The Need for Speed: Preserving Strategic Optionality in COVID-19 World

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TELOS CAPITAL ADVISORS
ADVICE/REPRESENTATION/RESULTS

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Agenda

- Introduction
- Current Situation
- Path Through Uncertainty
- Options
- Questions and Answers

Presenters

Michael Hogan

Managing Director, Corporate Finance & Restructuring

Armanino LLP

Email: Michael.Hogan@armaninollp.com

Phone: 408.240.4908

Brandon Tittle

Shareholder, Bankruptcy/Financial Restructuring

Ferguson Braswell Fraser Kubasta PC

Email: btittle@fbfk.law

Phone:: 972.826.4445

Robert Rough

Managing Director, Investment Banking

Telos Capital Advisors

Email: rrough@teloscap.com

Phone: 214.473.4714

Chad Zoretic

Managing Director, CFO Advisory, Transaction Advisory Services

Armanino LLP

Email: chad.zoretic@amarniniollp.com

Phone: 513.520.8832

The COVID-19 Crisis of 2020 disrupted the world

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Everyone is feeling the impact, especially related to cash and liquidity management. Are you asking:

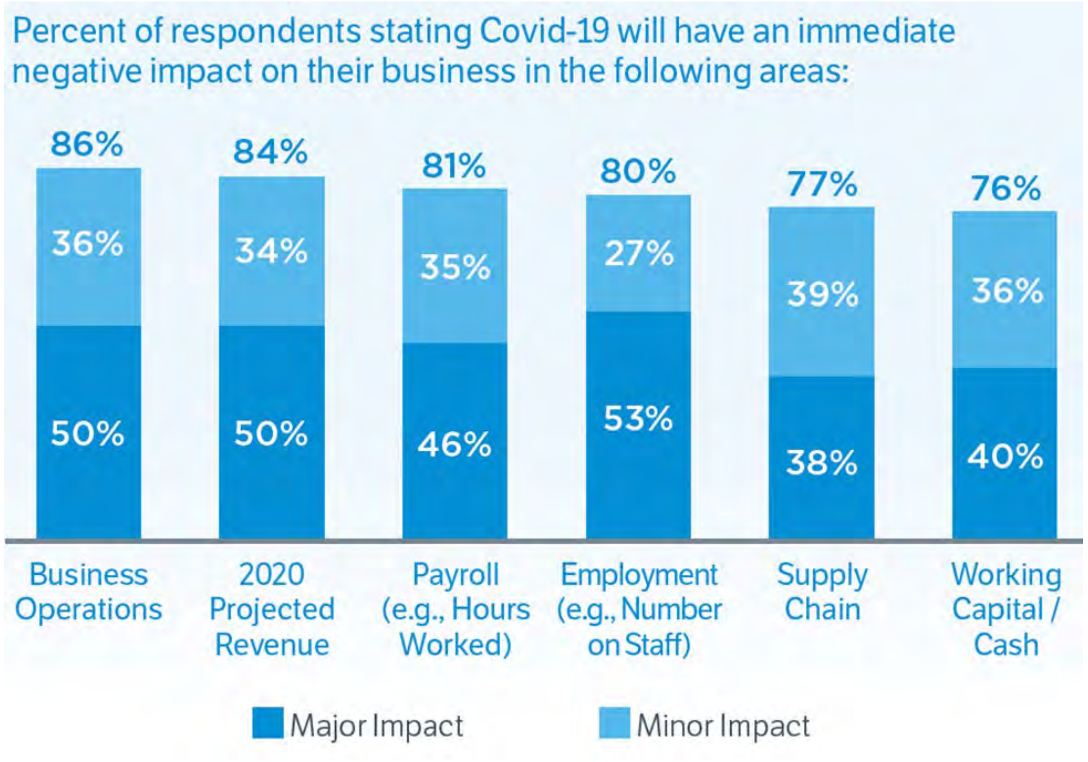
- How strong are my financials? Do I have enough cash (short and long term)? Am I forecasting correctly?
- Does my plan adapt as the market changes?
- What is the impact on my current loans? How about the borrowing base? What's the impact on financing or future funding?
- What are my options if I am facing a liquidity crisis? Should I restructure my business? What makes sense?

