



Bankruptcy for Businesses in the Era of COVID-19

August 27, 2020



Lender
Negotiations

Restructuring
Advisory

Private
Capital

Distressed
M&A

Interim
Management

Expert
Witness

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Turnaround Operator with Investor's Perspective

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With over 20 years of experience involving over 40 out-of-court workouts and Ch. 11 reorganizations, Mr. Anapolsky applies the valuable insights and creative solutions that he learned as an advisor, lender, investor, and attorney to create comprehensive solutions for special situations in multiple industries. As co-author of *The Art of Distressed M&A*, he teaches Restructuring to MBAs at Rice Business.

- T. Rowe Price: Distressed Debt
- American Capital: Special Situations
- Akin Gump: Bankruptcy Lawyer
- Bear Stearns, Wasserstein Perella
- Rice: Restructuring Professor
- Harvard: JD / MBA
- U Penn / Wharton: BA / BS
- TMA, ABI Member



Special Situations Expertise

Our special situations focus involves unconventional assets, out-of-court workouts and bankruptcy reorganizations across multiple industries.

We provide valuable advice on recapitalization and restructuring strategies for middle market companies confronted with limited resources, dwindling options and market realities.

Resolve Multi-Party Disputes

As turnaround operators with an investor's perspective, we advise operators, investors and creditors to make difficult decisions with imperfect information.

We unravel intertwined financial, legal and operational issues to create credible financial projections, enhance valuation and resolve disputes.

No Time for Do-Overs

Decades of experience with over 40 bankruptcy cases enables us to anticipate issues, predict outcomes and avoid common pitfalls along the unfamiliar path of distressed M&A.

We provide the skill and finesse to navigate multi-party negotiations and complex valuation to get challenging transactions closed.

Agenda

- Trends & Options: Commercial Real Estate Bankruptcy Wave
- SBRA Act
- 363 Sales v. Standalone Reorganization
- Single Asset Real Estate Sales



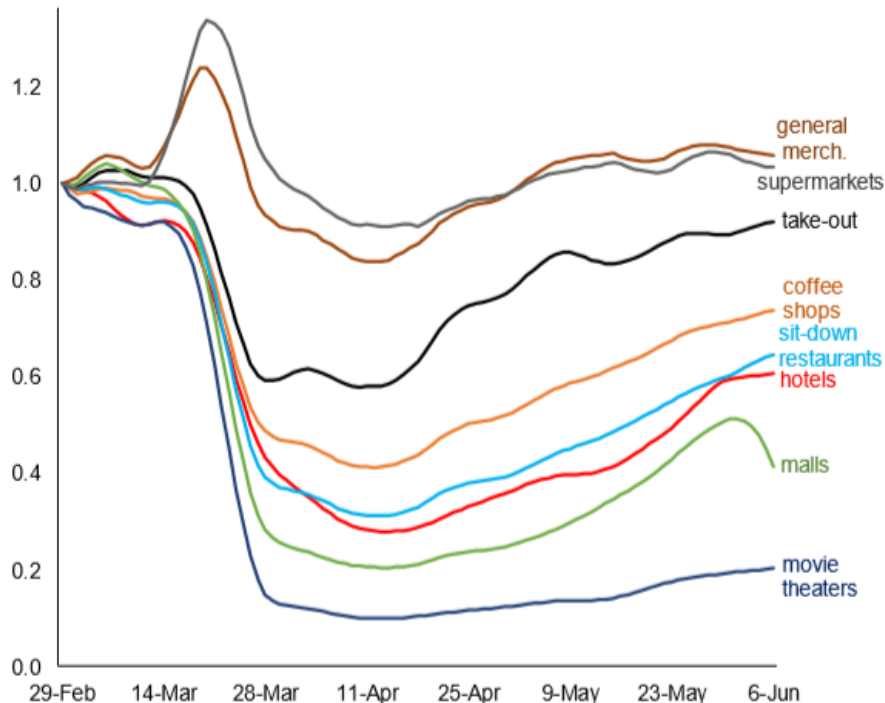
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COMMERCIAL REAL ESTATE BANKRUPTCY WAVE

