AMERICAN BANKRUPTCY INSTITUTE

2019 Mid-Level Professional Development Program

The Importance of Plan Feasibility

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2019

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Panelists

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Agenda

- “Chapter 22s” and Recent Filing Trends
- Overview of Plan Feasibility
- Caselaw and the Judge’s Perspective
- How Is Feasibility Typically Demonstrated?
- Red Flags and Suggested Best Practices

> "We Have a Feasibility Problem"
>
> Petition Newsletter
> November 28, 2016

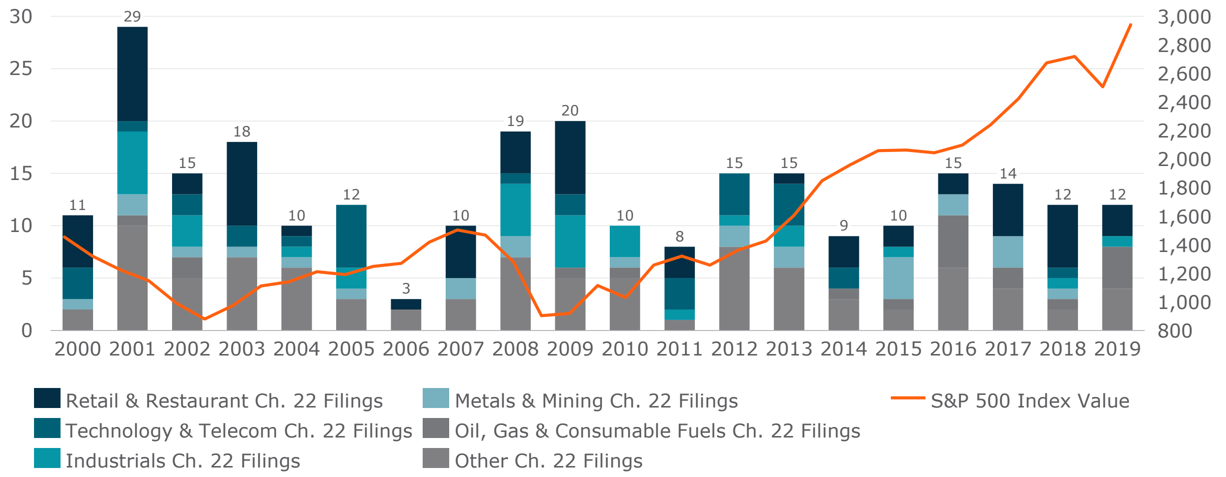
> "Now Oil & Gas Challenges Feasibility"
>
> Petition Newsletter
> May 19, 2019

> "Long Retail Chapter 22s"
>
> Petition Newsletter
> July 14, 2019

Tech & Telecom "22" Examples	Oil & Gas "22" Examples	Retail "22" Examples
nii	Vanguard Natural Resources, Inc.	RadioShack
TerreStar Solutions	Hercules Offshore	Payless

Sources: Petition LLC, BankruptcyData

Chapter 22 filing trends – which largely tracked markets in the 2000s – have behaved differently since 2010 …



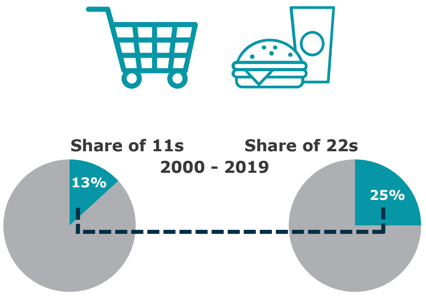
Sources: BankruptcyData, Bloomberg

“Chapter 22s” and Recent Filing Trends

… and not all sectors have been impacted equally

- Perhaps unsurprisingly, repeat filers are more likely to come from industries that have been dealing with significant disruption
- Specifically, companies in the *retail / restaurant*, *energy*, and *tech / telecom* sectors are responsible for significantly more than their “fair share” of chapter 22 filings

Retail & Restaurant



- The ongoing disruption faced by retailers and restaurants have been well-documented
  - Online shopping options and reduced mall visitation
  - Competition from new business models including DTC, rental, and subscription
  - Increased prevalence and ease of mobile food ordering and delivery
- Also, lease-related provisions in the BK code typically compress time frames in these types of cases, exacerbating the problem

