## *Financing when a lender wants out*

Competition, new technologies, volatile raw materials pricing, labor issues –these are just a few common issues that businesses face. Even the best of companies facing such challenges may find their operations seriously impacted, and quite possibly their very survivability at issue. Simultaneously, a company may find that its once supportive lenders have lost confidence in the company and would like to be refinanced, creating somewhat of a "perfect storm" for the business. If the company still has a sound fundamental business operation, the ability to service debt, and a readily achievable plan to combat its current challenges, there is a high likelihood that a new lender can be identified to provide financing sufficient for a full refinance. In other instances, refinancing with another bank simply may not be realistic and other alternatives considered. While the increasingly impatient bank may suggest that management raise new equity or subordinated debt, under such circumstances this strategy is likely to be extremely dilutive and for many closely held businesses, particularly those in "old" industries, may simply not be realistic. A second alternative may be to sell assets, divisions, or the entire business. Once again, for the business in the midst of a turnaround, it may not be a realistic alternative, and is definitely not a value maximizing strategy for shareholders. In such circumstances, both the borrower and lender may despair as the relationship becomes increasingly acrimonious. In such circumstances both parties can benefit from the sale of the bank's debt to a new capital provider.

A sale of existing debt, also known as a "secondary trade", is common among large corporations that issue public debt and large financial institutions that provide syndicated loans to companies. While these markets have been liquid over the last ten years, middle market and smaller commercial loans underwritten by a single institution have not always enjoyed the same flexibility. That is no longer the case.

Banks are increasingly active in seeking to market their loans to third parties and with good reason. Both regulators and the capital markets can react harshly with a bank that allows its 'problem' assets to rise beyond levels deemed acceptable. While in the long run, a bank might recover more by 'riding it out' with its distressed borrowers, bankers know that the road to recovery is rarely easy or quick. They also know that Wall Street will cheer moves to aggressively dispose of subpar assets if it means a cleaner, more predictable stream of earnings going forward. Finally, banks increasingly recognize that third party investors may be better positioned to work with their borrowers to create new financing structures for win-win solutions while the lender can avoid the unpleasantries and bad PR that is inevitably associated with the workout process and focus its efforts on its primary business of providing loans, which hopefully is a more profitable endeavor.

For the company in the midst of a turnaround, the prospect of having its loan sold to a 'vulture' may add yet another layer of anxiety and uncertainty. To be clear, the groups buying distressed debt are profit seeking institutions with a goal of maximizing returns. Still, on balance, the sale of the bank's loan to an experienced distressed investor can be a good thing for the borrower who gets a fresh new face unburdened by the past

Signature Capital Partners, LLC
David McReynolds
312-546-4603
mcreynoldsD@signaturecap.com

and a new financial partner who is more flexible in its ability to respond to the borrower's needs in a creative fashion.

Typically, the best solution for a management team and its advisors is to be proactive in seeking out a financial partner who can work with them to provide the bank with an acceptable alternative that allows them to monetize its troubled loan by providing fair value for the claim. By proactively seeking a solution from an alternative capital partner, the company (i) protects itself from the unknown – whether it be the existing lender's actions or the buyer of the lender's claim; (ii) achieves a much quicker resolution to its workout enabling time to be better focused on operations; and (iii) insures that the new capital provider understands its operating situation such that the company and financial partner's short and long term needs are addressed in a collaborative environment.

While investments in distressed debt do carry their own specific challenges, the fundamentals are the same as they would be for any other type of capital raise. For the management team and its advisors seeking to be proactive, information should be compiled to allow a potential debt buyer to understand the company's (i) current business challenges and management's plans for improvement, (ii) historical and projected financial performance, (iii) capital structure (including the status of relations with trade vendors) and financing needs going forward, and (iv) loan documentation including the loan agreement and any intercreditor agreement and documentation for other indebtedness the company may have.

Ultimately, there are some important decisions that need to be made about who, when, and how conversations about a loan sale occur with the lender. One thing the company should be wary of is approaching the lender without having identified a bona fide capital partner that the lender can take seriously. Once such a capital provider has been identified, it is usually best to allow the capital provider to take the lead in contacting the lender and conducting purchase discussions. In the alternative, the best party to facilitate these discussions is the crisis manager who is advising the company. While such advisors represent and are fiduciaries of the borrower, banks know that advisors are extremely reputation conscience, which typically promotes honest communication. Thus, while anything suggested by the borrower in distress may be suspect to the bank officer, the crisis manager frequently has much greater credibility, including relationships that go higher up the bank's decision making apparatus. This sort of credibility can be essential to the process of encouraging the bank to divorce emotion from reality and make a commercially sensible decision to recognize its losses and move on. Other considerations to keep in mind during these discussions are the ongoing relationship between the bank and the company, as well as the motivations of the bank's workout officer.

Upon completion of the debt sale, the new capital partner steps into the selling bank's shoes with the same loan documentation, rights and remedies. If the business is sufficiently stable, it may be possible to negotiate a global restructuring in conjunction with the purchase of the bank debt. More typically, there are too many uncertainties and a more narrow restructuring occurs to deal with liquidity or other immediate challenges with the ultimate long term resolution deferred.

Signature Capital Partners, LLC
David McReynolds
312-546-4603
mcreynoldsD@signaturecap.com

Case Study: Recently, we were introduced to a company in the heavy construction industry by its turnaround advisor. While the company had taken significant steps to address its challenges and it was in the early stages of a rebound, it was undercapitalized and unable to obtain the bonding necessary for it to bid on and win some of the most lucrative jobs. Meanwhile, its bank was fatigued over the prior two year's deteriorating performance. The turnaround advisor knew that a capital raise from a traditional financing source was unlikely. He also knew his client had a strong aversion to selling the company that had been his life's work for the past 40 years. The turnaround advisor approached Signature Capital Partners, LLC about partnering with the shareholder to purchase the bank's claim. Signature structured a deal where it would acquire the bank's existing loan, convert a portion of its discount into equity, facilitate a sale-leaseback of the company's headquarters property to further reduce debt and provide an additional capital infusion for ongoing liquidity. This restructuring had the effect of reducing debt by over sixty percent and positioning the company for a significant rebound in profitability.

A proactive company in the midst of a turnaround has the ability to convert adversity into opportunity. Traditional financing sources such as banks, mezzanine lenders, and private equity funds are unlikely to provide the amount and type of capital necessary to facilitate a business's turnaround. By exploring opportunities with an investment group experienced in investing in distressed situations, management can take practical steps in helping to position its business to recapitalize and thrive.

Signature Capital Partners, LLC
David McReynolds
312-546-4603
mcreynoldsD@signaturecap.com