MorrisAnderson®
Maximizing Enterprise Value

RENAISSANCE

IN THIS ISSUE

2
From the Desk of Craig Pace

4
News Desk

5
New Engagements

6
The ROC of CROs

7
Is it Time for a New Kind of Automotive Supplier Workout?

Summer 2009

Polaroid moment: A Snapshot of the Bankruptcy Auction Process

by Mark Kalla, Partner, Finance and Restructuring, Dorsey & Whitney LLP and Annie Trimberger, Summer Associate, Dorsey & Whitney LLP

The recent recession and credit scarcity have combined to advance the time frame for auction sales under U.S. Bankruptcy Code Section 363. Despite the popularity of this bankruptcy acquisition mechanism, however, there are a surprising number of issues that can make the process negative for the parties involved. This article focuses on the recent 363 sale of the Polaroid Corporation's assets and highlights what can go right and what can go wrong in the auction sale process.

Mark Kalla, Partner
Dorsey & Whitney

The auction of Polaroid's assets in the Minnesota Bankruptcy Court developed in three separate phases. Prior to its bankruptcy filing, Polaroid had engaged an investment banker to find a buyer for the company. The company was running out of cash and, forced to resort to bankruptcy, promptly fixed a time for an auction of its assets.

Phase one of the auction lasted two days, after which a dispute arose about the propriety of the bidding procedures. The two remaining bidders had made substantial cash bids that excluded some valuable assets and gave the creditors equity in the acquiring company. Late in the bidding, the debtor added restrictions on how much equity bidders could include in their offers. The debtor had negotiated this equity cap with one of the bidders, and only gave notice of the cap to the other bidder near the end of the second day of bidding. That bidder objected to the "secret" agreement and made a bid in excess of the cap. The debtor, without a clear end to the bidding, closed the auction and sought court approval of the bid that conformed to the new equity cap. The other bidder and the creditors objected to the sale based upon the unfair process and argued that the higher equity bid was actually the highest and best bid.

In phase two, the bankruptcy court ordered a final sealed-bid auction between the two remaining bidders. After this sealed-bid deadline passed, the debtor determined that the "losing" bidder from phase one had clearly submitted the higher bid, and asked the court to approve that bid. Prior to the approval hearing, the "low" bidder proffered another $7 million in cash, after the clearly established deadline (and after learning it had lost the auction). Faced with the higher cash bid, the debtor changed allegiances once again, seeking approval of the late bid.

Frustrated by the process, the court ordered a third phase of the auction, this time in the presence of the court. The debtor set a limit on the equity amount each party could include in its bid, and for bidding purposes placed a value on such equity (valuing equity in each company at the same level). After hours of additional bidding, a Gordon Brothers Brands/Hilco Consumer Capital joint venture submitted a bid of the maximum equity allowed as well

Continued on page 3

RENAISSANCE

Since 1980, MorrisAnderson has been working with stakeholders to steer more than 1,500 underperforming companies toward operational and financial success. With an average of 25 years of real-world line management success, executives in finance, manufacturing, distribution and logistics, marketing and information systems are working in virtually every economic sector to maximize enterprise value.

Chicago

Name	Phone	E-mail
Dan Dooley*	(312) 254-0888	ddooley@morrisanderson.com
Jim Ross	(312) 254-0889	jross@morrisanderson.com
Howard Korenthal	(312) 254-0895	hkorenthal@morrisanderson.com
Ken Yager	(312) 254-0897	kyager@morrisanderson.com
Sid Lambersky	(312) 254-0893	slambersky@morrisanderson.com
Bernadette Barron*	(312) 254-0890	bbarron@morrisanderson.com
Dave Mack*	(312) 254-0939	dmack@morrisanderson.com
Dave Bagley*	(312) 254-0920	dbagley@morrisanderson.com
Bob Wanat*	(312) 254-0919	rwanat@morrisanderson.com
Tim Czmiel *	(312) 254-0880	tczmiel@morrisanderson.com
Ed Bidanset	(312) 254-0880	ebidansetIII@morrisanderson.com
Craig Pace	(312) 254-0935	cpace@morrisanderson.com
Jason Paru	(312) 254-0922	jparu@morrisanderson.com
Aaron Gillum	(312) 254-0925	agillum@morrisanderson.com
Alpesh Amin	(312) 254-0926	aamin@morrisanderson.com
Joel Dryer	(312) 254-0880	jdryer@morrisanderson.com
Paulina Caprio	(312) 254-0929	pcaprio@morrisanderson.com
Mark Iammartino	(312) 254-0933	miammartino@morrisanderson.com

