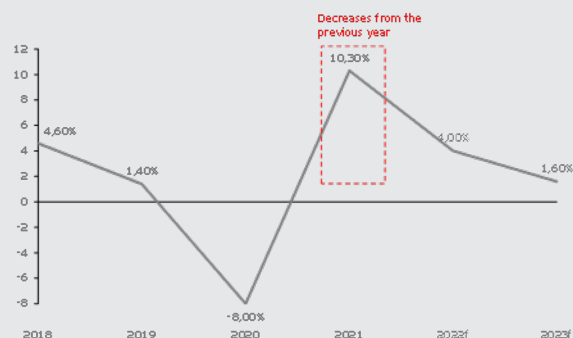
In 2022, however, things took another turn for the worse. The global economy, to its disillusionment, was faced with a collection of erratic events – though not entirely unexpected, which left the world's markets reeling once again. The cause this time was a geopolitical upheaval between Ukraine and Russia, as well as China and Taiwan, and compounded by a world supply chain disruption, partly due to renewed COVID-19 locked-down in China, labor shortage, and lead-time to restart distribution platform. This has ominously led to rising inflation and a serious threat of global recession.

Economic slowdown in 2022 dampens growing optimism of previous years

The war between Ukraine and Russia is believed to have wreaked havoc across economies far beyond the borders of the two nations. The geopolitical conflict disrupted the global supply chain of key commodities and consequently stimulated a global-scale inflation. For example, sanctions against Russian imports, coupled with Russia's subsequent retaliatory move of halting oil shipment (as the world's second largest crude exporter), caused oil price to ferociously fluctuate, which saw prices temporarily skyrocketing to above $100/ barrel. Likewise, the blockade of exports from Ukraine, which counts as third largest exporter of corn, spurred a significant price soar in agricultural commodities worldwide.

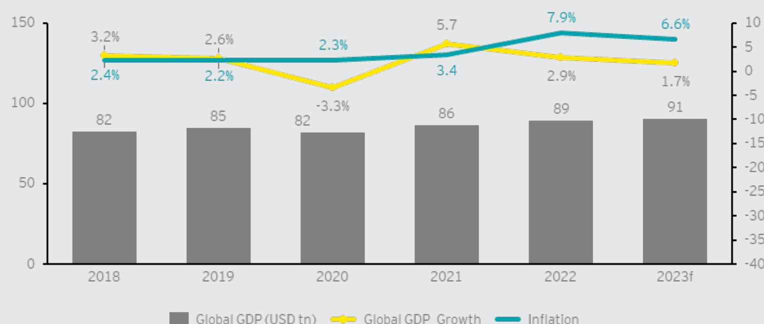
As a response to the global uncertainty triggered by the war and other contributing factors, the World Bank decided to lower its projection of Global Trade Volume and GDP growth in 2023 to 1.6% and 1.7%, respectively.

Figure 1. Global trade volume annual change



Source: World bank as of January 2023

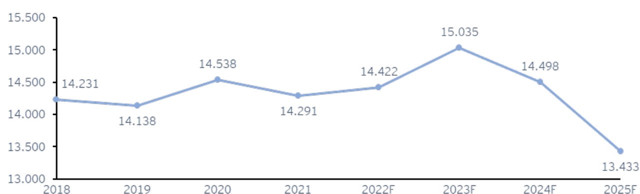
Figure 2. Inflation & Global GDP



Source: IMF as of February 2023 & World Bank as of January 2023

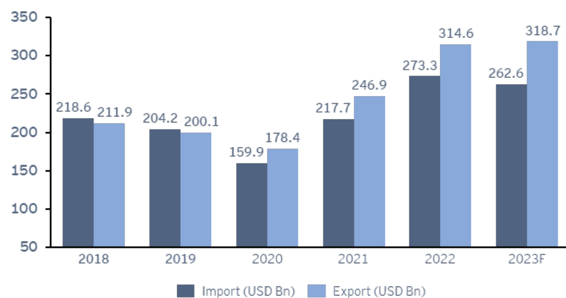
Indonesia recorded a strong growth of 5.3% in 2022 driven by spillover from rising commodity price & household consumption.

Figure 3. USD/IDR exchange rate



Source: Bank Indonesia as of February 2023 & Oxford Economics as of February 2023 (for projection)

Figure 4. Indonesia export and import of goods & services



Source: Indonesia Statistic Bureau (BPS) as of February 2023 & Oxford Economics as of October 2022

**Amount is annualized*

Indonesia, like almost all its peers, has been adversely afflicted by the global disarray. Towards the end of Q1-2022, Indonesia was battling a depreciating exchange rate against the USD as the FED started to crank up the fund rate for the first time since 2018 to manage domestic inflation.

However, despite growing unease in the global economy, Indonesia's GDP remarkably flourished, recording a strong growth at 5.3% in 2022, and is forecasted to grow at around 3.6% in 2023. The robust growth has been supported by strong household consumption, growing investment, and favorable commodity prices, leading to a positive trade balance.

Indonesia's handling of the COVID-19 storm has also been hugely exemplary – discarding any vulnerabilities at a difficult moment to administer some 420 million doses of vaccination to the country's population. The government has also been proactively ensuring economic recovery by promoting initiatives to support the economy, such as PEN (Pemulihan Ekonomi Nasional).

