2019 LENDERS & CHIEF CREDIT OFFICERS CONFERENCE

Driving Growth, Sustaining Performance

WESTERN BANKERS ASSOCIATION

Anatomy of A Workout – Is There a New Playbook?

Moderated By: Barry Smith
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Overview

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Biographies

Jeff Brandlin

Jeff is an industry-leading provider of consultative accounting and financial advisory services. Top tier banks, private equity firms, non-bank senior and mezzanine lenders and middle market companies depend on Jeff and his firm for the financial information they need to make intelligent decisions, both in advance of an investment and when a company's performance deteriorates. In litigation, attorneys and their clients rely on his thorough forensic accounting, concise reporting and expert witness testimony to help resolve highly-contentious situations.

During his 40 year career, Jeff has uncovered numerous financial frauds, accounting malpractice and complex grafts. He often remains involved in these situations to provide forensic accounting services, litigation support or assist with financial restructurings or workouts. Jeff also has provided thorough financial due diligence in support of hundreds of successful M&A transactions for equity and debt capital providers. Perhaps more importantly, he has saved clients from committing to money-losing investments on numerous occasions.

Jeff founded Brandlin & Associates in 1980 to provide clients with tangible, timely and action-oriented insight. Previously, he was a Big 4 audit manager. His experience spans a broad range of businesses in industries including entertainment, manufacturing, wholesale distribution, retail, technology, apparel, oil and gas, food service, health care, construction, automotive, financial services and professional services.

Biographies

Bob Riiska

- Robert O. "Bob" Riiska, a Managing Director at SierraConstellation Partners, has more than 27 years of turnaround and crisis management experience, including performing numerous consulting assignments and serving in interim senior management capacities for clients.
- Mr. Riiska is a Certified Turnaround Professional, Certified Public Accountant and Chartered Global Management Accountant. He received a Bachelor of Science Degree in Economics from the Wharton School of the University of Pennsylvania, and an M.B.A. in Finance and Marketing from the University of Chicago Booth School of Business.
- Mr. Riiska is a frequent speaker and panelist at industry events and conferences, including those of the Special Assets Management Association, Commercial Finance Conference of California and Risk Management Association.
- In 2019, Mr. Riiska received the Turnaround Atlas Award for his work as Chief Restructuring Officer of LORAC Cosmetics prior to joining SCP in 2018.

Biographies

David Scheiber

David Scheiber is a Senior Vice President, Deputy Manager Special Asset Department at Cathay Bank and has over thirty-five years' experience in diversified areas of portfolio management, corporate finance, institutional recovery, and related areas of investing for major financial institutions such as Boston Private Bank & Trust Company, ING Capital Advisors, LLC, and Transamerica Investment Services, Inc.. Mr. Scheiber is a reorganization specialist with broad experience in Chapter 11 reorganizations and non-judicial restructurings with years of experience representing creditors in all aspects of restructurings for both distressed and stressed companies in a wide array of industries. Mr. Scheiber has also served on the board of directors for public and private corporations and served as a consulting and testifying expert for numerous government agencies such as the FDIC, RTC, and SEC.

Biographies

Barry Smith

Barry A. Smith is a Shareholder in the Firm's Litigation Practice Group and Chair of the Financial Institutions Industry Practice Group. Mr. Smith focuses his practice on representing financial institutions and other business entities, both domestically and internationally. Mr. Smith has extensive experience in business and commercial litigation, creditors' rights, real estate, loan workouts and restructuring, provisional remedies, receiverships, collections, and post-judgment enforcement. He also handles complex defense litigation including tort, contract law, and real estate.

Mr. Smith is a frequent speaker on creditor's rights, enforcement of judgments, prejudgment remedies, workouts and turnarounds, wrongful termination, sexual harassment, business and banking fraud, arbitration, toxic waste, lender liability, legal ethics, probate estates and trusts, and collection strategy and tactics. He speaks at numerous seminars and conferences including the California Independent Bankers, Risk Management Association, Special Asset Managers Association, National Association of Chinese American Bankers, California Bankers Association, Western Independent Bankers Association, the Los Angeles County Bar Associations, and the Los Angeles Chamber of Commerce.

Mr. Smith is AV Preeminent rated by his peers (5.0/5.0) as being at the highest level of excellence in ethical standards and professional ability. He has also been voted Best of the Best in 2016, 2017, and 2018 as one of the top 1% of America's lawyers, and also voted as America's Most Honored Professional in 2016, 2017, and 2018 by *The American Registry*. Every year since 2013, *American Lawyer Media*, in conjunction with *Martindale-Hubbell*, has recognized him as a Southern California Top Rated Lawyer and a Top Rated Lawyer in the areas of Bank & Finance and Commercial Litigation, which appeared in *Corporate Counsel* and the *Los Angeles Times*. He is a member of the Financial Lawyers Conference, California Bankers Association, American Trial Lawyers Association, Los Angeles Business Trial Lawyers Association, California Bank Counsel, the Los Angeles County Bar Association's Commercial Law and Bankruptcy Section, and the Provisional and Post-Judgment Section. He is also a member of the International Bankers Association, the Independent Bankers of California, National Association of Chinese-American Bankers, Risk Management Association, Credit Managers Association, and the Southern California Mortgage Association.

Mr. Smith is a former Professor of Law, teaching courses on trial tactics and litigation techniques. He is named one of "Who's Who in Banking and Finance" by the *Los Angeles Business Journal*.

STATE OF THE MARKET – “COVENANT LIGHT” TRENDS

1. The leveraged loan market has grown by 112% since 2007, with a notable deterioration in ratings quality, given the rapid increase in single B and B3 loans outstanding.
2. As growth continues to weaken into 2H19, poor fundamentals will increasingly become a focus and lower quality credit will lead the market wider and drive poor performance in credit.
3. Despite the heavy volume, pricing power remained in borrower’s court, resulting in further relaxation in investor protections that were prevalent after the financial crisis.
4. Rising leverage ratios near cyclical peaks and declining coverage ratios as the Federal reserve raises borrowing costs will increase borrowers vulnerability to adverse shocks.
5. One such shock is the recent Tax Cut & Jobs Act which imposes a limitation on net interest deductibility to 30 %of EBITDA (increasing to 40% of EBIT in a few years).
6. Low loan defaults and minimal volatility until recently had created favorable credit environment.
7. There are dangerous trends in both sponsored and unsponsored deals.
8. Private equity sponsored transactions are the most aggressive.
9. Amidst weakening growth and earnings backdrop, the fundamental headwinds that have grown over the course of this cycle and there are signs of cracking in leveraged loan market.
10. Credit standards and covenants are important creditor protection mechanisms that have eroded since 2007.

STATE OF THE MARKET – "COVENANT LIGHT" TRENDS

11. A borrower with a deteriorating financial condition is more likely to trigger a covenant default before they trigger a payment default.
12. Covenants useful for bringing borrowers to table to renegotiate terms.
13. Covenant-lite loans generally refer to loans that contain no financial covenants.
14. The share of the U.S. leveraged loan market that is covenant–lite represents 80% or more of the loan market outstanding compared to approximately 30% six years ago.
15. Removal of covenants preserves borrowers and deal sponsor flexibility and their options in a downturn.
16. The consequences of weak covenants is unclear, but create significant concern that loosened covenants and weakening credit documents will reduce lender's recoveries in a downturn.
17. S&P reported default rate at slim 1.29% in August, but distress levels soar.
18. According to LCD, the share of performing loans quoted below 80 cents on the dollar jumped to a near-three-year high of 4.03% in August, from 2.81% the previous month.