New York

Name	Phone	E-mail
Domenic Aversa	(212) 867-6868	daversa@morrisanderson.com
Lance Miller	(212) 867-6868	lmiller@morrisanderson.com
Steve Agran	(212) 867-6868	sagran@morrisanderson.com

Atlanta

Name	Phone	E-mail
Rick Kazmier*	(678) 538-6678	rkazmier@morrisanderson.com
Alan Brumbaugh	(404) 915-0252	abrumbaugh@morrisanderson.com
Mike Musso	(678) 538-6678	mmusso@morrisanderson.com

Milwaukee

Name	Phone	E-mail
Phil Ostroski	(414) 289-7152	postroski@morrisanderson.com
Howard Korenthal	(414) 289-7152	hkorenthal@morrisanderson.com

Cleveland

Name	Phone	E-mail
Domenic Aversa	(216) 589-9440	daversa@morrisanderson.com
Mark Welch*	(412) 498-8258	mwelch@morrisanderson.com

Los Angeles

Name	Phone	E-mail
Sid Lambersky	(310) 403-7238	slambersky@morrisanderson.com

St. Louis

Name	Phone	E-mail
Larry Hennessy*	(314) 854-9191	lhennessy@morrisanderson.com
Daniel Wiggins	(314) 854-9191	dwiggins@morrisanderson.com

Florida

Name	Phone	E-mail
Alan Glazer	(561) 498-5620	aglazer@morrisanderson.com

*Certified Turnaround Professional (CTP)

Renaissance is published every spring, summer and fall by MorrisAnderson. No charge for subscriptions to qualified individuals.

Marjorie Dunn, Editor & Publisher
mdunn@morrisanderson.com

Editorial and design: The Simons Group

For subscription information or service, or for hard-copy single copies or back issues, please contact Charlene Zielinski at (312) 254-0947 or e-mail czielinski@morrisanderson.com

Change of address: Send old and new addresses to *Renaissance*, c/o Charlene, 55 W. Monroe, Suite 2500, Chicago, IL 60603, or send all old and new contact information by e-mail to updates@morrisanderson.com.

©2009 All rights reserved. The contents of this publication may not be reproduced in whole or in part without the consent of the publisher.

PDFs are available at http://www.morrisanderson.com/newsletter/Default.asp.

From the Desk of *Craig Pace*

A Year in the Life (and Death)

Craig Pace
Consulting Manager
cpace@morrisanderson.com

Most of us have friends or relatives who refuse to go to the doctor, despite the body's overwhelming indication that something is wrong. Take my grandmother. "You know, it shouldn't hurt that much to breathe," I tell her. "Oh, it's nothing serious," she responds with a laugh. "I just won't breathe." But she doesn't realize the irony of her joke. Grams is still kicking, but maybe not for long. And something tells me that, like most of MorrisAnderson's clients, if she would just seek help sooner, she could extend her life and enjoy the present. In other words, more quantity and quality.

I have been in turnarounds for a little over a year now. And I've learned that our clients are a lot like Grams in that they lack a few things when it comes to self-preservation: A willingness to acknowledge fault in the current situation, planning, speed and aggression.

The first requirement is willingness to accept fault. Grams won't admit that it was years of smoking, lack of exercise and stress that got her into this mess. And most of our clients won't either. In 12 engagements, I've had only one client state, "It's our fault. It's not the bank or the economy. It's due to our poor planning and execution."

The second requirement is planning. Many middle-market companies think about the day-to-day stuff and neglect longer-term planning. Stephen Covey wrote about it in, "The Seven Habits of Highly Effective People," but it applies to companies, too. Both spend too much time on activities that are seen as "Urgent" but "Not Important." As a result, companies often find themselves in near inescapable positions. One auto supplier client that had been around for almost 30 years had never used financial information for forecasting

Continued on page 7

The Bankruptcy Auction Process, continued from page 1

as substantial amounts of cash. The debtor, for the third time, sought court approval of the competing bid, which had a higher cash component.