Figure 5. Indonesia real GDP

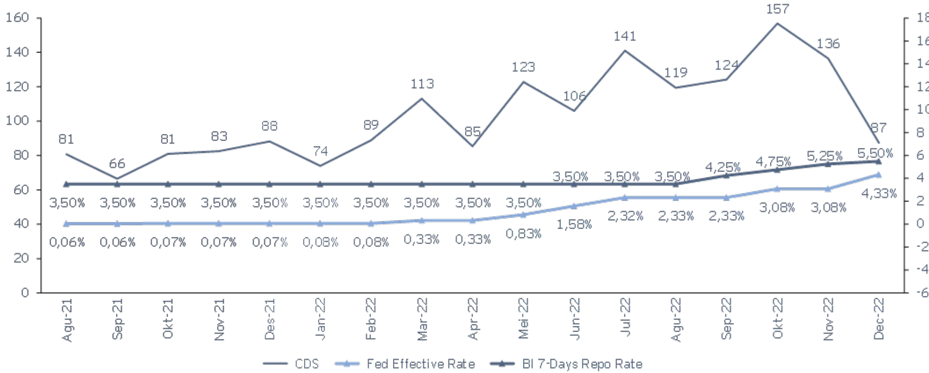
Source: Indonesia Statistic Bureau (BPS) as of February 2023 & Oxford Economics as of February 2023

The Central Bank of Indonesia ("BI"), meanwhile, was quick to assume its stewardship function and steady the faltering ship through by shielding the domestic economy from external shcck. One of its efforts was via a monetary policy of increasing the BI 7- day Reverse Repo Rate ("BI7DRR") to manage the spread to the rising Fed Fund Rate. This prevented capital outflow and expected rising inflation. In January 2023, BI responded to the 7th Fed Fund Rate hike by increasing the BI7DRR to 5.50%.

Due to preventive measures implemented by the BI, the increase in the Fed Fund Rate has little impact on the capital market as the IHSG went down from 7,081 to 6,851. Moreover, investors' confidence has begun to rise as the Yield of the Indonesia 10 Year Bonds and the 5-year Credit Default Swap are lower compared to the previous months (as an indication of decreasing risk perceived by the market).

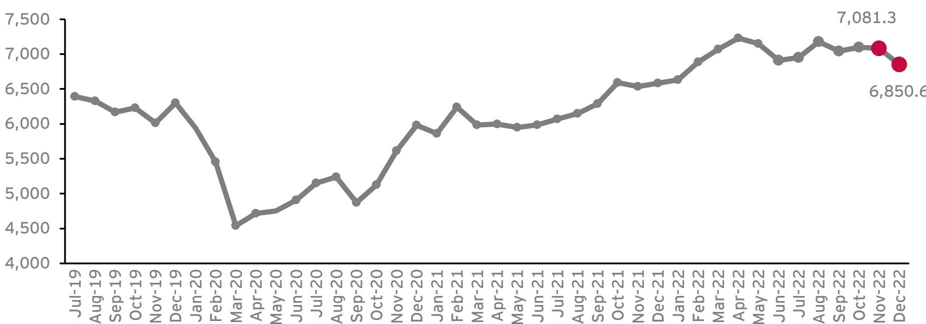
Investors are more cautious towards the Indonesian market as uncertainty arise.

Figure 6. Indonesia 5-year Credit Default Swap, Federal Reserve Fund Rate, and BI 7-day Reverse Repo Rate



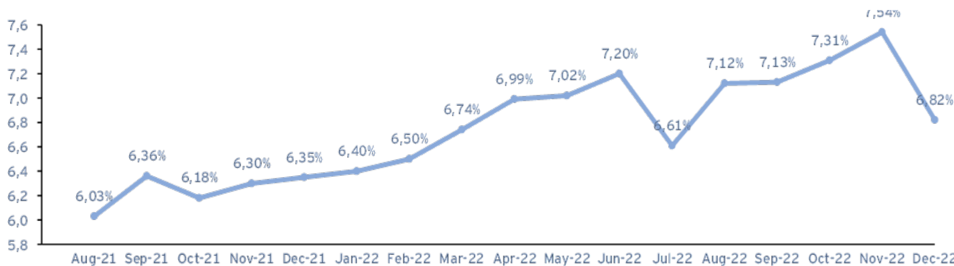
Source: Capital IQ, Federal Reserve, and Bank Indonesia as of December 2022

Figure 7. Jakarta Stock Exchange Composite Index (IHSG)



Source: IDX Channel as of December 2022

Figure 8. Indonesia 10-year Bond Yield

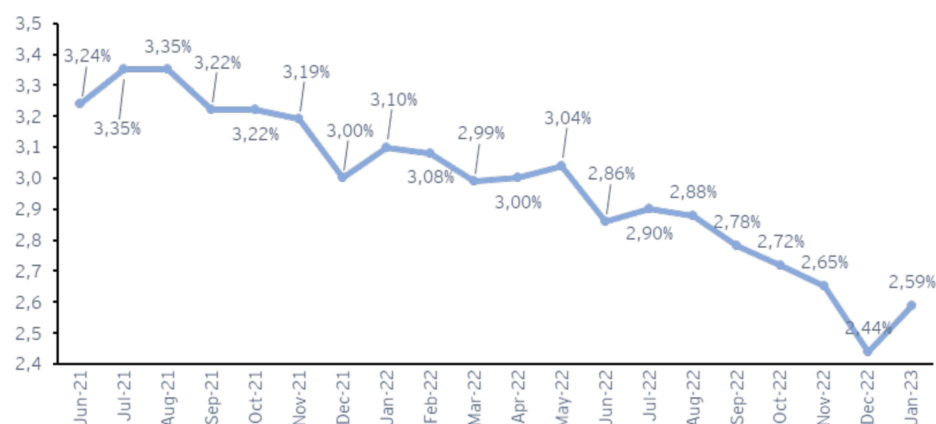


Source: Capital IQ as of December 2022

Through several relief efforts and initiatives, the Government have managed to suppress and control the non-performing loan of Indonesian banks. As shown below, the ratio of Indonesia's non-performing loan has decreased from 3.35% (at the beginning of pandemic) to 2.59% (as of January 2023).

However, to reach the pre-pandemic NPL rate, economic resilience, business sustainability, and healthy liquidity is needed when facing global economic risks.