What are we seeing:

- Early Stages of Grief:
  - Through: denial and anger;
  - Now: bargaining and depression;
  - Only limited acceptance (varies by sector)
- Focused on short-term, internal issues
- Marathon, not a sprint

Covid-19 Impact on Middle Market Companies

The National Center for the Middle Market surveyed >200 companies with revenues between $10MM and $1B in late March. Even at that early date, 25% of the respondents felt that Covid-19 would prove "catastrophic" for their company. PPP and other relief packages may have pushed out timing, but not necessarily the result.



What Are We Hearing

- Varies by industry and region

Path Through Uncertainty

Assessment

Where do we stand today?

- Establish the current health and liquidity of a company and evaluate its recovery (stabilization) plan

Plan Development

What can we or should we do?

- Realistic assumptions
- Optionality/adaptability
- Measurements
- Multiple re-opening scenarios
- Tax considerations

Implementation

How do we achieve the plan and where can Armanino help?

- Support execution
- Leverage firm resources to accelerate certain actions

Monitoring

How do we continue progress and measure against the plan?

- Ongoing support to review developed measures to ensure plan performance
- Identify weaknesses and develop adjustments to address

Assess where you are – Scenario Planning

- Planning for next 13 weeks - 3 months under different re-opening scenarios
- Cash vs. P/L
- 13 Week Cash Flow (Direct Model)
- Revenue, A/R and Collections
- Expenditures
- Waterfall

Macro Scenarios (Outside Our Control)

Potential Strategies (In Our Control)

