

Protecting the Balance Sheet

**How Accountants and Other
Trusted Advisors Can Protect
Clients**

October 21, 2020



Panel:



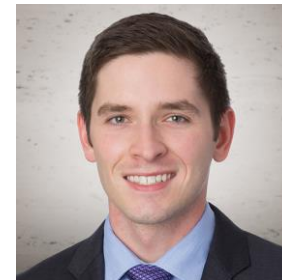
Patrick Finn
(651) 323-2260
pfinn@lighthousemanagement.com



Alex Dybsky
(651) 323-2266
pfinn@lighthousemanagement.com



James Brand
(612) 492-7408
jbrand@fredlaw.com



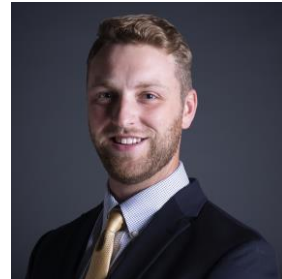
Sam Andre
(612) 492-7080
sandre@fredlaw.com



Clint Cutler
(612) 492.7070
ccutler@fredlaw.com



Austin Becker
(651) 323-2262
abecker@lighthousemanagement.com



Josh Clark
(651) 323-2269
jclark@lighthousemanagement.com



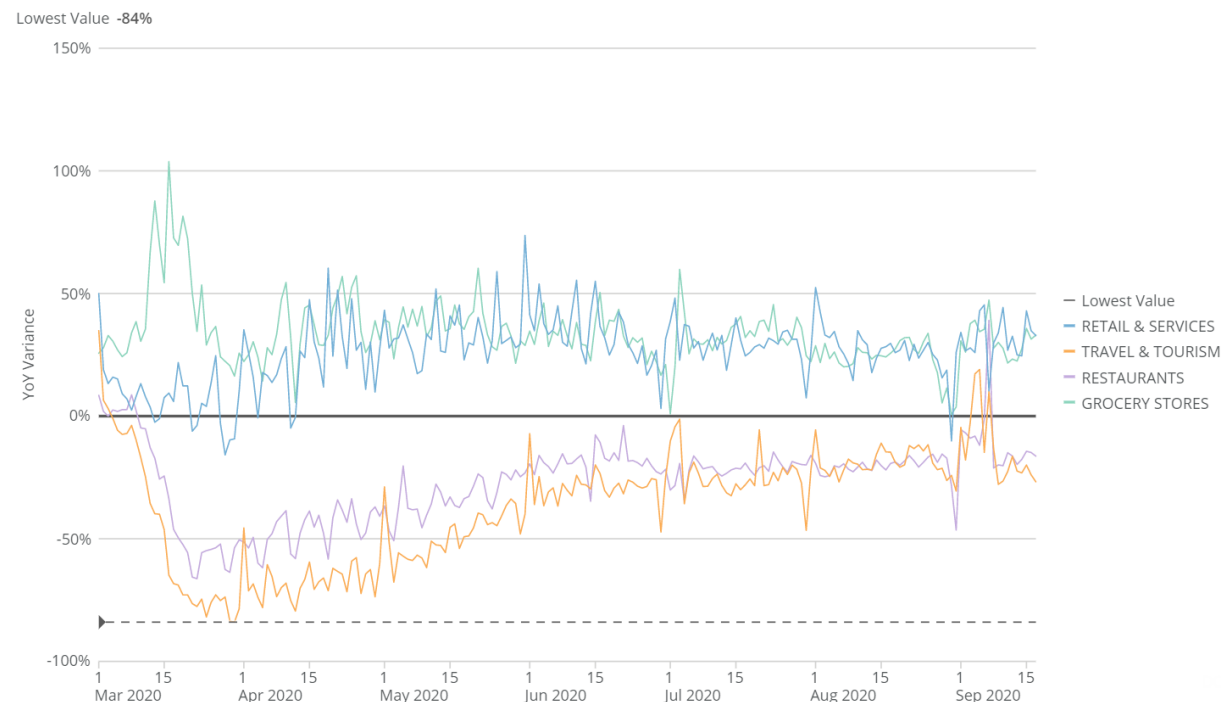
Turbulent Times/COVID-19

Almost All Industries Impacted

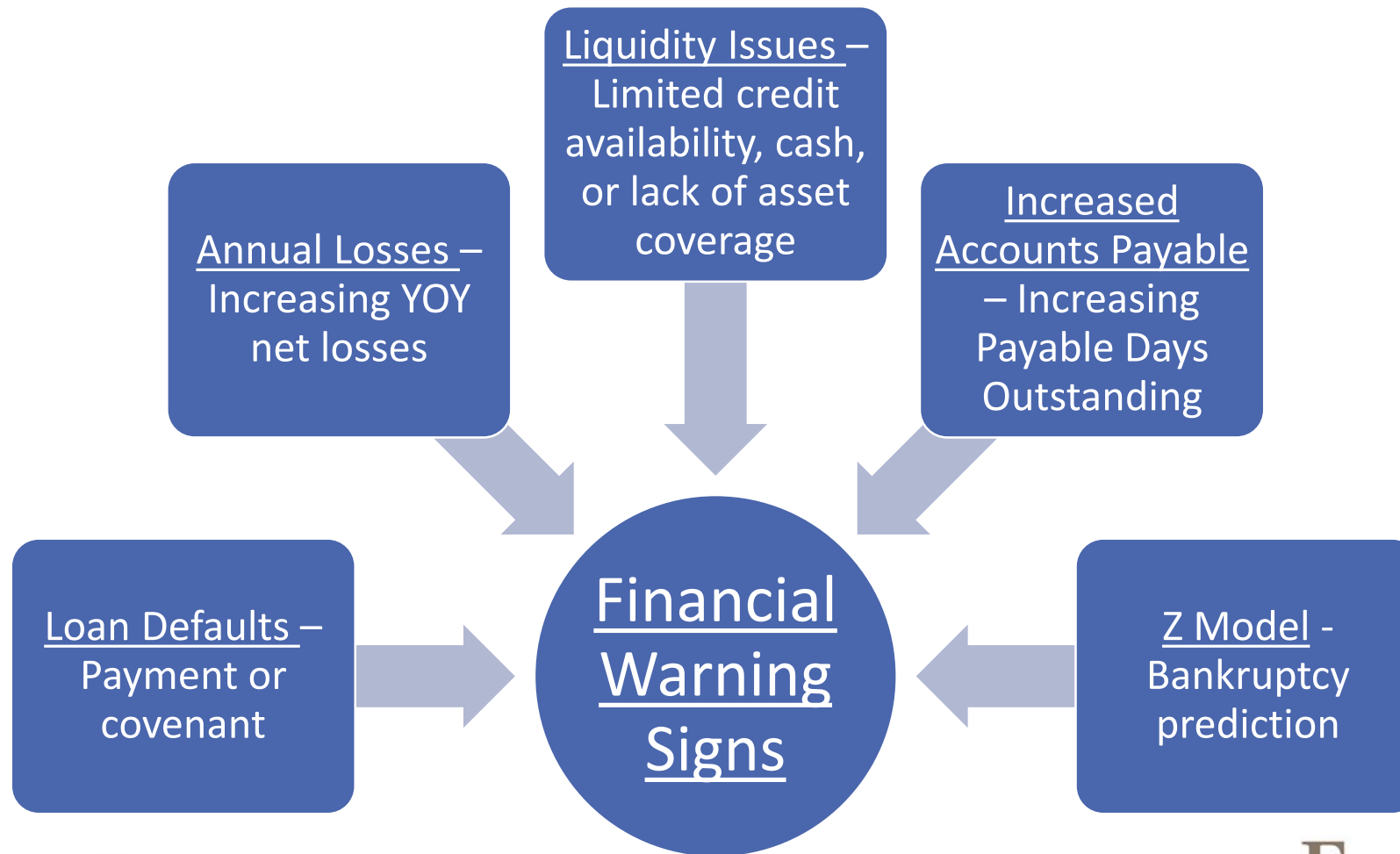
- Not All Impacts are Negative

Industries Acutely Affected Include:

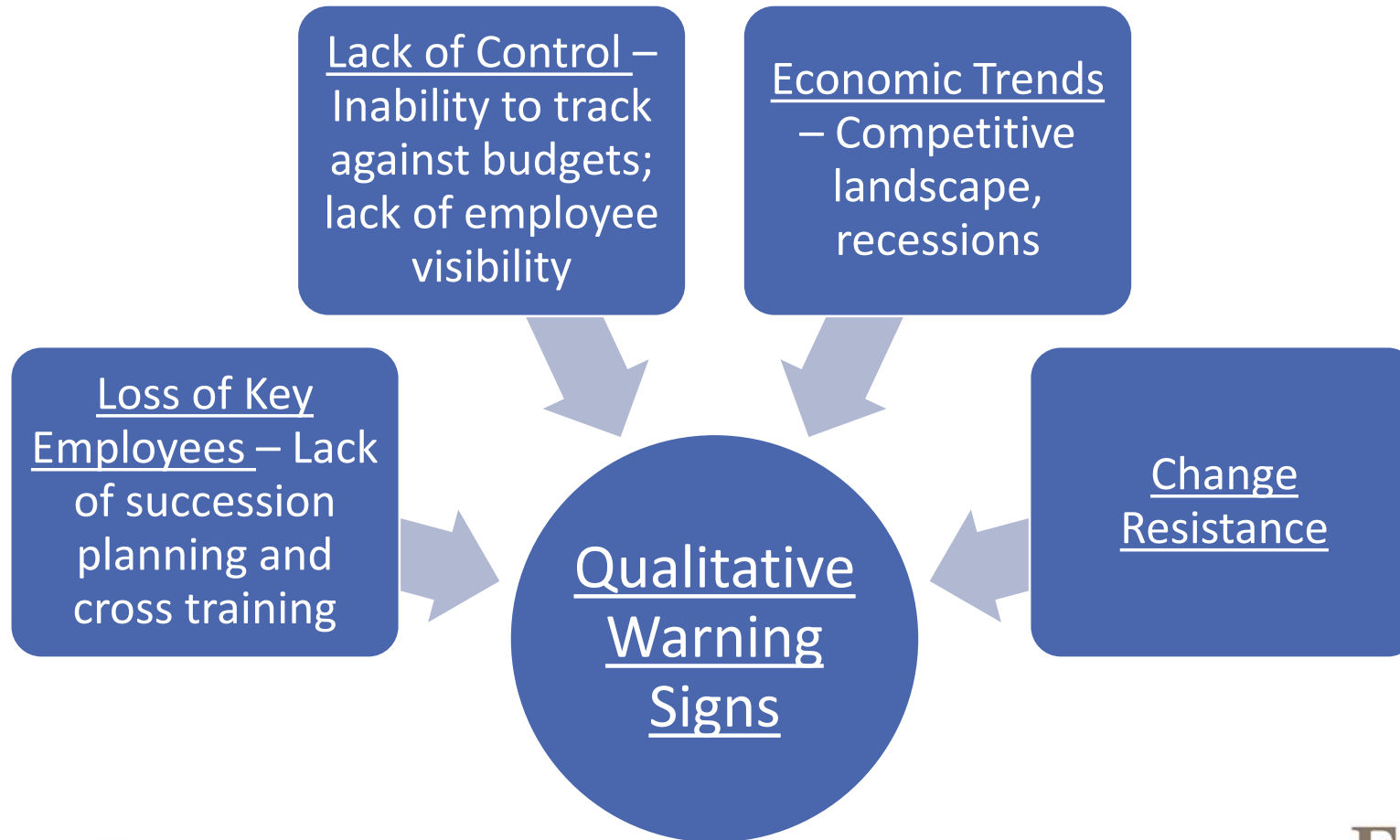
- Travel/Hospitality
- Restaurants
- Retail
- Commercial Real Estate
- Higher Education