Figure 9. Indonesia's non-performing loan (NPL) ratio



Source: Otoritas Jasa Keuangan as of January 2023

Table 1. Indonesia's NPL ratio per-sector

Sector	Jan 2022	Jan 2023	Δ%*
Agricultures, Hunting, fishery and Forestry	1.8%	1.7%	-0.1%
Mining and Quarrying	5.0%	2.5%	-2.5%
Processing Industry	5.2%	4.0%	-1.2%
Electricity, Gas and Water	1.1%	0.5%	-0.6%
Construction	3.7%	3.7%	0.0%
Wholesale and Retail Trade	4.2%	3.9%	-0.3%
Provision of accommodation and the provision of eating and drinking	6.5%	5.5%	-1.0%
Transportation, Warehousing, Communications	2.1%	1.7%	-0.4%
Financial intermediaries	1.4%	0.8%	-0.6%
Real Estate, Business, Ownership, and Business Services	2.9%	2.0%	-0.9%
Education Services	1.6%	1.8%	0.3%
Health Services and Social Activities	0.5%	0.8%	0.2%
Others	1.9%	1.7%	-0.2%

** % Changes from January 2022 to January 2023*

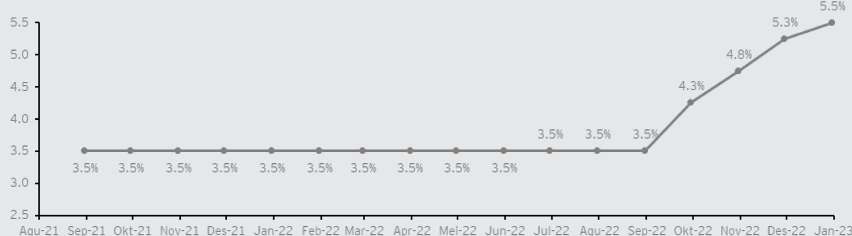
Source: Otoritas Jasa Keuangan as of January 2023

Government's Initiatives in Mitigating the Adverse Impacts of COVID-19 Pandemic

As part of relentless endeavor to alleviate the adverse impact of the COVID-19 pandemic and support vulnerable businesses, the Indonesian government has carried out numerous initiatives, such as tax subsidies and PEN (Pemulihan Ekonomi Nasional) *.

On 14 December 2022, BI made an aptly-timed move of increasing the country's benchmark interest rate from 5.30% to 5.50%, which was aimed at stabilizing the economy by preventing capital outflow and curb the expected inflation.

Figure 10. Indonesia 7-Day BI Reverse Repo Rate



Source: Bank Indonesia as of December 2022

The economic stimulus launched by OJK aims to protect the stability of Indonesia's financial system.

The Indonesian Financial Service Authority ("OJK") has passed a series of regulations allowing the relaxation of debt repayment, loan quality assessment and restructuring requirements for debtors affected by the pandemic.

Table 2. OJK regulations concerning the mitigation of COVID-19 impact

Reference	Title	Validity Period
18/POJK.03/2021	Written Instructions in Addressing Banking Issues	Until 31 March 2023
30/POJK.05/2021	Countercyclical Policy on the Impact of the Corona Virus Disease 2019 for Non-bank Financial Services Institutions	Until 17 April 2023
17/POJK.03/2021	National Economic Stimulus as a Countercyclical Policy on the Impact of Coronavirus Disease 2019	Until 31 March 2023

Source: Otoritas Jasa Keuangan as of August 2022

Regulatory push for banks experiencing financial distress and deteriorating performance to conduct merger and acquisition (18/POJK.03/2021)

The regulation highlights OJK's plan to launch written instructions addressed to banks experiencing financial distress and deteriorating going concern. In addition, OJK may also issue written notice to banks with limited capability in handling COVID-19 pressures, and to banks whose shareholders have limited capability to strengthen the banks' financial position. Banks that receive written instructions from OJK will be forced to conduct merger and acquisition, consolidation or integration process, upholding OJK's aim of ensuring stability in Indonesia's financial system.

* *PEN (Pemulihan Ekonomi Nasional) is a government initiative to respond to the COVID-19 pandemic. The program includes handling health crises and responses to the decline in economic activities.*

Requirement for non-bank financial institutions (IKNB) to assess business risks arising from COVID-19 pandemic (30/POJK.05/2021).

The regulation aims to mitigate the effects of COVID-19 pandemic that may degrade the financial condition of IKNB. The regulation specifies the following topics:

While series of economic stimulus have been launched by the Government, its impact may only be apparent in the longer run.

- The extension of reporting deadline for IKNB;
- Assessment of IKNB capability in handling COVID-19 pressure and compliance practice;
- Asset quality assessment and financing restructuring;
- Solvency calculations for insurance companies;
- Assessment of funding quality for pension funds; and
- Implementation of asset management provisions for pension funds that exercises defined contributions.

Relaxation of financial restructuring terms to allow banks and businesses to minimize the shocks from COVID-19 pandemic (17/POJK.03/2021)

The negative impact of the COVID-19 pandemic is pervasive to the extent that various industries (including banking) are severely undermined. This regulation looks to stimulate the economy through the relaxation of banking debt collectability classification. The stimulus provided by this regulation includes:

- Permission to instantly classify restructured bank loan as Collectability 1 (Col 1) after undergoing a financial restructuring process;
- Relaxed requirement in determining debt collectability for loans with credit limit up to IDR 10 billion; and
- Relaxation of classification to debtors whose transportation/supply chain route, trade volume, or projects are disrupted by the COVID-19 pandemic.

Supplementary document to this regulation highlights that the regulation is addressed to affected industries such as tourism, transportation, hospitality, trade, manufacturing, agriculture and mining. The ultimate purpose of the above stimulus is to manage the banks' NPL level.

How effective are the stimulus in promoting economic recovery?

