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TMA Turnaround Times

TURNAROUND MANAGEMENT ASSOCIATION OHIO

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In This Issue

President's Report

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BDO USA

"Wisdom is the reward you get from a lifetime of listening when you would rather have talked."—Mark Twain

The Ohio Chapter of TMA provided its members and guests with numerous opportunities to collaborate, commune and expand their knowledge in 2017. January saw our annual economics presentation, where Dr. Mark Schweitzer of the Federal Reserve Bank of Cleveland provided us with a forecast of the U.S. economy for 2017. In February Mark Bennett, Assistant United States Attorney, reviewed bankruptcy, tax, mortgage, health care and other types of white collar fraud. Barry Spencer, FBI Special Agent, enlightened our members and guests in March concerning cyber threats that affect each of us, our businesses and our clients. April saw the retirement dinner celebration for The Honorable Pat E. Morgenstern-Clarren, where we were introduced to the "Minnesota Goodbye." May saw better weather (save for a few raindrops) as members and guests enjoyed golf and dinner, followed the next morning by an inspirational message from Dick Kiko and a panel discussion on restaurant franchise/franchisor issues in bankruptcy.

As summer approached, June brought the annual joint meeting with the ACG at the Shoreby Club, where listening over the surf of Lake Erie often provides great opportunities. Similarly July's TMA Golf Classic offered members a chance to learn from one another. Wisdom was increased again in September as the Inaugural CFA/TMA Shuffle took place at the Forest City Shuffleboard Arena and Bar in the Ohio City neighborhood, where those attending learned the challenges of the facility buildout as well as how to participate in shuffleboard. And just a few days ago, Carole Rendon, former Justice Department official, gave us an insightful look into what the office of the United States Attorney does for the citizens of Northern Ohio.

On November 9th, the TMA and TMA NextGen jointly presented a panel discussion on "Dealing with Unexpected Events that can Upend Healthy and Restructuring Companies." And we'll finish the year with our annual Holiday Celebration on December 7th at the Hilton Cleveland Downtown. All in all, 2017 has brought and will bring plenty of opportunities for attendees to listen, learn, meet new contacts, renew old contacts, and think about subjects in perhaps a different way.

The challenge of having a year of great programs is presenting even better programs and ideas the following year. The programming team recently met and compiled a great schedule for 2018, which you'll be hearing more about once the New Year breaks.

Programs like these are but one of the many reasons that firms become sponsors of TMA for the year. Gus Kallergis (of Calfee) will be reaching out to existing sponsors first, then to any other firms that would like to consider sponsoring. Helping sponsor TMA's lineup of programs means your firm's name is always front and center, included on program flyers, newsletters, website and a host of other benefits Gus would be happy to share.

And while guests are always welcome, becoming a member of the TMA provides you not only with discounts on local chapter events, but membership benefits from the national Turnaround Management Association. Steve Skutch (of Skutch Arlow), Tom Furnas (of Inglewood) and Rick Szekelyi (of Phoenix) would be delighted to provide more details and help you become more integrated into the Ohio chapter.

As this is the last newsletter of the year, I want to reach out and thank my fellow board members for their hard work and dedication during 2017. I also want to thank our NextGen coordinators for their efforts to introduce younger folks into the world of distressed businesses. And I would be remiss if I didn't offer thanks to Louise Walsh, our chapter administrator, and to Chris Peer, without whose assistance and dedication these newsletters would never go out.

With that, I wish each of you a very happy and blessed holiday season!

Mark

About TMA

TMA is the premier national organization of professionals dedicated to corporate renewal and turnaround management.

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www.turnaround.org

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The Nuances of Solvency

By John K. Lane and John P. O'Brien
Inglewood Associates LLC

We thought TMA might be interested in this discussion of some of the nuances of solvency. Please note that there have been many articles and treatises on solvency, as well as extensive case law, which we could never do justice in covering here. Our focus in this article is to simply highlight some of the more interesting nuances and to sensitize you to the underlying issues.

SOLVENCY LEGAL STANDARDS

As most all of you know, a solvency analysis must involve one or more of three tests, of which only one is required for a company to be deemed insolvent:

Balance Sheet Test – The Bankruptcy Code defines "insolvent" as "a financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair value".[1] Fair value is not defined by the Bankruptcy Code.

