ASK THE EXPERTS WEBINAR

Navigating Change in a Distressed Environment

February 2020

PRESENTERS

James Lee *EXECUTIVE MANAGING DIRECTOR, RIVERON*

Years of Experience: 25+

Expert Areas: Public accounting, corporate finance, private equity and financial leadership with a strong emphasis in energy

Paul Jansen *MANAGING DIRECTOR, CONWAY MACKENZIE*

Years of Experience: 17+

Expert Areas: Energy, turnaround & restructuring, interim-management (CRO, CFO), valuations, and fiduciary services

Scott Mell *SENIOR MANAGING DIRECTOR, RIVERON*

Years of Experience: 24+

Expert Areas: Restructuring, business transformations, distressed financing & M&A, interim-management (Chief Restructuring Officer, Chief Transformation Officer)

Capital market transactions, M&A buy side due diligence, carve-out and divestiture activity, fresh start accounting, business enterprise and commodity derivative val

PRESENTERS

Zac McGinnis *MANAGING DIRECTOR, RIVERON*

Years of Experience: 17+

Expert Areas: Capital raising assistance, carve-out and pro forma financial statements, business combination and divestiture matters, IPO readiness, GAAP change and conversions, and audit assistance

Damon Kade *MANAGING DIRECTOR, RIVERON*

Years of Experience: 21+

Expert Areas: Business transformations, technology program management, supply chain, back office optimization, and EBITDA lift

Jason Tucker *MANAGER, RIVERON*

Years of Experience: 6+

Expert Areas: Capital market transactions, M&A buy side due diligence, carve-out and divestiture activity, fresh start accounting, business enterprise and commodity derivative valuation, data analytics, advanced modeling, transformation advisory

KEY REMINDERS

- Riveron webcasts – past and upcoming
- 4 polling questions must be answered to obtain CPE
- If you have questions, feel free to ask in Q&A option in Zoom
- Webinar evaluation form & CPE certificate will be emailed to you
- On demand video is not eligible for CPE
- You will receive a follow up email including:
  - Access to this webinar recording and deck
  - The ability to join our Webinars Mailing list to receive future invites
  - Presenter contact info

AGENDA

INTRODUCTION & REMINDERS

BANKRUPTCY OVERVIEW

FRESH START FINANCIAL REPORTING

EMERGENCE READINESS

Q&A

Polling Question 1

Which factors does your organization view as the biggest potential threat to continued profitability growth?