The move by the government is a pragmatic one, and whilst it is expected to be adequately constructive in helping the economy recover in the longer run, it may need some time to bed in and come to full fruition. For example, lowering the benchmark interest rate might prove insubstantial when it comes to increasing consumption and investment in immediate term. Moreover, so long as supply and demand have yet to recover to their normal level, the lower cost of fund does not solve the fundamental issues of deteriorating cash flow and liquidity.

> Although the government has relentlessly pushed to mitigate risk and bolster the economy's recovery, there are certain factors worth bearing in mind given the reemergence of market uncertainties.

Learn and Respond: Expecting the rainbow after the storm

While the global economic recovery has stimulated a certain degree of positive outlook, the return of uncertainty in the market has left companies with no choice but to develop a much-needed business immunity through a re-imagination of strategy beyond crisis.

It is the companies' turn to evaluate and set the strategy. Companies must identify the causes and impacts on the business and answer these questions:

- How do I make strategic decisions in times of ambiguity and uncertainty?
- How can I rapidly improve the financial and operational performance of my business?
- How can I reshape the business model through business redesign?
- How can I make more informed decisions about working capital and liquidity management?
- and many more.

Learn how we can help you realize your strategy and address your valuable queries in the next part.

> Reimagining company's strategy down to its operational to build a resilient business to encounter market uncertainty

When you can't change the wind, how do you set your tack?

As storm clouds gather, how you plot the course for calmer waters is essential. The EY Enterprise Resilience Framework can help you navigate the critical questions for now, next and beyond.

ey.com/enterpriseresilience

#BetterQuestions

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The better the question. The better the answer.
The better the world works.

Why Restructuring Over Financial Bankruptcy?

Diminishing repayment capability is a major cause of rising insolvency risk.

It is imperative for companies to develop a proper mitigation plan in order to guard itself from the looming detrimental impact of the external shock and to avoid falling to insolvency.

As many companies are starting to revel in their recovery mode after a grueling period of pandemic-inflicted hibernation, the recent geopolitical tensions and threat of recession have had companies bracing for another storm. The fate of companies amid the current turbulence ultimately depends on their exposure to current events. Those impacted will start to feel the strain, particularly on their cash flow and profit. Once a company finds itself in such a beleaguered situation, it becomes in danger of falling into, and crippling under, financial distress.

Financial distress, which could eventually lead to insolvency, can be sparked by several factors, such as delayed production due to supply constraints, cancellation of orders due to economic downturn, and the loss of revenue caused by the external shocks. These types of constraints will eventually affect the companies' capability to generate cash flow. If not managed properly, it is very probable that the cash flow problem would lead to insolvency. In addition, other factors such as poor management, unrealistic business plan, and uncompetitive product or service can also lead to financial distress. Below are common causes of financial distress that companies need to be aware of:

1. **Business underperformance**
   The disruption in global supply chain makes it harder for companies to procure raw material needed for production and distribute its products. They may also be inundated with challenges from a sales perspective, such as order cancellations, which can be common amid declining consumption. These shocks will eventually lead to a loss in revenue for the business, which would invariably affect its cash flow generation.

2. **Inflexible business plan**
   In facing disruptive situations, the ability to adapt with the changing market landscape is the paramount to the survival of a business. Leaders need to have the ability to shift their business focus appropriately to respond to the changing market trends (e.g., textile company refocusing its resourcing to surging demand of masks and personal protective equipment). A lack of flexibility with regard to business plan can lead to a loss of opportunity. Persistence in pursuing a business plan that might not be suitable to the current situation can also result in overproduction and waste of resources. On the other hand, rising inventory and storage costs may also occur due to a lack of demand and declining sales.

3. **Poor management**
   Poor management skills can derail a company and land it in a precarious position, particularly if the management is unable to initiate swift business adjustments. This could potentially lead to a greater risk of operational and business failure.

4. **Liquidity mismatch**
   Faced with tightened purse strings, customers are bound to ask for more lenient payment terms, which could lead to a longer cash conversion cycle for the company, which, particularly if not astutely managed, will dent the liquidity of the company and hinder its ability to meet its short-term obligation.

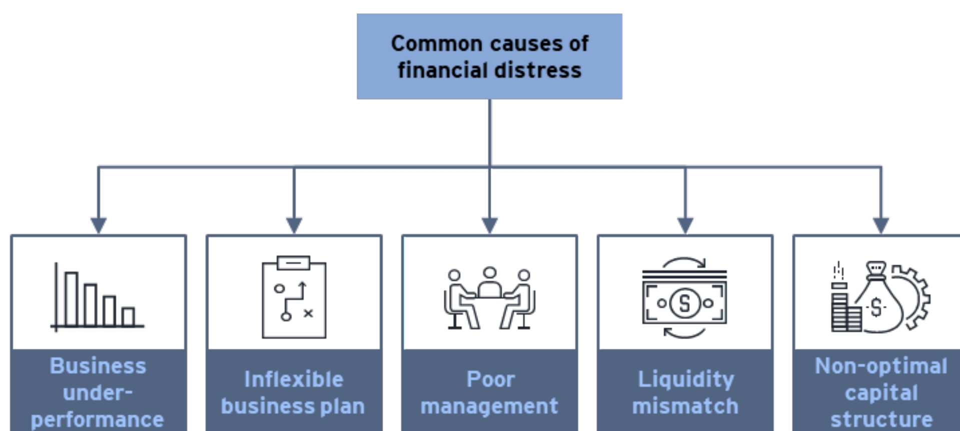
5. **Non-optimal capital structure**
   While having high leverage is beneficial to maximize value in 'Business as usual' conditions, high level of debt in period of downturn will result in complete backfire. With high leverage, companies are more vulnerable to external shock and decline in cash flow. Another potential complication could stem from a high exposure to foreign-denominated debt, which could leave a company prone to exchange rate movement, although the exposure might be significantly lower for those with natural hedge position (i.e., businesses with foreign-denominated revenue).