Again, despite the debtor's support, the creditors objected, stating that the Gordon Brothers/Hilco bid was higher and better because it was more valuable than the amount attributed to it. Ultimately, the court deferred to the arguments of the creditors, approving the sale to Gordon Brothers/Hilco.

It could be argued that this auction was a great success because of the ultimate price obtained; however, the auction was possibly in jeopardy on several occasions.

To ensure the success of a 363 sale, the parties must make efforts to notify all creditors and potential bidders, strategic and financial. The parties must inform the creditors and the judge of the nature of the expediency and the efforts made to give notice. Additionally, all parties should be given the same information. One key to maximizing the benefits of the auction is selecting an appropriate "stalking horse" — a bidder willing to commit to a certain sale price, often based upon limited due diligence. The stalking horse often wants the protection of break-up fees in the event that it is overbid, but it also has the benefit of a head start on due diligence in what is usually a quick process. The seller will often seek to minimize those protections because they discourage other bidders.

The parties should pay careful attention to the bid procedures, since a 363 sale should be framed so that bidders can rely on the approved procedures. If one party can manipulate the procedures or has special advantages, it undermines the process integrity, and bidders may walk away. The bid procedures should be transparent, but should also retain flexibility for the debtor to apply or waive them.

Although the debtor will obtain an order approving bidding procedures, it is not always in the debtor's best interest to strictly follow its own procedures. A bidder may accept non-complying bids or consider bids for a modified package of assets, and may insert modification rights within the bid procedure itself. For example, this "escape hatch" clause was written into the bidding procedures in one recent case:

> "If a party approaches the Debtor prior to the commencement of the auction without having submitted a bid, but is able to establish its financial wherewithal to consummate a transaction and is willing to make an offer on substantially the same terms as set forth in a previously proposed Transaction which the Debtor has deemed a qualified Bid, the Debtor may deem such party to have provided a Bid such that it may take part in the Auction."

Remember, the judge determines the highest and best bid, and a cash bid not complying with procedures, but of a higher *value*, may be approved.

Joint bidding can augment a sale, but collusive bidding can destroy it. Collusive bidding may result in the sale being avoided, as well as damages, attorney's fees, costs and expenses. Under Section 363, a trustee may avoid a sale when the price was controlled by an agreement among bidders. Note that not all agreements are prohibited. In *Lone Star Indus., Inc. vs. Compania Naviera Perez Companc*, the court ruled that "An agreement to 'control' the sale price is very different from an agreement that 'affects' the sale price." The court noted that a prohibition on all agreements that affect the sale price would cover a vast range of innocent agreements among potential bidders and would be very hard to enforce.

In most cases, it will be advantageous to set the price of certain assets that bidders may leave behind. If the bidders are bidding equity or have non-cash elements to their bids, the debtor should try to establish the value of such elements before bidding starts, rather than try to determine the value of each component during the auction. Usually, creditors will protect their best interests and determine which bid is highest. Ultimately, as in the Polaroid example, the judge determines which bid is the highest and best, and it may not always be the bid with the highest amount of cash. But for the purposes of conducting an orderly, efficient auction, the parties should agree, as much as possible, how to value all non-cash items prior to bidding. The debtor should also determine whether a secured creditor can bid in the amount of debt it is owed by the debtor for the purchase price of assets to be sold.

U.S. Bankruptcy Code does not spell out in any detail how an auction or sale should be conducted under Section 363. Many such auctions fail, and others seem to succeed where they might have been more successful. The key to a successful auction is notice and clarity in the auction process.

