STAGES OF FINANCIAL DISTRESS

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STRESS

- "Something's not quite right"
- The problem may be initially attributable to a single or temporary issue
- A mismatch of expected versus actual cash flows and operating performance begins
- Is it just a blip?

EARLY DISTRESS

- Under performance continues and other challenges may appear. Recognizing the signs of distress is important
- The cumulative impact of unmet expectations becomes visible in the balance sheet
- Proactive strategy is likely necessary to fix the problems

DISTRESS

- "High Anxiety" accompanies problems that command urgent attention
- Multiple problems may interact with each other
- Significant action is likely required —understanding the relevant strategies is crucial
- If unaddressed, distress may reach a point of no return

DEEP DISTRESS

- A common (but often too late) question is: Can the problems be fixed without bankruptcy?
- Active negotiations often impacting and/or involving multiple stakeholders
- Extreme actions required to avert further deterioration or bankruptcy

STRESS

SELECTED SIGNS

- Performance is less than originally forecast, especially EBITDA and Free Cash Flow (FCF) forecasts
- Limited Enterprise Value ("EV") deterioration (most value loss is stock price decline or equity-related)
- Bank debt may trade below par or begin being quoted at below par
- Bond debt trades @YTM 10-12%

COMPANY ACTIONS/ STRATEGIES

- Acknowledge there is a problem
- Develop monitoring systems
- Assign accountability
- Problems are often ignored
- Actions need to be aligned with challenges in order to prevent further erosion in value or the situation deteriorating

KEY RISKS

- Declining stock price, shifts in investor base and increased/critical investor queries
- Proxy contest/hostile takeover/activist investors/demand letters (ongoing)
- Rating Agency Negative Watch or Downgrade
- Calls for a management shake-up

EARLY DISTRESS

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SELECTED SIGNS

- Measurable deterioration of EV
  - Bank debt trades @<90
  - Junior debt trades @ 12-15% YTM
  - Stock decline LTM>50%
- Amendments and waivers may be required or foreseeable
- Leverage metrics deteriorating (interest coverage and debt/EBITDA)

COMPANY ACTIONS/ STRATEGIES

- Identify specific threats and begin mitigations
- Consider impact of distress on future events that can increase balance-related sheet risk, e.g. covenant violations and debt maturities
- Begin working with counsel to understand covenants and structural provisions of existing debt
- Consider advisors for performance improvement and initiate cash flow forecasting
- Consider onboarding independent directors with special situations, restructuring/turnaround experience
- Understand capital raising alternatives from investment banks

KEY RISKS

- Dilution from raising additional equity
- Management distraction/concern
- Employee retention
- Financial and competitive impact of deferring investments
- Shareholder litigation
- Diminished financial flexibility and vendor/customer concerns

DISTRESS

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SELECTED SIGNS

- Significant deterioration in enterprise value:
  - Bank debt/1L trades @<80-90
  - Junior debt trades @YTM>15%
  - Stock down>70% LTM
- Identifiable liquidity events in <24 months, e.g. debt maturity, contract expiration, other
- Inbounds from restructuring advisors
- CCC-credit ratings/outlook negative
- Multiple amendments to credit facility
- Ongoing performance erosion

COMPANY ACTIONS/ STRATEGIES

- Aggressively address specific threats/focus on performance improvement
- Focus on "Going Concern" opinion and debt maturity issues, establish special committee to address critical issues
- Interview or consider Financial and Restructuring advisors
- Dynamic and refined liquidity forecasting and active cash management
- Review/update projections and compensation structure
- Consider liability management transaction (LMT) and rescue financing options

KEY RISKS

- Management and director retention
- Customer concerns over long term viability
- Shareholder litigation
- Intermediate term default risk and cross default risk
- Lenders organizing and interviewing their own advisors
- Additional capital extremely limited and expensive

DEEP DISTRESS

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SELECTED SIGNS

- Large EV erosion:
  - Bank debt trades @<75
  - Junior debt trades @<50
  - Stock may be delisted
- Forbearance agreements/technical defaults/loan in workout and/or restructuring advisors

COMPANY ACTIONS/ STRATEGIES

- Board is formally working with advisors and focused on prospect for increased creditor scrutiny
- Creditors formally working with advisors
- Near term action on strategic/ restructuring alternatives, e.g. market test
- Aggressive liquidity management
- Prepare for bankruptcy/ other process

KEY RISKS

- Additional capital may not be available except DIP financing
- D&O resignations
- Vendors demanding cash in advance
- Stock delisting
- Involuntary bankruptcy filing
- Releases in a bankruptcy and tail for D&O insurance