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Key Considerations During Stressed & Distressed Situations

NOVEMBER 16, 2023 | 12pm ET/11am CT



Webinar

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Today's presenters and webinar reminders:

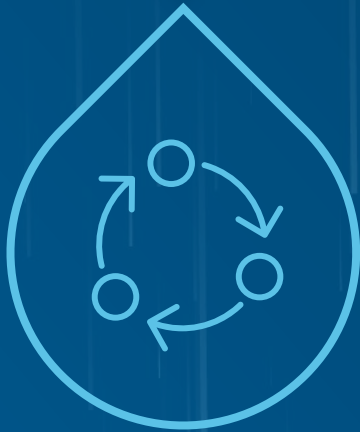
- You must answer 4 polling questions to obtain CPE
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A follow-up email will include:

- CPE certificate & webinar evaluation form
- Access to today's recording and slides
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Topics We'll Cover Today

Defining the Spectrum of Performance



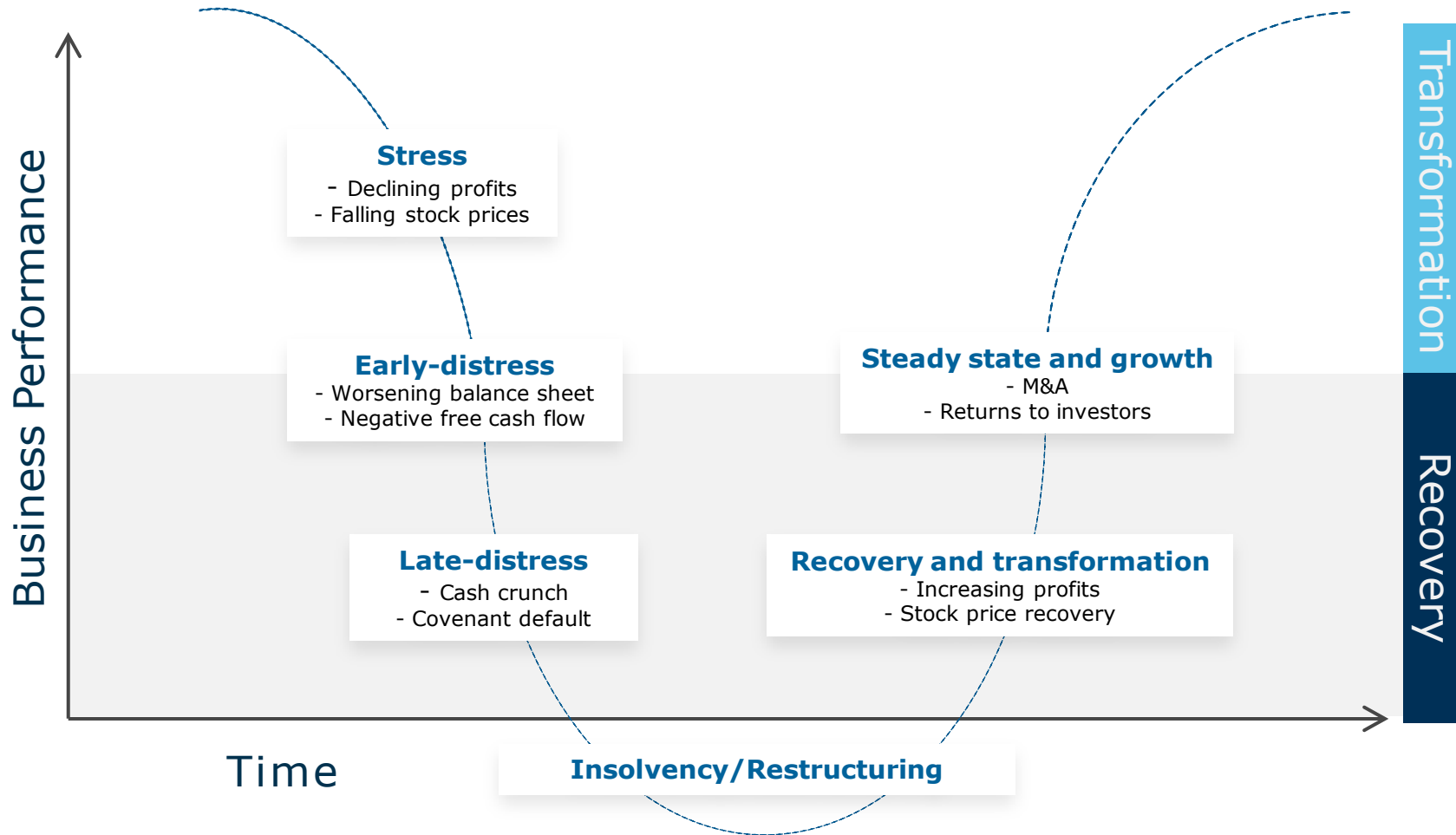
Stages of Stress and Distress



Strategic Issues and Steps You Need to Take Now



Defining the Spectrum of Performance



Key Questions to Determine the Extent of Distress

Liquidity Constraints

How much visibility do you have into short-term liquidity?

Have you experienced unforeseen increases in your working capital?

Leverage Profile

Have you explored all capital markets solutions to 'buy time'?

Have your lender group(s) become more active in demanding information from you?

Declining Stakeholder Support

Are your vendor payment terms contracted recently?

Are your lenders becoming increasingly proactive?

Organizational Stress

Have you streamlined the organizational structure in response to new operating environment?

Are there flight risk issues with key employees?

Worsening Operating Performance

Do you understand the underlying drivers of operating performance shortfalls against your annual budget?

Have you rapidly and aggressively reduced operating costs?



Polling Question

1

How much experience do you have in dealing with stressed or distressed situations?



None – I've never experienced this in a previous company



Low – one to two times



Some – two to four times



Very experienced. I have dealt with this many times in my organization or consulted clients on this topic.

