From Creditor to Equity Holder:

How to Make Your Post-Reorganization Equity Work Harder for You

A breakfast discussion
presented in conjunction with

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Business Considerations to Evaluate and Make Proper Sell/Hold Decisions for Post-Reorganization Equity

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Overview

Business considerations inherent in the sell/hold decision for post-reorg equities include:

- Immediate sale vs. extended (1-2 year) holding period
- Exchange listing or quasi-private
- Oversight of company/investment
- Composition of the new board of directors
- How to avoid dysfunction

Sell vs. Hold

- Conversion of debt to equity generally does not cause a company's TEV to appreciate right away
- The following questions help an investor make the decision of whether to sell or hold post-reorg equity:
  - Is the company fixable or is it destined for failure?
  - Is the company cyclical and, if so, where in the cycle?
  - Is the company still too levered; will it have sufficient cash to service remaining debt?
  - Is existing management competent; if not, are upgrades easily available?
  - Is there a logical strategic buyer for the company?
  - Based on the investor's outlook for the company, is there a better place to reinvest the capital?

Public vs. Private

- The most obvious benefit of being a registered public company post-reorg is access to liquidity
- Immediate public listing, however, could limit value:
  - A glut of sellers and no group of informed buyers
  - Lack of research coverage given no underwriter
  - Bankruptcy taint on the name
  - Likely earnings misses due to optimistic disclosure statement projections (and quarterly earnings focus vs. long-term value creation)
  - Costs of being registered
  - More difficult to deliver control to a strategic buyer once fully public
- Considerable liquidity available through trading desks

Oversight of Equity Investment

When determining the amount of time that an investor should spend overseeing an equity investment (which is a different challenge than managing a debt position in a larger debt portfolio), considerations include:

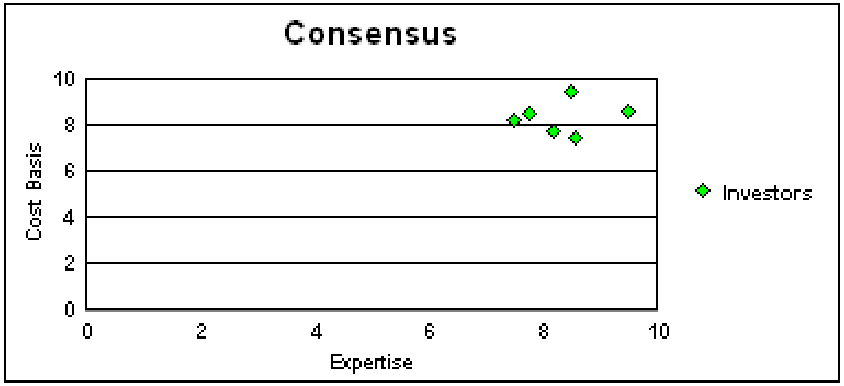
- How much money is invested on an absolute basis and with respect to the size of the overall fund?
- What percentage of the company is owned by the fund?
- Is there a PE-like co-investor who has indicated a willingness to lead the oversight process?
- How good is the management team, and how much oversight / enhancement does it require?
- Is additional capital needed for liquidity, capex etc.?
- Are there professionals in-house with the experience required to manage equity investments?
- How to stay informed without inhibiting ability to trade

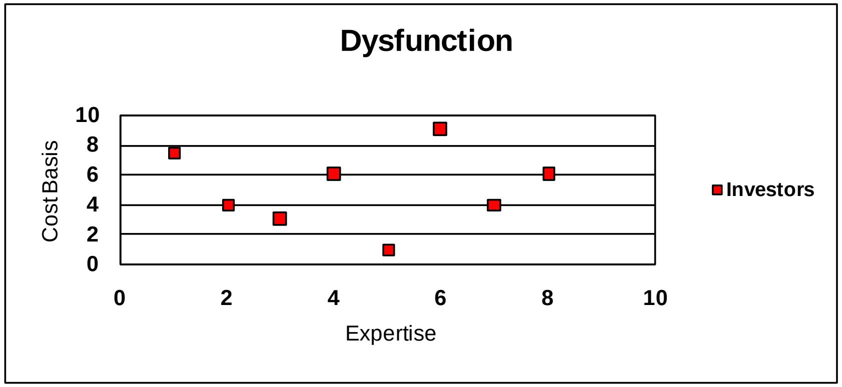
Board Composition & Purpose

- Should the investor sit on board or nominate a 3rd party?
  - Issues include investor's time, expertise, desire to remain unrestricted, holding period
- If third parties are to be nominated, issues include:
  - What is the desired outcome and is it known going in?
  - Industry expertise vs. financial / deal expertise
  - Will the directors form an effective team?
  - How much time is each director willing to commit?
- Typical post-reorg boards tend to have certain limitations:
  - Boards are typically reactive to information provided by management, not proactive
  - Time horizon for an independent director might be longer than investor's
  - Typically not immersed in company detail (part-time job)

How to Avoid Dysfunction

- During the restructuring, members of the Creditor's Committee may have had differing agendas, leading to protracted disputes and elongation of the process
- Post-reorg, the primary goal of the new shareholders should be to maximize recovery in a reasonable period of time
  - This goal may not be achieved if competing strategies and agendas arise due to a wide range of cost bases and PE expertise within the new group of owners





How to Avoid Dysfunction (CONT'D)

- If an investor senses early on that the post-reorg ownership group might be dysfunctional, a sale of the equity should be considered
- To avoid dysfunction and the related impact on company performance and the potential destruction of value, the following items should be considered:
  - Have an agreed-upon strategy at emergence, and ways to measure the attainment and continued viability of such a strategy
  - Team up with holders with the same point of view to form a *de facto* control block
  - Make sure that the directors share the same goals as the owners (and are incentivized that way)
  - Foster an active dialogue amongst directors and management between board meetings to avoid negative surprises

Conclusion

- Once debt is converted to equity as part of a reorganization, the new owners should look at the equity as an opportunity to make a sizable return rather than as a burden
- The desire to immediately attain the highest level of liquidity may come at the expense of value creation
- Holders should consider the different agendas and investment horizons of their fellow owners to best determine their own sell / hold strategy
- There should be an alignment of interests between owners, board directors and management such that everybody wins if the desired outcome is achieved
- The more focus and attention paid to post-reorg companies and their issues by investors or their proxies, the higher the likelihood of a successful outcome