



AMERICAN
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Southwest Bankruptcy Conference

Financing Small Business Cases/ Financial Concepts for Lawyers

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Financing Small Business Cases/ Financial Concepts for Lawyers

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Roadmap

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- Introduction
- What Financial Advisors Know and Attorneys Should Know
- Subchapter V Specifics
- Intricacies of Small Debtor Cases
- What are Judges Looking for in Small Business Cases?

Introduction

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- What cases are considered “small cases”?
 - Less than \$100mm
 - Subchapter V

- Three specific areas of focus for this panel:
 - (1) Financial materials, models, and tools that Financial Advisors (“FAs”) focus on that attorneys should understand
 - (2) Practical tips and tricks to help in small(er) cases
 - (3) What are Judges focused on that are unique to small(er) cases

Matt Foster – Managing Director, Sonoran Capital Advisors

What FAs Know That Attorneys Should Too

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Why Traditional Financial Documents Fall Short in Distress

- Net Income ≠ Cash

- Statement of Cash Flows ≠ Projection

- Balance Sheet: Some relevance, but often outdated or aggressively prepared






- Historical data doesn't always predict future distress

- Many factors are increasing turmoil, making it hard to predict and plan

Daniel R. Williams – Senior Managing Director, JS Held LLC

What FAs Know That Attorneys Should Too

Why Traditional Financial Documents Fall Short in Distress

 <p>Net Income</p> <ul style="list-style-type: none"> • Net Income ≠ Cash • Cash is King 	 <p>Cash Flow Statements</p> <ul style="list-style-type: none"> • Statement of Cash Flows ≠ Projection • Historical Spending 	 <p>Balance Sheet</p> <ul style="list-style-type: none"> • Relevant for valuations • Often aggressively prepared 	 <p>Historical Data</p> <ul style="list-style-type: none"> • Does not predict future distress 	 <p>Turmoil</p> <ul style="list-style-type: none"> • Hard to predict & plan • Uncertainty, increased cost & interest
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Daniel R. Williams – Senior Managing Director, JS Held LLC

What FAs Know That Attorneys Should Too

Detecting Hidden Distress

- Capital Expenditure (CapEx) vs. Depreciation
- Low Capex leads to deterioration
- Deferring: Maintenance, hiring, marketing, selling
- Working Capital = Current Assets – Current Liabilities
- Managing Working Capital: How to generate liquidity from assets
- Accounts Receivable, Accounts Payable, Inventory

Daniel R. Williams – Senior Managing Director, JS Held LLC

What FAs Know That Attorneys Should Too

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Detecting Hidden Distress

Capital Expenditure

- Capital Expenditure (CapEx) vs Depreciation
- Low CapEx leads to deterioration

Deferral

- Maintenance, hiring, marketing, sales
- Leads to increased costs, missed projections



Working Capital

- Current Assets - Current Liabilities
- Managing working capital: generate liquidity from assets
- A/R, A/P, Inventory

Daniel R. Williams – Senior Managing Director, JS Held LLC

What FAs Know That Attorneys Should Too

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Tools for Financial Survival

- Assumptions Page: Necessary for ALL projections
 - Shed light on the situation
 - Should be detailed and comprehensive
- EBITDA: Earnings Before Interest Taxes Depreciation and Amortization
 - Useful in valuation, but need to consider the whole picture
- SKU Analysis: Focus on revenues that create a profit margin
 - Analyze the product mix to drop unprofitable products
 - 80/20 rule: Most companies make 80% of their revenue on 20% of their products

Daniel R. Williams – Senior Managing Director, JS Held LLC

Tools for Financial Survival



Assumptions Page

- Necessary for **ALL** projections
- Used to shed light on the situation
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EBITDA

- Earnings Before Interest Taxes Depreciation and Amortization
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SKU Analysis

- Focus on revenues that create a profit margin
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Daniel R. Williams – Senior Managing Director, JS Held LLC

Subchapter V Requirements

- Debt Limit: Currently \$3,024,725 (though there are ongoing efforts to increase it again to \$7.5 million).
- Plan: Only the Subchapter V Debtor can file a plan [a court cannot order otherwise] and it must be filed within 90 days of the petition date.
- Some Courts allow parties in interest to stipulate to extend plan filing deadline.
- Some Courts will approve motions to extend this deadline.
- Status Conference: Mandatory Status Conference must be held within first 60 days of case.
- Subchapter V Trustee: appointed at the beginning of the case. Tasked primarily with facilitating a consensual plan.
- UST Fees: No quarterly UST Fees.
- Creditors' Committee: Only if the Court orders one to be appointed.