Indicators and Considerations by Stage

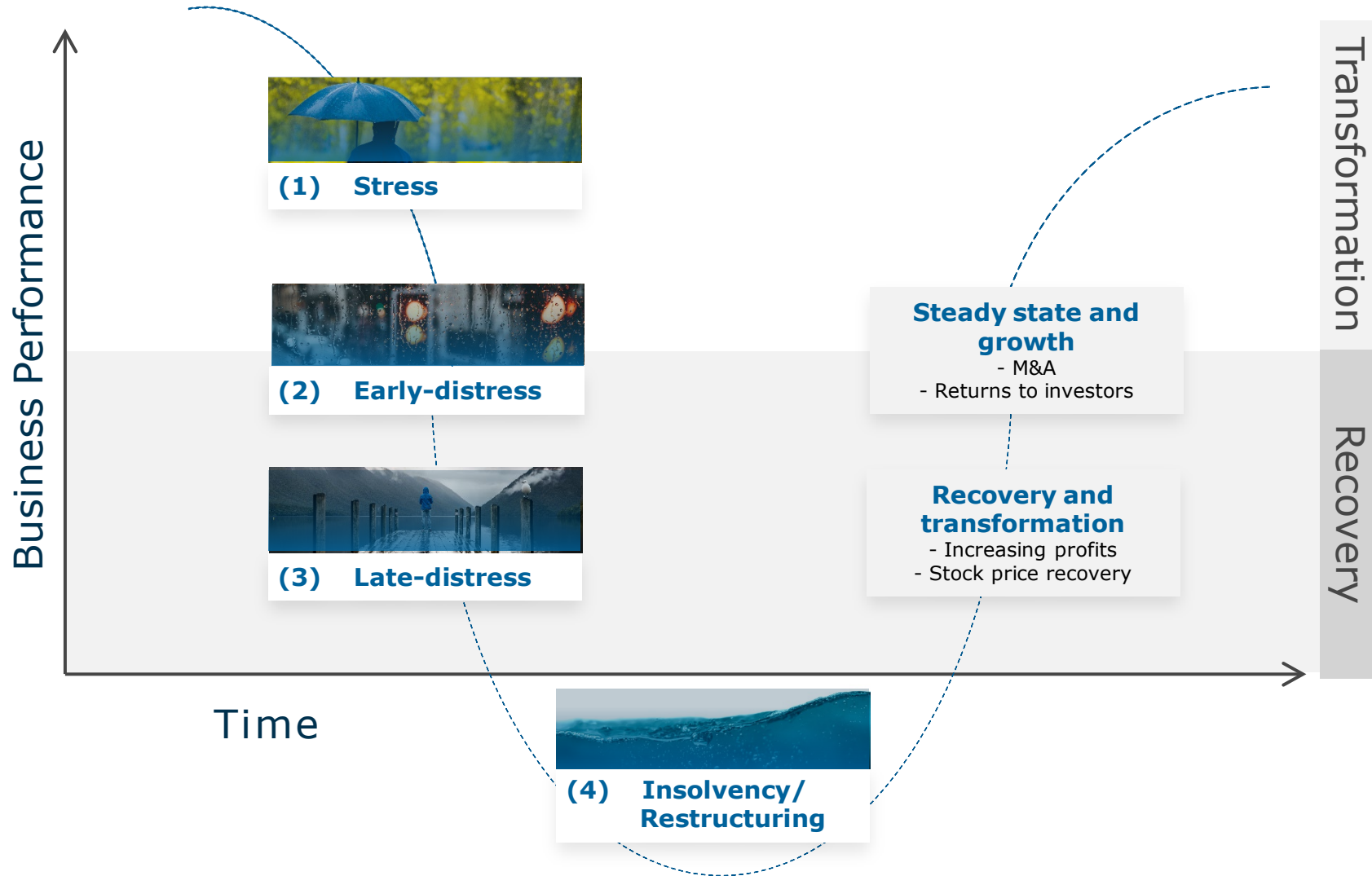
Defining the Spectrum of Performance

Stages of Stress and Distress

Strategic Issues and Steps You Need to Take Now



Comparing the Four Stressed and Distressed Stages



Stress

Indicators		
External Forces	Operations	Financial
<ul style="list-style-type: none">- Falling stock/bond Prices- Geopolitical and macroeconomic factors	<ul style="list-style-type: none">- KPIs trending downward- Significant impairment charges- Working capital challenges	<ul style="list-style-type: none">- Raising high-yield debt- Credit rating downgrades- Questionable strategic outlook

Financial and Operational Considerations	Tax Considerations	Accounting, Audit, and Financial Reporting Considerations
<ul style="list-style-type: none">- Liquidity assessment- Topline and profitability planning- Cost reduction measures (labor and non-labor)- Proactive engagement with key stakeholders- Working capital management- Development of asset and market strategies	<ul style="list-style-type: none">- Evaluate legal entity structure- Identify existing tax attributes (NOLs, credit carryforwards, etc.)- Review investments and receivables to confirm value	<ul style="list-style-type: none">- Assess accounting model- Impairment concerns- Covenant violation potential and financial reporting impacts- Inventory valuation and obsolescence matters- Accounts receivable valuation allowance and bad debt review- Internal control considerations, significant deficiencies, and material weaknesses



Early Distress

Indicators

External Forces

- Continuation of falling stock/bond prices and geopolitical and macroeconomic factors

Operations

- Extended period of declining KPI trends

Financial

- Negative free cash flow and/or cash flow insufficient to service debt

Financial and Operational Considerations

- Weekly cash flow forecasting
- Stakeholder management (creditors, suppliers, potential investors)
- Cost reduction measures
- Business plan development
- Contingency planning (e.g. asset sales, dilutive equity raises, restructuring events, etc.)

Tax Considerations

- Test whether COD income created by loan modifications or forgiveness
 - Safe Harbors allow some changes in loan terms without causing COD income
- Begin planning for path of distress - review recent valuations

Accounting, Audit, and Financial Reporting Considerations

- Continuation/update of the Stress phase accounting considerations with the potential of additional distress considered more likely
- Discontinued operations and assets held for sale (carve out)
- Impacts to financial statement footnote disclosures
- Potential review of going concern
- Ongoing SEC reporting disclosure updates, as needed, if public



Polling Question

2

In your industry, what is the likelihood that stress will occur during the next 12 months?