Source: BankruptcyData

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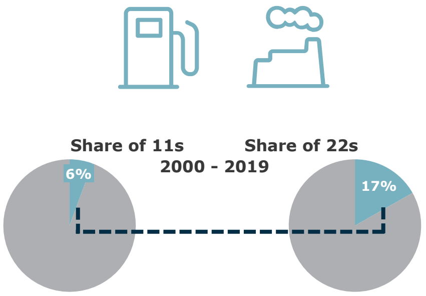
“Chapter 22s” and Recent Filing Trends

… and not all sectors have been impacted equally (cont’d)

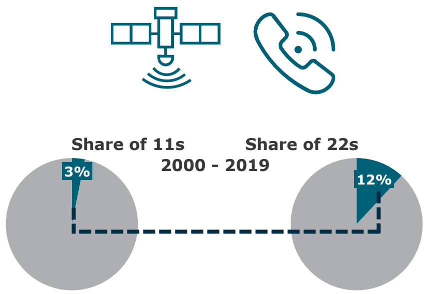
Energy

- Challenging environments in oil & gas and metals & mining have led to multiple repeat filings in energy
  - Knock-on effects of fracking technology
  - Expansion of renewables
  - Continued oil price volatility



Technology & Telecom

- Contending with a host of disruptive elements due to the rapid pace of technological change
  - “Cloud” impacts on data storage and enterprise software
  - “OTT” players cannibalizing messaging and voice revenues that telecoms have relied on



Source: BankruptcyData

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Plan feasibility – An overview

Pursuant to Chapter 11 of the Bankruptcy Code, one of the many statutory requirements that a plan must satisfy in order to be confirmed is Section 1129(a)(11), also known as the 'feasibility' requirement.

This section requires a bankruptcy court to find that the debtor has a reasonable chance of surviving and remaining solvent once the plan is confirmed and consummated and the debtor emerges as a reorganized entity. The burden for establishing feasibility lies with the plan proponent.

Plan feasibility – An overview (cont’d)

Section 1129(a)(11) specifically provides that:

(a) The court shall confirm a plan only if all of the following requirements are met:

> … (11) Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed by the plan.
>
> 11 U.S.C. § 1129(a)(11).

Plan feasibility – An overview (cont'd)

General factors that courts use in assessing feasibility of a Chapter 11 plan include:

- The adequacy of the debtor's capital structure
- The debtor's earning power
- Economic conditions
- The ability of debtor's management and the probability of its continued management
- Other factors that will affect the successful operations of the debtor's business and ability to carry out the plan's provisions
- Timely adequate protection payments and other payments during the case

Plan feasibility – An overview (cont'd)

Persuasive evidence of feasibility can include:

- The company's expected financial operations, including future cash flow, expected profitability and debt assumption
- The company's future operations, taking into consideration any expected changes as a result of the confirmed plan or the market, such as increased revenue, a reduction in expenditures, a change in a product or service, the company's competitive advantages and disadvantages
- *Chapter 11 plans that contain overly aggressive assumptions, unrealistic projections, and/or unreliable information will likely not satisfy the feasibility standard*

Plan feasibility – Caselaw

Paragon Offshore (Bankr. D. Del. No. 16-10386) (CSS) – Judge Sontchi denied confirmation and in his ruling examined the plan's feasibility in detail. He concluded the plan proposed by the debtors, global providers of offshore drilling rigs, was not feasible because, among other things the debtors' business plan was not reasonable and the debtor would be unable to refinance its debt upon maturity. Focusing on liquidity (as opposed to balance sheet solvency upon emergence), the court stated 'at the end of the day, these cases are all about liquidity.'

Plan feasibility – Caselaw (cont'd)

Friendship Dairies (Bankr. N.D. Texas 12-20405) (RLJ) – the court similarly denied confirmation after finding the plan was not feasible. The court highlighted the debtor's struggles during the case (failure to meet projections, adequate protection payment defaults, operational issues), coupled with insufficient liquidity and cash flow upon emergence to make plan payments in reaching its conclusion that the debtor essentially stumbled 'at the starting line.'

