

M&A Opportunities with Distressed Companies

Identifying M&A Opportunities in the Distressed Marketplace

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May 25, 2010

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Identifying Opportunities to Buy/Sell Distressed Assets and Businesses

- I The state of the economy will continue to present buying and selling opportunities in the distressed marketplace for buyers and seller
 - z Banks “Amend, Extend and Pretend” - Banks in “forbearance” mode while looking for alternatives to losses
 - z Not as many large bankruptcies as expected (at least locally)
 - z Many businesses and their lenders yet to face reality of their situation, so opportunities in distressed marketplace should continue
- I Experience with the typical processes which distressed businesses go through will be key to unlocking value

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Identifying Opportunities to Buy/Sell Distressed Assets

- I Buyer's Market - Failing businesses can present opportunities for savvy buyers to grow their businesses by taking advantage of economic downturn
- I If now is the right time to expand your business, you can acquire assets or business capacity you need:
 - z Market Share – Established Customer Base, Geography
 - z Synergistic or Complementary Product Lines or Capabilities
 - z Valuable Capital Equipment, Inventory, Intellectual Property
 - z Proven Revenues and Cash Flow
 - z Human Capital – Management, Employees, Owners
 - z Desirable Premises/Leases

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Identifying Opportunities to Acquire Distressed Assets

- I Understanding Seller Motivations Can Be Key to Finding “Win-Win” Deals in the Distressed Marketplace
 - z Many Companies Highly Leveraged
 - Burdensome Bank Debt and Obligations
 - Onerous Leases/Rental Obligations
 - z Seller Values Not Always Measured in Cash
 - Business Owners Want to Reopen “Pay Window”
 - Freedom From Personal Guaranties
 - Consulting Contract for Owners; Jobs for Former Employees
 - z Need for Better Management/Structure
 - Lack of Effective Leadership or Solid Business Model

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Opportunities for “Pre-Bankruptcy” Distressed Transactions

- I Many businesses kept on “Life Support” - while Banks forbear to “Buy Time” to get to a sale/restructure
 - q Banks reluctant to book significant losses
 - q Banks agreeing to delay their exercise of remedies in exchange for certain concessions from their borrowers
 - q Banks seeking opportunities to achieve “going concern” value over “forced liquidation value,” but traditional financing is largely unavailable
 - q Bankruptcy or foreclosure alternatives may not provide bank ability to maximize value above liquidation value
- I Result - Opportunities for Transactions between Sellers and their Banks and Buyers Prior to Bankruptcy

Distressed Transactions Outside of Bankruptcy/Insolvency Proceeding

- I Advantages to M&A Transactions Outside of and Prior to a Bankruptcy or Other Insolvency Process/Proceeding (e.g., Assignment for Benefit of Creditors or Receivership)
 - q Can be “exclusive” and can be done quickly
 - q For Certain Buyers, “No Cash, No Problem” - Utilize Creative Financing Strategies
 - z Buyer “Assumption” of Bank Debt
 - z Leveraging Assets and Credit of Buyer Company
 - z Seller Notes and other “No Cash” Financing Alternatives
 - Sellers may be willing to “loan” entire sale value
 - q Throw Owners a “Lifeline” By Extinguishing Personal Guaranties

Risks to Consider For Transactions Outside of Bankruptcy

- I Distressed Transactions, Especially in a Down Economy, Often Present Challenges from Competing Interests
- I Seller Risks
 - q Board of Directors and officers have fiduciary duty to do what is in best interests of all creditors, not just shareholders
- I Buyer Risks
 - q Successor Liability Claims (including tax claims)
 - q Fraudulent Conveyance Claims
 - z "Actual" - Intent to hinder or defraud creditors
 - z "Constructive" - Acquisition for less than "reasonably equivalent value"
- I Possible Claimants Include: Lien Creditors, Taxing Authorities, Shareholders (who think Management Sold Out)

Mitigating Risks For Transactions Outside of Bankruptcy

- I **DO YOUR DUE DILIGENCE CAREFULLY!!!**
- I Purchase Assets and Avoid Liabilities
 - q Asset Purchase Agreement
- I Partner with the Right Business Advisor
- I Consult Experienced Legal Counsel

When the Bank Forecloses - Sales By Secured Creditors Under Article 9 of the Uniform Commercial Code

- I Select assets/collateral may be sold by secured creditor
- I Only personal property – not real estate
- I Only liens junior to seller senior secured creditor are wiped out
- I Bankruptcy filing (voluntary or involuntary) may stop the UCC Code Sale
- I Timing: 21-45 days

State Court Receivership

- I Court appointed third-party to operate and/or liquidate the assets
- I Driven by lenders seeking to protect collateral value pending foreclosure
- I State law driven
- I Court process

When the Company Gives Up - Assignments for the Benefit of Creditors (“ABCs”)

- I Typically a process for smaller distressed companies
- I Company assigns its assets to a third-party “fiduciary”
- I Differs from state to state - and state law driven
 - q Illinois – common law without court involvement
 - q Wisconsin, Michigan and Indiana – statutory with court involvement
- I Assignee/trustee/receiver liquidates assets and distributes proceeds in accordance with priorities of law
- I Timing: Typically sale is advertised and completed 30-90 days from assignment

Assignments for the Benefit of Creditors

- I Advantages:
 - q Significantly less expensive than chapter 11 bankruptcy proceeding
 - q Debtor can choose assignee/trustee/receiver
 - q Company can be sold as a going concern
- I Disadvantages:
 - q Selling “Free & Clear of Liens” Requires secured lender approval - cannot sell asset free of liens without lender’s consent or court approval
 - q Lack of transparency and court oversight may compel creditors to file involuntary bankruptcy

Bankruptcy Options

I Chapter 11 under the U.S. Bankruptcy Code

- Continue to Operate to Preserve Going Concern Value and Restructure/Reorganize or Sell to Buyer to Maximize Value to Creditors/Stakeholders
 - z Business continues almost as usual - and creditor actions “stayed”
 - z Current management continues to operate business – typically no trustee
 - z Preservation of valuable assets
 - z Court approval required for anything “out of the ordinary course of business” - including sales of substantially all of business assets
 - z Discharge or reduction of burdensome obligations
 - z Goal – plan of reorganization with restructured debt or going-concern sale of business

Bankruptcy Options

I Chapter 7 Under the U.S. Bankruptcy Code

- Business Shut-Down and Orderly Liquidation of Assets
 - z Trustee appointed – management terminated
 - z Distribution of proceeds to creditors in accordance with priorities of law
 - z Unsuccessful Chapter 11 cases can be converted to Chapter 7 cases

Bankruptcy Sales

I Section 363 Sales (Prior to or through a Bankruptcy Plan)

q Advantages:

- z Assets “cleansed” – sold “free and clear” of essentially all liens, claims, encumbrances and liabilities (few exceptions: i.e., environmental)
- z “Stalking horse” receives breakup fee (3% to 10%) and bid protection (cover breakup fee plus) if outbid at auction

q Disadvantages:

- z Typically public auction - Secured creditor may “credit bid” at auction
- z Transparency and court approval/oversight
- z Costs (e.g., professional fees)

q “Loan to Own” - DIP Lenders can credit bid to acquire assets

q Sales can be teed up pre-bankruptcy (but subject to other bids)

q Timing: 30-60 days from filing or shorter if exigent circumstances (e.g., GM and Chrysler sales < 2 weeks from filing)

For more information, contact:

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