A. Interest rates

B. Geopolitical factors

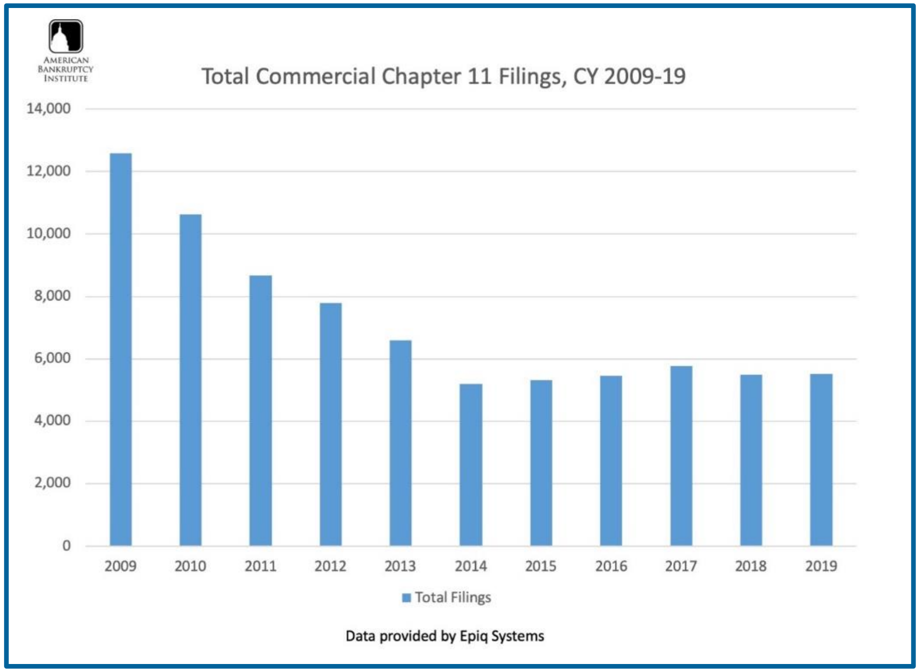
C. International trade wars

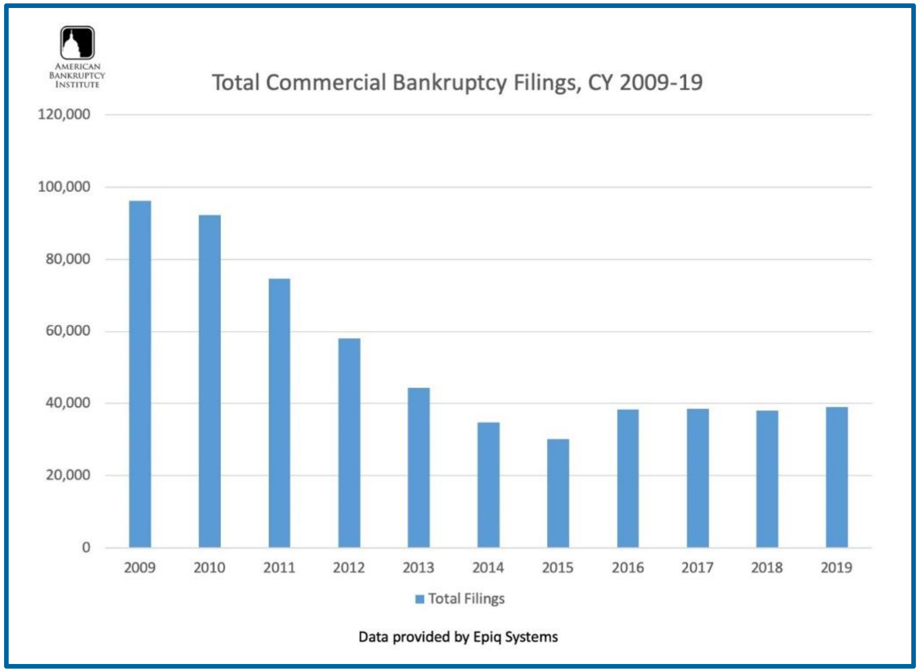
D. Labor market

E. Other

RECENT BANKRUPTCY FILINGS

- Commercial Chapter 11 bankruptcy filings in the US have been relatively flat since 2016 with approximately 5,500 per annum
- The ~5,800 commercial Chapter 11 filings in 2019 were significantly less than equivalent filings during the last meaningful economic downturn in 2009 (12,000+ filings)
- In addition, commercial Chapter 11 filings in January 2020 were up 72% YoY (630 filings) which equates to a ~7,500 run-rate for 2020





CHAPTER 11 INTRODUCTION

What is Chapter 11?

Chapter 11 under the Bankruptcy code gives a company some breathing space while it works on reorganizing its business. Chapter 11 allows a company to continue normal business operations while it reorganizes.

What is the difference between Chapter 11 and Chapter 7?

Under Chapter 11, a business continues to operate and reorganize. Management remains in control of the company. Under Chapter 7, a business closes, and a trustee is appointed to manage the liquidation process.

What is the goal of a Chapter 11?

The goal of a Chapter 11 case is for the company to work with creditors to restructure debt and ultimately develop a "plan of reorganization" that includes the terms of the debt restructuring and also explains how creditor claims will be satisfied.

How long does Chapter 11 take?

Chapter 11 reorganization cases can take anywhere from several months to several years.

BANKRUPTCY IN TODAY'S CONTEXT: CORE PRINCIPLES OF CHAPTER 11 RESTRUCTURING

Automatic Stay	▶ Creditors are prohibited, with few exceptions, from pursuing collection of any debt or claim that arose before the filing of the bankruptcy after chapter 11 petition is filed ▶ Gives debtor "breathing room" and ensures all creditors are treated fairly
"Debtor in possession"	▶ Companies maintain control of their business affairs during chapter 11, without the appointment of a case trustee ▶ Remains a "DIP" until the plan of reorganization is confirmed, the case is converted to a chapter 7, or a trustee is appointed
Maximize value of the estate	▶ Companies exit bankruptcy through a plan of reorganization ▶ The plan and steps leading up to it should seek to maximize the value of the estate, i.e., provide each credit class with the maximum total recovery possible
Elimination of pre-petition debts	▶ Plans of reorganization, once confirmed, typically provide for a discharge of all debts incurred by a debtor prior to filing unless otherwise specified in the plan ▶ Allows a debtor to reduce leverage and eliminate overhang of pre-petition obligations (e.g. asbestos litigation)
Equal treatment of creditors	▶ Within a given group of creditors (called a "class"), the plan of reorganization must provide the same treatment for each claim within that class ▶ Plans of reorganization must follow the "absolute priority rule" and distribute value according to priority of claims (discussed later in this document)
Other core proceedings	▶ Bankruptcy judges have wide latitude over a range of other proceedings that impact a debtor and its estate in addition to those listed above ▶ Areas of jurisdiction include (but not limited to) allowance of claims, obtaining credit, recovery actions, plan confirmation, use of cash collateral, and lien priority / validity