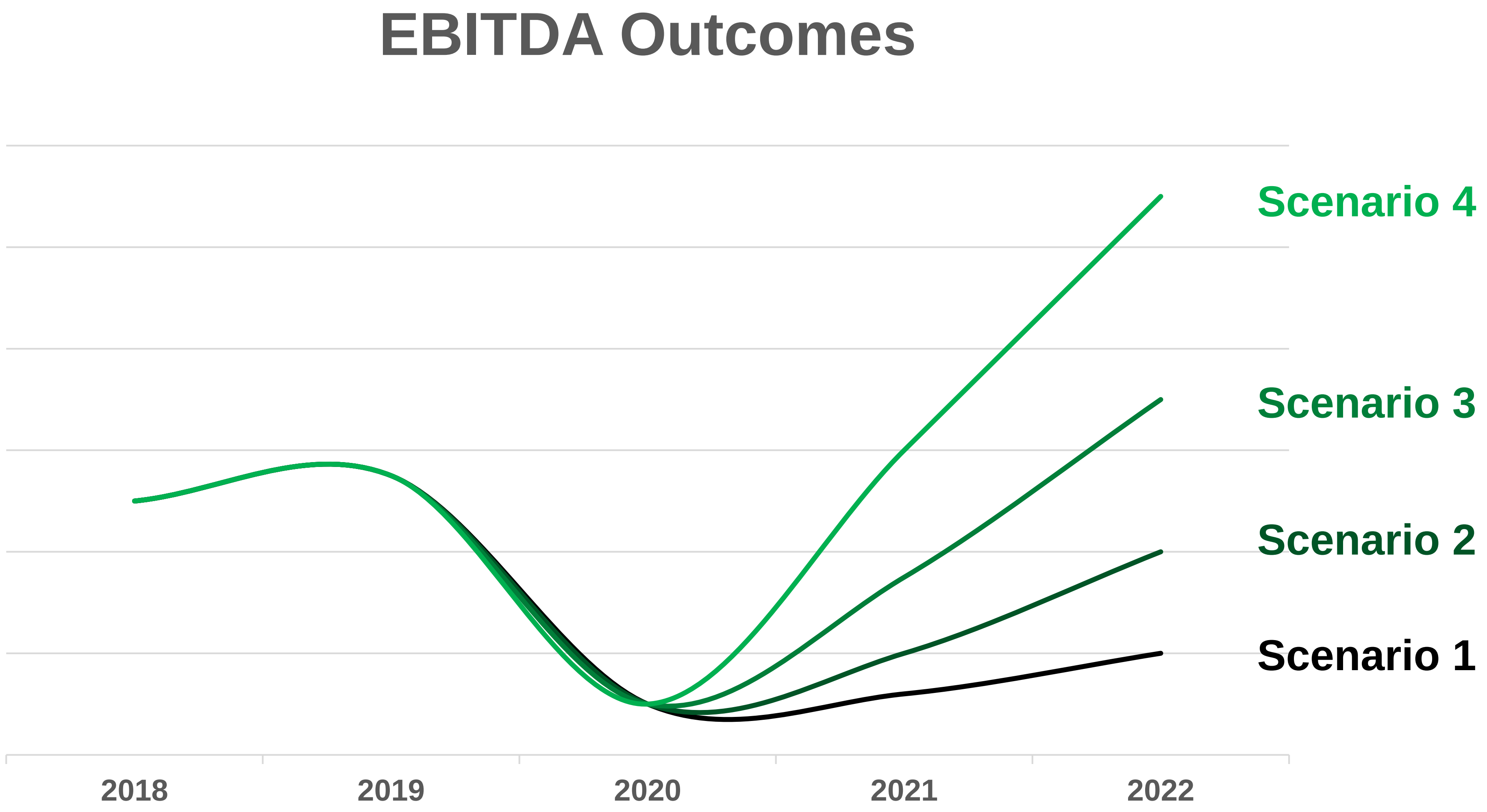
	Scenario A 3 months lockdown X% Revenue Loss	**Scenario B** 6 months lockdown Y% Revenue Loss	**Scenario C** 12 months lockdown Z% Revenue Loss
Plan A No change to plan	12 months runway $XM cash EO2020	9 months runway $XM cash EO2020	6 months runway $XM cash EO2020
Plan B -15% Opex	18 months runway $XM cash EO2020	12 months runway $XM cash EO2020	9 months runway $XM cash EO2020
Plan C -25% Opex	24 months runway $XM cash EO2020	18 months runway $XM cash EO2020	12 months runway $XM cash EO2020

**Key: Columns represent drops in operational expenditures, rows revenue losses.*
**Source: A Sequoia-backed company*

Building the Plan - Rethinking Spend and Decision Making

- Build an analysis that helps you understand where you stand now and in the near term
  - Quick, systematic approach: this is a great ‘clarifier’ for companies in complex times
  - Conservative: be sure projections are conservative enough; you don’t know what you don’t know
  - Assumptions: actively pressure test your assumptions to gain comfort
- Delve into your financials, operations and current strategic situation
  - Financials:
    - Cash Management – Cash is King: need crisp, detailed projections for remainder of 2020
  - Operations:
    - Pricing review/channel pruning: How has the landscape changed? Are products/services priced right?
    - Suppliers: will you supply chain be impacted?
  - Manage Internal Agendas
    - Hard conversations that have an impact. VPs vs. Receptionist
- Speed is important – Every decision is an imperfect decision

How will your recovery look?

