Distressed Company M&A: Approaches & Current Issues

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I. Introduction

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Focus for Today

- A private company target still operating to be acquired
- Target's liabilities more than (current) enterprise value
- Target is not (yet) in bankruptcy
- Today:
  - Distressed Company M&A Outside of Bankruptcy
  - Distressed Company M&A In a Bankruptcy
  - Comparison

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II. Distressed Company M&A Outside of Bankruptcy

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Non-Bankruptcy

- Impact on Buyers: Equity Deals
  - Negotiated workouts with creditors
- Impact on Buyers: Asset Deals
  - Creditor Successor Liability Claims
    - Higher risk for tax, pension, environmental and other favored creditors
  - Creditor Fraudulent Transfer Claims
    - Claim that Buyer did not pay “reasonably equivalent value”
    - Creditor leverage and time to assert
    - Buyer defenses

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Non-Bankruptcy

- Other Impacts on the Negotiated Sale
  - Focus on liabilities
  - Getting value to owners
  - Indemnities
  - Price terms, including escrows/holdbacks and earnouts
  - Process
- Risk of Bankruptcy Filing Post-Sale
  - Incentives to avoid bankruptcy/handle fraudulent transfer claims

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Non-Bankruptcy

- Other Non-Bankruptcy Sale Alternatives
  - Foreclosure Sale: extinguish liens but liability risks
  - Receivership/Assignment for Benefit of Creditors
    - Limited “free & clear”
  - Combined Private Sale & Subsequent Liquidation
    - Notice from Assignee
    - Notice of Voluntary Dissolution

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III. Distressed Company M&A in Bankruptcy

Bankruptcy

- Overview
- Sale through a Bankruptcy
  - Creditor “stay” to help stabilize the Target
  - Facilitate transfer of key contracts/leases
  - Sell without creditor (or equity) consent
  - Ability to cherrypick assets to buy
  - Other:
    - “Conflict” sales: Sales to insiders, parties wearing multiple hats
    - Management bonuses pre-filing

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Bankruptcy

- Sale Methods
  - (Slower) sale under a “plan of reorganization”
    - Longer Process
    - Chance for some exclusivity
    - Must resolve creditor fights before sell
  - (Quicker) “363” asset sale
    - Most common method employed in bankruptcy cases

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Bankruptcy

- 363 Sale Timeline Example with a "Stalking Horse"

Period	Action
30-60 Days Pre-Filing	Stalking Horse Buyer lined up after a marketing process
1-5 Days Pre-Filing	Conditional APA signed with proposed sale process terms
Filing	Chapter 11 bankruptcy filing
Next 20-30 Days	Court hearing and orders on APA, sale process terms and related matters
Next 30-60 Days	Continued marketing to find other qualified bidders
Next 10-15 Days	Public auction for qualified bidders to determine "highest and best" bid(s) -Often apples vs. oranges bids -May include creditors credit bidding
Next 1-5 Days	Court hearing and sale order
Next 1 to 15 Days	Closing

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Bankruptcy

- Stalking Horse Buyer in a 363 sale
  - Commitment to buy at a floor price
  - No real exclusivity only some process protections
  - At auction, Stalking Horse Buyer can increase its bid over its floor
  - Stalking Horse Buyer protections if overbid at auction
    - Including a fee of 2% to 4% and/or (partial) expense reimbursement
  - Advantages/disadvantages for being the Stalking Horse Buyer
  - Impact of credit bids

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Bankruptcy

- Impact on Successful Bidder in a 363 Sale
  - Negatives:
    - Typically no indemnities or holdbacks/escrows
    - Typically no earnouts or non-cash consideration
    - Need to address cure costs on assumed contracts/leases
  - Positives:
    - Court order on free and clear transfer of assets
    - No fraudulent transfer risks
    - Unassumed liabilities: Not a Buyer concern (limited exceptions)

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Bankruptcy

- Other Key Impacts/ Strategies for Buyers
  - Post close bankruptcy continues
    - Transition Services
    - Access to Records
  - Preference Claim Waivers
  - New: Reps and Warranty Insurance

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IV. Comparison

Process & Deal Terms

Legend
Positive
Neutral
Negative

Matter	Non-Bankruptcy Sale	Bankruptcy-363 Sale
Target and Buyer Control Over Process	Substantial (subject to potentially reaching accommodations with creditors)	Limited (dictated by the Court with substantial input from creditors)
Buyer Deal Exclusivity	Common to grant Buyer exclusivity	None (or very limited for Stalking Horse)
Public Deal Process	Private or semi-private	Very public
Timetable to Closing	Varies but can be very fast	Typically months
"Stalking Horse" Buyer	Not used	Very common (may be Overbid anytime)
Reps and Indemnities for Benefit of Buyer	Possible (but Owners may have no incentive to provide)	-May be some reps pre-closing -Typically no reps survive closing
Escrows/Holdbacks and Earnouts	Possible (but disfavored by creditors)	Typically none (highest and best bid)
Due Diligence Importance	Very important to critical	Critical (and often constrained other than for Stalking Horse Buyer)

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Protections & Results

Legend
Positive
Neutral
Negative

Matter	Non-Bankruptcy Sale	Bankruptcy-363 Sale
Creditor Stay Pre-Closing	None	Yes (which can be critical to keeping the business alive until closing)
Third Party Consents to Assign Desired Contracts	Required if anti-assignment or change of control clauses	Limited rights of contract parties to object if cure amounts addressed
Equity Deal-Buyer Exposure for Unpaid	Full exposure to all creditors, so requires creditor accommodations pre-closing	363 usually involves asset sales
Asset Deal- Creditor Priorities & Payments	Often requires Buyer involvement	Not a Buyer concern (Court process determines distributions post-closing)
Asset Deal-Buyer Exposure for Unpaid	Risks of fraudulent transfer claims post-closing (if no accommodation pre-closing)	None (with limited exceptions)
Buyer Certainty on Getting Clear Title	Risks of fraudulent transfer claims post-closing (if no accommodation pre-closing)	Full with Court order approving the sale free and clear

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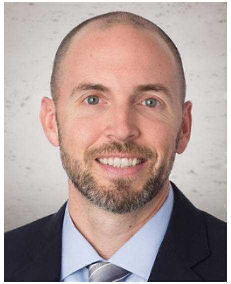

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