FRAMING WORKOUT SCENARIOS AND OPTIONS

GENERALLY THE PROBLEM LOAN SITUATION WILL FALL INTO ONE OF THE FOUR CATEGORIES

1. Turnaround/restructuring
2. Distressed sale / wind down / foreclosure / rights and remedies
3. Orderly sale / liquidation / Deed in lieu
4. False alarm

OBSERVATIONS

1. At the outset, management always believes in a turnaround
2. Try to establish the most likely scenario early in the process and convince management.
3. Focus on benchmarks, events, and things within control of your and borrower's control
4. Duration is everyone's enemy
5. Turnarounds are usually infrequent but the key to successful turnaround is early identification of problems, pro-active and capable management and rational creditors

DETERMINANTS OF OUTCOMES (See page 43)

1. Viability
2. Collateral/ asset / enterprise value
3. Management
4. External forces / factors

THE WORKOUT PROCESS AND ACTION PLANNING: FIVE STEPS TO SUCCESS

Step One
Understand the Facts

Step Two
Analyze & Determine the Problem

Step Three
Determine Mode & Evaluate Available Options

Step Four
Develop an effective Action Plan

Step Five
Implement, Manage & Adjust Action Plan

THE WORKOUT PROCESS AND ACTION PLANNING: FIVE STEPS TO SUCCESS

STEP ONE

UNDERSTAND THE FACTS

1. Bank’s position – History, relationship, legal, and economic
2. Customer –Industry, operating and financial – business strategy/plan
3. Management – Capacity, competence, character, and cooperativeness
4. Other constituents – Business relationship, status, rights, program/plan

THE WORKOUT PROCESS AND ACTION PLANNING: FIVE STEPS TO SUCCESS

STEP TWO

ANALYZE THE BORROWER

1. **Assess Viability** – Industry, operating, and financial
    a) Competition & Peer Group review
    b) Business model & Key Operating Metric Assessment
    c) Survival Financial Analysis
2. Business Plan – Are deficiencies corrected?
3. Management Adequacy – What does it take to effect a turnaround
4. Resource Availability – Human capital and money
5. Legal Analysis – Requirements/challenges/obstacles
6. Creditor and Equity Holder Evaluation
7. Bankruptcy Risk Review
8. **What's Broken about the Borrower?**
    a) Distinguish between symptom vs. problem
    b) Examine key factors/business drivers (external)
        i. Finance, marketing, sales, production, human resources, etc.
        ii. Industry/regulatory – external forces, factors, risks
        iii. Ownership/management – support/capacity, integrity
        iv. Creditor status – on and off balance sheet
        v. Legal – regulatory, contractual, judicial

THE WORKOUT PROCESS AND ACTION PLANNING: FIVE STEPS TO SUCCESS

STEP TWO (CONTINUED)

ANALYZE THE BORROWER

9. What's broken about the loan(s) facilities?

10. Syndication Issues with Lender or Participants?

a) Understand and identify internal problems and internal issues
b) Legal and documentary
c) Lender liability / conflicts
d) Collateral reporting and tracking
e) Financial/operating/industry reporting
f) Bank group and inter-creditor
g) Public / Community

THE WORKOUT PROCESS AND ACTION PLANNING: FIVE STEPS TO SUCCESS

STEP THREE: EVALUATE THE OPTIONS AND DETERMINE MODE (pg.42 & 43)

A. **EVALUATING THE OPTIONS: ESTABLISH OBJECTIVE: ACHIEVE OPTIMUM TIME – WEIGHTED COST ADJUSTED RECOVERY**
   1. Viability assessment is key driver
   2. Business and value proposition still sound?
   3. Collateral value and control – Can LTV be improved or maintained?
   4. Presence of sound / effective management?
   5. Management and control shareholder objectives and mindset
   6. Adequacy and integrity of financial reporting and data
   7. Regulatory and political impact
   8. Creditor constituency – relative rights, views, attitudes, bargaining power, and demands
   9. Accounting and regulatory rules – Troubled debt restructuring ("TDR")? OREO?
   10. Inter-creditor issues and dynamics
   11. Legal positions

B. **SCENERIO ANALYSIS – Restructure, liquidation, foreclosure, etc.**

C. **SEQUENTIAL OBJECTIVES AND STRATEGIES**

D. **PROBABILITY ASSESMENT**

THE WORKOUT PROCESS AND ACTION PLANNING: FIVE STEPS TO SUCCESS

STEP THREE EVALUATE THE OPTIONS AND DETERMINE MODE (CONTINUED)

MODE DETERMINATION

1. Relationship Status – Exit, Maintain, Temporary Assessment
2. Dynamic situation as facts and circumstances change
3. Clear communication is necessary. Lender, borrower, CRO, FA, counsel, participants
4. Action plan must be consistent with mode selection
5. Be realistic
6. Exit Mode is warranted if:
    a) Borrower or management not cooperative
    b) Loan to value protection cannot be maintained
    c) Loan is non-performing or poor return characteristics
    d) Loan cannot be upgraded to satisfactory within 12 – 24 months
7. Document exit

STEP FOUR ACTION PLAN

DEVELOPING AN EFFECTIVE ACTION PLAN

1. Address key internal and external issues
2. Primary focus on four key objectives
    a) Exposure and risk reduction – bank and borrower
    b) Stabilization – Non-performing asset protection (“NPA”) prevention
    c) Path to upgrade
    d) Repayment – pay out if deteriorating
3. Cash flow preservation / LTV prevention
4. Back up plans
5. Proactive customer communication
6. Increased competition for additional risk
7. Negotiate for success

THE WORKOUT PROCESS AND ACTION PLANNING: FIVE STEPS TO SUCCESS

STEP FIVE MONITORING, MANAGING, ACTION PLANS

MONITORING ACTION PLANS

1. Customer – business performance reporting
2. Financial / collateral tracking / forecasting
3. Use of commercial field examiner and other third parties
4. External information sources / following key issues and trends

Fraud Triangle

Over 90% of frauds are attributable to financial or vice-related pressures.

- Living beyond means
- Excessive personal debt
- Unexpected financial need
- Addictions, such as gambling or drugs.

Pressure

Opportunity

- Lack of internal controls.
- Weak audit trail.
- Poor tone from the top.
- It was just sitting there to be taken.

Rationalization

- “I deserve it.”
- “I’ll repay it soon.”
- “It’s for my sick family member.”
- “It doesn’t hurt anyone.”
- “We were partners!“

RED FLAGS

- 1. Overly-complicated corporate structure
- 2. Related-party transactions
- 3. Chronic liquidity issues
- 4. Physical operations inconsistent with financial reports
- 5. Unique and/or industry-specific accounting issues
- 6. Antiquated accounting & reporting systems
- 7. Specific transactions or customers handled by the owner
- 8. Cutoff issues – sales, payables, cash receipts, inventories, etc.
- 9. Significant turnover of financial staff – CFO, Controller, etc.
- 10. Disagreements with auditors and/or auditor turnover

USE OF THIRD PARTY PROFESSIONALS

USE OF CONSULTANTS AND OTHER PROFESSIONALS

1. Contact your workout department
2. Recommend consultant assistance vs. demand
3. Be careful of internal correspondence and what you say (see page 48)
4. Provide borrower with more than one name
5. Advocate the concept to borrower – biggest value add for the company
6. Service professionals recommended should have focused skill set
7. Meet with company and consultant specific guidance as to bank’s need for information
8. Establish timetable, benchmarks, in writing
9. Be careful with private conversations with consultant. Be sure to establish right of communication early on.
10. Lender professionals are best retained through counsel

USE OF THIRD PARTY PROFESSIONALS

WHY ARE THERE DELAYS IN GETTING A TURNAROUND CONSULTANT INVOLVED?

1. Financial reporting covenants are loose and don't provide early warning of liquidity issues:
   a) Quarterly financials (instead of monthly)
   b) Monthly BBC's (instead of weekly or even daily)
   c) Annual inventory and equipment appraisals (instead of semi-annually or even quarterly)
   d) Financial projections not required
2. Other signs of potential trouble are missed:
   a) Changed external auditors or auditors won't sign report – don't accept general statements as to reason … get and understand detail!
   b) Late monthly financial statements – inconsistent, irregular reporting is a sure sign of inadequate financial dept. Can you trust the numbers?
   c) Customer doesn't want bank to visit – always insist on going there! Make a point of looking around.
   d) CEO has high-level perspective and can't answer questions on performance … says he/she is not an accountant. That's not acceptable! Direct questions specifically to him/her.
   e) Company never has the right inventory (obsolete, slow-moving). Especially in apparel industry, companies are hesitant to unload product at a discount if they lose borrowing ability.
3. Fear of upsetting long-standing bank customer … maybe things will get better on their own?
4. Fear of cost … how does a loan officer overcome the customer's objection to incurring fees?
5. Loan officer doesn't want to rock the boat and risk customer's shortcomings coming to light … how can we hit our targets if we give up those borrowings?
6. Transfer to Special Assets delayed due to internal politics, etc.
7. Sponsor says that it has its own personnel working as "consultants" to the borrower … financial models often don't equate to reality.

