



DEALING WITH DISTRESS:
M&A Strategies for
Financially Troubled
Companies

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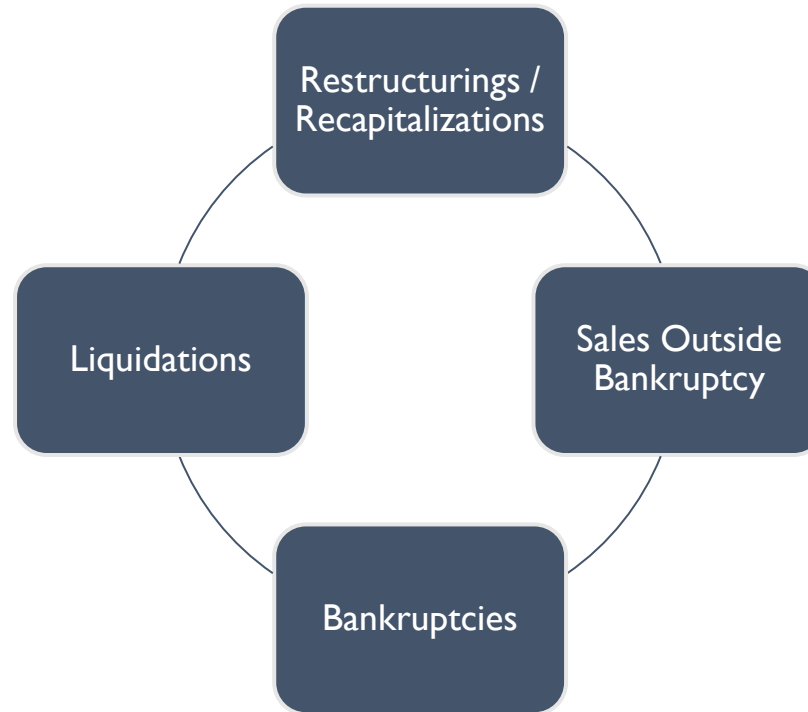
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Key Areas of the Presentation

- ▶ Introduction and Overview
- ▶ Initial Responses to Financial Stress
- ▶ Investment Banking Process
 - Traditional M&A v. Distressed M&A
 - Deal Structures Outside Bankruptcy
 - Crafting the Deal: Key Considerations
 - Availability of Financing
- ▶ Sales of Securities Outside Bankruptcy
- ▶ Sales of Assets Outside Bankruptcy
- ▶ Other Transaction Structures
- ▶ Q&A

Introduction and Overview

- ▶ Distressed M&A encompasses a wide array of transactions:



When is a deal considered distressed?

- Per se insolvency
- Risk of insolvency

Initial Responses to Financial Stress

▶ Pivots & Course Corrections

- Discontinuing certain operations
- Shifting business model
- Changing management
- Revamping marketing strategies

▶ Employees & Key Relationships

- Maintaining worker productivity, employee welfare, treatment of customers/suppliers

▶ Cash is King

- Protecting cash and liquidity positions is paramount; drawing down existing lines of credit; actively managing working capital: factoring receivables / stretching out payables