Mark J. Kalla

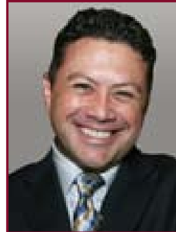
Mr. Kalla is a partner in the Finance and Restructuring Department of Dorsey & Whitney LLP. He focuses on bankruptcy and workout matters, corporate bond defaults and representation of various entities in commercial disputes, as well as the documentation of asset-based loans, including debtor-in-possession financing.

kalla.mark@dorsey.com
612.343.7961

NEWS DESK

Dan Dooley, principal and COO of MorrisAnderson, will speak on the topic of "Selling Distressed Businesses" at the Wisconsin Business Brokers & Intermediaries event on Sept. 15. Dooley will also be a panelist at the National Conference of Bankruptcy Judges Conference in Las Vegas on Oct. 20. The panel will discuss "Employment Issues in Chapter 11." In July, Dooley participated as a panelist at the American Bankruptcy Institute's Southeast Bankruptcy Workshop. The "Jumping the Queue: Administrative, Priority and Reclamation Claims in Chapter 11 Cases" panel addressed how to deal with issues related to "special" unsecured claims from the perspective of the debtor, committee and individual creditors.

Ken Yager, a principal of MorrisAnderson, participated in the "Surviving and Thriving in a Down Economy" panel sponsored by the Exhibit Designers and Producers Association's Midwest Chapter on July 20. Yager also participated as a panelist for the Turnaround Management Association's (TMA) program on July 14th at Oakton Community College in Des Plaines, Ill., where he discussed, "Early Warning Signs of Company Distress…What You Can See Coming." His other recent speaking engagements included moderating a panel on distressed investing at the Federal Reserve Board of Chicago Private Equity Event on June 26.



Paulina Caprio, a consultant with MorrisAnderson's Chicago office, co-chaired the TMA Women's Power Connections Networking Luncheon held at the East Bank Club on June 17. Caprio also co-chaired the TMA-Chicago Women's Dine Around event on April 27, which was held in conjunction with the TMA Spring Conference. *See photo at right.*

RECENT PROMOTIONS

Domenic Aversa has been promoted from managing director to principal. Aversa, who currently heads up MorrisAnderson's Cleveland office, will also expand his responsibilities to include overseeing the firm's New York office. Since joining MorrisAnderson, Aversa has worked on several high-profile projects in the Cleveland area, gaining national media attention for his turnaround work for Norwalk Furniture. He was one of 12 business professionals recently selected to Turnarounds and Workouts' 2009 "People to Watch" list and was recently featured in a Forbes magazine article.

HAPPY RETIREMENT

Chicago-based Managing Director **Robert Morris** recently retired after more than 11 years with MorrisAnderson. A prominent author and lecturer, Morris is one of a very small number of professionals holding triple certification as a Certified Turnaround Professional, a Certified Insolvency & Restructuring Advisor and Distressed Business Valuation. He will now split his time between his Chicago and Florida residences. Everyone at MorrisAnderson wishes Bob a very happy retirement!

New to MorrisAnderson

Paulina Caprio has joined MorrisAnderson's Chicago office as a consultant. Caprio is a seasoned finance professional with experience in business development; turnaround and change management; strategy and analysis; valuation; operational streamlining and optimization; and leadership and management. Her background includes working as a portfolio manager at Spot Trading LLC in Chicago, where she launched the company's first long-short equity portfolio, and working as a risk arbitrage and distressed debt analyst with Gabriel Capital LLC in New York City.

Mark Iammartino has joined MorrisAnderson's Chicago office as a consultant. Iammartino has more than 10 years of consulting and general management experience, providing a wide variety of lenders and investment managers with detailed, in-depth financial and operational analysis. His specific focus has been in developing and executing due diligence and company evaluations in relation to the origination and surveillance of debt investments, as well as the identification of transaction risks and mitigating factors. The analysis he has provided has been across a wide variety of industries located domestically and internationally. Prior to joining MorrisAnderson, Iammartino was a Senior Manager at Ernst & Young, where he managed the credit due diligence service line. He also worked as a senior consultant with the Transaction Advisory Group at Arthur Andersen.

New MorrisAnderson Engagements

Real Estate Developer Portfolio Assessment

We are assisting a $600 million real estate developer with an estate portfolio assessment that will likely result in a going concern sale.

Trucking Company Assessment

A regional trucker with $50 million in sales has sought our expertise in an assessment and workout.

Metal Stamper Restructuring

We are assisting an $80 million, multi-plant metal stamper by facilitating a wind-down of money-losing plants and a restructuring of remaining operations.