COVID-19 Impact on US Foot Traffic

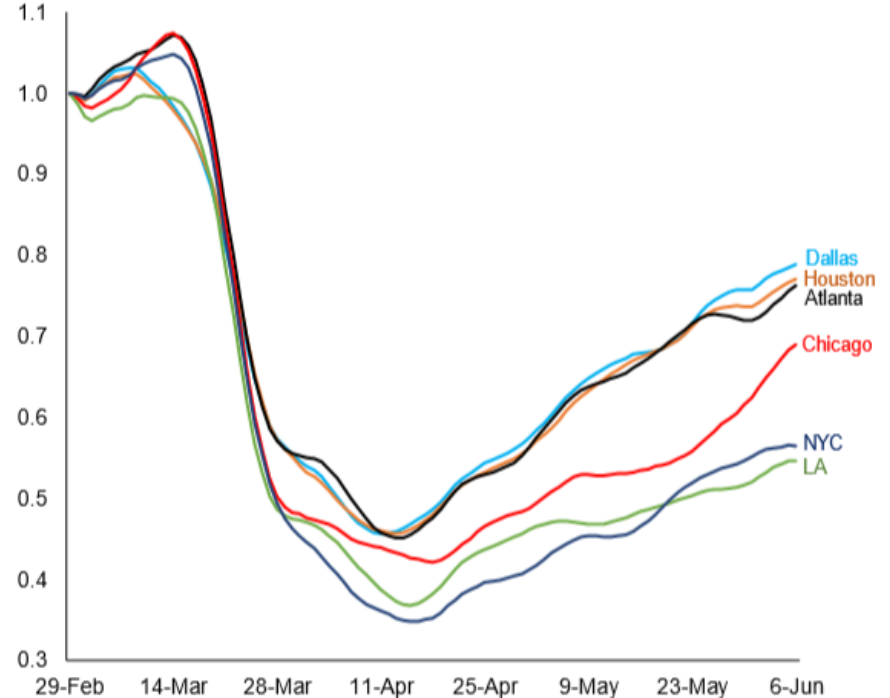
- Foot traffic (ex-malls) shows a gradual pick-up in activity as businesses adapt
- Dallas, Houston and Atlanta are outperforming LA and NYC
- As US reopens, unclear whether “V”-shaped or “U”-shaped recovery and if resurgent COVID-19 will cause a “W”-shaped recovery...or prolonged recession

Foot traffic data from SafeGraph (1.00 = 29-February, 7-day average)



Source: Macquarie

Foot traffic data from SafeGraph (1.00 = 29-February, 7-day average)

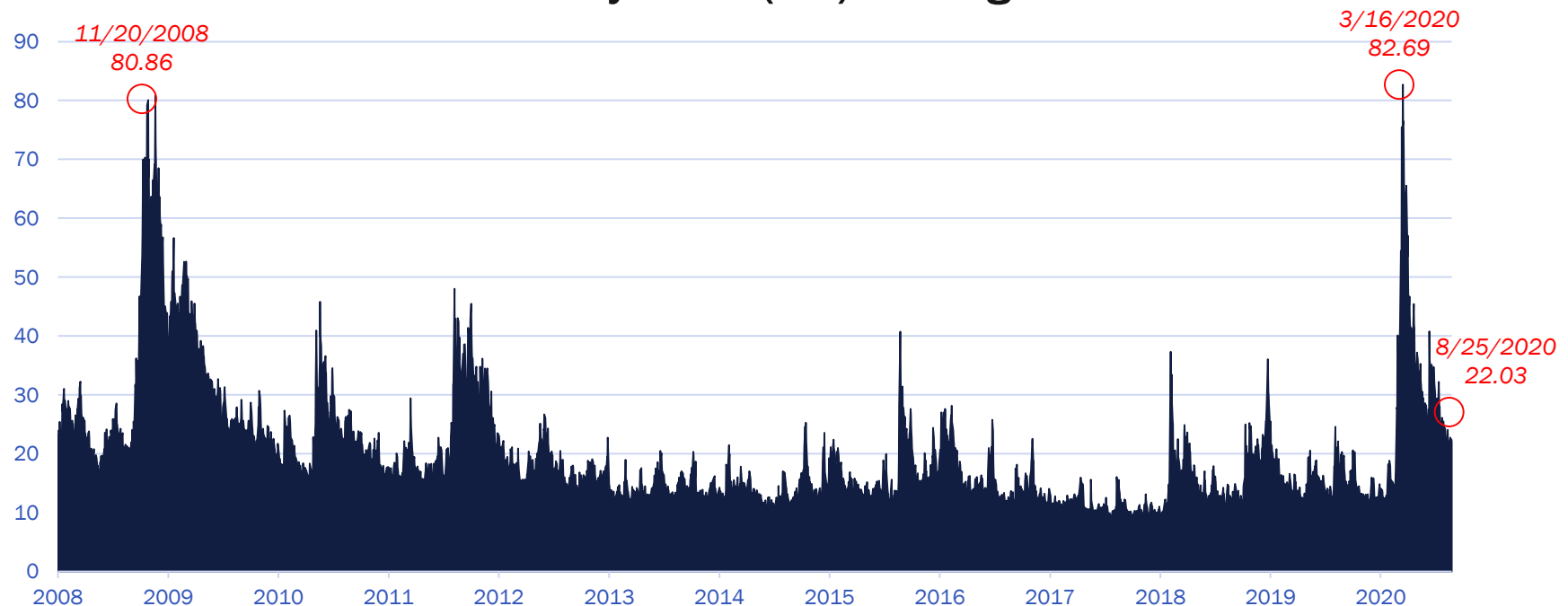


Source: Macquarie

COVID-19 Impact on Investor Confidence

- VIX measures investors' expectations for market volatility over next 30 days
- Often called the "Fear Index" because it is a key measure of investor sentiment
- COVID-19 crisis caused VIX levels not seen since the 2008 Global Financial Crisis
- Massive stimulus by Federal Reserve and U.S. Treasury calmed markets