Susie K. Seflin – Partner, BG Law LLP

Subchapter V Specifics

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Financial Advisors in Subchapter Vs

- Subchapter V debtors can hire financial advisors, though it may cost prohibitive to many small business cases.
- Financial advisors are often needed in these cases because many times the debtors do not have an accounting department and instead rely on one or two people to prepare their financials.
- Can FA's narrow the scope of what they offer to reduce cost and yet still provide these small business debtors with the assistance they need to, among other things, prepare projections, monthly operating reports, etc.?
- What should the debtor's counsel know if there is no FA?
- The Court and the Subchapter V Trustee will be looking for reliable projections during the case and in connection with plan confirmation.
- Debtor's counsel should have accountants / accounting firms / financial advisors to refer to debtors to ensure that accurate projections are produced.

Susie K. Seflin – Partner, BG Law LLP

What FAs Know That Attorneys Should Too

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Things for Debtor's Counsel to Contemplate in Connection with Subchapter V Cases

- Cash Collateral: If there are any secured creditors with an interest in a debtor's cash collateral, counsel must immediately file a cash collateral motion and the debtor cannot use any cash before obtaining an order.
- Connections to Related Entities: Any connection to related entities must be disclosed in employment applications. With these small cases, often times there are related entities that will later file and that must be disclosed.
- Financial Projections: Ask debtors to prepare financial projections prior to filing. Given the speed of Subchapter V cases, debtors should know in advance whether the business can support a chapter 11.
- Timing: Unless the Court extends the deadline, plans must be filed within the first 90 days. Getting an extension is not guaranteed and many judges will not grant an extension unless the debtor stipulates with the Subchapter V trustee, the United States Trustee, any secured creditor and any active unsecured creditors to such extension.

Susie K. Seflin – Partner, BG Law LLP

Intricacies of Small Debtor Cases

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Can Small Companies Afford Chapter 11

- Rephrased, can the debtor continue to operate on an ongoing basis **and** afford administrative costs
 - Professional fees, UST fees, committee fees, etc.
- Complications and Considerations
 - Ability to appropriately prepare for a case
 - DIP Financing
 - Professionals beyond attorneys

Eric W. Moats – Shareholder, May Potenza Baran & Gillespie, P.C.

Intricacies of Small Debtor Cases

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Can Small Companies Afford Chapter 11

- Ability to appropriately prepare for a case
 - Because it's a smaller company, the necessity for a smooth/short chapter 11 case is higher **but** also means (generally) less excess cash to fund adequate preparation
 - Consequence of the conundrum is issues arise during the case that increase cost and length that may have been addressed/predicted with more prep
 - Usually dealing with less executives/officers, who are still have very active and necessary role in the day-to-day operations
- Ways to address preparation conundrum
 - Have a good, user friendly, chapter 11 "checklist" for companies preparing to file
 - Keep case lightly staffed (for knowledge purposes, not necessarily fees)
 - Set hard filing deadline so company can confidently avoid unnecessary payments

Eric W. Moats – Shareholder, May Potenza Baran & Gillespie, P.C.

Intricacies of Small Debtor Cases

DIP Financing

- Much less common in small debtor cases
 - DIP Financing percentage by asset size of debtor(s) (as of November 2021)¹
 - Over \$200mm – 73.49%
 - \$100-200mm – 61.49%
 - \$10-50mm – 27.58%
 - Less than \$10mm – 4.06%

- Usually comes from prepetition lender. Sometimes smaller companies mean smaller secured lenders. Sometimes smaller secured lenders have less DIP lending experience or ability for exposure
 - Even if a third-party seeks to be the DIP lender, likely results in an early (and potentially costly) fight

- If no DIP financing to fund the case, necessity of solid exit plan amplifies
 - Appropriate milestones for case progress
 - Understanding plan classes and abilities to stretch payments, if possible, over time (i.e. Subchapter V)
 - Candid conversations pre- and postpetition regarding conversion, dismissal, or chapter 11 trustee

Eric W. Moats – Shareholder, May Potenza Baran & Gillespie, P.C.

1. Pandemic Hope for Chapter 11 Financing, The Yale Law Journal Forum, Nov. 10, 2021, 336 n. 97.

Intricacies of Small Debtor Cases

Professionals Beyond Attorneys

- Smaller companies = smaller workforce (generally), which can create unique challenges
 - People take on more roles (i.e., CEO that is CEO, COO, CFO, and CTO)
 - Financial fluency can be limited
 - Books and records can be less “intact”
 - Company has unique operations that only a handful of people are aware of

- Ironically, smaller companies usually are the ones that would best benefit from a FA or IB (if a sale is contemplated), but can’t afford additional fees
 - Benefits usually outweigh initial cost, but may require limited role
 - Key to have good relationship between attorneys and FA/IB to eliminate duplication or work

- Potential identification of OCPs prepetition to limit postpetition retention of professionals

- Does the case require a claims and noticing agent? If not, has the debtor and its professionals accounted for the size of the case and the cost of notice throughout the case?