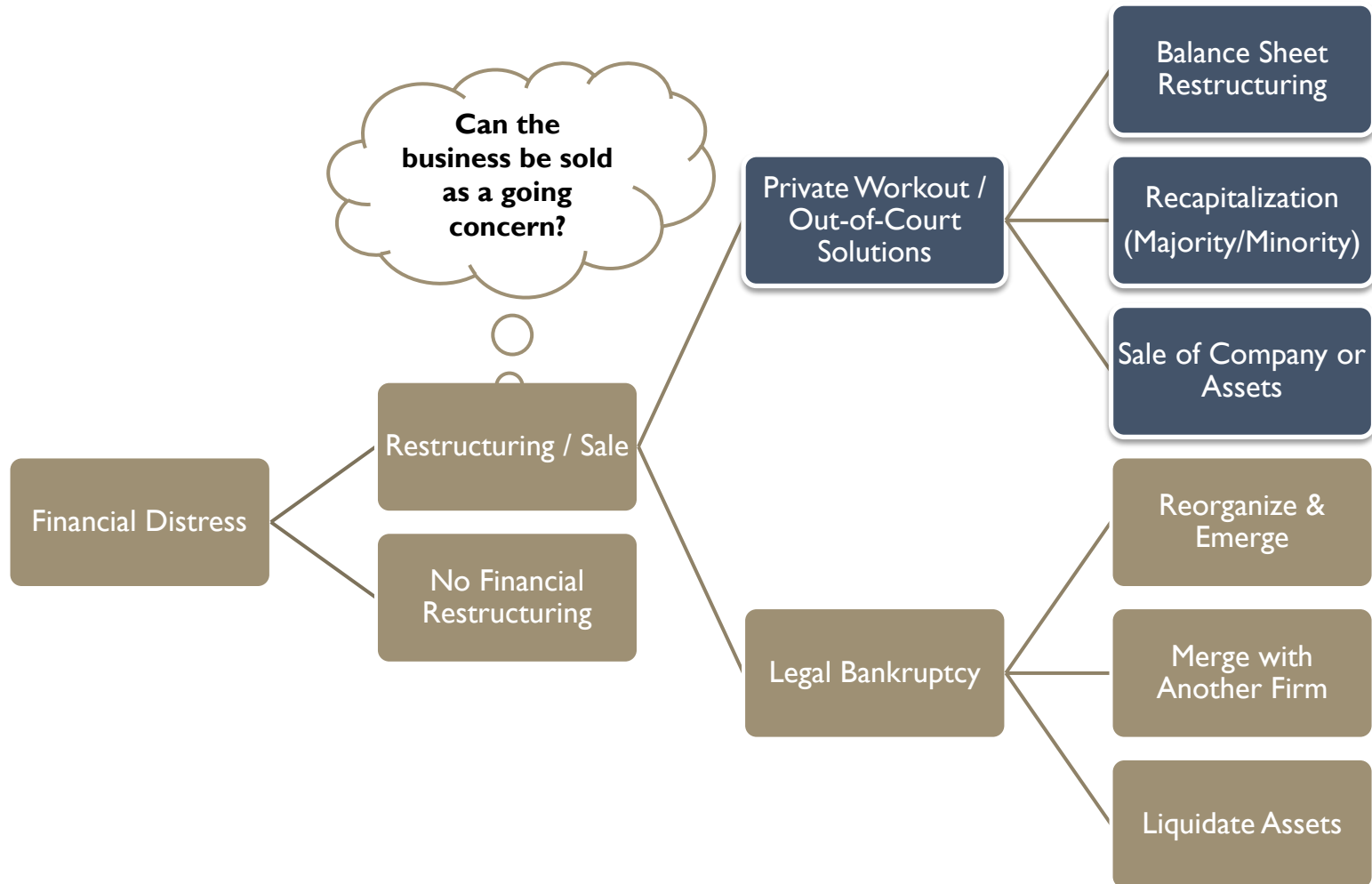
▶ Clean Up Your Balance Sheet

- Addressing obsolete inventory, uncollectible accounts; evaluating tax advantages (NOL carrybacks, tax shields)

▶ Work With Your Lenders

- Clear and consistent communication with lenders; planning solutions for loans that may move up the risk spectrum and avoid discord

Alternatives for Distressed Companies



Distressed M&A v. Healthy M&A

	Traditional M&A	Distressed M&A
Diligence	Available and organized data	Opaque and incomplete data
Timing	Quick	Urgent / Accelerated Pace
Valuation	At or above market	Lower due to risk / uncertainty
Competition	Relatively high number of bidders	Relatively low number of bidders
Liabilities	May need to assume	May be able to avoid
Legal	Out of court	In court or out of court
Management	May want to retain	May want to replace
Strategy	Grow	Fix

Deal Structures Outside Bankruptcy

Sellers/Debtors

Despite duress, maximize value;
speed and certainty to close

Buyers/Capital

Protect cash flow to be able to
cover all expenses and debt
service

Both

Explore
structures and
deal terms
beyond price to
balance
quantitative and
qualitative
factors

Potential Structures:

- Sale of Equity (stock or membership interests)
- Sale of Assets
- Merger

Potential Financing Sources:

- Buyer Equity
- Senior and/or Junior Debt
- Seller Notes
- Earnouts / Contingency Payments
- Minority Investment / Rollover

Structure is driven by a number of factors, including use of proceeds, cash flow dynamics, existing capital structure, control v. non-control, tax and timing issues among others

Crafting the Deal: Key Considerations

▶ Questions of Value

- Appropriate multiple or appropriate number to multiply
- Secured lenders may have their own view

▶ Compressed Time Frame

- Speed and certainty are almost equally important qualitative factors

▶ Addressing key stakeholders

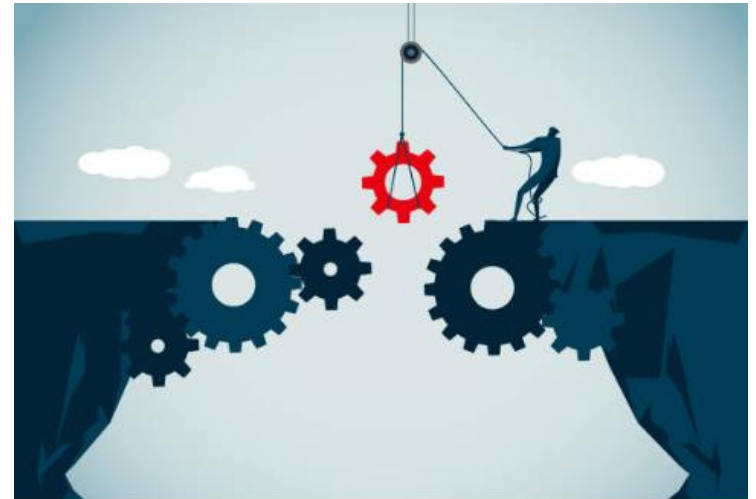
- Buy-in of certain secured creditors
- Pre-negotiated covenant waivers or extensions