Software Company Wind-down

Taking on the role of trustee, we are leading the wind-down of a $10 million computer technology software business.

Professional Staffing Turnaround

After conducting a company assessment, we are facilitating the turnaround and debt restructuring of an $85 million professional staffing company.

Trucking Company Representation

We provided lessor representation and loan recovery options for an $11 million trucking equipment leasing company.

Electronics Distributor Assessment

Our bank group representation will aid in assessing the financial and operating condition of a $750 million electronics distributor.

Concrete Company Liquidation

We are leading the liquidation of a $25 million concrete fabricator's multi-site operation.

Consumables Company Assessment

We are assessing the financial and operating condition of a honing, abrasive equipment and consumables company with $75 million in sales.

Catalog Distributor Advisory

An $80 million clothing, bedding and cosmetics catalog distributor employed our financial advisory services.

Restaurant Chain Restructuring

We are leading a $100 million restaurant chain through the restructuring process, resulting in an improvement in cash flow.

Motor Sports Company Capital Acquisition

A $10 million motor sports company sought our guidance in new capital acquisition.

Coal Mining Company Wind-down

We conducted an assessment of financial and operating conditions, as well as the subsequent wind-down of operations, for a $200 million coal mining company.

Steel Fabricator Bankruptcy

Acting as financial advisor to the unsecured creditors committee, we assisted the creditors in a $112 million steel fabricator through Chapter 11 bankruptcy.

Grocery Distributor Financial Advisory

We are acting as bank group financial advisory for a $600 million grocery distribution co-op during bankruptcy proceedings and liquidation of the company's assets.

Wood Products Fabricator Assessment

We provided cash flow projection for a $12 million wood products fabricator.

Furniture Manufacturer Sale

After a thorough assessment, we guided a $30 million furniture manufacturer toward stabilization and a subsequent going concern sale.

Cosmetic Manufacturing Turnaround

A $60 million cosmetic manufacturing company sought our assistance with a turnaround, interim management services and asset sales.

Medical Products Manufacturer Restructuring

We are assisting a $220 million medical products manufacturer with an assessment, profit improvement and restructuring.

Ethnic Foods Distributor Accounting

We are assisting a $60 million ethnic foods distributor with an accounting and reporting clean-up.

Military Housing Products Supplier Acquisition Plan

We are developing and implementing an acquisition due diligence and post-acquisition production integration plan for a $250 million military housing products supplier.

Construction Products Company Section 363 Sale

A construction products company with $250 million in sales hired us as financial advisor to facilitate a Section 363 sale.

Commercial Printer Assessment

Acting as bank group representation, we assessed the financial and operating condition of a $100 million commercial printer.

Return on Capital From Hiring a Chief Restructuring Officer: The ROC of CROs

Part 2 of the "Confusion About Turnarounds and Crisis Management" Series

by Ken Yager, Principal of MorrisAnderson

Ken Yager, Principal
kyager@morrisanderson.com

When interviewed about an ideal plan of action for distressed portfolio companies, investors often say they would select one of the following: 1) support the company with more money and stay with the same chief executive officer (CEO) who took the company into crisis, or 2) hire a growth-oriented CEO from the industry who just needs more time and money to fix the problems.

Seasoned turnaround consultants argue that it makes more sense to get the right interim help and retain existing management. Private equity groups are driven by return on capital (ROC), and this choice is a classic ROC optimization exercise.

We can summarize these choices with the example of two investors. Investor A has a $20 million investment in a $50 million purchase price on a company with $10 million in earnings before interest, taxes, depreciation and amortization (EBITDA). Investor A theorizes that it can sell the company in three years for $75 million on EBITDA of $15 million. Investor B has the same opportunity. Unfortunately, in both cases EBITDA has dropped to $5 million, increasing senior debt to six times EBITDA and impairing equity value. Things are now getting uncomfortable for management and the owners as the company begins to slip into crisis, or a "Stage 3" turnaround (Stage 1 = re-engineering opportunities and Stage 2 = the classic turnaround).

Investor A reacts flawlessly to its lenders' demand that it rectify the situation or lose the company. Over a 90-day period, it finds the perfect replacement executive(s), removes existing management and supports the company with a capital infusion of $3 million that had been earmarked for an acquisition. The new management battens down the hatches for about a year, changes the direction of the company, and the investor sells the company for $75 million three years later.

