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2021 Winter Leadership Conference

Understanding and Enhancing the Business Value of Post-COVID-19 Distressed Businesses

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Understanding and Enhancing Business Value of Post-COVID Distressed Businesses – Including Evaluating the Post-COVID Business Plan & Strategies to Preserve Value

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There are several key factors in understanding business values in a Post COVID world. For purposes of this panel, we will focus on how the three valuation approaches (income, market, and asset) are impacted by the COVID pandemic, how certain related methodologies to those valuations have changed (*from a company, lender, and advisor (legal/financial) perspective*), and some of the unique types of bankruptcy-related relief attributed to the COVID pandemic.

The following is an overview with additional subtopics that will be honed and developed, including in response to questions that will be framed and anticipated. *As with any educational panel, the views and topics covered by each of the panelists is presented solely for education purposes and does not reflect the views of their firms or that of their clients and nor should it be imputed to them or quoted in any fashion for purposes of existing or future matters.*

Part 1: Valuation Methodologies and Impacts

- *Subpart A: Expected or Required holding periods related to ROI.*
 - From the perspective of a buyer or financing partner, has the pandemic changed the expected holding period for a target interest?
 - How has the pandemic effected the return premium investors require for enduring illiquidity?
 - Relatively speaking, for returns on publicly-traded shares, an increasing premium for illiquidity would contribute to a higher marketability discount, while a lower illiquidity return premium would suggest a lower marketability discount.
 - What is really happening as a result of COVID relative to this specific subtopic.
 - Do companies/ lenders care or do they simply factor this into the risk / return profile as a risk in doing business in a post-COVID world?
 - Differences in impact on investments in different industries (*Restaurant/ Hospitality vs. Distribution/ Manufacturing companies*).
 - Panelists will share their respective deal reference points.
 - The impact of the pandemic on the likelihood of near-term sales of businesses and how that may impact the appropriate marketability discount (positive or negative impact of the pandemic).
 - *Subtopic – changing landscape for lending: ABL vs. Traditional Lenders*
 - *In the post-COVID market, more traditional based lenders are pursuing all types of lending, including ABL, which they may previously have avoided as too risky pre-COVID.*
 - *Discussion of impact*
- *Subpart B: Expected growth in value.*
 - How has the pandemic affected the expected capital appreciation over the anticipated holding period?

- If the discount used in the valuation of the business has increased, the resulting estimate of growth in value is likely higher as well, which may reduce the marketability discount.
 - Conversely, the pandemic may increase certain costs (i.e. labor shortages, supply chain, logistics/ freight, etc.), which could reduce the expected capital appreciation and thus would likely increase the marketability discount.
 - Policy Actions: Government actions have reduced interest rates, which reduced WACCs. Combined with additional liquidity that the government has provided to the market, this has created a period of generally frothy valuations, excess liquidity to be invested, and increased deal activity.
 - Increased Capital Availability: The liquidity has resulted in the accumulation of significant funds to be invested, which has created competition for deals¹
 - PE dry powder as of 3/31/21 was \$829 billion, higher than it has been.
 - After falling 7% in 2020, PE backed deals are expected to increase by 13% in terms of deal value in 2021. TTM Q3 PE deal value is expected to be up over 70% from the Q4'19-Q3'20.
 - Largest growth in IT, B2B, B2C. In deals over \$1 billion, those three sectors went from 54% of total deals in 2018 to 63% in 2019 to 69% in 2020 to 89% in YTD 2021.
 - Public Valuations have looked more and more attractive and therefore more and more companies are accessing the public capital markets. Since Q3'20, the dollar amount of PE exits through public offerings in each quarter has been higher than in any quarter since Q4'13. The dollar amount of PE exit value through public offerings in Q2 and Q3 2021 has been greater than that of the prior 7 quarters combined.
 - The ability to exit through the capital markets at good valuations will drive more PE deals as well. But how long will the environment last?
 - Due to their ability to increase deal speed, the infrastructure that has grown around them, and the increasing ease of their use, SPACs have experienced a significant increase from less than 20 SPAC listings per year in 2019 and before to 51 in 2020 and 123 in 2021.
 - More Debt: In Q2 and Q3 2021, the debt % of buyout financing was 48% and 50%, respectively, whereas it had stayed under 46% from Q4'19 to Q4'20.
 - In terms of understanding and enhancing value, does this imply that companies should be investing in ways to make themselves more deal / public listing ready?
- *Subpart C: Expected interim cash flows.*
 - How will the pandemic influence a company's ability or willingness or requirement to increase certain operating spend, thus potentially reducing the bottom line of profitability, which could in turn reduce dividends to shareholders?
 - If cash flow as a result of the pandemic has been reduced, and dividends are expected to be cut or suspended, the appropriate marketability discount should increase as it becomes a less attractive opportunity for a perspective buyer.