▶ Mobilizing people

- Internal management and external advisors
- Limiting information to people who need to know

▶ Accessing Capital Quickly

- Can set a bidder apart
- Focus on cash / liquidity
- What will financing look like?



Availability of Financing

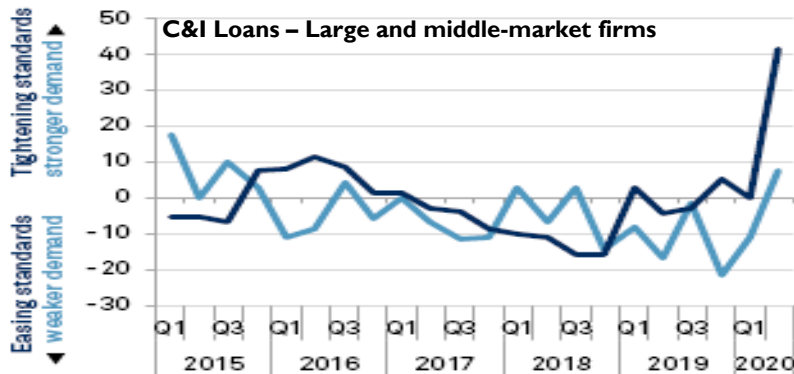
Traditional “Senior” Lenders

- ▶ Existing lines of credit
 - Drawing down on existing revolvers
 - Incremental lines
- ▶ New term debt
 - Cautious approach to underwriting
 - Lower leverage
 - Higher pricing; Tighter terms
- ▶ Bridge Financing
 - More “market flex” provisions
 - Higher pricing
 - Compare to alternative lending options

Alternative Capital / Direct Lenders

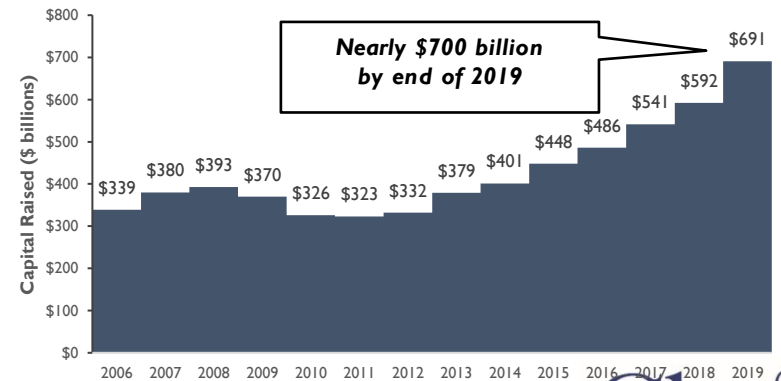
- ▶ Private Equity
 - Overhang (total amount of capital seeking acquisitions) is nearly \$700 billion in the U.S.
 - Very open to creative financing structures/solutions
- ▶ Direct Lenders
 - Target-rich environment versus 6 months ago
 - Credit work needed versus expected return
 - Tighter terms
 - Not short-term bridge with quick take out
 - Multi-year financing at a premium

Senior Lenders: Waiting, watching, tightening



Source: Federal Reserve; data as of May 8, 2020

PE Dry Powder Still on Sidelines



Source: Latest available data provided by PitchBook

Sales of Securities Outside Bankruptcy

- ▶ **Sale of 100% vs Sale of Control vs Sale of Minority Interest**
 - Deal specific determination
 - Each structure presents different issues for seller and buyer
- ▶ **Common Equity vs Preferred Equity in Sale of Less than 100%**
 - Buyer often requires preferred equity – Terms are Variable
 - ▶ Dividend / Distribution Preference
 - ▶ Liquidation Preference
 - ▶ Mandatory Redemption
 - ▶ Tag-Along / Drag-Along Rights
 - ▶ Governance Restrictions
- ▶ **Sale of Convertible Note(s)**
 - Buyer becomes a creditor (higher rank than equity) – Terms are Variable
 - ▶ Interest Rate
 - ▶ Maturity
 - ▶ Payment terms
 - ▶ Conversion terms
- ▶ **Distressed Target Presents Higher Risk of Unknown Liabilities, and Many Buyers Prefer Asset Acquisitions for This Reason**

