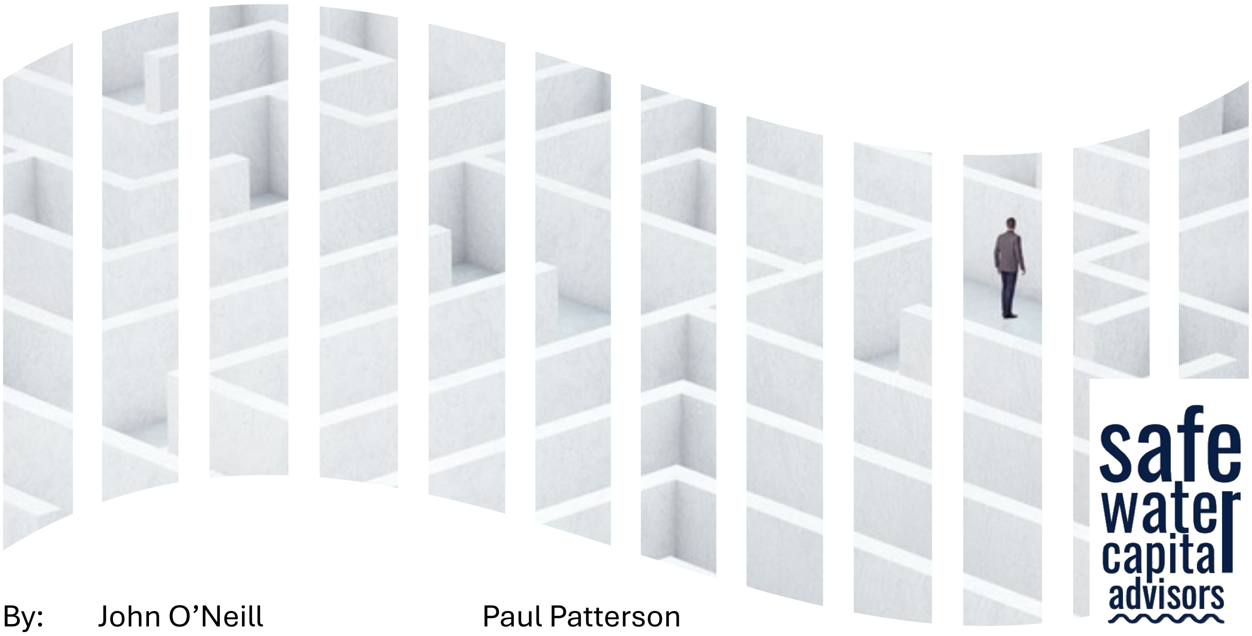
NAVIGATING SPECIAL SITUATIONS

--- A Business Owners Guide ---



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Many business owners have recently found themselves in unfamiliar territory. As 1) the economy slows, 2) interest rates remain high, and 3) the banking industry continues to suffer through a crisis in confidence, some underperforming companies are finding that they have been assigned to a <u>workout lender</u> inside the bank. This is often tied to a default under a **fixed charge coverage covenant**. <u>This is the point where a professional restructuring advisor should be engaged</u>.

Workout lenders are often motivated to, quickly and efficiently, remove credit exposure from the bank's balance sheet. This can is easily accomplished by: 1) a **liquidation**, 2) a **note sale**, or 3) an **M&A** transaction. This becomes a "**Distressed**" **transaction**, as equity value is assumed to be zero. The difference between a distressed transaction and a "**Special situations**" **transaction** is that the latter will consider 4) **refinancing** and 5) **restructuring** alternatives which can provide significant value to the stakeholders and equity holders.

As opposed to a CRO, a special situation investment banker will consider the full gambit of financial restructuring alternatives, from 1) refinancing to 2) mezzanine financing to 3) minority equity to 4) out-of-court sales to 5) 363 bankruptcy sales. This expansion of strategic alternatives becomes a **<u>valuable option</u>** to existing ownership within the process. Although equity value is still very much at risk.

The special situations deal team must have an in-depth knowledge of accounting, legal, commercial banking, restructuring, and regulatory issues, as well as strong analytical skills and a deep understanding of capital markets. For this reason, these transactions are typically avoided by mainstream investment banks.

Whether your business is only experiencing some level of "lender fatigue" or having more serious issues, this guide aims to equip you with the knowledge needed to make informed decisions.

Leverage Points for Business Owners

Borrowers may have limited leverage based on the reputation risk to the creditor, or potential lender liability issues. No bank wants somebody bad-mouthing them in the market or at the local country club. This goes back to the "**N**o **C**ash for **N**o **B**ody" slogan that dogged NCNB after they bought First Republic Bank and moved into Texas. Lender liability is a complex and time-consuming litigation process that is difficult to quantify. Nevertheless, this type of leverage can buy additional time which again can also be a **valuable option** within the process.

Conditions to Derail a Transactions

When significant additional liquidity is required prior to a transaction, bankruptcy may be the only realistic option. There are plenty of negatives associated with bankruptcy, but a big positive is the automatic stay on debt payments that frees up liquidity. Special situations bankers will try to anticipate liquidity issues and address them to avoid a "free fall" bankruptcy filing. Fortunately, lenders are typically not big fans of bankruptcy, because they lose control of the process.

Knowing When to Engage an Advisor

Recognizing the signs that indicate the need for professional assistance is crucial. Some early signals would be:

- As soon as it becomes evident that the bank is not continuing with "**business as usual**." This may be tied to a line of credit renewal request or a minor covenant breach waiver or amendment.
- Lenders often require execution of forbearance documents with **full release language**, which can result of the loss of critical rights or other potential leverage for the borrower.

When these early signals surface, seeking legal and financial advisors is crucial. **By retaining legal and financial advisors early in the process, there are more options to protect total value within an ultimate transaction**. The experience and expertise of seasoned advisors enable them to negotiate with lenders objectively, which should result in better outcomes.

Choosing the Right Advisor

Selecting the right advisor is paramount in navigating distressed situations. Look for an advisor with true availability (bench strength), credibility with lenders, bankruptcy experience, and the proper securities licenses. While evaluating an advisor's track record and experience in similar transactions is somewhat valuable, their credibility with lenders should be a primary consideration. Industry knowledge and an extensive network of contacts can be helpful, particularly when dealing with strategic players. Often a special situations advisor will partner with an industry expert in a transaction, in order to maximize value and timing.

If you need a consultation or guidance regarding a potential distressed or special situation, we would be happy to provide more detail.

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