Plan feasibility – Specific factors that may impact analysis

In conducting a feasibility analysis, a judge can be influenced by a number of key factors related to a debtor's business and post-confirmation business plan, which can include, among others:

- **Exit Debt Maturity:** Regardless of whether exit debt financing is reinstated or consists of new money, a judge will be concerned about when that debt matures. What is the anticipated revenue and earnings trajectory of this business?
  - A judge will want to know that the debtor will have the ability to pay off such debt come maturity, or if it will have the means to refinance such debt at maturity.
  - This issue may be exacerbated if a debtor has multiple tranches of exit debt financing maturing at the same time or in rapid succession, or if many similarly-situated companies have debt also maturing at a similar time, causing concern for a potential credit crunch by likely lenders.
- **Exit Debt Commitment:** If a debtor needs to secure new money exit financing post-confirmation but pre-plan consummation, or if the chapter 11 plan calls for near-term post-confirmation refinancing of exit debt, a judge will want to ensure that either the debtor has investor commitments in place to secure or refinance such debt, or has a robust marketing plan in place to obtain the same.
- **Cash Liquidity:** Generally, the greater the cash liquidity a debtor has upon emergence, the more comfort a judge will have with respect to ensuring a debtor will be able to perform in the ordinary course of business post-confirmation.
- **Cash Flow:** Closely related to cash liquidity, if a debtor's business is cash-intensive, or if it has variable cash-flow issues (either in the ordinary course or due to the nature of the debtor's business) a judge may focus on the debtor's go-forward ability to satisfy its obligations in the ordinary course where it may experiences acute periods of either (i) diminished cash-inflows or (ii) extensive cash-outflows.

Plan feasibility – Specific factors that may impact analysis (cont'd)

- **State of the Industry:** A key factor that may weigh over a debtor's overall restructuring is the state of the industry in which a debtor operates.
  - If a debtor's industry is severely volatile or cyclical (commodities), going through a period of depressed pricing (such as oil & gas), or going through a period of extensive turnover or industry-wide upheaval (retail), a judge will want to be assured that a debtor's plan accounts for such industry-wide market factors such that the debtor can perform post-confirmation.
- **State of the Economy:** A judge will be concerned with the overall state of the economy.
  - As noted, stability and a debtor's ability to perform its obligations in the ordinary course post-petition is a key consideration for a bankruptcy judge in feasibility. If the market economy as a whole is stressed or struggling, a judge may want to be assured that a debtor's business plan can weather the effects of the down cycle
- **Third Party Approvals:** Whether a debtor's plan relies upon the success of potentially contingent or third-party actors that will not be received until post-confirmation may also weigh on a judge's mind in a feasibility analysis.
  - For example, if a plan calls for governmental approvals, or consummation of a purchase transaction (whether the debtor is the seller or the purchaser), the contingency risk of those conditions not being satisfied may impact a judge's overall feasibility analysis, particularly if the process for securing such conditions is not already in the works by the debtor.
  - For that reason, it is always good practice, where practicable, to secure or gain commitments of necessary third-party approvals before plan confirmation, to assuage a judge of concerns on this point.

Overview of the projections exhibit

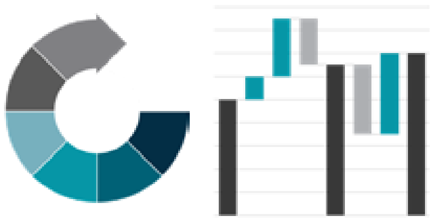
- Goal is to allow readers of the disclosure statement to answer important questions about the reorganizing company:
  - What is the anticipated revenue and earnings trajectory of this business?
  - What will the reorganized company's leverage and working capital profile look like?
  - Will the company generate enough cash to service debt payments or other obligations?
- Because companies rarely share their long range plans, projections must "toe the line" between sharing too little or too much information
  - Too little detail makes it challenging for a user to make assessments on achievability
  - Too much detail puts sensitive information in the hands of the public, including competitors
- While a portion of today's panel will be dedicated to examining the "normal course" approach, the typical process is far from an afterthought
  - The long range plan is an integral part of most valuation exercises (needed to size distributable value) and informs views on debt capacity (needed to determine what "currency" creditors will receive – debt or equity)
  - Stakeholders often spend a large amount of time performing due diligence on a debtor's long range plan, and plan objectors will often focus on projection accuracy and achievability in their arguments
  - As a result, a large amount of time and energy is often dedicated to the development of a projection and projection exhibit, as illustrated on the following page