¹ Data source: Pitchbook's 2021 Q3 US PE Breakdown

- Pandemic has rewarded companies that have been able to show adaptability in both resilience of their supply chain and ability to shift in line with changes in consumer demand (i.e. away from work clothes towards workout gear)
- Another impact was the push to hold more cash / liquidity to weather storms in this unpredictable environment
- If investors believe that certain business models will be profitable post-COVID, are those investors willing to substantially reduce the view of value because of COVID impacts or do they perceive these impacts as temporary liquidity shortfalls which need to be funded but have little impact on long term value?

Part 2: Bankruptcy Related Relief As a Result of the COVID Pandemic

- Valuation Fights
 - Case examples
- Lease concessions / stagnation / COVID protections
 - Case examples (e.g. Models, 24HR Fitness)
 - Type of relief being seen, impact on the various constituents
 - Deferral vs. forgiveness (short term needs from landlords, i.e. coverage of expenses)
- Speed of cases: The Rise of the Pre-Pack on Steroids
 - Pre-solicitation vs. Pre-Pack (1 day cases – are they an anomaly or a sign of “more to come”)
 - Decline in the free fall case contrast to the middle of the road fast track cases like *Friendly's* (relying on pre-petition marketing; Pre-COVID would have been MUCH longer)
- Supply Chain Issues (non-bankruptcy/bankruptcy rights / recourse)
 - Current events of the supply chain crisis
 - Constituents and responses
 - Ultimate sellers are pivoting to keep supplying while still protecting rights
- PPP Loans/CARES/Debtor-challenges to Forgiveness: - PPP Loans / CARES / Debtor Challenges to Forgiveness - see article on "New Challenge for Debtors who received PPP Loans under the CARES ACT."

Part 3: Future Post-COVID 19 Environment – Constant Evolution Expected with Agility as the Only Response

- Future state will be directly impacted by continued technology issue (chip shortage), closures / openings of markets, schools, businesses
- Companies will need to build more resilience in their supply chains
- Some companies may need to become nimbler in terms of product offerings
- Is it now wise to retain more liquidity than before to weather unexpected bumps, make new investments, and avoid distress?
- Expected increase in additional competition in the middle market (with more high level and low level squeezing the middle)

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- Critical to stay well-informed of the many changes in market conditions and “new norms” to ensure they are able to develop reasonable and credible estimates of value for businesses.
- Critical to be agile in the analysis offered for clients

Faculty

Amir Agam, CIRA is a senior managing director in FTI Consulting, Inc.'s Corporate Finance & Restructuring practice in Los Angeles and has more than 17 years of experience advising senior management and creditors regarding companies that are stagnant or underperforming. He specializes in the revitalization of underperforming businesses, as well as in advising creditors and potential acquirers of financially distressed companies. Mr. Agam has been a financial advisor or Chief Restructuring Officer for Corinthian Colleges, THQ, Inc., Fresh & Easy, LLC and Fleetwood Enterprises, and worked on the turnaround plan of a Fortune 500 manufacturer of auto-related equipment. He is a member of ABI, the Association of Insolvency & Restructuring Advisors and the Turnaround Management Association, and in 2015, he was named one of the restructuring industry's "40 under 40" emerging leader service professionals by *The M&A Advisor*. Mr. Agam received his B.A. with honors in business-economics with a minor in accounting from the University of California and his M.B.A. with honors from the Wharton School at the University of Pennsylvania.