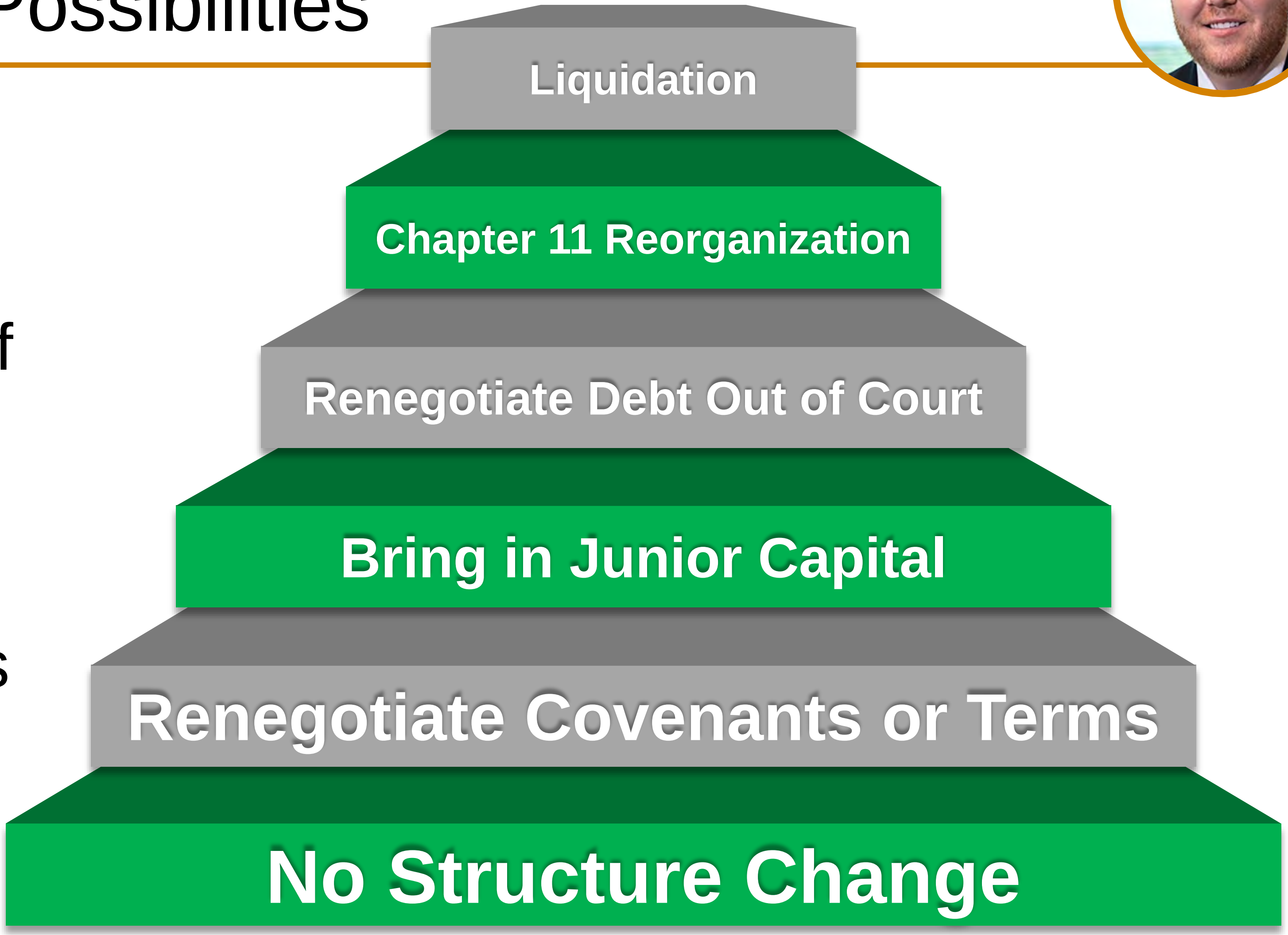


Refinancing/Restructuring/Bankruptcy is a Strategy

- When many people hear the words bankruptcy or restructuring, the first thing they think of is fear and despair. While the aftermath of refinancing/restructuring/ bankruptcy may result in a period of change, it doesn't have to be synonymous with fear. Restructuring your debt or filing for bankruptcy in certain situations can just as easily be seen as a path to a fresh start.

Post-PPP Financial Possibilities

Most companies will need to do something to address the impact of Covid-19 on their business and capital structure. The survivors will be those companies that act quickly and decisively.