Kodak example

Background / Level Setting

Purpose and Intended Use	Disclaimers
Basis of Presentation	List of Risk Factors

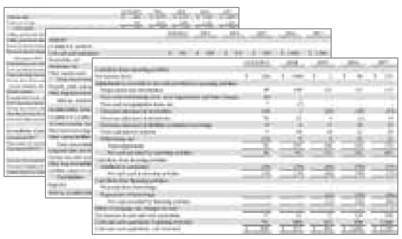
Forecasting Process Overview & Explanatory Bridge to Prior Versions



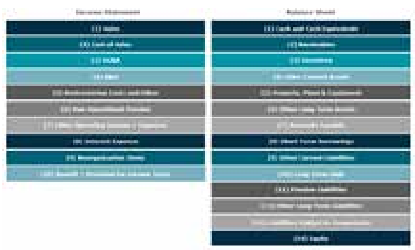
Other Common Elements

Pro Forma Balance Sheet

5 Year Projections For IS, BS, CF



Detailed Assumptions for Key Line Items



Sources & Uses

Kodak Example Totaled 15 Pages in Length (Not Uncommon)

What are some of the red flags?

Antennae raising circumstances

1. History of missing guidance (for example, revenues, production levels, EPS)
2. Recent and anticipated management and BOD changes
3. Significant reinstatement of funded debt
4. Major constituencies not part of deal
5. Exogenous industry risks
   - Consumer trends impacting retail businesses
   - Regulatory changes impacting healthcare sector
   - Commodity fluctuations impacting energy/metals
   - Feedstock supply, customer concentration, etc.

Related concerns

- Why are these latest financial projections any more credible?
- Who’s business plan is reflected?
- Has leverage been sufficiently reduced?
- Are financial projections 'massaged' to support the plan proponent(s’) position(s)?
- Are the downside risks properly quantified?

Incremental disclosures to assess feasibility

Qualitative

- Key drivers of risk and steps taken to mitigate both during Chapter 11 and post
- Process undertaken to prepare the disclosure statement projections including preparer(s) and qualifications. Identify differences, if any, with existing internal business plans
- History of meeting business plan projections

Quantitative

- Liquidity projections for 24 months post emergence (cash and borrowing capacity)
- EBITDA sensitivity analysis for key assumption (for example, same store sales, commodity pricing)
- Downside scenario financial projections showing impact on EBITDA, liquidity and financial covenant cushions
- Filing to date actual operating results vs budget

What can debtors do to further shore-up plan feasibility demonstration?

A debtor and its advisors can take a number of actions to shore-up the demonstration of plan feasibility.

- **Robust Business Plan Creation Process:** Create a process that bolsters a debtor's, its advisors', and the business plan's credibility. This can be done through a variety of methods, such as:
  - Having the business plan approved by an independent governing authority such as a duly formed restructuring committee.
  - Ensuring that the business plan is developed by management with proper involvement from the debtor's advisors
    - An additional measure could be having third-party industry experts independently verify a debtor's proposed business plan in accordance with appropriate industry standards.
    - This verification can take a number of forms, for example, focusing purely on the debtor's go-forward ability to perform, or comparing the debtor's business plan to other plans of similarly situated companies in the debtor's industry.
    - Independent verification can also be used to protect a debtor's business plan where the credibility of the business plan's proponents or creators has been previously called into question.
  - To the extent there is a marketing process required, ensuring such process is robust, with enough time to properly solicit third-party interest and engage with third-parties to determine whether a better third-party offer is available.
- **Reduce Contingency Risk:** Many of the concerns discussed herein relate to various contingencies inherent in a proposed plan (e.g. liquidity) or in the debtor's business environment (e.g. industry). Accordingly, another method of mitigating feasibility risks is to directly protect against the worst contingency risks that may present themselves before a judge.
  - This can include, among other things, (i) including a higher cash liquidity cushion, (ii) demonstrating feasibility through reliance on a lower projected commodity valuation, (iii) reducing debt capacity or debt service capacity, and (iv) spreading out or reducing the timing of debt repayment or refinancing.

Suggested best practices?

1. Establish minimum guidelines for disclosure statement financial projections such as:
   - Three year balance sheet, income statement and cash flow projections
   - 24 month liquidity projections
   - Key driver sensitivity analysis
   - Downside scenario(s) showing impact on EBITDA, liquidity and financial covenant cushions
   - History of meeting financial projections
2. Affirmative statement by current board of directors regarding reasonableness of projections
3. Feasibility assessment should be increased to three years
4. Accelerate feasibility testimony to disclosure statement hearing