Early Warning Signs



Early Warning Signs



Role of Professionals—Financial Advisor

Financial Advisor Role

- Credibility – track record of performance and relationships
- Fresh and unbiased review with realistic assumptions
- Change Agent

Financial Advisor Process

- Viability/Financial Assessment
- Assess Operational Issues
- Evaluation of Strategic Alternatives
- Communication with Stakeholders Including Lenders
- Implement Plan

Role of Professionals—Legal Advisor

Legal Advisor

- Credibility
- Attorney-Client Privileged Communication
- Respond to Creditor Actions
- Evaluation of Strategic Alternatives
- Communication with Stakeholders
- Implement Plan

Role of Professionals—Accountant

Accountant

- Trusted Advisor and Advocate
- Source of Information and Background
- Evaluation of Strategic Alternatives
- Financial Reporting and Tax Matters
- Change Agent
- Fresh Start Accounting

Accountant Considerations

Retention and Payment Considerations

- Retainer
- Risk of Non-payment
- Risk of Claw-back
- Bankruptcy & Receivership/Process for Retention and Payment

Viability/Financial Assessment

Cash Flow and Liquidity Analysis

- Rolling 13-Week

Asset and Collateral Valuation

Liquidation Analysis

- Baseline for Alternatives

Availability of Additional Capital Sources

ABC Company

Thirteen-Week Cash Flow Projection

Example Format

Period	1	2	3	4	5
Week Ending:	5-Sep	12-Sep	19-Sep	26-Sep	3-Oct
1 Accounts Receivable	1,032,192	655,333	1,035,000	1,499,129	904,200
2 Orders Shipped	-	-	-	-	-
3 Other Cash Receipts					300,000
Operating Cash Receipts	\$1,032,192	\$655,333	\$1,035,000	\$1,499,129	\$1,204,200
4 Materials and Inventory	348,420	425,000	572,895	942,858	958,040
5 Wages and Benefits	172,500	550,000	172,500	550,000	172,500
6 Rent & Occupancy	300,000	25,000	-	-	300,000
7 General & Admin	25,000	38,500	35,000	20,000	175,000
8 Professional Fees	50,000	25,000	-	-	75,000
9 Operating Cash Disbursements	\$895,920	\$1,063,500	\$780,395	\$1,512,858	\$1,680,540
10 Term Debt & Leases	86,220	81,398			86,220
11 LOC Interest	41,000				41,043
12 Line of Credit (Advance)/Pay down					
13 Financing (Receipts)/Disbursements	\$127,220	\$81,398	\$0	\$0	\$127,263
14 Net Cash Receipts/(Disbursements)	\$9,052	(\$489,565)	\$254,605	(\$13,729)	(\$603,603)
15 Ending Cash Balance	\$517,592	\$28,027	\$282,632	\$268,903	(\$334,700)

Evaluating Company Performance

Can conduct preliminary solvency tests in order to evaluate current company performance and stability.

If company performance is deteriorating and some or all warning signs are present, should conduct:

- Cash flow and liquidity analysis.
- Asset and collateral valuation.

Questionnaire		
1. Margin sustainability and/or volatility	No	▼
<u>2. High leverage or other financial risk</u>	Yes	▼
3. Rapid growth/acquisition	No	▼
	No	▼
4. Physical expansion into new geographies (sales or production)		
5. Change in direction or product lines	No	▼
<u>6. Changes in management structure, the ability of new management, or succession</u>	Yes	▼
<u>7. Industry changes or volatility, such as: buyer power, supplier power, industry entrants (competition), industry consolidation, and potential product obsolescence</u>	Yes	▼
8. Lack of asset coverage	No	▼