Anticipated Recovery Period Proved Optimistic

- 39% of respondents to the National Center for the Middle Market survey believed they would be back to full capacity by the end of April. 19% thought it would take more than six months.

Renegotiating Covenants or Restructuring Senior Debt Terms

- Commercial banks anticipate many clients' loans will need adjustment
- Likely result in higher rates for senior debt – 0.50% to 1.00% - due to higher perceived risk
- Focus will be on senior debt and overall leverage multiples now and as EBITDA recovers, and debt service coverage ratios
- Depth of drop, shape of recovery and lender's confidence in projections will drive decisions
- Negotiating power largely lies with the creditors unless bankruptcy is a credible threat

When a Senior Lender Requires Additional Capital

- When decline in EBITDA too great and/or recovery projected to take too long
- Variety of structures and types of debt and equity available to companies with viable business prospects
- Structures can accommodate a variety of cash flow projections
- Expensive compared to senior debt; less expensive than equity or losing the company

Debt Restructuring Example

- Pre-Covid-19 EBITDA - $5MM
- June 2020 EBITDA run rate - $3MM
- Projected return to $5MM EBITDA run rate – December 2021, gradual
- Current Debt - $13MM senior term loan (LIBOR + 3.50%, no floor); $4MM revolving line of credit (LIBOR + 2.5%, no floor)
- Bank wants reduction to $7MM term loan (LIBOR +4.50%; 6% floor); $3MM RLOC (LIBOR +3.0%; 4.5% floor)
- Capital Raise
  1. $5MM 2-year Interest only mezzanine debt, 5-year amortization beginning in year 3, balloon in year 5. 12% cash pay interest, 4% PIK, Excess cash flow sweep
  2. $2MM Preferred Stock, 6% cash dividend, 6% PIK dividend, Put/Call after year 5, Floor/Cap on repurchase return
  3. Modeling 20% IRR

Significantly Distressed Companies End in Four Different Outcomes

- **Outcome A:** Your Company Successfully Restructures Out of Court
  - A nonjudicial process where significant creditors reach an agreement for adjusting the company’s obligations.
  - Requires participation of the company’s lenders, major suppliers, and depending on the circumstances, other organizations or entities such as unions or governmental agencies.
- **Outcome B**: Your Company Successfully Reorganizes Under Chapter 11
  - file a plan of reorganization that had no objections by creditors, had at least one impaired class of creditors that voted to accept the plan
- **Outcome C:** Your Company Is Forced to File a “Cram-Down” Plan in Chapter 11
  - Company has exhausted all efforts to propose a plan that pays creditors in full. As a result, company is faced with objections to the plan by secured creditors and/or unsecured creditor
- **Outcome D:** Your Company is Forced to Sell its Assets and Liquidate
  - An orderly liquidation controlled by the company (in Chapter 11), which would typically provide for the sale of the company’s assets or alternatively, liquidated by trustee (Chapter 7)

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The New Subchapter V of Chapter 11 – New Fast Track Option

- Subchapter V of Chapter 11 allows small businesses whose non-contingent debts are less $2.7 million (now $7.5 million for one year as a result of CARES act, which expands this option to many) to reorganize without many of the costs and risks associated with Chapter 11. Benefits include:
- No creditors' committee unless appointed by the court for cause
- Only the debtor proposes a plan of reorganization
- No need for disclosure statement; creditors do not vote on the plan
- Debtor has 90 days to file a plan
- There is no absolute priority rule; debtor may "cram-down" creditors and still maintain equity interest

When to Call a Counselor/Advisor

- The number of experienced, competent professionals serving distressed middle market companies is limited. Demand will likely exceed supply in the next 3 to 6 months.
- Not only competent professionals to help is limited, the whole system is strained
- Engaging with a lawyer or advisor quickly (while you still have cash) is perhaps the most essential practice to saving your company.
- Companies that wait too long to hire a lawyer or advisor may prevent the company from successfully restructuring and may even push the company into a Chapter 7 liquidation.

Questions and Answer Session

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