



AMERICAN
BANKRUPTCY
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2020 Northeast Virtual Bankruptcy Conference and Consumer Forum

Business Breakout **Out of Workouts**

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 <p>AMERICAN BANKRUPTCY INSTITUTE</p> <h1>NORTHEAST VIRTUAL BANKRUPTCY CONFERENCE & CONSUMER FORUM</h1>	<h2>ABI NORTHEAST JULY 2020 OUT OF WORKOUTS</h2> <p>The Honorable James J. Tancredi U. S. Bankruptcy Judge District of Connecticut</p> <p>Elisabeth O. da Silva, CPA, CFF Partner DGC</p> <p>Sandra J. Vrejan Partner MORGAN, LEWIS & BOCKIUS LLP</p> <h3>JULY 29-30, 2020</h3>
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<h2>NORTHEAST VIRTUAL BANKRUPTCY CONFERENCE & CONSUMER FORUM</h2>	 <p>AMERICAN BANKRUPTCY INSTITUTE</p> <h3>JULY 29-30, 2020</h3>
<h4><u>AGENDA</u></h4> <ul style="list-style-type: none">➤ RECENT TRENDS IN WORKOUTS➤ CASH FLOW AND FINANCIAL CONSIDERATIONS➤ THE REEXAMINATION OF KEY BANKRUPTCY CONCERNS IN WORKOUTS IN THE COVID-19 ERA➤ LOOKING AROUND THE CORNER – WHAT’S NEXT?➤ Q&A	

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RECENT TRENDS IN WORKOUTS

- Expanded timing horizon for workouts due to uncertainty of recoveries during COVID
- Delays in audits of financial statements
 - Business
 - Risks and uncertainties
 - Subsequent events
 - Going concern
 - Auditor
 - Performing audits remotely
 - Emphasis of a matter
 - Scope limitations

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- Collateral valuations and reserves
- Valuations are depressed/declining
 - Deteriorating macro economic outlook
 - Risks and uncertainties
 - Access to capital
- Uncertainty and risk are correlated
 - Increase in risk
 - Increase in discount rate
 - Decrease in value
- Valuations that are not on the decline
 - Half year of actual results may indicate
 - Certain industries
 - Key players
 - Need evidence of these valuation outliers

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- Anti-cash hoarding covenants making a comeback
 - Impact on transactions that are not currently subject to full cash dominion cash management requirements
 - In conflict with management's cash cycle efficiency, liquidity management initiatives
- MAC defaults
 - Material adverse impact caused by COVID-19 pandemic on the seller's financial condition or operations
 - Adverse impact will persist for a significant period of time
- EBITDA add-backs
- Pre-petition super priority or amend and extend facilities
 - Recent covenant light lending facilities include head room to effectively allow certain lenders to lend in a senior position or for portions of a bank group to participate in amend and extend facilities

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- A borrower's ability to transfer assets to unrestricted subsidiaries (similar to J. Crew/Chewy/Neiman) creates pockets of unencumbered collateral that can serve as credit support for new lending facilities
 - Post-petition concerns
- Pre-petition Landlord collaborations
- Impact of PPP loans and potential Main Street Loans
 - Will forgiven PPP loans be pulled from CH 11 debtors
 - Use of proceeds limitations and claims of administrative and general unsecured credits on PPP funds

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CASH FLOW AND FINANCIAL CONSIDERATIONS

- Cash and cash flow are key
 - Financial ratios – red flags
 - Current
 - Operating cash flow to sales
 - Debt to equity
 - Difference between liquidity and solvency
 - Liquidity is a short-term measure – ability to meet current obligations (key ratios are current, cash, quick – the higher, the better)
 - Solvency is a long-term measure – ability to meet debts in long-term (key ratios are debt to equity, interest coverage, debt to asset – higher interest coverage and lower debt to equity indicate default is less likely)

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- Access to short term liquidity – PPP loans used appropriately?
- Access to capital – investors, opportunity
- Financial reporting and audit implications
 - Accurate, well-supported historical and current books and records
 - Quality of data
 - Support for management's assertions
 - Accounting estimates/management's judgment
 - Consistent with historical
 - In accordance with GAAP
 - Allowance for doubtful accounts
 - Inventory reserves
 - Contingent liabilities

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- Going concern analysis
- Goodwill impairment – Does future cash flow support the intangible assets
- Increased fraud risk
- Businesses may be delinquent on sales tax, withholding tax
- Business owners funding failing businesses

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**THE REEXAMINATION OF KEY BANKRUPTCY CONCERNS IN WORKOUTS
IN THE COVID-19 ERA**

- Preparations/Critical Strategic Assessments and Their Consequences
 - It's all about cashflow and its effect on the reorganization timeline!
 - Can EBITDA and available business models be revived with realistic prospects?
 - The decision to downsize, rightsize, cease operations, or create a flex business model must be made promptly with creditor review
 - Management's threshold challenge will be to access capital to operate and revive the business through the recovery period
 - A strategy which fails to soberly adjust executive compensation, staffing, perks, severance and excesses will invite an accelerated demise

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- What measures should be taken pre-filing or post-filing to minimize adverse consequences?
- Workforce considerations matter
- Mothballing and virtual business models may provide the only feasible model which preserves the future value of a core team, its infrastructure, distribution scheme and proprietary assets
- The motivations and capabilities of constituents as buyers/new equity have likely changed
 - Landlords and secured parties
 - Trade creditors/principal suppliers
 - Principal customer(s)
 - Core management
 - Opportunistic funds
 - Institutional lenders

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- The problems with valuations, closed markets and second waves of COVID will dampen alternatives and the vision to reemerge
- Who/How do you pay for the “opportunity” to reorganize, sell or orderly liquidate?
 - Is there adequate time to create value?
 - Stalking horses, key customers, secured lenders and opportunistic buyers as funding sources

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LOOKING AROUND THE CORNER – WHAT’S NEXT?

- Industries negatively impacted currently
- Industries with head winds
- Industries favorably impacted
- How to respond to unprecedented times?

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QUESTIONS?

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