NEGOTIATING A DEAL PRIOR TO FILING, CAN SHORTEN THE TIME A COMPANY SPENDS IN BANKRUPTCY

	Overview	Typical Circumstances	Examples
Pre-packaged bankruptcy	▶ Plan negotiated and voted on by creditors before filing ▶ Shortest time spent in bankruptcy (<60 days)	▶ Significant pre-filing negotiating period ▶ Plan converts debt to equity & gives control to creditors ▶ Trade creditors unimpaired	Houghton Mifflin Harcourt LodgeNet connect | inform | entertain
Pre-arranged bankruptcy	▶ Plan is negotiated prior to the chapter 11 filing ▶ Votes solicited later ▶ Can exit in 4-6 months	▶ Liquidity or other constraints curtail pre-filing negotiations ▶ Shorter process pre-filing ▶ Confirmation is riskier because all votes not solicited	Charter Reader's Digest
"Traditional" chapter 11 bankruptcy	▶ Stakeholders unable to come to agreement on plan for sharing value ▶ Time spent preparing to enter, not to exit	▶ Large block of holdout creditors or other impediment to restructuring ▶ Disagreement on valuation ▶ Longer time in bankruptcy	Kodak Hostess Brands Hostess Wonder
Unplanned	▶ Emergency filing ▶ Chaotic first few days / weeks ▶ Frequently result in sale or liquidation	▶ "Run on the bank" or other liquidity crisis ▶ Difficult to retain employees and customers	Lehman Brothers MF Global Washington Mutual

ONE CRITICAL TOOL AVAILABLE TO DEBTORS SEEKING TO IMPROVE THEIR PERFORMANCE IS THE ABILITY TO REJECT UNFAVORABLE CONTRACTS AND LEASES

Overview of contract rejection

- Debtors generally have the **right to assume or reject** executory contracts and unexpired leases
  - Executory contracts are generally contracts with material obligations remaining unperformed on **both** sides
  - A debtor typically has until plan confirmation to decide whether to assume or reject executory contracts
  - Unexpired **commercial real property leases** must be assumed within 120 days, otherwise such leases will be deemed rejected
- This ability gives Debtors **tremendous leverage** with landlords and contract counterparties
  - Above-market leases can be **renegotiated or exited** without paying damages (which become an unsecured claims)
  - Debtor can use the **threat of using alternate suppliers** to secure concessions from contract counterparties

Rejection decision tree

Is contract **profitable (e.g. at or below market)** or **difficult to replace**?

YES

Assume the contract
- Debtor is bound by the contract and must perform
- Debtor must **cure any outstanding defaults** (pre or post-petition)

NO

Reject the contract
- Debtor is no longer bound by the contract
- Counterparty has general unsecured **"rejection damages" claim**

SELLING ALL OR PART OF A COMPANY USING BANKRUPTCY CODE SECTION 363 HAS BECOME INCREASINGLY COMMON OVER THE LAST 15 YEARS

Section 363 sale process

Hire investment bank	Market asset	Locate stalking horse bidder	Determine bidding procedures	Conduct auction

▸ Company hosts "beauty contest" where banks present their credentials, experience and approach
▸ Company selects investment bank tasked with selling the asset (sometimes the entire company)
▸ Some banks (e.g. Houlihan, Rothschild, Moelis) with significant distressed experience frequently win mandates in Ch. 11
	▸ Investment bank prepares marketing materials (typically a Confidential Information Memorandum, or "CIM")
	▸ CIM is circulated to wide universe of potential buyers:
	  ▸ Financial (PE, pension funds, SWFs)
	  ▸ Strategic (competitors, customers, and suppliers);
	▸ Company participates in management presentations
		▸ Investment bank attempts to locate a so-called "stalking horse" bidder
		▸ The "stalking horse" agrees to purchase the asset for a set price if no other bidders show up to the auction
		▸ In return, the debtor grants some consideration to the stalking horse (e.g. breakup fee)
			▸ The debtor, its investment bank and its attorneys, working with creditors, determine the "rules of the game" for the auction
			▸ Wide variety of potential terms, including:
			  ▸ Minimum overbid increment
			  ▸ Valuation of non-cash bid components
			  ▸ Ability of various creditors to "credit bid"
				▸ Parties must pre-qualify to bid, e.g. by submitting bids prior to a deadline and by demonstrating means of consummating a transaction
				▸ Auction is held through open bidding process
				▸ Bidding can take variety of forms (e.g. agreeing to assume a liability)
				▸ Winning bidder acquires asset free and clear of all liabilities (other than those specifically assumed)

