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M&A

MERGERS AND ACQUISITIONS

Crisis Management

Businesses in distress should know their M&A options

By Diana Drake

Marcal Paper Mills, headquartered in Elmwood Park, is a company in distress. Last November Marcal, which makes tissue and towel products, filed for Chapter 11 bankruptcy, the corporate reorganization chapter of the bankruptcy code, blaming soaring energy costs that had climbed 40% in the past 12 months and forced it to default on $155 million in loans. At the time, CEO Nicholas Marcalus said, "The price increases in energy have proven to be immensely difficult. Demands by our lenders created liquidity pressures which caused the company to file for the continued restructuring under Chapter 11."

So does this signal the end for a company that has been a household brand name for decades? Definitely not, says an area hedge-fund executive who didn't want to be identified. His company specializes in investing in financially troubled and distressed credits. Marcal is looking, as do many companies in distress, to sell the company in the context of its bankruptcy. "Marcal is interesting," suggests the source, who has researched the company as a potential investment. "A company like that might have an easy fix. The problem, they claim, is energy prices. Bankruptcy is often the way to address that. There have been a lot of success stories of companies that go to small profits from raw material and energy prices and bankruptcy can turn them around amazingly within one year. People think of bankruptcy as the end of the game and it's really just the beginning of the game for a lot of companies. It allows them to survive."

Many professionals in the region specialize in what is more commonly known as distressed M&A. These might be companies that are heading into bankruptcy, are already there, or are even emerging from bankruptcy. Companies that are in distress need to understand the nuances of their situation and how a merger or acquisition may become a viable solution for them.

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A hedge fund that is in this business, for example, will buy bonds, bank debt or equity in companies that are in distress. These rescue investors can passively buy securities of troubled companies or buy them and then become active and agitate the management for change—take an active role in the restructuring process. In some circumstances, the firm might look to buy the whole company. "The market for rescue financing has really grown," notes the hedge fund source. "There are a lot of alternative lenders out there, so it's a good time if you're distressed to seek rescue financing."

The first steps before financing, however, are for an owner to acknowledge that his business is in distress and seek guidance from an advisor. Turnaround professionals are critical to assessing distressed companies and figuring out how best to handle the situation. "It's a very tall order to expect a company in this condition to have the objectivity to step aside and say they've got a problem," explains Karen A. Giannelli, an attorney and president of the New Jersey chapter of the Turnaround Management Association in Raritan. "They are in crisis management. They really need to consult with a professional." These are professionals who serve the needs of and consult with or participate in the management of troubled under-performing businesses in order to facilitate their renewal and recovery. They include:

- Turnaround managers, interim corporate managers who serve in a hands-on management role within the enter-

prise, including senior-level positions such as CEO, COO and CFO

- Accountants, financial advisors and bankers
- Attorneys with expertise in bankruptcy and restructuring
- Service providers, such as debt or equity investors, asset based lenders, venture capitalists, trustees, appraisers, auctioneers, liquidators, executive recruiters for interim and permanent positions and turnaround consultants

The turnaround specialist is able to enter a company with a fresh eye and objectivity. "The crisis manager might say, 'Look, I think you can streamline the business by getting rid of these people and maybe combining these jobs or we can go out and sell this division. You've got all this excess equipment, let's start selling it,'" explains Giannelli.

Distress Red Flags

- All of a sudden payables are going way up or receivables aren't being collected and they are going way up.
- Someone important to the company in terms of sales walks out the door.
- The company is losing sales. Why? Maybe a competitor is eating your lunch or you have a product line that has become obsolete.

The turnaround specialist is usually brought in when a lender who spots red flags (*see box*) starts putting pressure on the business owner. "If a turnaround manager is brought in by a secured lender like a bank, which they often are, it's to see if there is a way to have the company survive on its own. But often times that leads to a sale. That's when your M&A issues come in," says Giannelli. "Companies can be sold various ways, privately, under the auspices of a formal court proceeding, like Chapter 11. A lot of companies are sold in the context of a Chapter 11 case. The company could also stop existing because the assets are sold. More times than not, the preferable way to go is to sell the company as a going concern. This is good for the vendors and sometimes the employees."

Giannelli's advice to owners of distressed businesses is to seek help as quickly as possible—they might be able to turn the company around and they can potentially salvage more value from the business and be a better prospect for buyers. "The goal is to maximize what you can escape with," Giannelli explains. "In a distress situation, the presence of personal guarantees is a very distinguishing factor. If you have personally guaranteed the bank debt, you can't walk away from the situation. If you do and the bank doesn't recover the full amount, you're liable for the balance. If you have not personally guaranteed the debt and the situation is really hopeless, you can say to the bank, 'I'll give you the keys and you can have the business.' The bank typically doesn't want it because they're not in the business of running businesses. That's when you can get the bank to more readily work with you. They'll say, 'OK, we will continue to support you while you get the appropriate help you need to find a buyer for the company that will maximize the value that you get so that you can pay the bank.'"

Distressed-business experts agree that a proactive approach is the most prudent. "Recognize the problem early. Be self-evaluative. Don't put your head in the sand and hope that things will change," urges the hedge fund expert. "Develop a plan and be really analytical about it. If necessary, hire a professional and develop a turnaround plan. The longer you wait, the deeper in debt you can get and the more likely you'll lose control."

In January, Marcal received court approval for an $84.5-million loan commitment from Highland Financial of Murphys, Calif. The loan, a debtor-in-possession financing, made a $20 million revolving credit facility available immediately to Marcal. The financing package allows the company to use all of its cash balances and provides Marcal with more liquidity to fund normal business operations. Things are looking up. **M&A**