CBOE Volatility Index (VIX) Closing Price



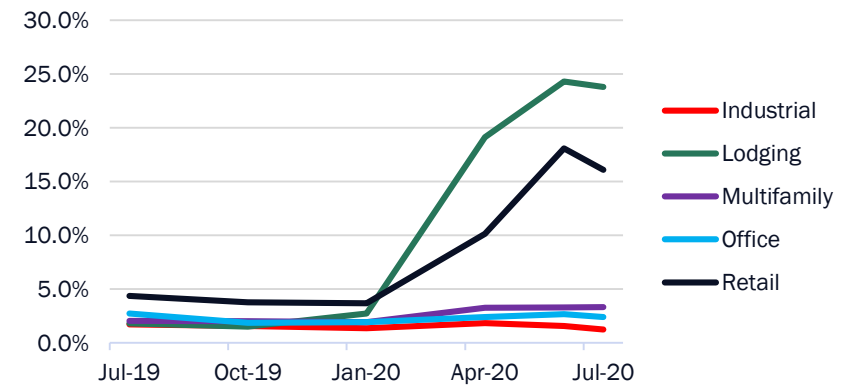
Source: Yahoo Finance

Created by the Chicago Board Options Exchange (CBOE), the Volatility Index, or VIX, is a real-time market index that represents the market's expectation of 30-day forward-looking volatility. Derived from the price inputs of the S&P 500 index options, it provides a measure of market risk and investors' sentiments. It is also known by other names like "Fear Gauge" or "Fear Index." Investors, research analysts and portfolio managers look to VIX values as a way to measure market risk, fear and stress before they take investment decisions.

Real Estate Bankruptcy Wave: Imminent or Lag?

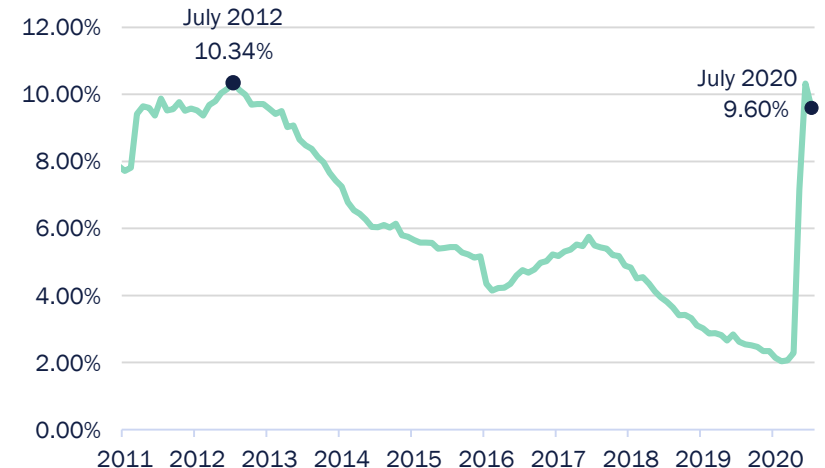
- Current driver of real estate distress differs from Global Financial Crisis
 - 2008: Wall Street (financial institutions)
 - 2020: Main Street (global pandemic)
- CMBS delinquency rates spiking for multiple types of tenants
 - Tenants seeking rent concessions and deferrals...or just not paying
 - Eviction not a solution if no substitute tenants
 - Landlords are effectively taking equity risk in their tenants' businesses
- Stimulus from Federal Reserve and U.S. Treasury is supporting many companies
 - Even extraordinary measures may not prevent current recession from deepening further
 - Once COVID-19 crisis ends, how long will it take for economy to repair the damage?