Jill B. Bienstock is a managing director with PwC in New York and heads its Bankruptcy Consultation & Facilitation Team. She previously was a partner with Cole Schotz P.C., where she focused her practice on a variety of areas, including creditors' rights, avoidance actions and reorganizations for both individuals and corporate entities. She has represented Fortune 500 companies, various debtors, secured and unsecured creditors, landlords, equipment lessors, restaurants, hedge funds and banks, creditors' committees and liquidating trustees, both in and out of bankruptcy court. Ms. Bienstock's work has been recognized in *New Jersey Super Lawyers* and *New York Metro Area Super Lawyers*. Prior to joining Cole Schotz, Ms. Bienstock was a judicial intern for Hon. Ronald J. Hedges, a magistrate judge in the U.S. District Court for the District of New Jersey and a summer associate for the firm. Prior to attending law school, she worked for a publicly traded company in its in-house legal department, supporting and managing its U.S. and out-of-country boards of directors, Section 16 pre-clearances and corporate governance initiatives, as well as the integration and training for new technology. Ms. Bienstock is admitted to practice in New York and New Jersey, as well as in the U.S. District Courts for the Southern and Eastern Districts of New York and the District of New Jersey and the U.S. Court of Appeals for the Second Circuit. She received her B.A. *magna cum laude* from Lafayette College, where she was a member of the National Honor Societies for Phi Beta Kappa, Sigma Delta Pi and Pi Sigma Alpha, and received her J.D. *cum laude* from New York Law School.

Chris Creger is a principal of CohReznick LLP's Restructuring & Dispute Resolution Practice in New York and provides financial advisory, business restructuring and transaction support services to corporations, debtors, bondholders, hedge funds, law firms, lending institutions, private-equity firms, secured lenders, unsecured creditors and other constituents. His industry experience includes media, consumer goods, distribution, retail, manufacturing, oil & gas, telecommunications, publications, textiles, health care, nonprofit and energy. Mr. Creger advises his clients on matters involving turnaround, bankruptcy, out-of-court workouts, litigation, lender and M&A due diligence, transactional support and profit improvement. His areas of expertise include liquidity/ vendor management, organizational and process reformation, capital-sourcing, and business and creditor workout/management/restructuring. Prior to joining CohnReznick, Mr. Creger built his career as a consultant with niche bankruptcy and turnaround consulting firms such as CR3 Partners, BDO Consulting and

Epiq Systems. He has served the New York Turnaround Management Association in various roles, including chair of the NextGen Committee. He also was an integral part of the deal team that was recognized as M&A Advisor's 12th Annual Turnaround Award Winner "Chapter 11 Reorganization of the Year." Other engagement honors include the 2018 Turnaround Atlas Awards for the Corporate Turnaround of the Year, and separately for the Energy Restructuring of the Year. Mr. Creger received his B.S. in financial economics from Centre College and a degree in international business and managerial finance from the University of Nicosia (Intercollege), Lefkosia, Cyprus.

Soneet R. Kapila is a founding partner of KapilaMukamal, LLP in Fort Lauderdale, Fla., where he focuses on litigation support, restructuring, insolvency, fiduciary and creditors' rights matters. He regularly advises clients about the insolvency implications involved in business transactions, and represents debtors, secured creditors and creditors' committees in formulating, analyzing and negotiating plans of reorganization. Mr. Kapila is a recognized expert in fraudulent conveyance, Ponzi scheme and insolvency issues. He has provided expert testimony and extensive litigation support services to law firms involving complex insolvency issues and in commercial damages. To that end, he has worked in conjunction with the SEC, the FBI and the U.S. Attorney's Office, and has served both as a consultant and expert witness for litigation matters in state and federal courts. Mr. Kapila is a federal bankruptcy trustee and has served as an examiner, chief restructuring officer, chapter 11 trustee, liquidating trustee, corporate monitor (SEC appointment), and state and federal court-appointed receiver of operating businesses in numerous matters in the Southern and Middle Districts of Florida. He has spoken to various groups, including New York Law School, St. Thomas University Law School, National Conference of Bankruptcy Judges, National Association of Bankruptcy Trustees, Receiver's Forum, Association of Insolvency and Restructuring Advisors, Florida Institute of Certified Public Accountants, National Business Institute, National Association of Bankruptcy Trustees (NABT) and ABI on topics related to insolvency, underperforming businesses and insolvency taxation. Mr. Kapila is a Fellow of the American College of Bankruptcy and was named best trustee in the *Daily Business Review's* "Best of 2012." He is also on the board of directors and is a past president and past chairman of the Association of Insolvency and Restructuring Advisors, co-chairs ABI's Southeast Bankruptcy Workshop, and co-authored *Fraud and Forensics: Piercing Through the Deception in a Commercial Fraud Case* (ABI 2015). Mr. Kapila received his M.B.A. in 1978 from Cranfield School of Management.