The advent of the COVID-19 pandemic has underscored the the pressing need for companies to have a dependable mitigation plan, and to re-evaluate their strategy in managing their liquidity to cushion any sudden and unprecedented event that may occur in the future.

Without a solid mitigation mechanism in place, all those circumstances could drive companies to insolvency. It is immensely critical that companies identify the causes early and develop a proper risk management plan, in order to minimize the disadvantageous impact of the external shock and to circumvent insolvency.

It is necessary for businesses to identify and mitigates causes of financial distress in order to avoid falling into insolvency.

Graph 3. Common causes of financial distress



Financial restructuring as a solution in the face of inevitable insolvency

Financial Restructuring serves not only as a short-term solution to liquidity crunch but could also provide longer-term relief by enabling a company to maintain its commitments to fulfill long-term repayment obligation.

While financial restructuring is by no means the only required fix for a company in financial distress, it will serve as a quick win solution with the potential of evolving into a permanent solution.

For instance, a company facing liquidity or insolvency and unable to meet its obligation will typically seek remedy via Debt Restructuring and/ or Raising Additional Capital.

Debt restructuring can be done by negotiating the existing financing terms such as the extension of repayment period, principle and/or interest haircut (thought principal haircut will be difficult for stated-owned banks), and reduction of interest rate. Moreover, long-term solution via debt restructuring can also be achieved by way of deleveraging via debt-to-equity conversion.

More details discussion on Debt Restructuring initiatives can be seen on page 16.

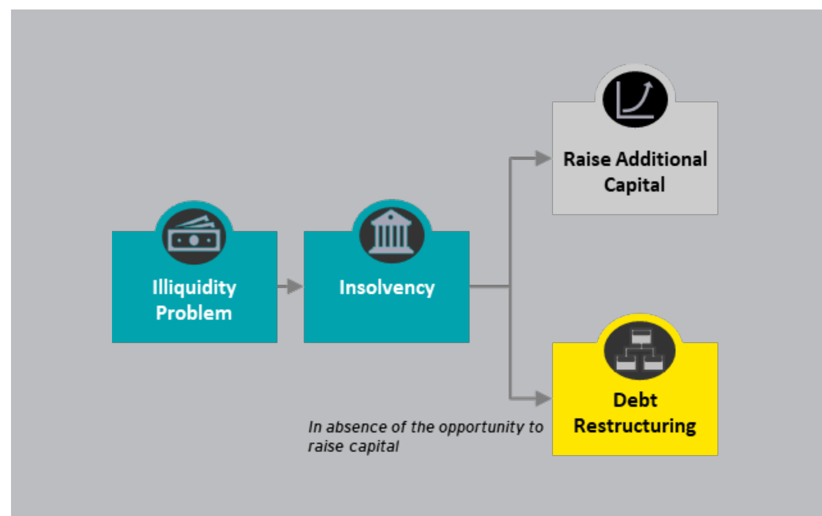
Depending on the company situation and commitment of the sponsor (shareholders), raising additional capital is an option. The most common ways of raising additional capital include sale of assets, obtaining secured financings, entering sale-and-lease back arrangements, and, in the event of company's majority shares is owned by institutional shareholder(s), request for equity sponsors. However, there are several considerations and circumstances that need to be carefully analyzed in deciding on the most suitable approach.

Based on a sample from courts in major cities in Indonesia, the number of in court restructuring cases is three times higher compared to bankruptcy, illustrating the market's preference towards restructuring process in resolving issues related to financial distress.

Bankruptcy proceedings are seen unfavorable due to fact that the process comes with hefty costs, hence lower recovery. Through debt restructuring, debtors and creditors may avoid the hefty costs associated with bankruptcy proceedings (e.g. litigation cost, severance payment, liquidation cost, etc.). It is worth noting that in bankruptcy proceedings, the liquidation process is often conducted through a force sale, which causes the assets to be sold at an unfavorable price, thus resulting in lower recovery for the creditors.

A carefully-designed financial restructuring plan and prudent implementation increase the likelihood of achieving a successful result and minimizing pitfalls in the financial restructuring process.

Graph 4. Financial restructuring for insolvent businesses



Moreover, from an accounting perspective, debt restructuring is also preferable for creditors as, unlike bankruptcy proceedings, it will not result in a direct write-off.

Approaches and key considerations in financial restructuring process.

Options in raising additional capital include divestment of non-core assets, addition of secured financing, sale-and-leaseback financings, and capital call from equity sponsors .

Reduction of leverage though the raise of additional capital and debt restructuring are solutions to the threat of insolvency. Below are the explanation of the two solutions:

Capital raising to unlock additional liquidity

Capital raising provides relief to insolvency by unlocking additional liquidity to repay (in part or full) outstanding financial obligations. Below are several approaches in capital raising which can be considered in the event of insolvency:

Table 3. Common approaches in raising additional capital

Method	Detail
Divestment of non-core assets/business	In certain situations, companies can divest their non-core assets/businesses in order to increase liquidity position. The proceeds from the sale will be used to repay indebtedness (in full or partial) as the debtors cannot rely much on its operation to generate enough cash. The feasibility of this option vary by business and circumstances depending on the availability of the assets to be divested (existence of non-core assets and/or assets which are free from encumbrances).
Secured Financings	In the event that debtors have a substantial amount of uncollateralized and/or non-core assets or businesses, raising capital by way of secured financing can also become a viable alternative. However, debtors need to take into account the approval requirement from existing debt provider in conducting such actions.
Sale-and-leaseback financings	The sale-and-leaseback is a hybrid of assets sales and secured financings in which the company will sell their asset and then lease back that same asset from the purchaser. In this way, the company can get both the cash and asset it needs to operate business and to repay the creditors.
Equity sponsors	In the event that the debtors shareholding structure is dominated by institutional investor(s) such as private equity or leveraged buyout fund, Debtors may consider to request for additional capital to the equity sponsors. As an equity holder, institutional investor(s) have strong interest in the company's performance.