Investor Outcome: Time Equals Money
$ in millions

Group	Purchase	Investment	Debt	EBITDA Last Year	EBITDA Now	New Cost	EBITDA Terminal	Terminal Value	Years to Realize	Cash on Cash ROI	NPV
Investor A	$50	$20	$30	$10	$5	$3.1	$15	$75	3	$51.93	$25.85
Investor B	$50	$20	$30	$10	$5	$0.5	$15	$75	2	$54.50	$32.63
Variance	$0	$0	$0	$0	$0	$2.6	$0	$0	1	($2.58)	($6.79)

Notes and Assumptions

(1) Cost of Capital 10%

(2) Debt is not amortized during investment

(3) Initial investment is one year old at time of "New Cost" above

Investor B takes a different approach. A chief restructuring officer (CRO) is hired to work with management for a few months, and management modifies its behavior and plan of action in the short term. The situation is improved in about four months as the company moves away from crisis. Interim management costs the company $500,000, all paid out of its cash flow. Management stays on, and the company is sold in two years for $75 million.

In the Investor A example, after the original 90 days to find replacements, it took the new management team a year to work through its turnaround. The replacements were unwarranted because they led to unforeseen risks, such as an unnecessary change in business model, an employee continuity gap, customer relationship risks and a loss in vendor leverage. This meant investors had to put $3 million into the company. Plus, hiring management cost an additional 30 percent of their first-year salaries.

Investor B gained nearly a year by supplementing management and avoiding the need to infuse the $3 million in capital. While the company did incur the cost of a CRO, during the sale process two years later it was able to claim that expense as a one-time cost and was therefore not penalized in the final purchase price. Investor B was further rewarded due to the continuity of management, which accelerated the due diligence process and made the buyer more comfortable.

Crisis is not a time to play with modest modifications in strategy or lengthy planning and execution horizons. Companies in covenant default are in crisis mode, which is often outside the normal domain of almost all management teams. Unless management wants to spend all of its time in an extended battle of half measures with uncertain outcomes, then briefly expanding the team with a CRO is a wise decision with an extremely high ROC. Once a company uses the CRO to solve its problems, it can move on with the investment thesis.

Is it Time for a New Kind of Automotive Supplier Workout?

by Robert Wanat, Consulting Manager at MorrisAnderson

Robert Wanat
Consulting Manager
rwanat@morrisanderson.com

The demise of automotive suppliers has become so common that it rarely even makes cable TV. But there is breaking news worth paying attention to: Detroit original equipment managers (OEMs) are showing signs of adopting a more accommodating attitude when suppliers enter bankruptcy or restructuring.

The "Detroit 3," or D3, has long approached automotive supplier workouts and reorganizations in an atmosphere of hostility. A recent case, however, hints at an attitude change that may benefit all parties involved in the automotive supplier restructuring.

A primer on workout approaches

Three operating strategies are available when any company goes into a workout: the good, the bad or the ugly.

"The ugly" is an approach where all constituents are adversarial, funding is pulled, access and accommodation contract clauses are exercised, and business interruption is the norm. Workout costs are high and the constituents rarely recoup all of the cash expended during the proceedings.

"The bad" is a hostile environment where trust and cooperation do not exist and everyone lobbies to improve their individual position at the expense of others. Workout costs are very high, the process takes many months or years, and all constituents end up with little to no positive financial realization.

In a "good" workout, consensual restructuring takes place based on mutual trust and respect, resulting in a financially equitable transition with minimal business interruption. Frequently, this approach can be accomplished quickly, outside of a reorganization bankruptcy filing. This is the optimum approach.

The typical D3 workout approach has been "the bad," and the result is a very costly, protracted bankruptcy that consumes large amounts of cash and time with no benefit to the constituents. Recent experience suggests, however, that positive change may be on the horizon. Hope lies in the preplanned, consensual workout that is executed outside a bankruptcy filing for as long as possible, and that benefits all constituents, not just the D3.