Eric W. Moats – Shareholder, May Potenza Baran & Gillespie, P.C.

Intricacies of Small Debtor Cases

How SubV Helps

- Establishes tighter timelines, like plan filed within 90 days (§ 1189(b))
- Reduction of case fees
 - No committee unless ordered (§ 1181(b))
 - Deadline to file plan means attorneys must work quicker
 - No UST fees (28 U.S.C. § 1930(a)(6)(A))
- Simplified plan and confirmation process
 - No disclosure statement required (§ 1181(b))
 - Payment of admin claims over time (§ 1191(e))
 - No absolute priority rule

Eric W. Moats – Shareholder, May Potenza Baran & Gillespie, P.C.

What Are Judges Looking for in Small Business Cases?

To see that the debtor and counsel in a Subchapter V case understand the fundamentals from the outset. Judges will want to see that --

- Debtor meets the Bankruptcy Code’s qualification standards for Subchapter V relief [11 U.S.C. §§ 1182(1) and 101(51D)]
- Debtor has made timely disclosure of important information early in the case [11 U.S.C. §§ 1187, 1188(c), and 1116]
- Debtor has engaged in communication with key secured creditor(s) and the Subchapter V trustee early in the case
- Debtor has sought permission to use cash collateral, either by stipulation or first day motion [11 U.S.C. §§ 1184 and 363(c)(2)]
- Debtor presents evidence to support the use of cash collateral in the form of a reasonably detailed budget and meaningful projections
- If debtor in possession financing is required, Debtor has sought early approval

The Honorable August B. Landis – United States Bankruptcy Court for the District of Nevada

Paul W. Bonapfel, *A Guide to the Small Business Reorganization Act of 2019* (June 2022 rev. ed.), available at https://www.ganb.uscourts.gov/sites/default/files/sbra_guide_pwb.pdf

What Are Judges Looking for in Small Business Cases?

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Judges will also want to see that the debtor and counsel in a Subchapter V case understand the tight timetables for case prosecution

- There is a 90-day deadline to file a plan except when a requested extension “attributable to circumstances for which the debtor should not justly be held accountable” [11 U.S.C. § 1189]
- Failure to timely file a plan is cause for dismissal [11 U.S.C. § 112(b)(4)(J)]
- To avoid an untimely and unfortunate disposition of a Subchapter V case:
 - Effective negotiations with key creditors have to happen early and quickly
 - Counsel should be aware that a form plan is available and can assist in meeting the 90-day deadline [Official Form 425A]
 - The plan must be supported by a meaningful liquidation analysis [11 U.S.C. § 1190(b)]
 - The plan must be supported by meaningful projections as to debtor’s ability to make the requisite plan payments [11 U.S.C. § 1190(b)]

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What Are Judges Looking for in Small Business Cases?

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Judges really want to see debtors accomplish the goals that underpin Subchapter V generally. So, judges want to see:

- Honesty and timeliness in the debtor’s filings, so as to avoid any potential for removal of the debtor as a debtor in possession [11 U.S.C. § 1185]
- Prompt prosecution of the case at all stages
- Cooperation with the Subchapter V trustee to attempt, whenever possible, to bring forward a consensual plan of reorganization
- Effective use of attorney time in prosecuting the case so as to minimize the administrative expense attendant to reorganizing the small business debtor
- To see as many Subchapter V cases as possible confirmed swiftly through consensual reorganization plans

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Questions/Comments

Faculty

Matt Foster is a managing director and founding partner of Sonoran Capital Advisors in Phoenix. His clients include debtors (in and out of court), private-equity firms, secured creditors, unsecured creditors' committees, liquidating trustees, distressed investors and special committees. Mr. Foster has experience representing every portion of the balance sheet, including equity, unsecured debt and senior debt. Prior to co-founding Sonoran in 2017, he worked as a director for international insolvency firm KRYS Global, and before that he worked for another restructuring boutique, Odyssey Capital Group. Mr. Foster began his finance career in private equity working for Citizens Capital, Inc. (CCI), the private equity arm of RBS Citizens Bank. He oversaw CCI's interests in its private-equity portfolio consisting of investments in over a dozen private companies. Since that time, Mr. Foster has been involved in a wide range of restructuring engagements, including out-of-court restructurings, chapter 11 restructurings, litigation support and solvency. He has served in multiple CRO, CFO, financial advisor and investment banking positions across various industries. In the past few years, he's been engaged as the CRO of an oilfield services company, CRO of a cryptocurrency bank, and financial advisor to a land development and mining company. Mr. Foster received his B.S. in finance from the University of Utah and his M.B.A. from Northeastern University.