Source: EY analysis, Distress Debt Analysis by Stephen G. Moyer

In deciding the most suitable approach to mitigate insolvency, there are various factors that need to be considered in developing the suitable financial restructuring plan.

Preparation and prudent implementation is the key to achieving a successful financial restructuring

It is worth noting that debt restructuring does not provide a guaranteed solution to insolvency problems. There are instances where debtors have undergone a financial restructuring process and still end up falling into bankruptcy shortly after.

A notable precedent for this comes from the financial restructuring case of one of the major Indonesian agriculture companies, whereby the debtor is declared bankrupt by the court following its negligence in fulfilling its financial restructuring plan obligations.

Financial restructuring attempt can also fail prematurely due to failure in negotiation process with the creditors. The relevant example for this case is the debt restructuring attempt of one of the major Indonesian construction companies, in which financial restructuring process didn't go as planned as they failed to reach an agreement with the creditors on the financial restructuring planl.

Therefore, carefully-designed and down-to-earth financial restructuring plan, as well as prudent implementation could increase the likelihood of achieving a successful outcome result and minimizing pitfalls in the financial restructuring process.

Deleveraging by way of debt restructuring

Debt restructuring process heavily involves both debtors and creditors, and can be generally broken-down into adjustment to financing term and debt-to-equity conversion.

There are several key considerations which need to be taken into account to determine the most suitable approach for debt restructuring. The key factors are as follows:

Future business prospect and cash flow capability: A thorough analysis of debtors' current and future cash flow condition need to be conducted prior to developing an effective financial restructuring plan. In doing so, debtors may also need to identify initiatives that will help to improve future cash flow and ensure a successful turnaround.

Timeline: When dealing with a distress situation, time is of the essence. Liquidity deteriorates as time runs out. Therefore, the financial restructuring plan needs to be developed and executed in a timely manner, to avoid swelling costs and risk of falling into insolvency.

Parties involved in debt restructuring process: Managing stakeholder's interest is a crucial part in achieving a successful financial restructuring. Of all the parties involved in debt restructuring process, creditors are arguably one the most important stakeholders. Debtors need to carefully tailor its negotiation approach to the characteristics of the creditors they are dealing with.

Table 4. Common approaches in debt restructuring

Method	Detail
Adjustment to financing terms	The most common approach in debt restructuring, whereby distressed debtors attempt to renegotiate the payment structure and terms of the existing loan agreement/financing terms with the creditors. The process is typically carried out by: ▶ **Reduction of interest rate**: debtors request the creditors to reduce the interest rate (e.g.,10% to 8%). ▶ **Extension of repayment period**: debtors request for longer repayment period or extension of maturity date. ▶ **Principle and/or interest haircut:** creditors agree to partially write-off the current portion of their receivables. ▶ **Deferred interest:** debtors could request for payment-in-kind (PIK) on their interest payments for a period of time. This might also include the arrangement of balloon payment at maturity. The adjustment of terms might apply throughout the maturity of the loan, or temporarily until the cash flow generation capability recovers.
Debt-to-equity conversion	In the event that the adjustment of financing terms do not help improve debtor's credit quality and there is an absence of assets worth divesting, creditors may choose to step-in through debt-to-equity conversion and management takeover (usually by appointing CFO as representative) to help turnaround the company in accordance with OJK regulation number 36 of 2017. The typical exit options for the creditors are M&A sale or IPO later after the company has recovered.

Source: EY analysis, POJK 40, 2019, Distress Debt Analysis by Stephen G. Moyer

While creditors' characteristics greatly vary in each financial restructuring case, (e.g., junior vs senior lender, traditional vs syndicated loan, etc.), there are 3 basic types of creditors in the Indonesian financial restructuring context, which every debtor needs to be aware of:

- **Opportunity to unlock additional liquidity:** Excess assets can be an important source of liquidity. Thus, debtors need to look into their list of assets to seek for source of additional liquidity. There might be a case where a debtors have plenty of idle assets without much of additional value to the business. These assets might come in various forms, such as building, land, machinery, etc. In absence of sufficient operational cash flow during distressed situation,divesting these assets might be useful to unlock additional liquidity and help the debtors to reduce its financial indebtedness.
- **Complexity of capital structure:** : In general, the more layers that exist in the capital structure, the more difficult it will be for the firm to conduct debt restructuring. In particular, significant amount of secured bank debt is likely to limit the range of options available due to numerous negative covenants which limit the action that can be taken by the debtors. For examples, prohibition to sell certain assets, increasing indebtedness (particularly more senior debt), prohibition to take parts in M&A process, and enter certain types of agreements. Therefore, it is essential for the company to evaluate the provisions of all significant capital instruments when formulating an analysis of the available options.

Table 5. Types of creditor

Reference	Title
Kreditor Preferen	*Kreditor Preferen* has superior liquidity preference that prioritize them over other type of creditors in the event of default, as regulated by the prevailing law. The examples of *Kreditor Preferen* are tax authorities and employee's compensation.
Kreditor Separatis	*Kreditor Separatis* is what we usually call Secured Creditor or Senior Debt. Secured Creditor is a lender backed by collateral (mainly fixed assets), which gives the creditor a predominant right to the collateral in case of insolvency or bankruptcy. *Kreditor Separatis* can be further divided by the debt seniority where payment due to senior debt will be prioritized compared to the junior debt.
Kreditor Konkuren	*Kreditor Konkuren* is the least prioritized among all creditors as they usually hold relatively low-valued unsecured-loans. In the event of debtors' insolvency, *Kreditor Konkuren* has the lowest liquidation preference over the two other creditors. Examples of *Kreditor Konkuren* include supplier and contractor without collateral.

Source: EY analysis, Kitab Undang-Undang Hukum Perdata

Overview of PKPU process and relevant regulations

Debtors need to fully understand the applicable terms and conditions in PKPU process to achieve successful financial restructuring

In order to create a healthy banking system and mitigate credit risk, the Government of Indonesia has issued UU no.37, 2004.