Unreasonably Small Capital Test – Under this test, a company could be deemed to be insolvent if it "was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital".[2] Unreasonably small capital is also not defined by the Bankruptcy Code.

Ability to Pay Debts Test – Under this test, a company could be deemed to be insolvent if it "intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured".[3]

The nuances begin almost immediately when one starts to apply these tests. Following is a portion of our personal favorite hit parade of nuances.

WEDDED TO BALANCE SHEET

The term "Balance Sheet Test" itself is a misnomer, given the balance sheet is only the starting point of the analysis. Assets recorded in a company's accounts must be adjusted to reflect Fair Market Value. In other words, the historical balance sheet can be used as the starting point, but most certainly cannot the only data point.

Several issues arise here in this regard. First, the balance sheet is based on the historical cost of acquiring the assets and may have nothing to do with current-day values. An obvious example of the disconnect between the balance sheet and fair value includes property, plant and equipment which may be substantially under- or overvalued on the balance sheet, depending on age, condition, possible technological obsolescence, and use, among other things. Moreover, external factors--such as environmental restrictions, legal easement issues or an absence of an economical and/or sufficient power/electricity supply--could impact values. There may be recorded assets that could have no benefit to a potential buyer, such as purchased goodwill, deferred assets, prepaid expenses, or nonrefundable deposits, which therefore should likely have no fair market value. More subtle examples may include deposits made long ago, rebate rights, royalties, patents, technology, or other

1 11 U.S.C. Section 101(32)(A).
2 11 U.S.C. Section 548(a)(1)(B)(ii)(II).
3 11 U.S.C. Section 548(a)(1)(B)(ii)(III).

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proprietary rights that have may not been recorded in the balance sheet, but should be considered as part of fair market value.

Second, an asset that has some value in a healthy company may have less value when that same company becomes unhealthy. For example, intangibles or acquired intellectual property or rights may have less value in the hands of a troubled business that is less able to monetize these assets. Also, receivables from related parties may no longer be collectible if they are due from an owner who has invested all of his/her available cash to support the failing business.

When a company is in trouble, many times it is in management's perceived best interest to "polish the apple," despite the potential of internal rot. It is not unusual to review a troubled company's balance sheet and find that either certain recorded assets are long gone or perhaps they never existed in the first place.

Third, sometimes normal day-to-day liabilities are not recorded on the balance sheet. For example, if a company only records its expenses when paid (not a good approach), then every incurred and unpaid expense is an unrecorded liability. This has a higher likelihood of occurring in more troubled companies. Unrecorded warranty, gift cards, retail coupons, advance payments or deposits from customers, could all give rise to unrecorded liabilities. If the company has provided offset rights to its customers, this too could either lead to unrecorded liabilities or diminished value for the assets.

In other words, when reviewing the historical balance sheet, one needs to recognize that the balance sheet may have nothing to do with actual values. You have to look at both what is recorded and what is not. And, you have to consider whether the company's situation has an impact on values.

GALLIA EST OMNIS DIVISA IN PARTES TRES

As Caesar noted that all of Gaul was divided into three parts, so is this article! Keep a look out in the coming months for a discussion on how relevant and irrelevant events can drive value and how "What did you know and when did you know it?" might have applicability in the evaluation for solvency.

Going Once, Going Twice…Sold! Using Auctions to Sell Business Assets

By Sarah McIntosh
KIKO Real Estate & Auctioneers

Auctions work! Auctions create a forum where interested buyers engage in competitive bidding to receive true market value for assets.

Too often, auctions are misunderstood and seen as something that should be used only for the dead or desperate. But the turnaround world is very different and more vibrant today than it was seven years ago. In the past, engagements usually ended up in bankruptcy, with either a 363 or a receivership sale, and though some struggling businesses still opt to use Chapter 11 bankruptcy to sell their assets, the last several years have revealed new options to monetize assets by a sale motion without entering Chapter 11.

Investigating a short sale or a sale motion using the new PSO (Private Selling Officer) statute, is gaining popularity as a means to quickly liquidate a debtor's asset. Under the new provision R.C. § 2329.152(A), a judgment creditor (not just a mortgagee) can file a motion to request that a PSO instead of a sheriff conduct a judicial sale. This law applies equally to both residential and commercial foreclosures.