Delinquency Rate by Property Type (% 30 Days+)



Source: Trepp CMBS Research

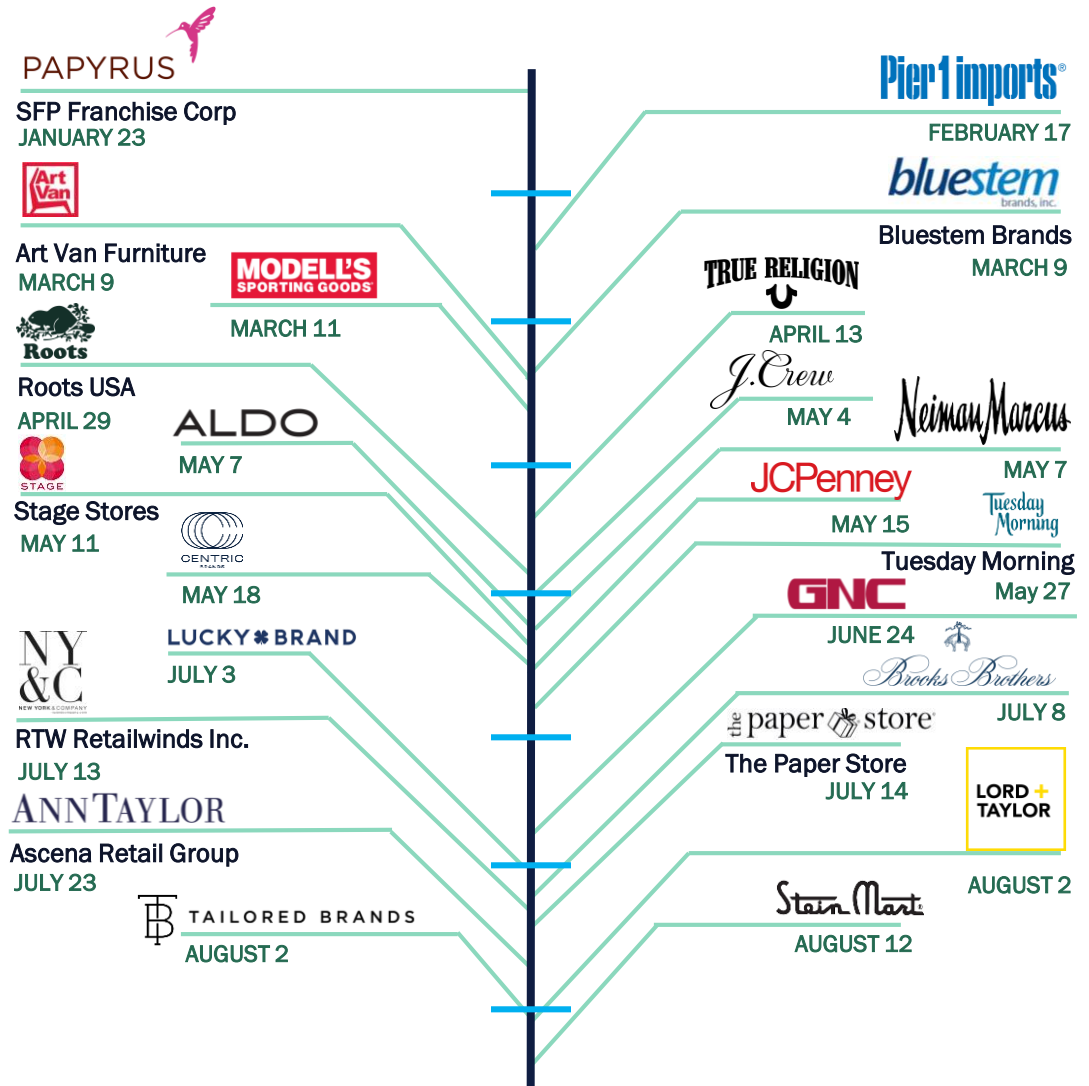
Percentage of CMBS 30+ Days Delinquent



Source: Trepp CMBS Research

Retail Bankruptcies Rage on in 2020

- As the pandemic continues, retail bankruptcies approach the highest number in decades
- According to S&P Global, there have been more retail bankruptcies this year than in any year in the past 8 years
- Over 100 consumer-focused companies have filed for bankruptcy this year
- Countless retailers have used bankruptcy to break or modify leases by the thousands



Source: SEC Public Filings & Yahoo Finance

Retailers Lead 2020YTD Real Estate Bankruptcies

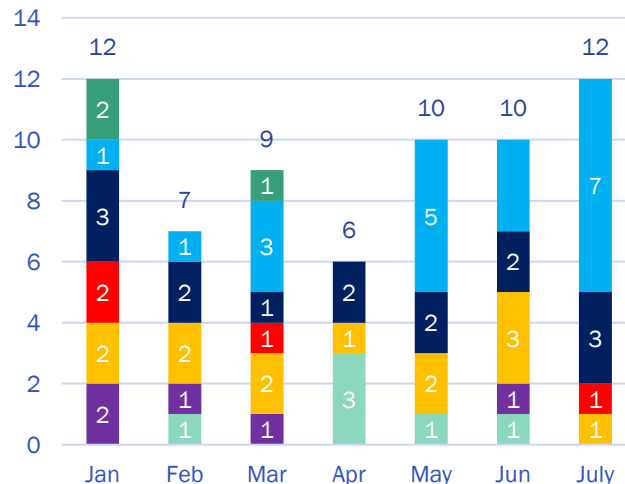
- Retailers comprise 78% of “real estate” bankruptcies (by amount) in 2020YTD⁽¹⁾
- Notably, JC Penney and Neiman Marcus are headquartered in Dallas but filed in Houston
- 6,600 retail locations closed in the U.S. YTD⁽²⁾
- Nearly 16,000 U.S. restaurants expected never to reopen⁽³⁾