The law regarding bankruptcy and insolvency was first regulated through the Law of Bankruptcy in Faillissements-verordening, Staatsblad 1905:217 juncto Staatsblad 1906:348. During the 1998 Indonesia Crisis Monetary, the Government realized the irrelevancy of the law and issued UU no.1, 1998 as a replacement to help debt repayment failure. After some adjustments and developments, The Government issued UU no.37, 2004 which regulates the requirements and procedures for a declaration of bankruptcy and PKPU request, including the provision of a definite time frame.

According to an OJK regulation, debtors' credit quality is classified into 5 collectability levels. Typically, loans classified as Collectability 3 and below are required to undergo financial restructuring process. In accordance with the prevailing regulation, creditors and debtors with deteriorating repayment loan quality are eligible to request for PKPU.

Table 6. OJK credit quality classifications

Collectability	Due date	Growth	Earnings	Liquidity
Group 1	Completed on due date	High potential	High	Strong
Group 2	< 90 days	Limited potential	Moderate – High	Strong
Group 3	90 – 120 days	Highly limited, maybe none	Small – Moderate	Moderate
Group 4	120 – 180 days	Degrading	Small	Low
Group 5	> 180 days	Degrading and has potential to shut down	Negative	Null

Source: Otoritas Jasa Keuangan, POJK 40, 2019

Financial restructuring process and requirement for independent consultant

Both debtors and creditors are eligible to submit PKPU application to the court when all basic criteria stipulated in the regulation before has been fulfilled. Once approved by the court, as stated in POJK 40 Chapter 59, 2019, debtors need to appoint an independent consultant to analyze the credit restructuring proposal based on debtors' existing condition and cash flow prospect. The consultant's roles also include assisting debtors in negotiating with lenders on the restructuring terms, a crucial activity which will significantly determine the outcome of creditors voting process during the court hearing.

PKPU process is divided into 2 phases. The first phase is temporary PKPU which will be conducted 45 days after approval of PKPU process by the court. During the process, negotiation will be held between the debtors and its creditors to determine the restructuring plan. The debtor, along with its consultant, needs to present their proposal of repayment terms

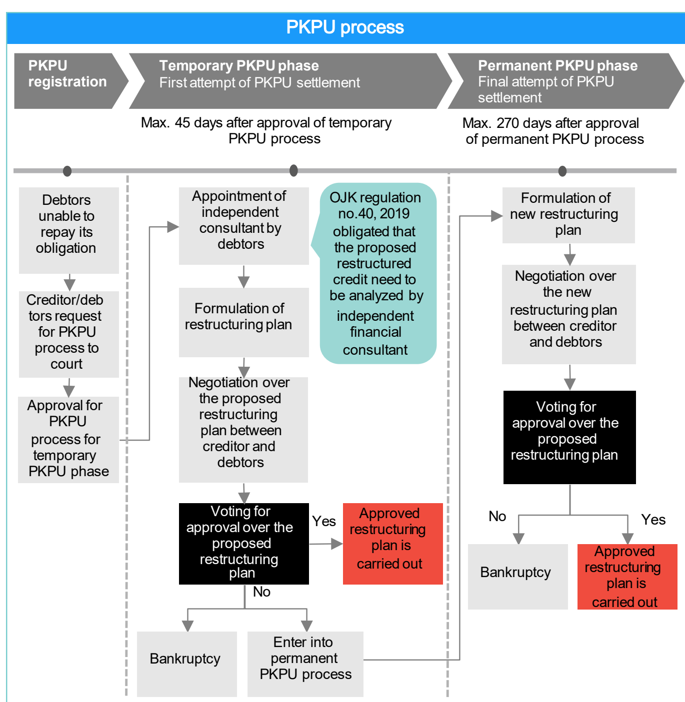
to creditor which includes the estimated cash flow available or debt, proposed interest and principal payment, and the timeline of payment. UU 37 2004 states that in order to win the or needs to get approval from:

a) >50% of kreditor konkuren, representing minimum 2/3 from total credit of kreditor konkuren loan amount; and

b) >50% of creditors with collateralized loans, fiduciary guarantee, mortgage and other collateral rights (kreditor separatis), representing a minimum of 2/3 of the total recognized loan.

Had the creditors not been able to decide on PKPU approval, the process will be extended maximum 270 days after the approval of temporary PKPU. In this time, debtors will be given a time to further negotiate the restructuring plan with creditors and prepare for the next court hearing.

Graph 5. Summary of PKPU proces



Source: Regulation No. 37, 2004

> Negotiation with creditors and a subsequent agreement on the terms are the most crucial process during PKPU.

How EY Can Help You

We offer an extensive suite of services for your restructuring needs

Our integrated approach is designed to help find the right solutions to your restructuring needs.

Graph 6. EY debt restructuring service offerings

EY debt restructuring service offerings		
	Capital Raising	Analysis and formulation Of debt restructuring plan
Objective	Develop plan and execute company's strategic plan in relation to fund raising	To identify and develop the most suitable restructuring plan and assist debtors to negotiate with creditors
EY Reporting/ Deliverables	• Formulation of capital raising strategy, which include identification of assets available for divestment. • M&A, asset divestment, secured financing, sale-and-leaseback, and equity sponsors assistance which includes: • Development of marketing documents; • Indicative pricing analysis which include financial projection, valuation and/or pricing analysis; • Due diligence management; • Negotiation and closing assistance.	Independent Business Review Report on: • Historical financial performance and cash flow requirements • Financial projection, prospective financial performance and stress-testing • Industry outlook and benchmarking analysis • Structuring and option analysis memo • Detailed restructuring plan including recommendation on the most suitable restructuring option • Restructuring terms negotiation assistance