IN ORDER TO SUCCESSFULLY REORGANIZE, A COMPANY MUST PUBLISH AND GET COURT APPROVAL OF 2 KEY DOCUMENTS:

1) A PLAN OF REORGANIZATION AND 2) A DISCLOSURE STATEMENT

	Plan of Reorganization	Disclosure Statement
Purpose	▶ **"Court sanctioned contract"** between debtor and its creditors that replaces pre-bankruptcy obligations ▶ Classifies claims and interests, and outlines compensation to each	▶ **Disclose all relevant information** a "hypothetical creditor" would need to decide whether to vote for the plan ▶ **Solicit votes** of impacted creditors ▶ Similar to SEC registration statement
Elements	▶ **Classification** of claims & interests ▶ Form (stock, cash, etc.) and amount of **compensation** paid to each class ▶ Details of **capital structure** and **corporate governance** of debtor after it exits bankruptcy ▶ Discharge of pre-bankruptcy debts	▶ **Estimated recoveries** by class (including valuation of securities issued as compensation to creditors) ▶ **"Best interests" test** (e.g. creditors receive more than in a liquidation) ▶ **Feasibility** of plan
How Riveron Helps	▶ Advises debtor on feasibility of capital structure and business plan ▶ Create recovery analyses outlining consideration paid to each class	▶ Develops best interest test and going concern recovery models ▶ Testify in court as to validity of these analyses and feasibility of plan

AS A COMPANY EXITS BANKRUPTCY, IT MAY HAVE TO REVALUE ITS ASSETS AND LIABILITIES UNDER A PROCESS KNOWN AS "FRESH START ACCOUNTING"[1]

- Companies that emerge from bankruptcy **may qualify for "fresh start accounting"** if there was a change of ownership
- Assets and liabilities are **presented at their fair values** rather than historical cost
- May result in **increase or decrease** of both assets and liabilities

Assets

What might increase?

- **Land** purchased many years ago that has increased in value
- **Investments** in a foreign subsidiary or joint venture that has grown significantly
- **Intangible assets** like trademarks and customer relationships not previously carried on the balance sheet

What might decrease?

- **Inventory** carried at historical cost but with little market value
- **Capital equipment** that is obsolete but not fully depreciated
- **Goodwill** (which could even be negative depending on the fair value of liabilities)

Liabilities

What might increase?[2]

- **Reinstated debt** that traded below par prior to bankruptcy
- **Deferred revenue** if bankruptcy exit is financed by customers (e.g. advance product purchases)
- **Accrued payroll expenses** for management incentive plan bonuses

What might decrease?

- **Accounts payable** eliminated due to the bankruptcy
- **Long term debt** converted to equity as part of the restructuring
- **Derivative contracts** canceled during the bankruptcy

1 Enterprise value typically estimated by investment banks. Accounting firms allocate value to assets & liabilities.
2 GAAP requires companies to carry liabilities at fair value so these items will increase due to exiting bankruptcy and not based on fresh start accounting.

Polling Question 2

Question: What types of costs are non-recurring restructuring related that a company would report separately in its income statement?