A Very likely

B Likely

C Unlikely

D Very unlikely

Late Distress

Indicators		
External Forces	Operations	Financial
<ul style="list-style-type: none">– Peers retaining bankruptcy counsel and/or filing for Chapter 11	<ul style="list-style-type: none">– Increasing vendor pressure/stretching vendor payments	<ul style="list-style-type: none">– Failure to service debt– Breach of debt covenants

Financial and Operational Considerations	Tax Considerations	Accounting, Audit, and Financial Reporting Considerations
<ul style="list-style-type: none">– Weekly cash flow forecasting – daily cash management with tight controls– Optimization of working capital– Implementation of strategic transactions– Development of value creation plan– Scenario planning for possible insolvency proceedings	<ul style="list-style-type: none">– Determine whether Company is insolvent for tax purposes– Model various outcomes for insolvency or bankruptcy<ul style="list-style-type: none">– Legal entity level analysis, including disregarded entities– Use NOLs to offset gain from asset sales/COD income	<ul style="list-style-type: none">– Continuation/update of the Stress & Early Distress phase considerations but likelihood now more certain– Scenario planning for possible accounting models, financial reporting impacts and deliverable/decision dates– Begin to consider financial reporting impacts of Chapter 11 and potential accounting under applicable GAAP ASC 852– Ongoing SEC reporting disclosure updates, as needed, if public– Communication and coordination with legal counsel, financial advisors, and restructuring officers



Insolvency

Indicators		
External Forces	Operations	Financial
<ul style="list-style-type: none"> – Capital markets closing 	<ul style="list-style-type: none"> – Vendors stop shipping goods or providing service – Unable to make payroll 	<ul style="list-style-type: none"> – Limited/no borrowing availability under credit facilities

Financial and Operational Considerations	Tax Considerations	Accounting, Audit, and Financial Reporting Considerations
<ul style="list-style-type: none"> – Intense cash flow management – Ensure funding for any insolvency proceedings (DIP financing) – Value creation plan implementation (5-year) – Crisis communication <p>Fiduciary obligation to the corporation</p>	<ul style="list-style-type: none"> – Estimate COD income realized from debt exchange, relief, or forgiveness – Determine tax attributes to be reduced – Plan for emergence from insolvency – Project taxable income in future years and remaining tax attributes available to reduce cash tax 	<ul style="list-style-type: none"> – Finalize ASC 852 Fresh Start Accounting two-step test: <ul style="list-style-type: none"> Step 1 - Solvency Step 2 - Change of control Potential for other applicable accounting model upon emergence: <ul style="list-style-type: none"> – Business Combination – Extinguishment or Modification – TDR – Chapter 7 Liquidation – Quasi-Reorganization – Communication and coordination with legal, financial, valuation, and restructuring advisors – Ongoing SEC reporting disclosure updates, as needed, if public – Need for the application of bankruptcy-specific accounting



Polling Question

3

What macroeconomic factors will most likely impact your organization?



Rising interest rates



Supply chain issues



Labor shortage /
wage inflation



Other

Steps to Take Now

Defining the Spectrum of Performance

Stages of Stress and Distress

Strategic Issues and Steps You Need to Take Now







Polling Question

4

Of the strategic issues highlighted on the previous slide, which is an area you are least familiar with?

A Debt capacity and liability management

B Liquidity

C Value creation planning

D M&A/Divestitures

E Analysis of Financial Alternatives

F Negotiation strategy



Q&A and Additional Resources



INSIGHTS

[Addressing the Tax Impacts of Cancellation of Debt Income When Restructuring](#)



INSIGHTS

[Today's CFOs Walk Tightrope of Growth, Caution](#)



INSIGHTS

[Moving to Strategic M&A When Debt Is Not the Strongest Path](#)

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