KPMG

Capital Structure Solutions in a Disruptive Market

Due to economic headwinds, recessionary concerns, and disruption in the markets caused by geopolitical risks, companies must actively manage pressure on revenues and cash flows – and ultimately on their capital structures.

Balance sheet restructuring

An impending or actual breach of a financial covenant in a borrower's credit facility is an early warning sign of financial distress.

Lenders are:

- Closely monitoring the performance of their borrowers and carefully evaluating any covenant defaults.
- Assessing the preparedness of borrowers to deal with any defaults, as well as what corrective actions borrowers might take.

What can you do to restructure your balance sheet?

Communicating frequently and transparently with lenders can go a long way to ease concerns and set the stage for a successful balance sheet restructuring – whether a resetting of financial covenants or realignment of outstanding debt to better fit the current state of operations.

Alternative capital sourcing

Traditional funding sources are not always available in a disruptive market, and new funding is often needed to address balance sheet pressures.

Today, debt capital markets remain open, but at a cost given the substantial increase to SOFR and the widening of spreads. Fed actions have raised the federal funds target range to 5.25% - 5.50%, the highest in 22 years.

What can you do if the debt markets tighten/close altogether or if the current high cost of capital does not solve your balance sheet issue?

Turn to alternative sources of capital like non-bank lenders, mezzanine providers and structured / preferred equity solutions. These capital providers are well suited to quickly analyze and fund companies in financial distress and can lessen the burden of cash pay interest with PIK interest and warrants while usually requiring little to no amortization. While more expensive than "traditional lenders," alternative capital sources can provide increased cash flow and greater covenant flexibility allowing businesses to navigate choppy markets.

M&A considerations

If the level of financial distress or required capital investment is more significant, an M&A transaction may be the optimal path to pursue.

In a disruptive market, the greatest challenge to an M&A process may be the typical timeline, which can stretch from 6 – 9 months. An accelerated M&A process is frequently required in distressed situations, which can significantly shorten the timeline to as little as 1 – 3 months.

What does an accelerated M&A process look like for your business?

- An accelerated M&A process typically includes "special situation" investors, comprised of financial sponsors who are well-equipped to react quickly, perform diligence, and close transactions on an expedited basis.
- If the potential transaction is complicated by debt defaults and the distracting influence of recalcitrant creditors, companies can avail themselves of the protections offered under Chapter 11 of the US bankruptcy code which stays creditor actions while a sale transaction or debt restructuring is concluded.

The M&A process may need to be accelerated as a result of financial distress

Solvent — **Financial condition continuum** — **Insolvent**

Traditional process: 6 – 9 months

Accelerated process: 1 – 6 months

Going concern

- Profitable
- No cash flow or working capital concerns
- Standard warranties and indemnities
- Negotiations between buyer and seller only
- Valuation mutually agreed upon by parties

Under pressure

- Growing cash flow and operating performance concerns
- Going concern value in question
- Approaching "zone of insolvency"
- Limited access to capital
- Requires operational and/or balance sheet restructuring to avoid bankruptcy

Business in bankruptcy

- Chapter 11 filing required to stay creditor actions
- Covenants breached and DIP financing typically required
- Multiple constituents involved in process and decision making
- Public auction process of assets to repay creditor
- Sale is free and clear, final, and requires court order to confirm

KPMG's experienced M&A, Capital Markets and Turnaround & Restructuring professionals can help you address the complex issues facing your Company in this disruptive market environment

Covenant analysis

Developing a financial model to stress-test financial covenants and analyze headroom under different operating and cash flow scenarios is important to assess the likelihood of a potential loan default.

Lender communications

Transparent communications with lenders regarding the business outlook, challenges encountered, and planned corrective actions will enhance credibility and drive success in any restructuring dialogue.

Creditor negotiations

Resetting covenants, addressing maturity dates, and potentially right-sizing the capital structure to better fit the long-term operational outlook are potential topics for discussion with creditor constituencies.

Alternative capital sourcing

Refinancing existing lenders or sourcing additional junior capital may be needed. It's important to have multiple parties at the table including non-bank lenders, credit funds, and other alternative capital providers.

Business plan modeling

Preparing a forecasting model that will facilitate efficient due diligence and funding is critical. Investors will require an updated financial forecast to most effectively structure any new capital investment.

Lender due diligence

Lender diligence can be taxing on already strained management resources, especially when multiple capital providers are involved. A third party advisor can be helpful in coordinating and expediting the due diligence and closing process.

Accelerated M&A process

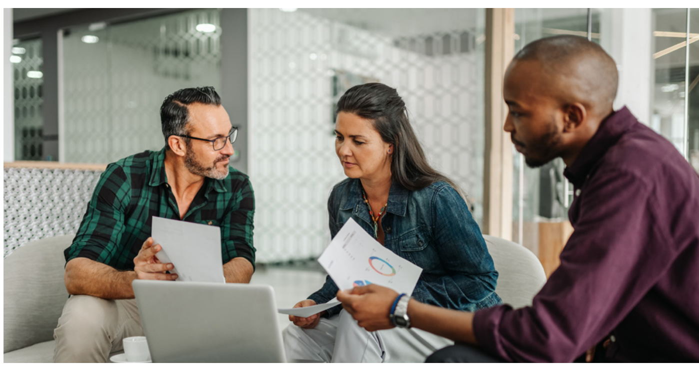
An efficient and expeditious M&A transaction involves the following key steps: developing the transaction strategy, preparation of marketing materials, negotiating with buyers, and closing.

Special situation investors

Involving investors from the "special situations" community in your M&A process can expand the number of potential buyers while simultaneously allowing for accelerated diligence, negotiations, and closing.

Chapter 11 strategies

If the situation becomes highly stressed, consummating a sale through Chapter 11 could provide additional time to forestall creditor actions, such as foreclosure processes, and preserve value for your business.

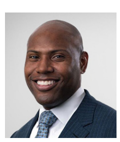


How KPMG can help

The evaluation of strategic alternatives can be a daunting exercise, especially in a disruptive market environment. With decades of experience sourcing capital, negotiating with creditor constituencies, and executing M&A transactions, KPMG Corporate Finance LLC can help you objectively evaluate all possible alternatives and chart a path to preserve value for your business. KPMG LLP's turnaround and restructuring practice can also help organizations to work through challenges, restore value, and enhance financial and operational performance for the long-term.

Contact us

Rebecca Brokmeier
Principal
Capital Advisory
312-665-3152
rbrokmeier@kpmg.com



Mychal Harrison
Principal
Turnaround & Restructuring
212-220-5938
mychalharrrison@kpmg.com

Ford Phillips
Managing Director
Special Situations
312-665-1537
frphillips@kpmg.com

Mike Rudolph
Managing Director
Debt Capital Advisory
312-665-1442
msrudolph@kpmg.com

Pete Smidt
Managing Director
Deal Advisory and Strategy
248-225-9698
pjsmidt@kpmg.com

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

kpmg.com/socialmedia

DASD-2023-13866