“Real Estate” Bankruptcies By Number

Number of Filings: 66

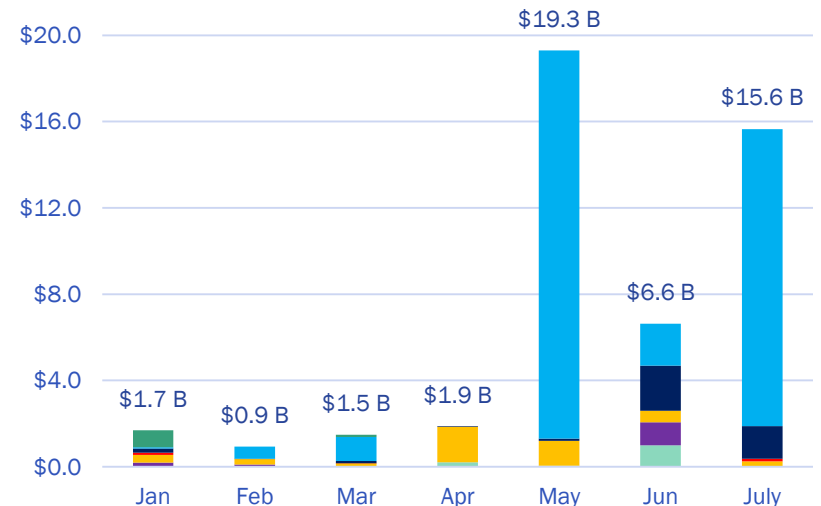
Legend

- Supermarket
- Retail
- Restaurant
- Real Estate
- Healthcare and Medical
- Food, Beverage and Tobacco
- Entertainment



By Amount

Total Liabilities: \$47.6B



Source: Bankruptcy Data

(1) Public and private companies with heavy real estate presence and over \$50MM in prepetition assets or liabilities. Additionally, the real estate category refers to real estate developers, agents, and managers.

(2) Coresight Research

(3) Business Insider

Commercial Real Estate: Survival Tactics

Landlords Purchase Struggling Retailers to Avoid Vacancies

- Simon Property Group and Brookfield Property Partners are nearing a possible deal to purchase J.C. Penney
- Simon Property Group and apparel-licensing firm Authentic Brands group bought bankrupt Brooks Brothers



“Flexible Workspaces” Ditch Locations to Survive

- Parent to Regus, IWG PLC, has already closed 32 locations, with plans to close an additional 4% of total coworking spaces in the second half of the year
- Reflecting a broader trend, WeWork and Knotel are also looking to decrease portfolios, buying leases and closing locations



Spaces' parent, Regus Group, files for bankruptcy in D.Del on 8/17/20

Source: Public Filings and WSJ



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DISTRESSED M&A

Distressed M&A: Risks for Pre-Bankruptcy Transactions

FRAUDULENT TRANSFER RISK

1



Seller was **insolvent** at time of the transfer or became insolvent

2



Transfer involved less than **“reasonably equivalent value”**

3



Transfer occurred within 2 years⁽¹⁾ prior to Seller’s bankruptcy

REASONABLY EQUIVALENT VALUE

Less than
Fair Market Value

Net Orderly
Liquidation Value

More than
Fire Sale Value



“Sweetheart” bilateral deals done 2-4 years prior to Seller filing bankruptcy are vulnerable to future challenge by creditors

Distressed M&A: Bankruptcy Process Summary



Entering Ch. 11 is *simple*

- File petition, pay fee
- Debtor gets “breathing room” to
 - Fix operations
 - Unravel contracts/leases
 - Resolve litigation

Exiting bankruptcy is *complex*

- Creditors’ recoveries: reorganization > liquidation
- Exit needs sufficient liquidity
- Creditors vote in classes on Debtor’s reorganization plan



Landlord's bankruptcy claim for rejection damages usually capped at **1 year of rent**

Standalone
Reorganization

YES

Ability to reorganize?

*Debtor and Creditors agree
on reorganization plan?*

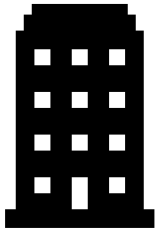
Plan maximizes valuation?