A sale motion will typically ask the court to establish procedures for the sale that will be approved before the sale itself is conducted. The complexity of the procedures will vary depending on the nature of the assets to be sold and how the sale itself might be executed, either by private sale or public auction. Almost any physical asset that a business owns, including inventory, equipment and real estate, can be sold to the highest bidder at auction by PSO.

Feature Story

Even products as diverse as oil & gas leases, specialty machinery, and intellectual property can be sold at auction. These sellers have discovered that auctions are a powerful method for delivering fair market value. Competitive bidding processes vary for different types of auctions, but each has proven remarkably effective in capturing markets and yielding premium results.

Once the sale procedures are established and public auction is chosen, this is when a qualified and experienced auction firm should be engaged to ensure the seller receives market value for the assets. The process typically allows a specified timeframe for notice to creditors and to develop a marketing strategy aimed at generating buyers. Also, because all auctions are "as-is, where-is," the buyer is responsible for the assets they purchase, and the money is in hand before they can take possession. Here are a few things to consider and steps to follow.

Hire the Right Auction Firm
It is important to seek the help of qualified professionals when planning an auction. Once the decision is made to sell or liquidate business assets, working with a professional auction company has multiple benefits for the business owner.

Exclusive Benefit for Real Estate
When selling real estate or land, an auction firm will advise the seller on how best to market and sell the property to the buyers. Subdividing and partitioning real estate is very complicated. An auction firm can outline a plan and by selling parts verses the whole and using choice, create competition where competition didn't exist to maximize the sale price.

Inventory of Assets
Auction firms will complete a full inventory of the assets. The assets are organized, cataloged, and presented at auction to their best potential. Customers appreciate an auction that is displayed in an organized manner, with a comprehensive sale catalog to provide an easy bidding experience.

Bidders Come Ready to Buy
People love auctions and arrive ready to buy. Auctions promote competitive bidding, which drives up the prices. More often than not a customer will come to an auction focused on buying one particular item for a particular price, but the atmosphere and competitiveness compels them to purchase more and generally for more than they intended. A good auctioneer provides an open, fair, and non-discriminatory bidding environment.

No Negotiations
There are no negotiations in an auction setting. Everything is sold "as-is" and "where-is." Once the bidding begins, an auctioneer ALWAYS closes the sale -- there are no contingencies! Customers know a winning bid means they have committed to purchasing the item and must pay and remove their purchase in a specified period of time. This provides bankers and sellers additional assurance of an arms-length transaction.

Global Bidding Potential
Advances in technology have contributed greatly to the power and efficiency of auctions. Thanks to internet technology, bidders from around the county, state, country, and world can participate in an auction. Online, onsite or simulcast auctions are used to maximize the number of qualified bidders at an auction. This technology has resulted in a significant increase in auction returns.

Fast and Efficient
Auctions are the fastest, easiest, and most efficient way to convert assets to cash. Instead of waiting for an offer that may never come, auctions create a market environment with qualified buyers on a predetermined sale date. This provides sellers with the peace of mind that a definitive end is in sight. All the worry and frustration due to inefficiencies related to multiple showings, fruitless negotiations, and extended sales periods are eliminated.

The time has passed when the thought of using an auction was just for liquidating assets that could be sold in no other way. Today, sellers of commercial properties, businesses and business assets turn to auctions as their first choice in selling real estate and chattel. These options to sell the debtor's assets should be considered by workout professionals because the process is open, transparent and accomplished quickly. Who can fault them for the prices they get if those prices are the outcome of a competitive bidding process?

Featured Sponsor

KIKO Auctioneers is a full-service auction company specializing in the sale of real estate and many types of personal property. The company leverages a team of licensed auctioneers to help clients turn assets into cash.

2017 Schedule

December 7

Annual TMA/CMA Holiday Event

Hilton Cleveland Downtown Hotel

NOTE: The dates and subjects listed in this tentative 2017 calendar are subject to change to accommodate speaker's availability, facility availability, verification of availability of other organizations in the case of joint events, and current events which might pre-empt this current schedule. This schedule will be updated as necessary.