



Navigating Financial Distress and Bankruptcy during the Age of COVID-19

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Agenda

- Turnaround and Restructuring
- Bankruptcy and Reorganization
 - Chapter 11 (Free-fall, Prearranged, Prepackaged)
 - Small Business Reorganization Act of 2019
 - Other bankruptcy filings
- Accounting for Bankruptcy
 - ASC 852, *Reorganizations* and Fresh Start Reporting

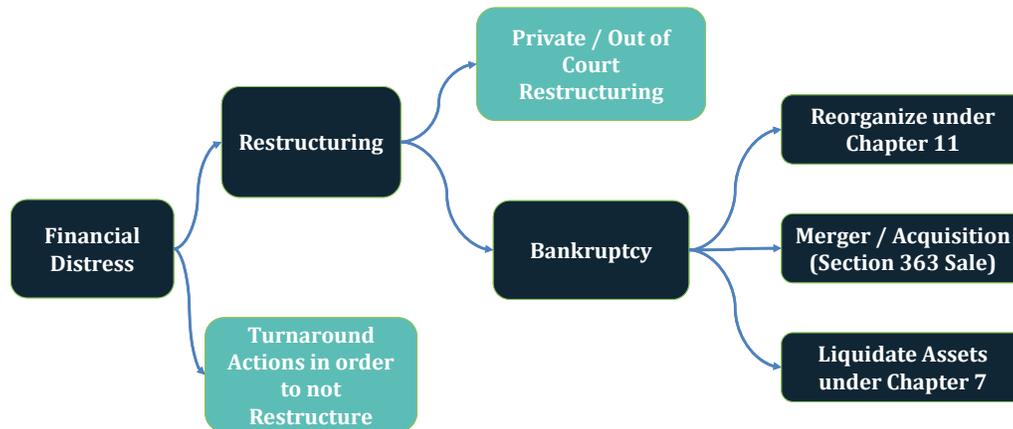


Morning Headlines

- “U.S. Economic Recovery Will Drag on Through Next Year, CBO Says”
 - Wall Street Journal
- “How long will Louisiana's coronavirus recession last? It's going to be a challenge”
 - The Advocate
- “Low bankruptcy filing rate across Louisiana not expected to last”
 - Greater Baton Rouge Business Report



Understanding Financial Distress



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Turnaround and Restructuring

Common questions from companies concerned for their future.

1. How can a business cope with market uncertainty?
2. Is it too late for us to “right the ship?”
3. What options are available to my company?

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Turnaround and Restructuring

Maintaining a forward-thinking mindset can help your business identify opportunities early on and possibly avoid bankruptcy.

Companies need to assess future business operations post-COVID.

- Did the company alter operations (i.e. breweries pivoted to making hand sanitizer)?
- How will a state's phase rules impact cash flow?

Taking initiatives to review cash flow and liquidity early on can help conversations with your lenders in negotiating relief. Instances of 'leniency' by major creditors as a result of communication and due diligence have been documented regularly over the last months while dealing with the COVID shutdown.



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Turnaround Activities

Consider speaking with financial advisors frequently.

Leverage professionals to evaluate company's options for adapting to economic uncertainty, including:

- Financial forecasting, including the development of 13-week budgets
- Analysis of liquidity needs and management
- Working capital improvement analysis
- Financial analysis of vendor contracts and lease obligations
- Supplementing/outsourcing financial reporting and operating activities



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Restructuring Activities

While performing turnaround activities, management should establish effective communication with stakeholders as early as possible and consider potential alternatives:

- Divestitures and distressed M&A transactions
- Negotiations with existing stakeholders
 - Collateral reviews
 - Exploring potential covenant amendments
 - Obtaining covenant waivers
 - New money capital raises
- Cost/benefit analysis of out-of-court vs. in-court restructurings



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Filing for Bankruptcy

The prospect of filing bankruptcy can, however, sometimes be unavoidable. These filings are often not the result of a single economic factor, but rather, the result of multiple financial and economic events that act as a domino effect for the company.



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Bankruptcy and Reorganization

Bankruptcy can be a tool to protect your company and facilitate negotiations.