NO

363
Sale

Distressed M&A: Special Considerations for Real Estate

Single Asset Real Estate Cases



- Single property/project generating nearly all of Debtor's gross income
 - Operating property is only substantial business being conducted
 - Cannot be residential property with fewer than four units
- Modified automatic stay: Debtor must make interest payments to mortgage holder during the bankruptcy case
- Debtor must file feasible plan of reorganization within 90 days
- Otherwise, secured creditors may foreclose

Small Business Reorganization Act of 2019 (SBRA)



- Single asset real estate cases are ineligible, but tenants may be eligible
- COVID-19: small business with debts under \$7.5MM (normally \$2.7MM)
- Only the Debtor may propose a plan and may spread debt repayment over 3 to 5 years, including unpaid rent and administrative expenses
- Subchapter V Trustee is automatically appointed
- Owners may retain ownership without contributing new value

Distressed M&A: 363 Sale Summary



Sale of Assets

- **Free & clear** of all liabilities, claims and debts
- Certain assets or entire business
- Only the Debtor may propose



"As is, where is"

- Limited warranties & representations
- Limited escrows
- No refunds
- Can agree upon orderly transition
- *Caveat emptor*



Qualified Bidders

- Cash bids only
- Deposits typically required
- No financing or diligence outs
- The Debtor may choose a "**Stalking Horse**" bidder



Faster Process

- No voting like Plan
- Auction is typical but not required
- **Highest & best** offer wins
- Bankruptcy Court must approve

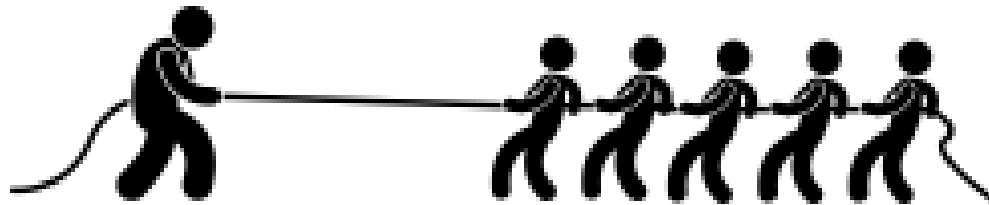
IRS

Although 363 sales can be completed outside of a plan, a 363 sale for real estate should be part of a confirmed plan to avoid transfer and stamp taxes

Distressed M&A: Who Can Propose a 363 Sale?



Only the Debtor may propose a 363 Sale
but management may prefer a standalone reorganization



Creditors' Negotiating Leverage to Influence 363 Sale



Restrict liquidity for operating in a Chapter 11



Vote against any standalone reorganization plan



Terminate the Debtor's exclusive right to propose a plan



Appoint a CRO or Ch. 11 Trustee free of conflicts of interest



Lift automatic stay to seize assets

Distressed M&A: Who Bids in a 363 Sale?

Qualified Bidders



Financial Bidders

- ❖ Rapid decisions
- ❖ Take risks
- ❖ Proven closers



Strategic Bidders

- ❖ Industry knowledge
- ❖ Valuable synergies
- ❖ Faster due diligence



Secured Creditors

- ❖ May “credit bid”
- ❖ No cash
- ❖ Claim as currency

Credit Bidding

- Secured creditors may offer to relinquish their claims in exchange for assets
- Allows lenders to block asset sales for less than face value of the loan
- Undersecured creditors may accept a lower price if the Debtor agrees to their terms

“Loan to Own” Strategy

- Buy secured debt at a discount
- Credit bid up to the face amount to drive up price of the assets
- Win: pay bargain price for the company
Lose: profit by redeeming debt at par

Other Considerations

- No collusion among bidders
- Grouping assets to maximize value
- Secured creditor may “chill” bidding
- Antitrust concerns
- Regulatory approvals

Distressed M&A: “Stalking Horse” Bidder



Bankruptcy stigma may bias the market against the Debtor and make a 363 Sale auction risky



Stalking Horse Bidder's Advantages



Gains a first look at confidential information



Determines the break-up fee (usually ~3% of bid)



Influences which assets are sold, terms and conditions, deadlines, and legal documentation



Sets minimum topping amount (overbid protection)



Requires qualifications for other bidders to limit competition

Distressed M&A: How Free & Clear is “Free & Clear”

363 Sale

- In a 363 Sale, Debtor sells some or all of its assets “free & clear” of all liabilities, claims, and debts
- Encourages bidders to submit their best bids without discounting for uncertainty and risk related to Creditors

Contracts/ Leases

- Winning bidder can require Debtor to **reject** selected leased properties, leased equipment, and/or expensive vendors
- If winning 363 Sale bidder wants to keep any contracts or leases, Debtor must **cure all defaults** at or before closing

Other Considerations

- Title Company’s standards may differ from Bankruptcy Court’s 363 sale standards (e.g., unpaid property taxes)
- Formal notice of 363 sale must be provided to any party with a right of first refusal to purchase the property

Can a Bankrupt Tenant Reject a Lease?

Free & Clear?