Strengths, Weaknesses, Opportunities, and Threats "SWOT"

SWOT ANALYSIS

	Strengths	**Weaknesses**
Opportunities	Pursue good fits	Overcome weaknesses to pursue opportunities
Threats	Identify competitive advantages to reduce threats	Reduce external threats by creation of defensive plan

USE OF THIRD PARTY PROFESSIONALS

S.W.O.T. ANALYSIS

INTERNAL ATTRIBUTES	EXTERNAL ATTRIBUTES
1. Resource constraints	1. Competitive
2. Poor integration and workflow	2. Supply demand landscape and forces
3. Overexpansion	3. Substitutes and new products
4. Resistance failure to change and adapt; exit barriers	4. Economy
5. Management weakness	5. Technological
6. Operational and functional failures	6. Consumer preferences, behavior

USE OF THIRD PARTY PROFESSIONALS

TURNAROUND STRATEGIES

1. OPERATIONAL
   a) Define

2. STRATEGIC
   a) Define

3. EXAMPLES
4. Revenue increasing or decreasing
5. Asset disposition or acquisition(s)
6. Management changes -frozen management and exit barriers
7. Cost reductions
8. Product mix
9. Market strategy
10. Financial restructuring – short, intermediate, and long term

USE OF THIRD PARTY PROFESSIONALS

ACCOUNTING, FINANACIAL ADVISORY, CHIEF RESTRUCTURING OFFICER

1. 13-week cash flows
2. Cash flow problem solving
3. Accurate A/R & A/P aging
4. Perpetual inventory reports
5. Fixed asset records

USE OF THIRD PARTY PROFESSIONALS

HIRING A CHIEF RESTRUCTURING OFFICER (CRO) / FINANCIAL ADVISOR (FA)
KEY TERMS AND CONDITIONS

1. **Scope** – agreed upon procedures
2. **Deliverables** – reports, detailing the audience of the report and terms around distributing outside of the intended audience, typically states financial advisor has no obligation to update
3. **Reliance on Information** – financial advisor relies on information provided, does not audit the accuracy or validity of the data
4. **Confidentiality of Information** – terms on confidentiality and procedures regarding information obtained during the engagement
5. **Record Retention** – terms of retaining, returning or destroying confidential information
6. **Compensation for Testimony** – compensation for fees and expenses if required to testify
7. **Agreement for No Jury Trial** – agree not to seek a jury trial to facilitate a resolution of differences arising out of or relating to services provided
8. **Conflict Check** – financial advisor's representation that conflicts relating to the engagement do <u>not</u> exist

USE OF THIRD PARTY PROFESSIONALS

Engagement Letter Terms	Representing the Debtor	Representing the Senior Lender
Retention	1. By the Company, the Debtor	1. By the Lender's outside Counsel
Act at the direction of	1. By the Company. However, the FA will typically advise the Debtor which direction to take 2. If representing the Debtor as CRO, authorities will be detailed in CRO Management Agreement with Debtor	1. By the Lender's outside Counsel
Directors & Officers Liability Insurance	1. If representing the Debtor as CRO, clause requiring that CRO, and potentially other professionals, to be named on Debtor's D&O coverage	1. N/A
Access to systems and records	1. Access to books, records and reports of the Debtor. May include system sign-on authorities 2. If representing the Debtor as CRO, authorities will be detailed in CRO Management Agreement – may include full access and control to cash management system along with check signing authorities 3. FA's/CRO's are authorized to communicate with lender with or without Borrower's approval or knowledge	1. Access to books, records and reports of the Debtor.
Fees & Expenses	1. Advance or retainer 2. Fees paid directly by Debtor, may be guaranteed by the Senior Lender or another interested party 3. Interim, such as semi-monthly or weekly, invoices may be required 4. Reasonable out of pocket expenses 5. May include some form of success fee	1. Senior Lender reimburses outside Counsel. Senior Lender pays the FA's Fees & Expenses. 1. Outside Counsel is not liable for the FA's Fees & Expenses. The FA's Fees & Expenses are the obligations of the Senior Lender

MANAGING KEY ISSUES

PRE-WORKOUT AGREEMENTS-FORBEARANCE-DEFERRALS-WAIVERS AND AMENDMENTS-BASIC RULES

GENERAL RULES AND CONSIDERATIONS

1. BS Opening Comment
2. Try avoiding waivers as they leave you naked for those covenants that were breached and waived
3. Failure to act can constitute a waiver
4. Oral waiver should be avoided
5. Waivers should be:
   a) specific / limited
   b) short term
   c) written and
   d) prepared by counsel
6. Amendments are preferred since they allow for continued covenant protection
7. Serial and constant amending imply a loan structure problem or financial problems
8. When documentation changes, consider the increased risk and focus on the need for additional protection, covenants, and / or compensation
9. Be mindful of loan participant requirements
10. Waiving or amending a credit should not increase your credit risk, particularly in a deteriorating situation
11. Forbearance agreements are often used in an “exit” mode and / or it is not appropriate to grant a longer term amendment or restructure

MANAGING KEY ISSUES

PRE-WORKOUT AGREEMENTS-FORBEARANCE-DEFERRALS-WAIVERS AND AMENDMENTS-BASIC RULES

LOCK UP AGREEMENTS aka PLAN SUPPORT AGREEMENTS

1. Executed prior to the commencement of Chapter 11 filing and used to obtain binding assurances from creditors and other stakeholders to support the proposed restructuring transaction
2. Generally the agreement provides the creditors will not oppose and vote in favor of plan and will not take any adverse actions subject to carve outs and milestone achievements
3. Attachments to the agreement include the proposed plan of reorganization, term sheets, and other documents
4. Stakeholder negotiation with impaired creditor(s) – fulcrum security
5. Borrower/Debtor Obligations
6. Creditor Obligations
7. Timeline – Critical Path
8. Reorganization Plan Term Sheet

MANAGING KEY ISSUES

PRE-WORKOUT AGREEMENTS-FORBEARANCE-DEFERRALS-WAIVERS AND AMENDMENTS-BASIC RULES

PRE-WORKOUT AGREEMENTS

1. Recitals – define obligation, admit event(s) of default, acknowledge loan docs enforceable
2. Confidentiality Clause
3. Non Disparagement Clause
4. Tax Consequences
5. Material Misstatement as to Financial Condition
6. No Oral Modifications
7. Assignment Clause
8. Judicial Reference and Waiver of Trial by Jury
9. Prohibited Activities on Premises
10. Clarify Forbearance Period
11. Release of Lender
12. Clarify Maturity Debt
13. Set forth total outstanding obligation (P+I+late charges, default interest, legal fees and costs)
14. Set forth Payment Terms and Conditions
15. Understanding of Agreement Clause
16. Right to Consult with Legal Counsel
17. Incentive Clause
18. No Impact on Deed of Trust Clause
19. Document Imaging Clause / Electronic Signatures
20. Intention of the Parties Clause
21. Confirming ones signing are authorized to sign
22. Conditions Precedent to Enforceability of Agreement
23. Notification Clause upon default / cure period
24. Extension FEE or Loan Modification Fee or Forbearance Fee
25. Governing Law (which state) and Venue (where case filed)

Generic Real Estate Restructuring Alternatives

Do Nothing

- Wait and see
- Reservation of rights

Reinstatement of Loan

- Short term cure
- Justification of default
- Borrower/Guarantor(s) reaction to market
- Technical defaults

Discounted Payoff

- Disinvestment as an exit strategy
- Discounts create incentives in recourse and non-recourse
- Include remedies such as consent judgement of foreclosure, confession of judgement to ensure finality
- No releases until payment or consensual liquidation occurred

Generic Real Estate Restructuring Alternatives

Short Term Forbearance

- Short term forbearance to cure identified problem(s)
- Modified DSC covenant and other covenant waivers
- Waiver of defenses, release claims, acknowledgement of debt, representations and warranties

Note Sale to Third Party

- Supply demand for distressed loans
- Benefits of speed, certainty, finality, further loss and expense
- Public relations and lender liability considerations

Generic Real Estate Restructuring Alternatives

Deed-In-Lieu

Consent Judgement of Foreclosure

Consensual Turnover

Liquidation of Assets

- Business decision to take back collateral
- Speed, control, predictability, finality
- Borrower and staff cooperation and assistance in takeover
- Deed or consensual liquidation faster than court remedies
- Need consent judgement to extinguish subordinate liens on real estate
- Remedy can be part of workout
- Benefits of entry of judgement of foreclosure with stay of execution

Longer Term Forbearance

- One to two years
- Shortened maturity
- Economic concessions
- Discounted payoff included in restructure
- Remedies in forbearance agreement include confession of judgement, consent judgement of foreclosure
- Additional collateral, guarantors, guaranties,
- Additional default interest premium, default premium deferral, partial or contingent waiver(s).