A. Bankruptcy counsel

B. Fresh start accounting advisors

C. Severance compensation

D. Site location closing costs

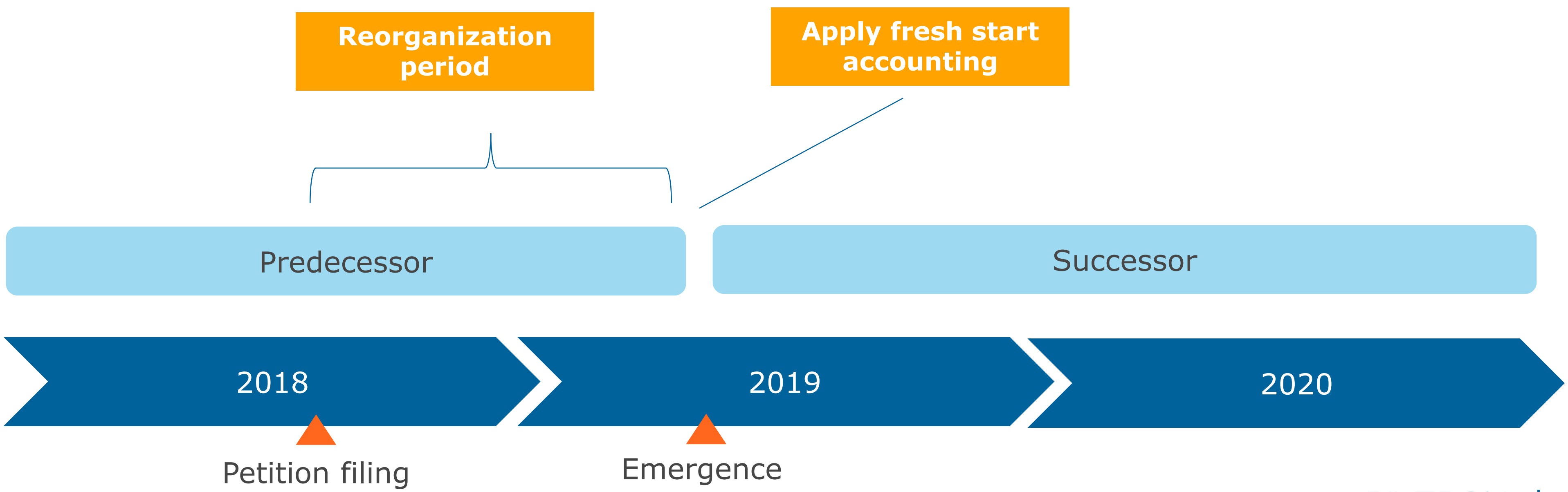
E. All of above

CHAPTER 7 LIQUIDATION VS CHAPTER 11 REORGANIZATION

Chapter 7	**Liquidation**	**ASC 205**
Chapter 11	**Reorganization**	**ASC 852**

FRESH START FINANCIAL REPORTING: PROCESS & CONSIDERATIONS

Two step qualification test	"Blackline" presentation	IT systems upgrades and configuration	Four column balance sheet footnote
Reorganization Items	Liabilities Subject to Compromise	Enterprise Value vs Reorganization Value	Allowed claims recognition
Third party valuation assessment	Emergence date cutoff	Dashboard reporting	Segments, impairment & income tax



FRESH START FINANCIAL REPORTING: 2-STEP QUALIFICATION STEP

In order to qualify to apply fresh start accounting under ASC 852, <u>both</u> the following two conditions must exist:

SOLVENCY TEST

Reorganization value of the assets of the emerging entity immediately before the date of confirmation