*Can bankrupt
tenant
reject lease
without
landlord's
consent?*

Debtor Tenants Can Reject Leases in Bankruptcy

- Bankruptcy gives tenants rights to assume or reject leases
- If **assume**, must:
 - Cure all monetary and non-monetary defaults
 - Provide adequate assurance of future performance
- If **assume and assign**, assignee may need to pay deposit
- After 60 days, unassumed leases **rejected automatically**:
 - Landlord may assert “rejection damages” claim
 - Treated as a pre-petition unsecured claim

Best Practices for Landlords with Bankrupt Tenants

Need Court permission to offset security deposits against unpaid rent

Require tenant to post a letter of credit prior to bankruptcy

Obtain a lease guarantee by third party, preferably uncapped

File motion for relief from automatic stay or motion for adequate protection



Rejection Damages: greater of (1) one year's rent or (2) the rent for 15% of the remaining term of the lease, not to exceed three years

Can a Bankrupt Landlord Reject a Lease?

Majority View (No)

- Landlord cannot reject a lease without tenant's consent
- Federal courts majority view: tenant's possessory interest will survive a "free and clear" sale of property by landlord in 363 sale

Free & Clear?

*Can bankrupt landlord reject lease **without tenant's consent?***

Minority View (Yes)

- Landlord can terminate lease without tenant's consent for "indubitable equivalent" value
- 7th and 9th Circuits' minority opinion: real property can be sold free and clear of leasehold rights

Protecting Tenant's Interest

Promptly record tenant's leasehold interest in property

Object to the sale unless acquirer assumes responsibility to tenant

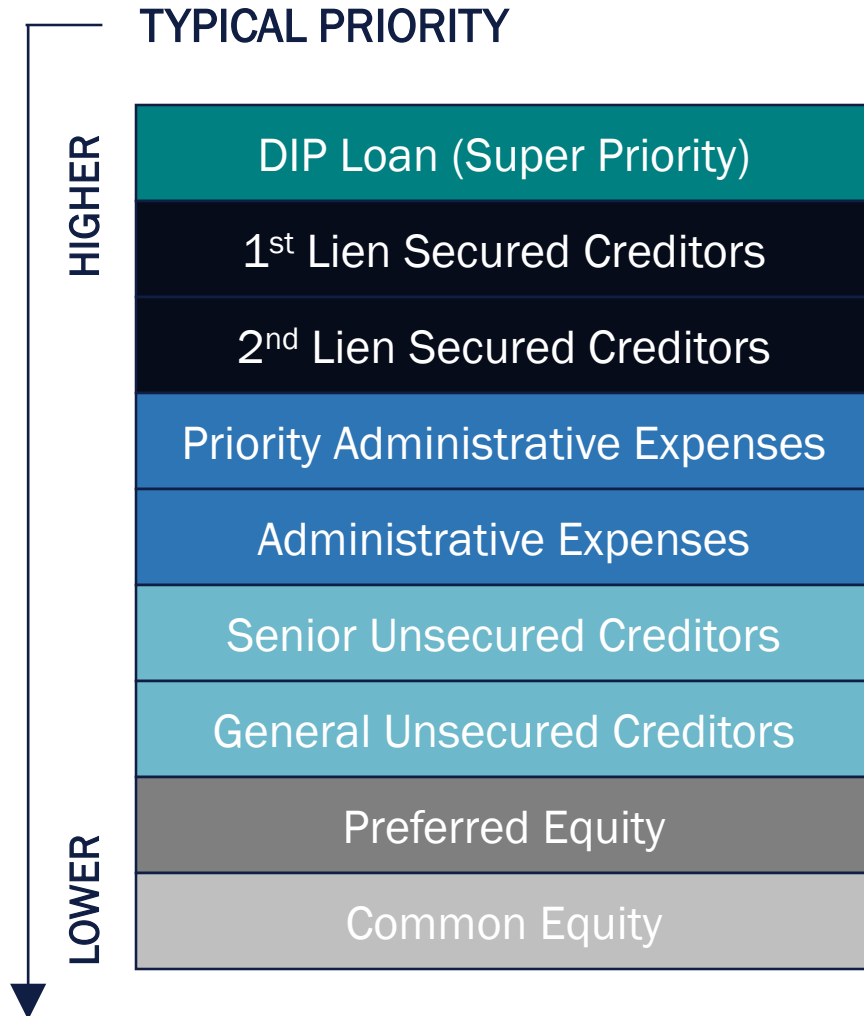
Argue none of the five "free & clear" provisions are satisfied

Seek adequate protection for tenant's leasehold interest



Bankruptcy Courts have not yet developed standards for determining the "indubitable equivalent" under the minority view