Generic Real Estate Restructuring Alternatives

Substantive Loan Restructure

- Modify the loan to conform to market terms
- Additional real property security, collateral, third party assistance may justify reduced interest rate or principal reduction
- Principal amortization with contractual incentives
- Cash flow claw back as stabilization occurs, debt reduction, matches viability of ongoing operations
- Incorporates remedies such as consent judgement of foreclosure, consent to asset turnover, confession of judgement, and liquidation
- Fractionalize notes into A, B, and C notes
- A Note is performing
- B Note is claw back note tied to cash flow business improvements, guaranteed, due on default, possibly in lieu of forbearance agreement
- C Note is deferral note, potentially forgiven dependent upon financial

Generic Real Estate Restructuring Alternatives

Hope Certificate

- Soft note provides lender with retention of some debt
- No debt service payments
- Potentially collateralized by second mortgage or lien with or without foreclosure remedies
- New senior lender consents to soft second lien
- Refinancing or sale results in payment to lender
- Potential burn off after negotiated period to prevent premeditated flip.

LOOKING BACK AND LOOKING FORWARD

BANKERS' MISTAKES

1. Failure to periodically re-examine a borrower as if it were a new prospect … may not be the same risk/reward relationship as before.
2. Failure to act quickly at the first hint of trouble can result in:
   a) Deterioration in collateral position and options
      i. Unpaid payroll taxes, sales taxes, etc.
      ii. Desperate borrower entering into one-off payment plans with vendors, using cash that could have gone to secured lender
   b) Reduced ability for a borrower to refinance, resulting in greater likelihood of having to contend with the uncertainties of liquidation
3. Not being open to advancing additional amounts a company may need to get through an immediate crisis or season. This of course needs to be supported by a realistic well thought out plan with planned repayment, such as in the two examples below:
   a) Lender approved $5 million over-advance for 90 days to jump start trucking company's plan to rebuild its pool of owner operators. O/A was paid down as per plan and company was able to be sold, resulting in payment in full to lender.
   b) Lender approved $15 million over-advance for 120 days to allow book distributor to stay afloat during seasonal lull. O/A was paid down as per plan and company was sold in a 363 sale, resulting in payment in full to lender.
4. There is such a thing as <u>too short</u> of a leash – a series of several 2-week forbearance agreements chews up everyone's time for no good reason (updating covenants, requirements, negotiating, etc.). With such a short runway, there is no way working to make "real progress" comes first. Difficult to make sustained improvements when every other day could be your last.
5. There is such a thing as <u>too long</u> of a leash – a 6-month forbearance with little monitoring provides little benefit. There is not going to be a good result unless milestones are set and there are consequences for non-performance.
6. Not reading inventory or M&E appraisals carefully. What limitations are there? Were physical counts taken? What are the liquidation assumptions?
7. Order a new appraisal if necessary. Make sure the appraiser visits site, is familiar with the product, aware of intellectual property issues impacting possible liquidation channels, etc. The lender can then make an informed judgment when considering various options … sometimes the loss was already there but no one knew it.
8. Not taking incremental steps to improve position at every opportunity. Shore up the lender's position on items such as:
   a) Reduce sub-limits on stretch collateral (e.g., unbilled A/R)
   b) Implement PACA and similar reserves
   c) Build in cumulative intra-month reserve for large monthly remittances such as sales, excise or fuel taxes
9. Obtain titles on unencumbered rolling stock

LOOKING BACK AND LOOKING FORWARD

COVENANTS TO CONSIDER IN A RESTRUCTURE (see pages 44 and 45)

1. Weekly cash flow projections and variance reporting
2. Monthly financial reporting deadlines (not quarterly)
3. Past-due trade A/P as reserve on BBC
4. CAPEX – restructure not time for adding equipment
5. Prohibit dividends, distributions, related party transfers, etc.
6. Require CRO if milestones are not met (sale, refi, etc.)
7. Cash flow sweep
8. Monthly payment of P&I

CONCLUSION

SUMMARY POINTS

1. Part science and part art
2. Know your borrower inside and out
3. Documentation is important
4. Third party professionals help reduce risk and accelerate timeline to resolution

THE END

APPENDIX - ACTION PLAN HIERARCHY (from pages 16 to 18)

Objectives

1. Preserve and protect principal
2. Risk and exposure reduction
3. Maximize recovery – timeline
4. Relationship / Mode determination
5. Non performing asset (“NPA”) minimization

Mode Determination

MAINTAIN OR EXIT

1. Considerations
2. Viability
3. Collateral values and assets
4. Management
5. Creditor issues
6. Equity sponsor / Resources
7. Trends
8. External factors

Action Plans

INTERNAL STEPS

1. Review, coordinate, all exposure
2. Perform legal review of documents
3. Review all bank conduct and correspondence
4. Review financials and collateral
5. Determine need of third party service providers
6. Creditor, Inter-creditor rights review

EXTERNAL STEPS

1. Preservation of loan to value
2. Review key drivers, assumptions, and factors
3. Management changes, addition, supports
4. Equity and other stakeholder support
5. Communication
6. Legal plan and documentation
7. Negotiating
8. Alternative and plan “B”
9. Workout plan
10. Yield enhancement

FRAMING WORKOUT SCENARIOS AND OPTIONS (From pages 11,16 and 17)

KEY PRIMARY DETERMINANT MATRIX

- V + C **Orderly Sale / Liquidation**	**- V - C** **Distressed Sale / Liquidation / Foreclosure / Wind-down**
+ V - C **Turnaround / Workout / Restructuring**	**+ V + C** **False Alarm**

Primary Determinants
V = Viability
C = Collateral / Asset Values

Secondary Determinants are Management, External Factors, Trends

Commercial & Industrial Loans	Real Estate Loans
• Orderly Sale / Liquidation	• Foreclosure / Wind down
• Delayed Liquidation / Foreclosure / Wind down • Turnaround / Workout / Restructuring	• Restructuring / Workout • Orderly Sale / Liquidation • Deed in Lieu / Settlement

MANAGING KEY ISSUES

SETTING STRUCTURE, REQUIREMENTS, CONDITIONS PRECEDENT, COVENANT and PERFORMANCE STANDARDS

1. Sensible and Sound Structure should accomplish
   a) Tracks key business benchmarks and business plan elements
   b) Provide the lender with sufficient protection and triggers should material financial deterioration occur
   c) Be understandable, enforceable, reportable by borrower
   d) Limits risk
   e) Enables the company to operate
   f) Provides some frequency of testing
2. Prioritize mandatory covenants that provide loan protection, those that are non negotiable, and non-negotiable
3. Set covenants to workable standards and or “step-up” provisions should conditions deteriorate
4. Monitor for appropriateness as circumstances change
5. Understand implications of blanket and cross security provisions with corporate structures
6. Financial reporting should be sufficient and timely

MANAGING KEY ISSUES

SETTING STRUCTURE, REQUIREMENTS, CONDITIONS PRECEDENT, COVENANT and PERFORMANCE STANDARDS (CONTINUED)

Sound Structure (Continued)