In most cases, a cooperative restructuring can be executed in 75 to 120 days without the upfront costs or delays of a filing. At the end of the workout process, everyone gets what they set out to achieve: The OEM/customer maintains a continuous supply of fairly priced parts; the secured lenders have maximum collateral preservation; unsecured creditors gain incremental revenue; and the suppliers survive.

Case A — The bad

A multi-plant automotive supplier found itself in a workout after taking on several transfer tooling jobs in six months, replacing three bankrupt suppliers. Margins turned out to be too thin, but requests for pricing relief from the D3 failed, and the supplier was unable to break even. With no success from the friendly negotiations route, the supplier was forced to file Chapter 11 bankruptcy.

Immediately, the D3 sent in attorneys and financial advisors who made demands for more parts, faster delivery and expedited order processing. The release of debtor-in-possession (DIP) funding was delayed several times by one of the D3. Expedited freight costs soared, more DIP financing was required, and the vicious cycle continued.

Continued on page 8

From the Desk of Craig Pace, continued from page 2

purposes. In the latest crisis, they were blindsided when their revolver availability ran out.

The third is speed and aggression. A recent client had an 80-year operating history. In 2008, a terrible year for most companies, their sales were down a mere 3 percent. But the bank's perception of the riskiness of the company's operation and customer base changed with the economic decline. The company was told its loan would not be renewed. Rather than tighten up, they dragged their feet. By the time we were called in, the bank was out of patience. We cut more than half the employees and saved the company close to $2.5 million in annual payroll. But without long-term funding, they were forced into a fire sale at a much lower multiple than they would have been able to achieve otherwise.

The message is this: Get professional advice at the first sign of trouble. It is one thing to regret spending a few bucks to find out all is okay. It's quite another to find out you waited too long. Indeed, it can be a matter of life and death.

A New Kind of Automotive Supplier Workout, continued from page 7

At the end of the process, everyone lost. The $6 million in DIP financing was not repaid, the estate paid $4 million in professional fees at the expense of the creditors, and 1,000 people lost their jobs. The company ended up paying a new supplier a 15 percent unit price premium to re-source the needed volume. Almost $10 million in out-of-pocket cash was lost because the D3 chose an adversarial approach.

Case B — The good

Case B shows there can be a less traumatic restructuring alternative. This supplier lost more than 50 percent of its volume in less than a year, ultimately deciding it was time to sell, merge or liquidate the company. It became apparent a new business partner was not a viable alternative, so the supplier went to Plan B: an orderly wind-down.

The supplier laid out detailed operating plans, production schedules and financing requirements to support the D3 customers' volume needs through the workout/wind-down time frame. This approach ensured an uninterrupted supply of parts for the D3 and allowed them time to find suitable replacement suppliers without interrupting operations.

The secured lenders agreed to "stand still," allowing the supplier to use cash generated in normal-course activities to support the wind-down. The D3 agreed to cash-in-advance terms for all new production shipments and cleaned up all outstanding accounts receivable balances in exchange for tooling releases on a pay-as-you-go basis. Accounts payable were frozen and suppliers agreed to cash-on-delivery terms. The property, plant and equipment were put up for sale to maximize value for all stakeholders.

Bottom line: This "good" wind-down strategy worked. The D3 got the needed parts without any business interruption; the tooling was transitioned smoothly to the new suppliers; the secured lenders were paid out; and once the PPE is sold, the unsecured creditors should realize 30 to 60 cents on the dollar. The out-of-pocket expense for Case B should be less than $500,000, and the entire process required about 75 days to complete.

The orderly wind-down is by no means a perfect solution, but it yields a much better result for all constituents. No one wants a supplier to have a financial crisis, but behaving in a hostile manner only makes the restructuring more costly and time consuming.

Time for a new workout paradigm

A new workout process paradigm is needed. Auto supplier workouts should be a four-way process (involving the D3/OEM, the supplier, lenders and vendors), jointly orchestrated for the benefit of the whole. Will the D3/OEM or the mega suppliers agree to say goodbye to the old ways of conducting a workout? Only time will tell, but at least all constituents should be able to agree that drawn-out cases and costly bankruptcy filings benefit no one.

55 W. Monroe, Suite 2500
Chicago, IL 60603

Return Service Requested

Route to:

- ☐ ____________________
- ☐ ____________________
- ☐ ____________________