Distressed M&A: Distribution of 363 Sale Proceeds



- Each class of creditors receives the same percentage recovery
- **Fulcrum security:**
where does value run out?
 - Who is paid in full?
 - Who is impaired?
 - Who is hopeless?
- Answer may shift as bankruptcy progresses
- Creates iterative negotiation among Debtor and Creditors regarding plan v. sale



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CONCLUSION

Conclusion: Now is the Time to Adapt, not Retreat

“Investment success doesn’t come from buying good things but rather from buying things well” – Howard Marks

Point of Maximum Risk



Point of Maximum Opportunity

Q&A

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Reliable Chapter 11 Expertise: No Time for Do-Overs

- Prompt action to unravel intertwined legal, financial, and operational issues in order to reveal viable paths forward
- Understand the bankruptcy process from multiple perspectives
- High level of trust and credibility with the bankruptcy bar

Debtor



Creditor



Investor



Relevant Experience with Numerous Real Estate Businesses

- Help investors and creditors make difficult decisions with imperfect information
- Navigate the unfamiliar path involved with the restructuring process
- Our valuable insights and creative solutions unravel intertwined financial, legal and operational issues
- Decades of experience with prior cases enables us to anticipate issues, predict outcomes and avoid common pitfalls

Retail



RadioShack.



Berry-Hill Galleries



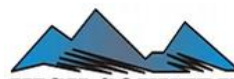
Manufacturing



Logistics



MERIT
SERVICE SOLUTIONS



HIGH COUNTRY
TRANSPORTATION

Other



ROBINS CLOUD



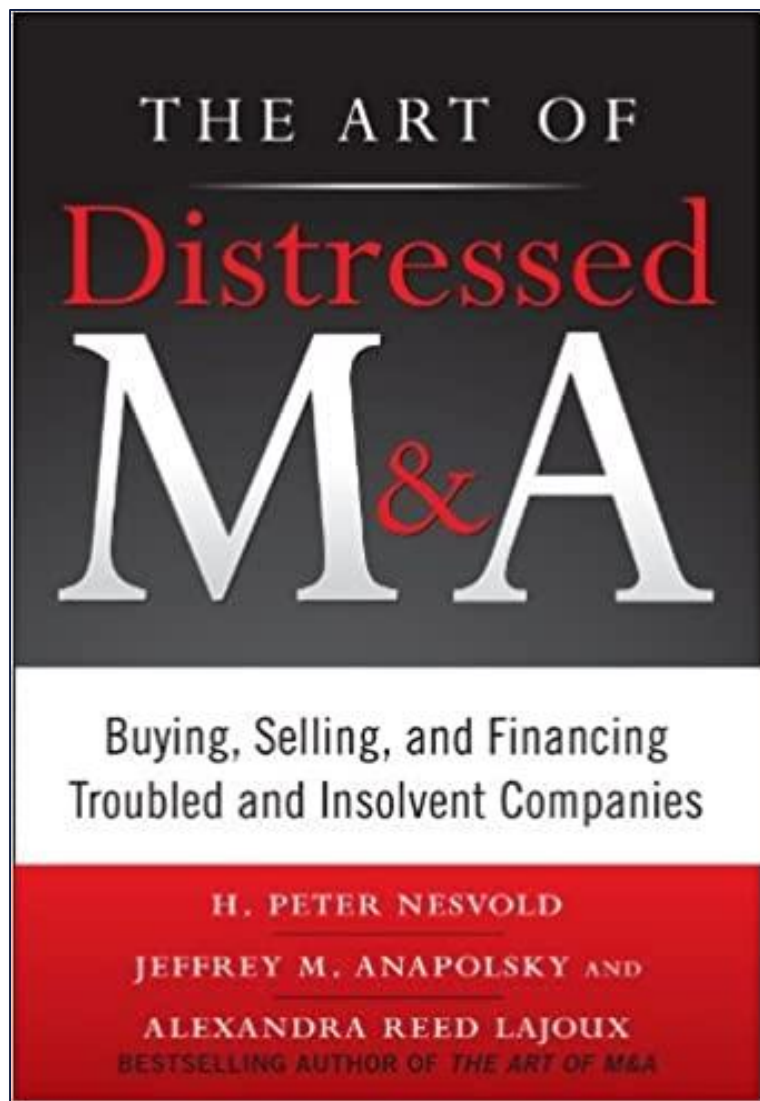
Development Corporation

Healthcare



HUMBLE
SURGICAL
HOSPITAL

The Definitive Book on Distressed M&A



Pessimists see **distressed** M&A . . .
Optimists see distressed **M&A**

Opportunities abound in “bankruptcy beauties”—both in good times and bad. Distressed mergers and acquisitions used to be the domain of a handful of specialists, who generated handsome profits by unlocking value in troubled companies.

Now, you can learn the secrets for participating in these deals with knowledge and confidence. *The Art of Distressed M&A* provides the critical information needed to manage the unique complexities of buying, selling, and financing troubled companies.