1. Covenants should be at “all times”
2. Deteriorating credits high risk credits, and aggressive loan structures require intensive monitoring, borrowing base, and regular audits
3. Forecast borrowing availability, cash receipts and disbursements, to avoid crisis and surprise
4. Pay attention to defined terms such as “eligible” accounts receivable and inventory

MANAGING KEY ISSUES

DEFAULTS : THINK THEN ACT

1. Unaddressed defaults may be regarded as an unintentional waiver
2. Enforce borrower accountability – importance / seriousness
3. Develop comprehensive legal analysis of all the parties and understand all parties rights and remedies
4. Address funding and availability ASAP
5. Use reservation of rights letters
6. Obtain notice or acknowledgement from the borrower
7. Implement acceleration carefully – course of dealing doctrine
8. Use default rate and other forms of remuneration as a deal motivator
9. Work expeditiously toward forbearance, amendment, or waiver, if appropriate

MANAGING KEY ISSUES

GUARANTORS

1. Improve the guarantee structure when appropriate
2. Be cognizant of state law restrictions on timing and extent of pursuing collection from guarantor
3. Require updated financial disclosure and don't let this repayment source weaken
4. Consider contingent or other guarantee exposure that guarantor has
5. Vigorously pursue uncooperative guarantors upon default
6. Don't ignore inviting them to the dance
7. Should be a positive
8. Be aware of guarantors right to termination and subrogation
9. Guarantor first, collateral second
10. Communications should be clear and frequent

MANAGING KEY ISSUES

CREDIT FILES – E MAIL – COMMENTS- LETTER WRITING

1. All written material can be subpoenaed except attorney client privilege material
2. Communication should be factual and concise, lose the snarky, subjective, and emotional comments
3. Ask yourself how the correspondence would appear in court or the public domain
4. Consider having counsel review all draft and final documents before mailing or placing in the file
5. Minimize the volume
6. Emails and spoilage – the forensic experts and embedded meta data will uncover critical information

ELEMENTS OF INDUSTRY STRUCTURE

Entry Barriers
Economies of scale
Proprietary product differences
Brand identity
Switching costs
Capital requirements
Access to distribution
Absolute cost advantages
Government policy
Expected retaliation

New Entrants

Threat of New Entrants

Rivalry Determinants
Industry growth
Fixed or storage costs /value added
Intermittent overcapacity
Product differences
Brand identity
Switching costs
Concentration and balance
Informational complexity
Diversity of competitors
Corporate stakes
Exit barriers

Suppliers

Bargaining Power of Suppliers

Industry Competitors

Intensity of Rivalry

Bargaining Power of Buyers

Buyers

Determinants of Supplier Power
Differentiation of Inputs
Switching costs of suppliers and firms in industry
Presence of substitute inputs
Supplier concentration
Importance of volume to supplier
Costs relative to total purchases in the industry
Impact of inputs on cost or differentiation
Threat of forward integration relative to threat of backward integration by firms in industry

Threat Substitutes

Substitutes

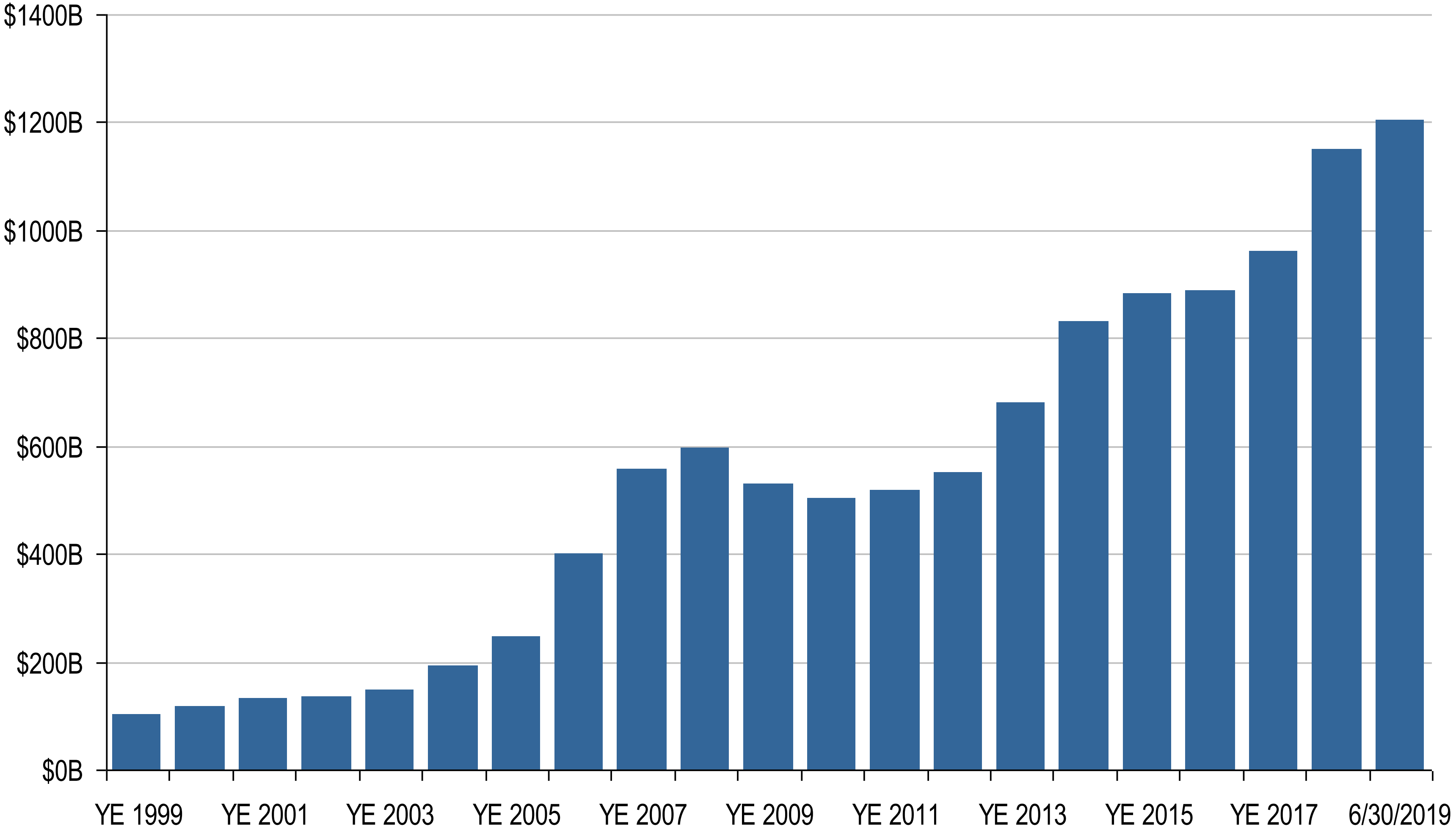
Determinants of Substitution Threats
Relative price performance of substitutes
Switching costs

Determinants of Buyer Power

Bargaining Leverage
Buyer concentration vs. firm concentration
Buyer volume
Buyer switching costs relative to firm switching costs
Buyer information
Ability to backward integrate
Substitute products
Pull through