Basic Solvency Tests

Tests

- Balance Sheet Test
- Cash Flow Test
- Adequate Capital Test

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES (DEBTOR-IN-POSSESSION)
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	June 30, 2020	December 31, 2019
(\$ in millions)		
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents (\$2 and \$2 attributable to our VIE)	\$ 82	\$ 6
Accounts receivable, net	513	990
Short-term derivative assets	—	134
Other current assets	95	121
Total Current Assets	690	1,251
PROPERTY AND EQUIPMENT:		
Total Property and Equipment, at Cost	34,947	34,748
Less: accumulated depreciation, depletion and amortization ((\$748) and (\$713) attributable to our VIE)	(29,255)	(20,002)
Property and equipment held for sale, net	10	10
Total Property and Equipment, Net	5,702	14,756
Other long-term assets	161	186
TOTAL ASSETS	\$ 6,553	\$ 16,193
LIABILITIES AND EQUITY (DEFICIT)		
CURRENT LIABILITIES:		
Accounts payable	\$ 39	\$ 498
Current maturities of long-term debt, net	1,929	385
Accrued interest	3	75
Short-term derivative liabilities	—	2
Other current liabilities (nominal and \$1 attributable to our VIE)	418	1,432
Total Current Liabilities	2,389	2,392
Long-term debt, net	—	9,073
Long-term derivative liabilities	—	2
Asset retirement obligations, net of current portion	209	200
Other long-term liabilities	8	125
Liabilities subject to compromise	8,135	—
Total Liabilities	10,741	11,792
CONTINGENCIES AND COMMITMENTS (Note 5)		
EQUITY (DEFICIT):		
Chesapeake Stockholders' Equity (Deficit):		
Total Chesapeake Stockholders' Equity (Deficit)	(4,209)	4,364
Noncontrolling interests	21	37
Total Equity (Deficit)	(4,188)	4,401
TOTAL LIABILITIES AND EQUITY (DEFICIT)	\$ 6,553	\$ 16,193

Thirteen-Week Cash Flow Projection

Management Decision Making

- Identify cash shortfalls & borrowing needs
- Accelerate receivable collections
- Prioritize payables
- Instills discipline

Lender & Stakeholder Communication

- Provides insight to projected exposure
- Can be used to convince lenders or stakeholders to continue funding

Forbearance Agreements

- Establish terms under which lenders will advance funds

Bankruptcy Cash Collateral Orders

- Can be incorporated in order as budget for post-petition funding

The screenshot displays an Excel spreadsheet titled "Thirteen-Week Cash Flow Projection" for "ABC Company". The spreadsheet is organized into columns for each week from 05-Sep to 28-Nov, plus a "Total" column. The rows are categorized into "Operating Cash Receipts", "Operating Cash Disbursements", "Financing (Receipts)/Disbursements", and "Net Cash Receipts/(Disbursements)". The "Ending Line of Credit Balance" is shown at the bottom of the main table. Below this, a "Borrowing Base Calculation" section details the components of the borrowing base, including "Orders Shipped", "Collections", "Ending Receivables", "Ineligible Receivables", and "Borrowing Base Availability @ 80%". The final row shows the "Availability Remaining" for each week.