Types of Reorganizations:

- **Traditional or “Free fall” Chapter 11**
- **“Prearranged” and “Prepackaged” Chapter 11**
- Small Business Reorganization Act of 2019 (the “SBRA”)

Other bankruptcy chapters include:

- Chapter 7 (liquidation)
- Chapter 9 (municipal reorganizations)
- Chapter 13 (personal reorganizations)



Five Phases of Chapter 11

Each Chapter 11 reorganization can be organized into five phases generally.

Phase 1 – pre-filing preparation

Phase 2 – first day motions

Phase 3 – pre-confirmation administration

Phase 4 – confirmation

Phase 5 – post-confirmation administration, substantial consummation and bankruptcy exit



Phase 1 - Preparing for Bankruptcy

Adequate preparation with the accounting department and advisors is necessary for a smooth bankruptcy filing process:

- Delegation of duties and tone at the top
- Understand the collection points
- Prioritize the work at Petition Date and monitoring shortly after
- Prepare for month end close under a condensed timeline at Petition Date
- Eliminate communication silos and flatten information exchanges



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Phase 2 – First Day Motions

- The Bankruptcy Code does not explicitly provide a process for transitioning into Chapter 11.
- Debtors file so-called “first day motions” on the petition date.
- These motions are necessary to maintain the debtor's business operations that cannot be taken unless the court first issues an order authorizing the debtor to take the actions.
- Examples:
 - Motion to Use Cash Collateral
 - Motion to Use Pre-Bankruptcy Bank Accounts
 - Motion to Assume (or Reject) Unexpired Leases



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Cash Collateral (the Big One)

- Cash Collateral
 - Debtors regularly grant security interests in their cash and accounts receivable.
 - Debtors need Court authority or permission from the secured creditor to use cash collateral.
 - Debtors need to prepare a 13-week budget to show how they will responsibly use cash collateral.



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Phase 3 – Case Administration

- After the flurry of first-day activity, the case slows down very rapidly.
- Debtors file more substantive motions such as motions such as:
 - Motions to sell property free and clear under 11 U.S.C. sec. 363(f)
 - Motions to assume (or reject) unexpired leases and executory contracts under 11 U.S.C. sec. 365
- Debtors also file monthly operating reports to show success (or failure) of post-petition operations.



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Bankruptcy Reporting

Bankruptcy involves additional financial reporting requirements from the accounting department which can be burdensome over normal day-to-day duties, including:

- Statement of Financial Affairs (“SOFAs”)
- Summary of Assets and Liabilities (“SOALs”)
- Monthly Operating Reports (“MORs”)
 - Includes cash disbursements
 - Filed timely during bankruptcy and after emergence



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Section 363 Sales

- Sale motions under section 363(f) are very important in cases under Chapters 7 and 11 because they can represent significant sources of cash for the debtor’s estate.
- Valuation is key because assets are usually sold pursuant to section 363(f)(3):
 - The value of the property must exceed the amount of all security interests in the property.
 - Expert valuation can mean the difference between an approved sale and conversion to Chapter 7.



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Phase 4 – Plan Confirmation

- Within 120 days after the petition date, the debtor files a plan of reorganization and disclosure statement.
- The disclosure statement is similar to a prospectus in that it must provide “adequate information” to allow a creditor to vote to accept (or reject) the plan.
- The disclosure statement generally includes 5-year financial projection, 12-month lookback income statement, and a balance sheet.
- Valuation, both liquidation and going concern, is important to show the debtor has met confirmation standards.



Phase 5 – Post-Confirmation

- After confirmation, the debtor begins substantially consummating its plan.
- The debtor is required to file post-confirmation operating reports.
- Substantial consummation includes making distributions called for under the confirmed plan.



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Small Business Reorganization Act

Small Business Reorganization Act of 2019

- The SBRA became effective on February 19, 2020.
- It creates new Subchapter V within Chapter 11. See 11 U.S.C. §§ 1181-1195 (2020).
- The SBRA is intended to streamline existing bankruptcy procedures and provide new tools to increase a small business' ability to achieve a successful restructuring.



Why Small businesses?

Small businesses account for:

- 99% of all businesses in the U.S.; and
- 47.5% of the total U.S. workforce.