Sales of Assets Outside Bankruptcy

- ▶ **Asset Sales Can Allow Buyers to Leave Unwanted Liabilities Behind**
- ▶ **But There Are Important Exceptions**
 - The Risk that the Transaction Could be Characterized as a “Fraudulent Conveyance” in a Post-Transaction Seller Bankruptcy Proceeding
 - Successor Liability Statutes (e.g., Environmental and Sales Tax)
 - Successor Liability Legal Theories (e.g., Product Line Doctrine and De Facto Merger Doctrine)
- ▶ **These Exceptions Require Additional Buyer Diligence and Legal Protection**
 - Higher Escrow or Hold-Back, for Longer Period
 - Solvency Opinion from Target’s CPA or Investment Banker
 - Tail Coverage on Seller Insurance Policies
 - Environmental Assessment
 - Sales Tax Certificate from Taxing Authority

Other Transaction Structures

▶ “Loan to Own”

- Either Acquisition of Secured Debt from Senior Lender, or Enter as Senior Secured Lender, then Foreclose

▶ Section 363 Sale in Bankruptcy

- Buyer Acquires Free and Clear of Seller Liabilities by Order of Bankruptcy Court

▶ Pre-Packaged Bankruptcy

- Seller, Buyer, and Material Creditors (i.e., creditors needed to approve a plan of reorganization under Chapter 11 bankruptcy rules) Agree on a Plan of Reorganization that Includes the Sale to Buyer, Prior to Seller filing for Bankruptcy

Inside or Outside Bankruptcy?

▶ Out of court

- Benefits
 - ▶ Private sale
 - ▶ Not subject to court supervision
 - ▶ Greater control over the process
 - ▶ Faster and more flexible solutions
 - ▶ Substantially lower cost
 - ▶ Confidentiality (no public hearings or public records)
- Risks
 - ▶ Unknown Liability Risk
 - ▶ Fraudulent Transfer Risk
 - ▶ Practical problem of the melting ice cube

▶ In Court

- Benefits
 - ▶ Automatic stay on all collection activity
 - ▶ Sell or liquidate assets “free and clear” of any liens, claims or encumbrances
 - ▶ Rid company of burdensome assets, contracts, etc. and leave behind liabilities
 - ▶ Judicial determination of fair market value
- Risks
 - ▶ Equity generally wiped out
 - ▶ Expensive and time consuming
 - ▶ Greater problem of the melting ice cube
 - ▶ Requires full transparency / strict supervision
 - ▶ Creditor bodies may organize
 - ▶ Reputation / brand concerns

Closing Remarks

▶ Owners Need Advice

- Current and potential business value
- Impact of de-risking and qualitative improvements on value
- All exit and legal alternatives
- M&A transaction process and market dynamics
- Disciplined, methodical, and prioritized approach
- Advisors whom they can trust: Attorney, CPA, Investment Banker, and perhaps Turnaround Specialist

▶ Advisors Should Provide

- Education and awareness of current market trends
- Striking the right balance of perspectives and navigating thorny negotiations
- Collaborative approach to facilitate an effective process that meets the personal financial goals of the owner



Questions?

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Mr. Whittaker represents clients in a wide variety of transactions, including buying, selling and merging companies; private placements of securities; venture capital and private equity transactions; joint ventures; roll-ups, spin-offs and split-ups; and all phases of real estate acquisitions, development and financing. Mr. Whittaker leads the Merger's and Acquisitions practice at Stone Pigman. He is also the immediate past Chair of the M&A Committee of the Business Law Section of the American Bar Association, and has been named by Best Lawyers as "Lawyer of the Year" in New Orleans, in the fields of Mergers and Acquisitions, Venture Capital Law and Corporate Law.

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Ms. Le Breton heads the Mergers & Acquisitions group of Chaffe & Associates, Inc., with emphasis in services to privately held companies. She has more than 30 years experience in the structuring and negotiation of transactions, the valuation of small- and mid-sized companies, and the development and execution of competitive processes for the sale or purchase of businesses. Ms. Le Breton is also President of Chaffe Securities, Inc., the firm's broker dealer subsidiary.

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Mr. Rieveschl concentrates his practice in the areas of corporate, mergers, and acquisitions and securities law. His practice includes structuring public and private sales of equity and debt instruments and advising clients on compliance with federal and state securities laws. In addition, he regularly counsels established and emerging enterprises on issues affecting legal structure, intellectual property rights and venture capital financing, with particular focus on technology, life sciences, natural resources and energy companies. Mr. Rieveschl also represents publicly traded and privately held clients (as buyers and sellers) in complex merger, stock and asset purchase transactions.

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Mr. Gilbert works in the Mergers & Acquisitions Group of Chaffe & Associates, Inc., having joined the firm in 2012 as a financial analyst. He specializes in deal execution, database and market research, due diligence, financial modeling, and strategic planning and financial analysis of critical business decisions for clients in various industries.



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