	05-Sep	12-Sep	19-Sep	26-Sep	03-Oct	10-Oct	17-Oct	24-Oct	31-Oct	07-Nov	14-Nov	21-Nov	28-Nov	Total
Operating Cash Receipts	\$1,032,192	\$655,333	\$1,035,000	\$1,499,129	\$1,204,200	\$829,700	\$1,845,542	\$1,304,800	\$897,894	\$1,670,045	\$1,421,100	\$825,000	\$679,200	\$14,899,135
Operating Cash Disbursements	\$895,920	\$1,063,500	\$780,395	\$1,512,858	\$1,680,540	\$1,101,868	\$1,147,000	\$1,087,200	\$349,903	\$1,115,000	\$1,117,592	\$1,478,730	\$927,310	\$14,257,816
Financing (Receipts)/Disbursements	\$127,220	\$81,398	\$0	\$0	\$127,263	\$81,398	\$0	\$0	\$0	\$208,661	\$0	\$0	\$0	\$625,980
Net Cash Receipts/(Disbursements)	\$9,052	(\$408,565)	\$254,605	(\$13,729)	(\$603,603)	(\$553,566)	\$698,542	\$217,600	\$547,991	\$346,384	\$303,508	(\$653,730)	(\$248,110)	\$15,379
Ending Line of Credit Balance	8,437,268	8,026,833	8,672,228	8,685,957	9,289,560	9,643,126	8,944,584	8,726,984	8,178,993	7,812,609	7,529,101	8,182,831	8,430,941	
Borrowing Base Calculation:														
Orders Shipped	1,300,000	992,300	950,000	965,665	929,800	1,027,700	956,400	1,073,500	716,140	1,250,000	1,250,000	1,250,000	1,250,000	
Collections	(1,032,192)	(655,333)	(1,035,000)	(1,499,129)	(904,200)	(829,700)	(1,845,542)	(1,304,800)	(897,894)	(1,670,045)	(1,421,100)	(825,000)	(679,200)	
Ending Receivables	13,426,926	13,763,893	13,678,893	13,145,429	13,171,029	13,369,029	12,479,887	12,248,587	12,066,833	11,646,788	12,263,788	11,533,788	14,763,788	
Ineligible Receivables	(939,885)	(963,473)	(957,523)	(920,180)	(921,972)	(935,832)	(873,592)	(857,401)	(844,678)	(815,275)	(858,465)	(945,965)	(1,033,465)	
Borrowing Base Availability @ 80%	\$9,989,633	\$10,240,336	\$10,177,096	\$9,780,199	\$9,799,246	\$9,946,558	\$9,285,036	\$9,112,949	\$8,977,724	\$8,665,210	\$9,124,258	\$10,054,258	\$10,984,258	
Availability Remaining	\$562,732	\$73,167	\$327,772	\$314,043	(\$289,560)	(\$643,126)	\$55,416	\$273,016	\$798,730	\$832,601	\$1,470,899	\$817,169	\$569,059	

Altman Z-Score

Used as early predictor of bankruptcy/insolvency

Equation: $Z = 1.2A + 1.4B + 3.3C + .06D + 1.0E$

- A = Working Capital/Total Assets
- B = Retained Earnings/Total Assets
- C = Earnings before Interest and Tax/Total Assets
- D = Market Value of Equity/Total Liabilities
- E = Sales/Total Assets

Different weighted equation for different industries

- Was originally created to analyze public manufacturing firms with assets greater than \$1MM
- Later was modified to be applied on a broader scope

Example: Chesapeake Energy

- Filed for Bankruptcy on April 1, 2020.
- Z-Score from '17-'19 all indicate financial condition of company is in "Distress Zone"

Zone	Range
Distress Zone	$Z < 1.8$
Grey Zone	$1.8 < Z < 2.99$
Safe Zone	$Z > 3$

- Distress Zone - indicates a high probability of financial distress
- Grey Zone – indicates there is a good probability of company going bankrupt within the next two years of operations
- Safe Zone – company is considered "Safe" based on the financials

Z-Score for Chesapeake			
\$CHKAQ - Chesapeake			
	12/31/2019	12/31/2018	12/31/2017
Working Capital	(1,141)	(1,230)	(831)
Total Assets	16,193	10,947	12,425
A	(0.07)	(0.11)	(0.07)
Retained Earnings	(14)	865	949
Total Assets	16,193	10,947	12,425
B	(0.00)	0.08	0.08
EBIT	(31)	1,577	1,519
Total Assets	16,193	10,947	12,425
C	(0.00)	0.14	0.12
Market Value of Equity	1,665	1,957	3,617
Total Liabilities	11,792	10,480	12,797
D	0.14	0.19	0.28
Sales	8,489	10,231	9,496
Total Assets	16,193	10,947	12,425
E	0.52	0.93	0.76
Z - Score	0.44	1.40	1.21

Questions?

Thank you!