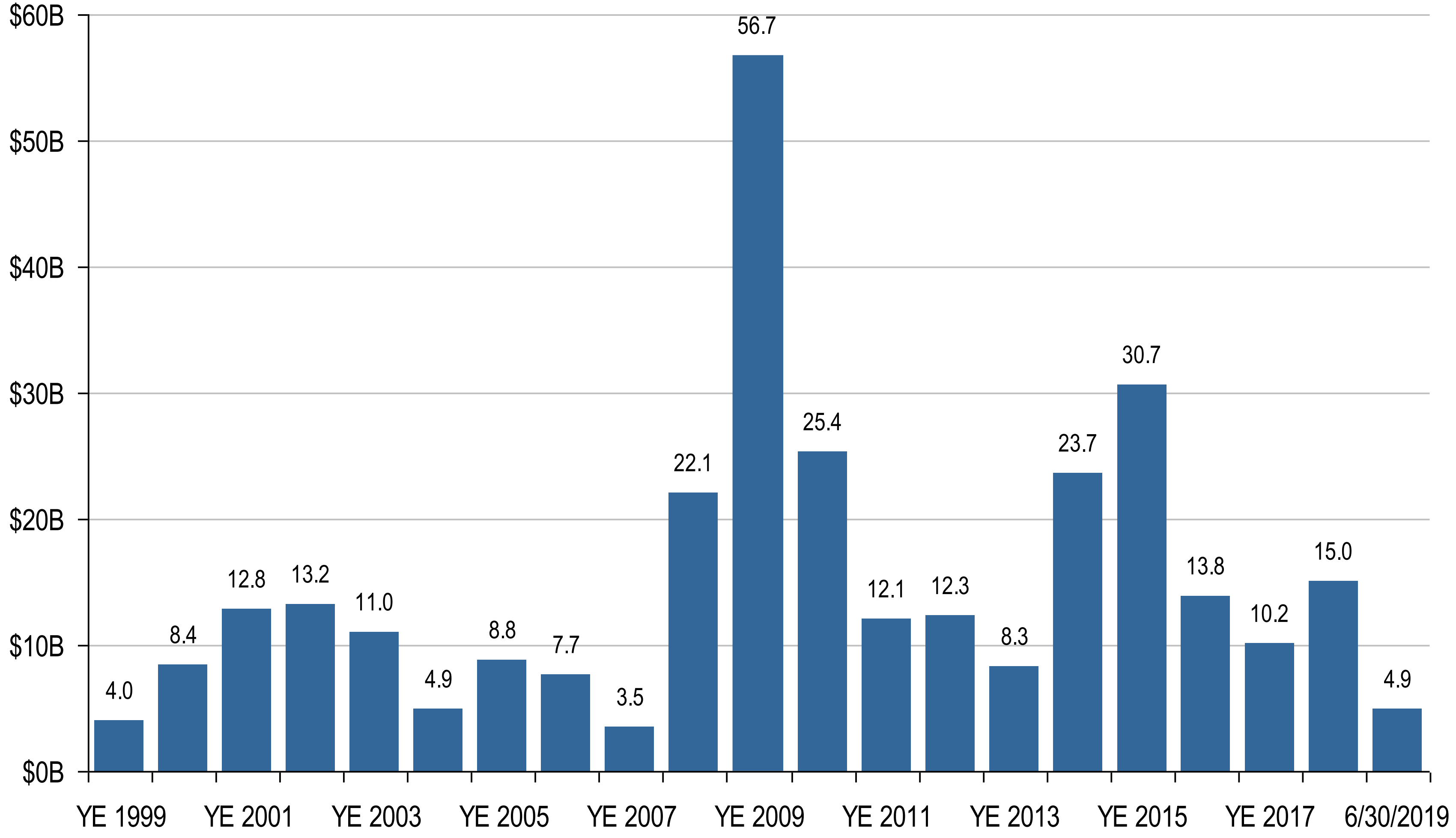
Price Sensitivity
Price/total purchases
Product differences
Brand Identity
Impact on quality/performance
Buyer profits
Decision maker incentives

S&P/LSTA Index: Par Amount Outstanding of Leveraged Loans



Includes all loans including those not included in the LSTA/TRLPC mark-to-market service. Primarily institutional tranches.

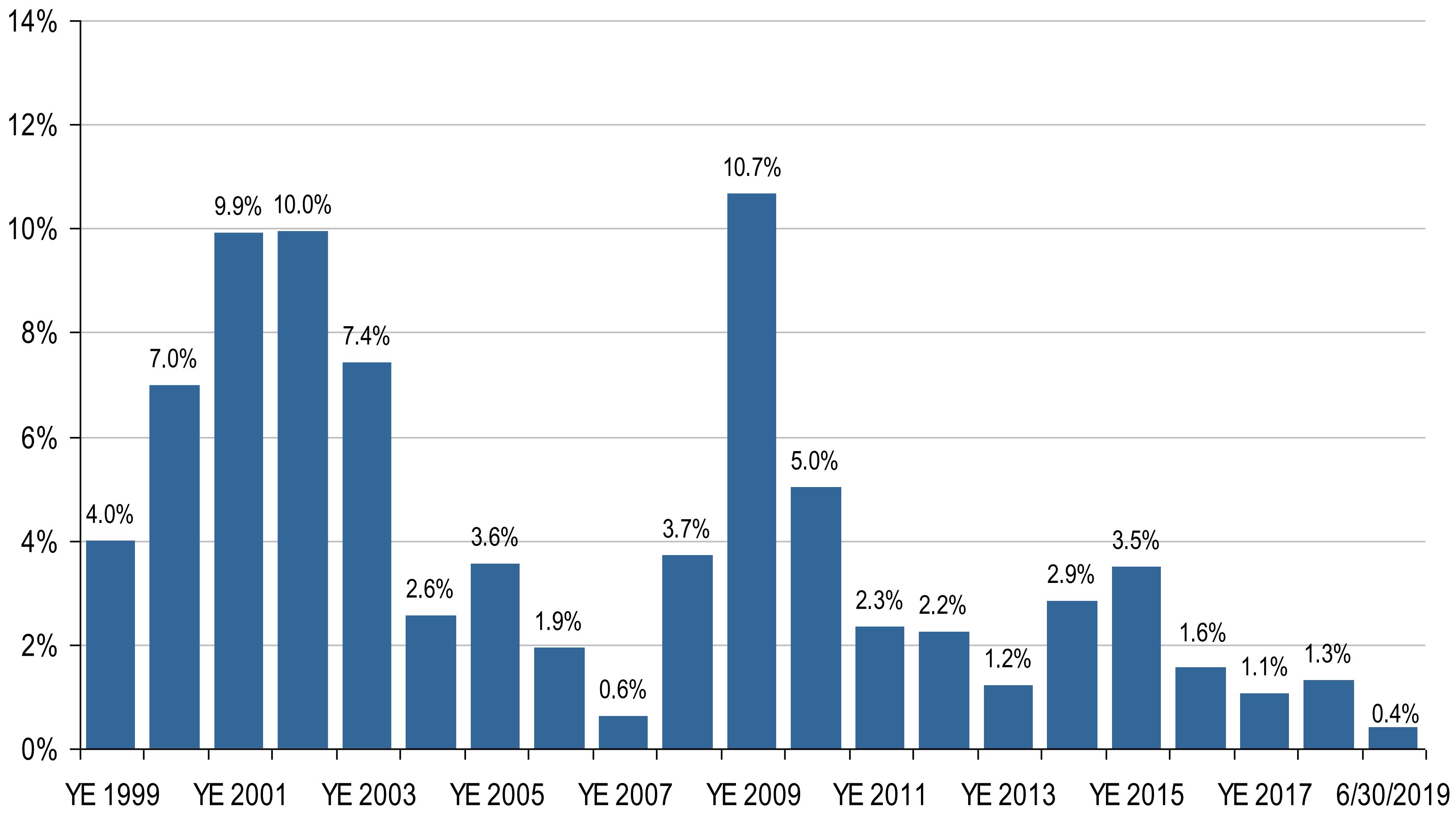
S&P/LSTA Index: Par Amount of Leveraged Loans in Payment Default or Bankruptcy



Includes all loans including those not included in the LSTA/TRLPC mark-to-market service. Primarily institutional tranches.