<

Total of all postpetition liabilities and allowed claims

AND

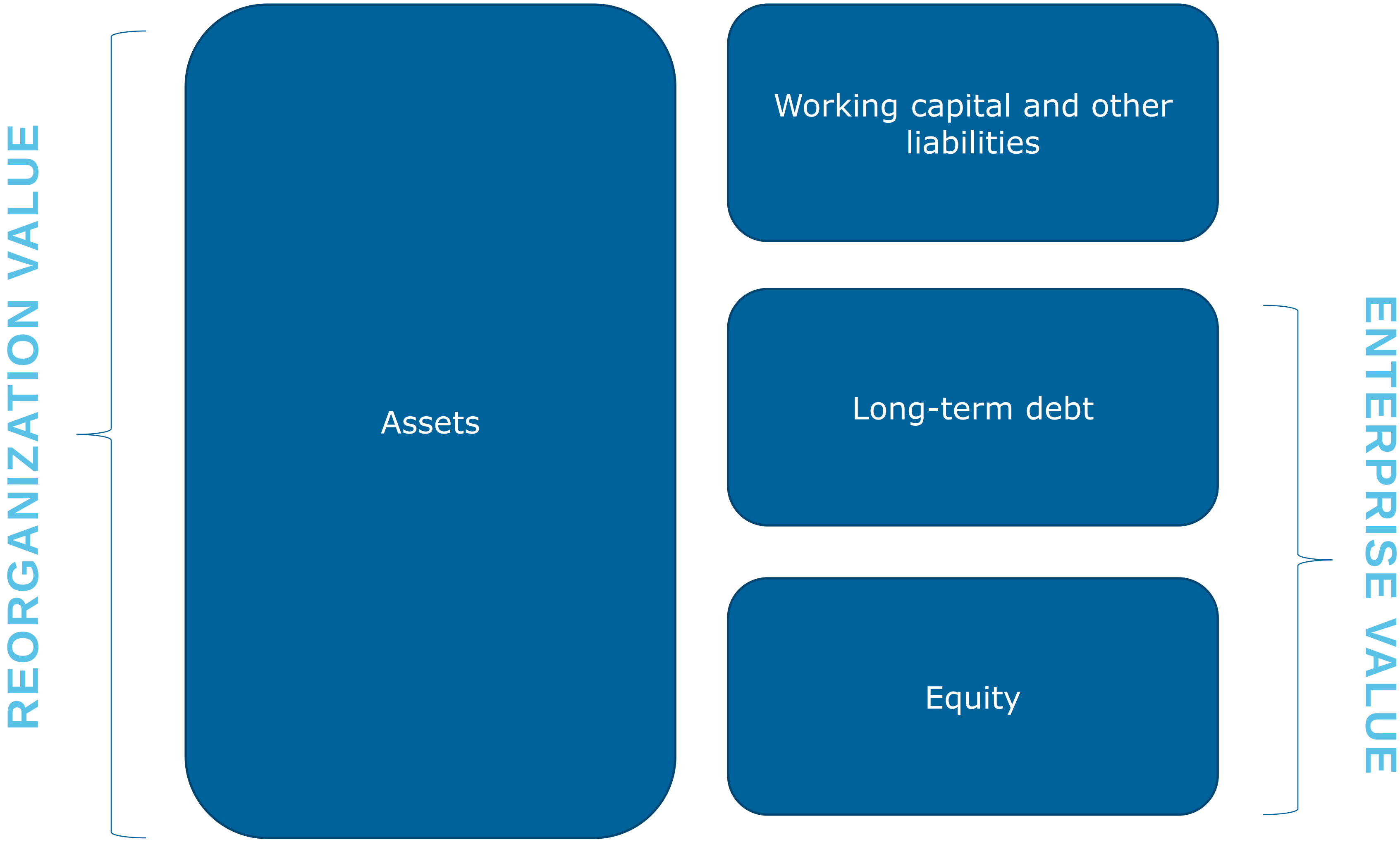
CHANGE OF CONTROL TEST

Holders of existing voting shares immediately before confirmation receive less than 50% of voting shares of the emerging entity

If ASC 852 is not met:

- Any debt or liabilities "reorganized" need to be assessed as a troubled debt restructuring, extinguishment or modification
- Similar income statement treatment for Reorganization Items
- No book basis step up to fair value, no blackline presentation, no four column balance sheet presentation, different disclosures

FRESH START FINANCIAL REPORTING: REORGANIZATION VALUE VS ENTERPRISE VALUE



FRESH START FINANCIAL REPORTING: BLACKLINE & FOUR COLUMN PRESENTATION

	Successor		Predecessor	
	December 31, 2018		December 31, 2017	
Cash	$	100	$	150
Accounts receivable		250		200
Inventory		85		115
Property and equipment, net		125		100
Intangible assets		100		0
Goodwill		65		0
Total assets	**$**	**725**	**$**	**565**
Accounts payable		115		140
Accrued liabiliities		120		150
Other current assets		105		125
Long-term debt		200		95
Total liabilities		**540**		**510**
Equity-predecessor			$	55
Equity-successor	$	185		
Total liabilities and equity	**$**	**725**	**$**	**565**

Balance sheet face

Four column footnote

	As of July 15, 2017 (Emergence Date)							
	Predecessor Company		Reorganization Adjustments		Fresh Start Adjustments		Successor Company	
Cash	$	120	$	-	$	-	$	120
Accounts receivable		90		-		-		90
Inventory		120		-		10		130
Property and equipment, net		135		-		25		160
Intangible assets		-		-		35		35
Goodwill		-		-		45		45
Total assets	**$**	**465**	**$**	**-**	**$**	**115**	**$**	**580**
Accounts payable	$	65	$	-	$	-	$	65
Accrued liabiliities		55		-		-		55
Other current assets		70		-		-		70
Liabilities subject to comprimise		100		(100)		-		-
Long-term debt		65		-		-		65
Total liabilities		355		(100)		-		255
Equity-predecessor		100		(100)		-		-
Equity-successor		-		-		115		115
Total liabilities and equity	**$**	**455**	**$**	**(200)**	**$**	**115**	**$**	**370**

FRESH START FINANCIAL REPORTING: REORGANIZATION EXPENSES

	Successor	Predecessor	
	Period from June 9, 2017 through December 31, 2017	Period from January 1, 2017 through June 8, 2017	Year ended December 31, 2016
Revenue, net	$ 285,539	$ 156,238	$ 216,719
Cost Of Revenues			
Cost of products and services	(221,491)	(143,234)	(200,271)
Depreciation and amortization	(34,465)	(8,026)	(18,106)
Impairment of property and equipment	-	-	(3,518)
Total Cost Of Revenues	(255,956)	(151,260)	(221,895)
Gross Margin (Loss)	29,583	4,978	(5,176)
Operating Expenses			
Selling, general and administrative	(41,601)	(41,490)	(65,002)
Depreciation and amortization	(23,389)	(5,440)	(11,938)
Goodwill and intangible impairment and restructuring charges	-	-	(3,070)
Total Operating Expenses	(64,990)	(46,930)	(80,010)
Loss From Operations	(35,407)	(41,952)	(85,186)
Other Income (Expense)			
Interest income	128	46	123
Interest expense	(7,188)	(27,348)	(54,228)
Gain on extinguishment of debt	-	-	32,076
Reorganization items, net	-	385,654	-
Other, net	70	636	333
Total Other Income (Expense)	(6,990)	358,988	(21,696)
Income (Loss) From Continuing Operations Before Income Taxes	(42,397)	317,036	(106,882)