Hon. August B. Landis is a U.S. Bankruptcy Judge for the District of Nevada in Las Vegas, appointed on Nov. 27, 2013. He served a term as Chief Judge from April 1, 2020, until March 31, 2025, and a one-year term as chair of the Ninth Circuit Conference of Chief Bankruptcy Judges from Oct. 1, 2023, to Sept. 30, 2024. Between 2005 and his appointment to the bench, Judge Landis served as an Assistant U.S. Trustee for the District of Nevada in Las Vegas, as the U.S. Trustee Program's first Acting Associate General Counsel for Chapter 11 Practice, and as the Acting U.S. Trustee for Region 17. Prior to joining the U.S. Trustee Program, he was an attorney in private practice with the Des Moines, Iowa, firms of Neiman, Neiman, Stone & Spellman (1987-90) and Whitfield & Eddy, P.L.C. (1990-2005), representing debtors, creditors and a chapter 7 panel trustee in contested matters and adversary proceedings. Judge Landis is a member of the Iowa State Bar Association. He received his B.S. in business administration from Drake University in 1984 and his J.D. from Drake Law School in 1987, where he served as a staff member of the *Drake Law Review*.

Eric Moats is a shareholder with May, Potenza, Baran & Gillespie, PC in Phoenix, where he focuses on corporate restructuring and bankruptcy. Prior to joining MPBG, he clerked for Hon. Kevin Gross of the U.S. Bankruptcy Court for the District of Delaware and for Hon. Christopher J. Garrenger of the Superior Court of New Jersey. As a clerk, he prepared memoranda, drafted opinions in complex chapter 11 cases and researched novel legal issues. Mr. Moats is admitted to practice in Arizona, Delaware and New Jersey. He received B.S.s in 2012 in both marketing and economics from Utah State University, and his J.D. in 2016 from Rutgers School of Law with a Certificate in Business and Corporate Law. In law school, he was a fellow for the Rutgers Center for Corporate Law and Governance, and he served as president of the Rutgers Sports & Entertainment Law Society.

Susan K. Seflin is a partner with BG Law LLP in Woodland Hills, Calif., where she guides and represents a wide range of businesses through the chapter 11 reorganization process. She has represented

more than 80 chapter 11 debtors (excluding related entities) and has successfully confirmed chapter 11 plans of reorganization. Ms. Seflin focuses her practice primarily on chapter 11 reorganizations and related matters such as § 363 sales, insider litigation and trustee representation. She also is a chapter 11 subchapter V trustee for the Central District of California. Ms. Seflin was listed in *Southern California Super Lawyers* from 2016-24, and she has been recognized in *The Best Lawyers in America* since 2018. She received her B.A. in 1996 from the University of California, Berkeley, her M.B.A. *magna cum laude* from Pepperdine University School of Business Management in 1999, and her J.D. in 2000 from Pepperdine University School of Law.

Daniel R. Williams, CPA is a senior managing director for J.S. Held LLC in Phoenix, where he leads many of the firm's engagements in restructuring, turnaround and bankruptcy matters. He is frequently contacted in high-profile and complex matters to advocate for creditors and lenders. Mr. Williams has more than 30 years of experience as a restructuring professional and financial expert. He has advised numerous underperforming companies in various industries through the restructuring, turnaround and recapitalization process. Mr. Williams's experience includes leading highly successful restructurings to create significant equity and liquidity, actively restructuring billions of dollars in debt and equity, and developing strategic restructuring alternatives to maximize value. In corporate finance, he has provided diverse technical consultation to clients, serving as CEO, CFO and CRO of numerous companies and emerging businesses across multiple industries, including construction, real estate, commercial, manufacturing, technology and agriculture. In bankruptcy, Mr. Williams has served as a court-appointed trustee in numerous chapter 11 and chapter 7 cases. He also has served as an examiner, examiner with expanded powers, expert witness, plan administrator and § 702 expert in bankruptcy court, including on numerous national matters. Mr. Williams's project geographical experience includes the U.S., Mexico, France, Switzerland and Canada. He received his B.A. in accounting from the University of Arizona.