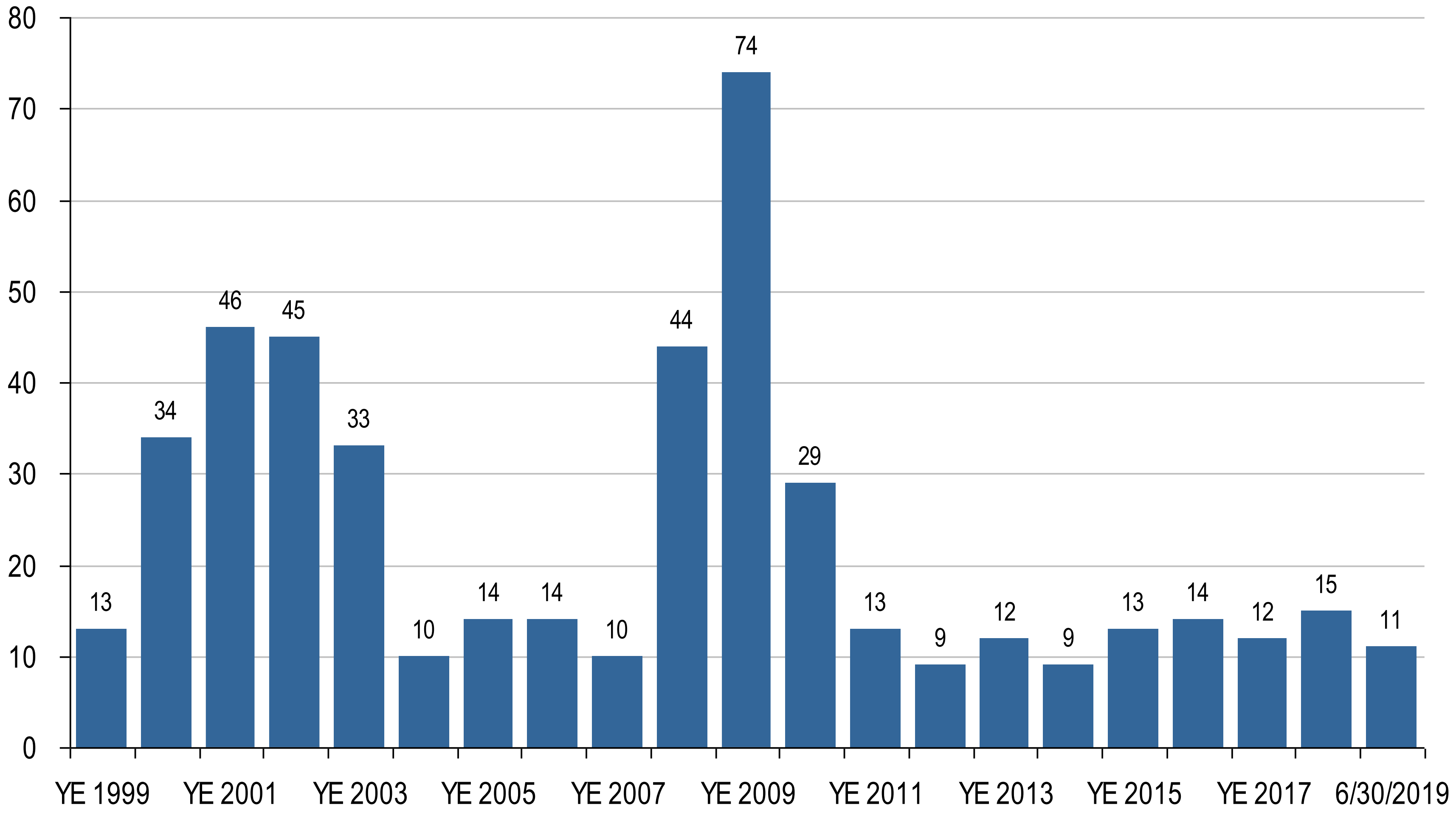
To access the data points underlying charts, double-click on the chart. NA reflects not enough observations.

S&P/LSTA Index: Percent of Outstanding Leveraged Loans in Default or Bankruptcy



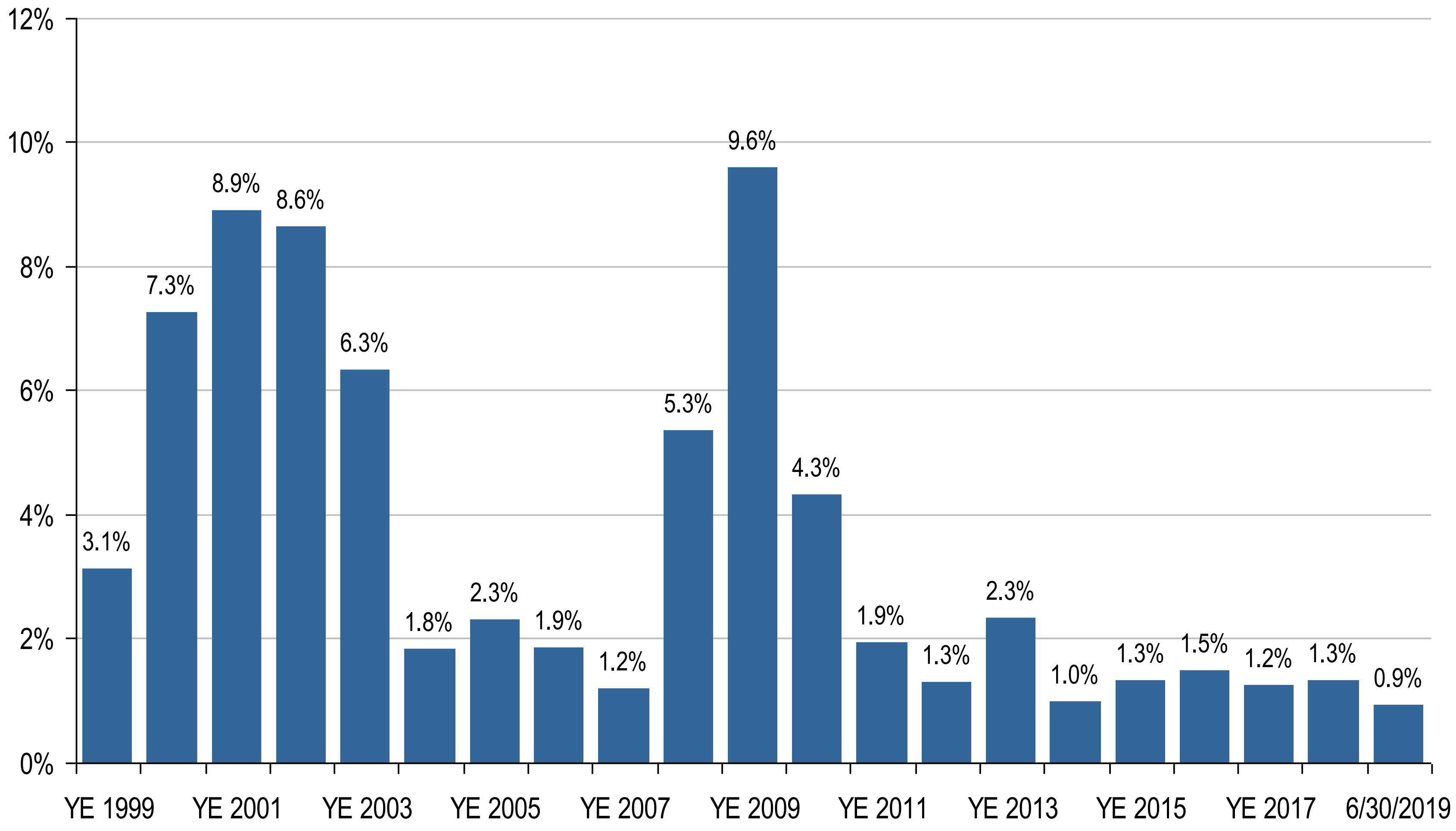
Includes all loans including those not included in the LSTA/TRLPC mark-to-market service. Primarily institutional tranches.

S&P/LSTA Index: Number of Issuers in Payment Default or Bankruptcy



Includes all loans including those not included in the LSTA/TRLPC mark-to-market service. Primarily institutional tranches.