- Reorganization Expenses are expenses that directly relate to the company and its bankruptcy
- Items directly related to the bankruptcy should be classified as Reorganization Expenses. Examples of such expenses are:
  - consulting fees to investment bankers to determine alternatives to emergence
  - bank fees related to Debtor in Possession financing
  - legal fees related to bankruptcy filings.
  - adjustments to carrying basis of liabilities due to accounting under the standard

Polling Question 3

Question: Which industry saw the highest number of Chapter 11 filings in 2019?

A. Retail

B. Real estate

C. Energy

D. Manufacturing

EMERGENCE READINESS: PREPARING FOR "FRESH START OPERATIONS"

Prior to Petition Filing | Reorganization | Post-Emergence

Common client challenges

- Applying the same approach to operational changes regardless of the strategy behind the filing decision
- Inability to quickly and accurately assess operational performance and align to financial performance

Best Practices in Preparing Operations for Filing

- Initiate a period of operational due diligence, focusing on:
  - Decreasing COGS and SG&A through reviewing potential process efficiencies for Supply Chain, HR, IT, Marketing, Shared Services and general business management
  - Go-forward strategy for inventory and cash management
- Identify opportunities based upon due diligence, quantify benefits and estimate level of effort required
- Prioritize opportunities and develop emergence roadmap that aligns with financial obligations and strategy during reorganization and post-emergence

In cases where companies restructure to focus efforts on core business performance, companies should develop a roadmap optimizing human capital, technology and key business processes.

In other instances, such as the decision to divest under-performing assets, a more structured approach involving capital reallocation can be used to invest in other business units.

EMERGENCE READINESS: DESIGNING "FRESH START OPERATIONS"

Prior to Petition Filing → Reorganization → Post-Emergence

Evaluate Operating Performance

- High procurement and production costs
- Convoluted logistics and distribution strategies
- Poor inventory management
- Inefficient management of corporate support functions such as HR, IT, Marketing and Shared Services

Reinvest in Business

- Optimize working capital
- Increase revenue potential
- Reduce Costs
- Plan for future technology needs that support performance management

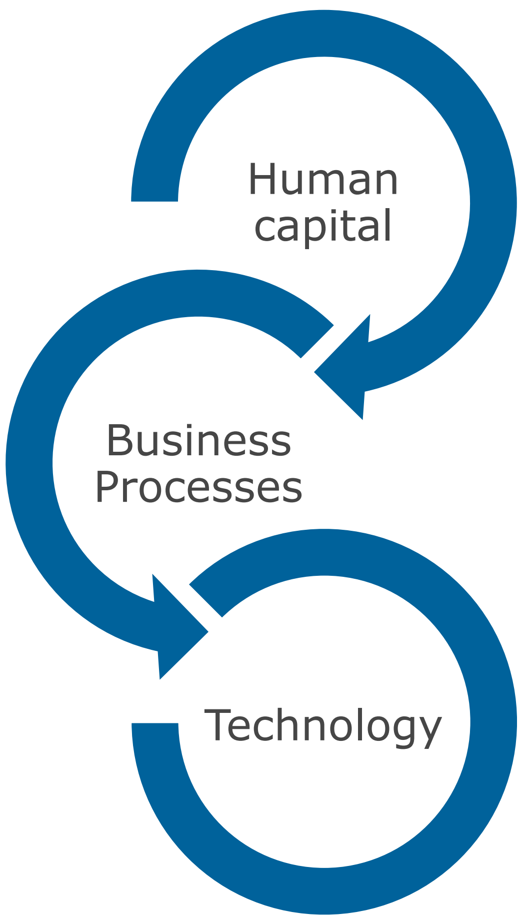
Execute Operational Strategy

- Manage cash through adjusting AR, AP and Inventory Management processes
- Align marketing, sales and ongoing account management with future revenue goals
- "Right-size" organization
- Implement KPIs and reporting that supports strategic direction

Key operational restructuring activities that support financial reorganization

EMERGENCE READINESS: EXECUTING "FRESH START OPERATIONS"

Prior to Petition Filing | Reorganization | Post-Emergence



Build an organization that utilizes resources efficiently

- Restructure teams based on capabilities and organizational needs
- Outsource business functions where internal transactional activities are cost-prohibitive

Focus business activities on driving enhanced performance

- Improve pricing strategies, cash management and marketing to increase revenue
- Improve front and back-office processes to grow margin and decrease costs

Implement the IT-related infrastructure required for operational and financial alignment

- Create a unified platform to synthesize operational data and integrate with financials
- Generate easy-to-consume dashboards that allow management teams to monitor business performance and be agile in adjusting operations

Polling Question 4

Question: How likely does your organization anticipate navigating a 2020 distressed situation?