Reasons for change:

1. Administrative costs made exiting Chapter 11 burdensome.
2. Small businesses lack access to capital.

Eligibility for SBRA Relief

- A “person” with an aggregate amount of non-contingent liquidated secured and unsecured debt of not more than \$2,725,625.
 - CARES Act increased threshold to **\$7,500,000** (expires 12/31/20).
- Not less than 50% of the debts may arise from business of commercial activities.
- Single asset real estate debtors are not eligible.

Key Provisions

- Only the debtor may file a plan.
- Relief from the absolute priority rule.
- Plans must provide for payment of the small business debtor's "projected disposable income" over a 3-5-year period.
- No official committee of unsecured creditors.
- A Subchapter V Trustee is appointed in every case (but does not run the business)
- The trustee acts like a mediator – helps the parties reach a consensual plan of reorganization.



The Absolute Priority Rule

- In regular Chapter 11, a debtor must pay all creditors in full before it can retain its property – the absolute priority rule.
- Under the SBRA, the absolute priority rule is modified.
- If the debtor pays its "projected disposable income" over the life of the plan (3-5 years), then the plan is "fair and equitable" and the absolute priority rule is satisfied.



Petition Date Accounting

Adoption of ASC 852, *Reorganizations*

- Primarily a “***presentation standard***”

New financial statement line items:

1. Liabilities subject to compromise (“LSTC”)
 - Pre-petition liabilities which are not fully secured are separately presented on the Balance Sheet
 - “Allowed claims” accounting
2. Reorganization items, net
 - Incremental bankruptcy-related expenses are presented on the Income Statement
 - Beneath “Net operating income”



Fresh Start Reporting

Qualification for Fresh Start:

Solvency Test

Reorganization Value
of Total Assets
<
Total post-petition
liabilities and allowed
claims prior to
emergence

AND

Change of Control

Existing voting shares
receive less than 50%
of Reorganized
Company voting
shares



Adopt Fresh Start
Accounting



Fresh Start Reporting

Proper planning and coordination is necessary for a smooth and effective emergence from a GAAP perspective.

- Black-line presentation of financials and footnotes (Predecessor and Successor)
- Fresh Start Footnote
 - *“Four Column Balance Sheet”*
 - *“Gain on settlement of LSTC”*
- Under fresh start accounting, the company “resets”
- Adoption of new Accounting Policies
- Valuations must be performed over **all** assets and liabilities
 - Sale-leaseback transactions, Deferred Revenue, etc.



Emergence Accounting

At emergence, old agreements will be cancelled and new agreements will be executed, all of which need to be reviewed for fair value and accounting implications, including:

- Exit Debt Agreements
 - Assess for discounts and premiums
 - Embedded derivative analysis
- Preferred Stock
 - Liability classification
- Warrant Agreements
 - “Hidden” value
- Management Incentive Plans (“MIP”)
 - 409A valuations



Other Accounting Considerations

- Tax implications at emergence (CODI, NOLs, etc.)
- Section 363 Sales
 - Specific Assets sold during bankruptcy proceedings
 - Carve out financials and due diligence
- Trusts may be established at emergence to handle litigation matters or creditor settlements for the Predecessor Company
 - Deconsolidation
- Liquidation (Chapter 7)
 - Financial statements to be prepared under liquidation basis of accounting

Important to note that incremental Bankruptcy Court reporting will continue after emergence



Navigating the Path Forward



- Restructuring & Turnaround
 - Cash flow forecasting
 - Distressed valuation and transaction advisory
 - Outsourced CFO and accounting services
 - Other financial advisory
- Bankruptcy & Reorganization
 - Pre-filing planning
 - Preparation of "first-day" motions, SOFAs, SOALs, and MORs
 - Fresh start accounting
 - 409A Valuations
- Bankruptcy & Reorganization
 - Sub-Chapter V Trustee - Louisiana
 - Debtors counsel in Chapter 7 & 11
 - Chapter 7 Trustee representation
 - Certified bankruptcy mediator
 - Avoidance action litigation
- Business Services
 - Concierge legal services
 - Business litigation
 - Tax counsel
 - Start-up services





A Professional Accounting Corporation