S&P/LSTA Index: Percent of Issuers in Default or Bankruptcy

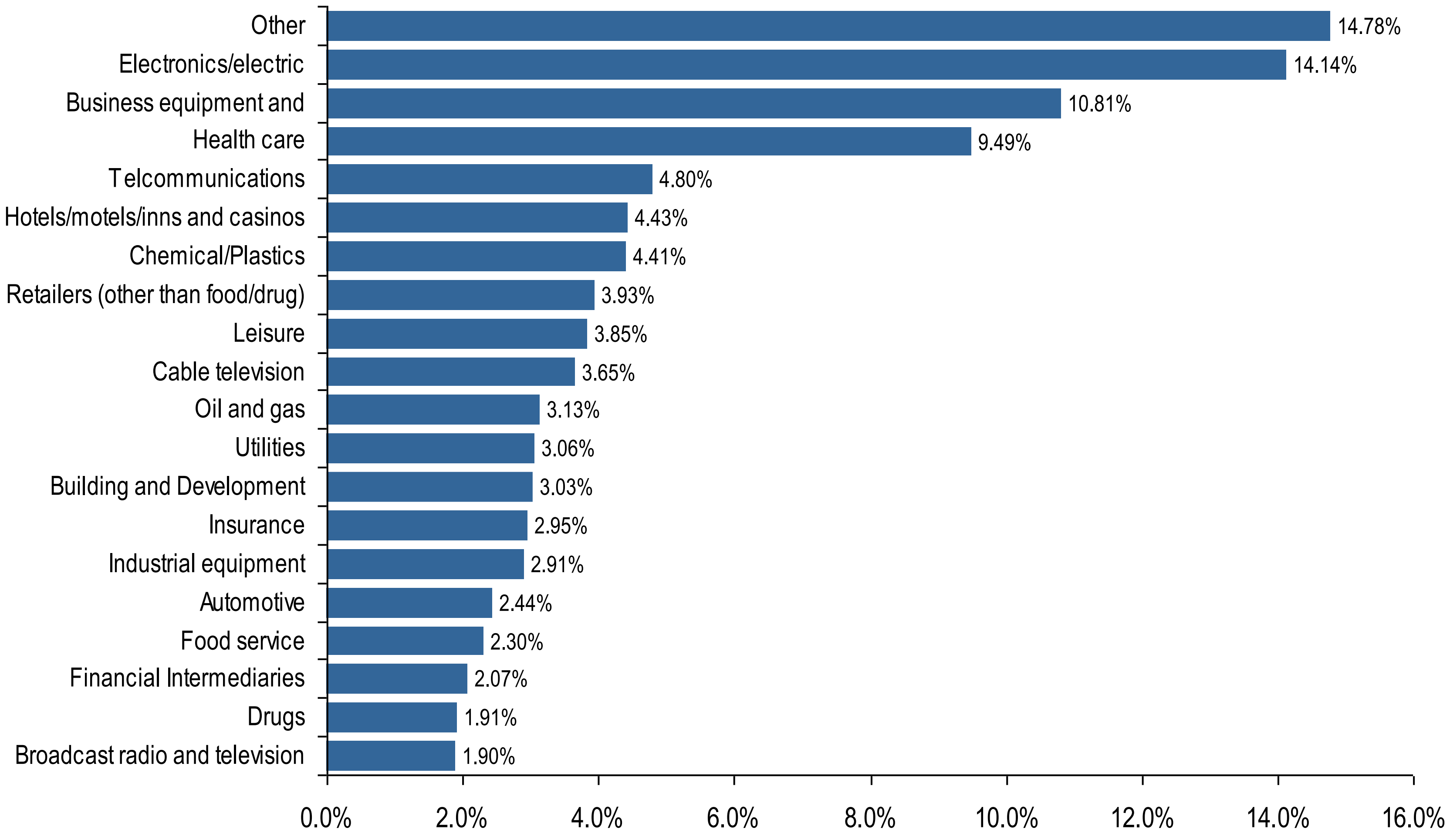


Includes all loans including those not included in the LSTA/TRLPC mark-to-market service. Primarily institutional tranches.

To access the data points underlying charts, double-click on the chart. NA reflects not enough observations.

S&P/LSTA Index: Par Amount Outstanding of Leveraged Loans by Industry

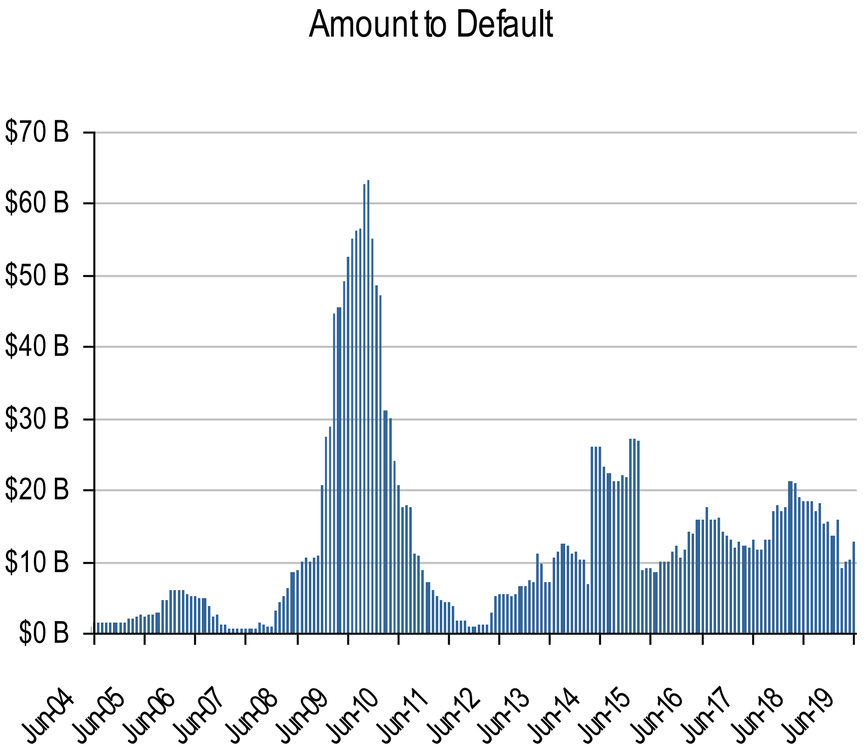
Total Par Outstanding: $1,203.6B as of 6/30/2019

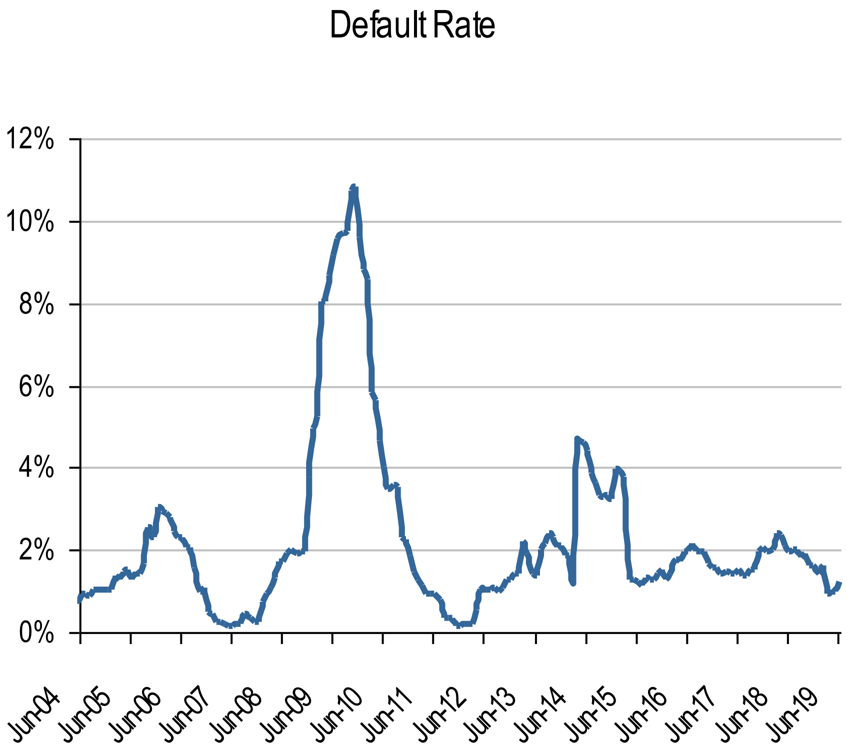


Includes all loans including those not included in the LSTA/TRLPC mark-to-market service. Primarily institutional tranches.

To access the data points underlying charts, double-click on the chart. NA reflects not enough observations.

S&P/LSTA Index: Lagging 12-Month Default Rate – Principal Amount





Default rate is LTM total default amount over par outstanding at the beginning of the 12 month period.
Includes all loans including those not included in the LSTA/TRLPC mark-to-market service. Primarily institutional tranches.