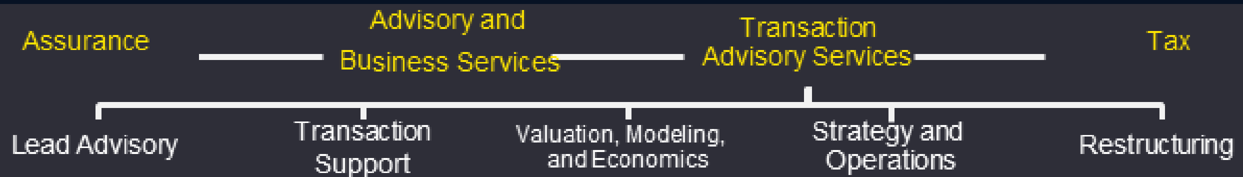
- **Capital raising:** In the case where divestment is an essential part of the restructuring plan, we can help you in conducting the M&A process and connect you to a wide network of potential buyers.

  We also offer a thorough analysis on a company's current condition to develop a plan to gain secured financings through bank, private equity, or mezzanine lenders.

  By leveraging our extensive national and global connections, we will provide you with several potential investors and assist you into the negotiation process.

- **Analysis and formulation of restructuring plan:** We offer assistance in identifying available restructuring options by conducting analysis to determine the degree of distress, assess long-term business strategy and viability through projection analysis, sensitivity analysis, valuation analysis, and industry outlook. Based on the before mentioned examination, we will formulate a tailored restructuring plan to help debtors and creditors navigate through the financial distress and achieve a win-win solution to their liquidity problem.

Snapshot of EY Indonesia



Why EY?

- One of the largest professional service firms in the world: With over 400,000 employees around the world, our teams are united by our shared values, making us one of the world's most globally integrated professional services organization – in our mindset, actions and structure.
- Integrated approach: A combination of unique and holistic approaches for strategy, organization, tax and other perspective on businesses. Our goal is to help you achieve your best capital performance, deliver value to your stakeholders, and meet your strategic objectives.
- Extensive experience: We are equipped with deep knowledge of prevailing regulations on restructuring subject. Our understanding of the previous restructuring experiences will pave the way for a successful restructuring process.

EY in Indonesia

We are one of the world's largest professional service firms with deep understanding in debt restructuring subjects.

Our selected credentials in debt restructuring services

Cash Monitoring for one of the largest property investment company in Indonesia

EY value add

We leveraged our experience working on similar engagement and knowledge of the industry. We were able to provide the required tailored cash monitoring accountant services which were required by the Singapore International Arbitration Centre.

Debt Restructuring and Cash Monitoring for one of the largest Indonesian construction company

EY value add

EY delivered a holistic solution, including updating the company's restructuring model and developing cash monitoring budget including the cash accounts, capital expenditures, and operating expenses. Following our deliverables, the Bank was able to monitor the company's financial restructuring plan realization.

End-to-end debt restructuring strategy for one of the largest Indonesian construction company's subsidiary

EY value add

EY constructed a integrated solution from creating a 15-year cash flow forecast, identifying non-productive assets to divest, and negotiating with creditors/lenders with a new repayment schedule. As the lead advisor, EY also coordinated with stakeholders and other consultants throughout the process.

Debt Restructuring and Debt Refinancing for one of Indonesia's ship manufacturing company

EY value add

EY delivered a suitable and sustainable restructuring plan for one of Indonesian's ship manufacturing company to help them unlock the values of their turnaround opportunities. Further, we also leveraged our connection in the financial market to help them finding the suitable funding requirement.

Assistance in the PKPU process for one of the largest players in Indonesia's paper industry

EY value add

EY integrated teaming to come up with strategic solutions for the company. The company has successfully renegotiated the financing terms by extending the repayment period and more favorable interest rate.

NPL divestment process of a sizeable Buku III Bank

EY value add

We delivered an integrated solutions from assisting in structuring portfolios, tax impact, contracts structuring, implications of financial statements for the transactions and proper documentation of the process to meet with the good governance policy of the Bank. Following our deliverables, the Bank was able to identify the best transaction strategy, plans in mitigating risks, and successfully divested its NPL portfolio.

Debt-to-equity conversion and capital raising of Tuban Petrochemical Industries

EY value add

EY delivered a holistic solution, including limited due diligence, business plan review, negotiations with regards to debt-to-equity conversion of the principal and restructuring of the interest and penalties. TPI was able to reach an agreement with its creditor n debt-to-equity conversion, and successfully renegotiated the financing terms for the unconverted obligation portion.

Debt Restructuring on behalf of listed bank in Indonesia (creditor's side)

EY value add

EY delivered a robust analysis for a listed bank in Indonesia on a restructuring proposal of a USD 150 million loan provided by one of the property business units of a conglomerate company in Indonesia.

PKPU process preparation for PT Mount Dreams Indonesia

EY value add

EY constructed the composition of the restructuring process plan of PKPU for PT Mount Dreams Indonesia, including analysis of the state of the Company, analysis of debt sustainability and identifying potential reallocation.

Cash monitoring for one of the largest Indonesian commercial property industry

EY value add

EY conducted a cash monitoring budget for the company's monthly cash flow to execute the company and lender arbitrage agreement. Following our deliverables, the lender was able to observes the company's budget cash flow realization.

Contact Us For Immediate Support

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EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

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Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

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EY-Parthenon teams work with clients to navigate complexity by helping them to reimagine their eco-systems, reshape their portfolios and reinvent themselves for a better future. With global connectivity and scale, EY-Parthenon teams focus on Strategy Realized — helping CEOs design and deliver strategies to better manage challenges while maximizing opportunities as they look to transform their businesses. From idea to implementation, EY-Parthenon teams help organizations to build a better working world by fostering long-term value. EY-Parthenon is a brand under which a number of EY member firms across the globe provide strategy consulting services. For more information, please visit ey.com/parthenon.

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