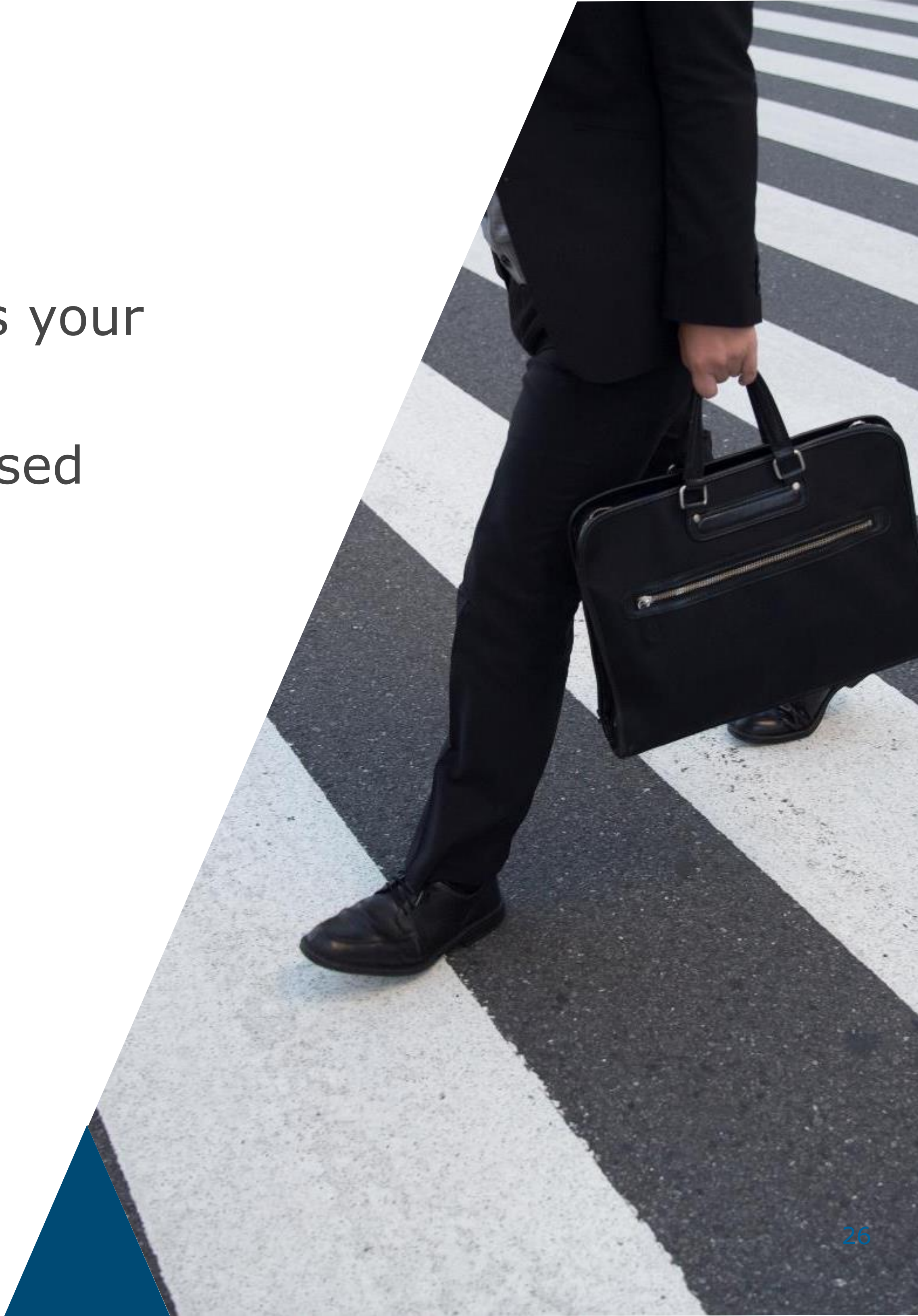
A. Imminent

B. Likely

C. Moderate

D. Low

E. Unlikely



Q&A