

Valuation Plays Key Role in Bankruptcy Process

Distressed companies handle their problems in a variety of ways. Enterprises with minor troubles frequently work them out by borrowing additional funds, cutting costs, and perhaps selling assets or business segments. Companies in greater difficulty engineer workouts in conjunction with their lenders, creditors, and bondholders. Operations with grave problems often must file for reorganization under Chapter 11 of the U.S. Bankruptcy Code. In a Chapter 11 proceeding, a business entity attempts to restructure its obligations to creditors in a court supervised proceeding. At several points during a reorganization, an objective valuation may be necessary. This article discusses the role of valuation in the bankruptcy process.

PREPACKAGED PLAN

A prepackaged plan or "prepac" is a plan of reorganization accepted by creditors prior to a Chapter 11 proceeding. A requirement of the Plan is the "best interest of creditors test." The debtor must be able to show that each creditor would receive as much as it would in a liquidation. The test often requires an appraisal of the debtor to establish an appropriate liquidation value.

ADEQUATE PROTECTION

In a Chapter 11 case, a debtor is not allowed to use its encumbered cash or cash collateral unless either the secured party holding the encumbering lien consents, or the bankruptcy court approves a motion to use cash collateral. Before an order allowing the debtor to use cash collateral can be entered, the bankruptcy court must determine whether the order would jeopardize the creditor's prospects of being paid in full. To prove that there is ample equity cushion to use cash collateral, a debtor often provides the court with testimony from a valuation expert as to the value of the collateral.

SALE OF ASSETS

The objective of most Chapter 11 filings is the confirmation of the Plan of Reorganization. However, in some cases the proceeding is used to accomplish the sale of the debtor's assets prior to Plan confirmation. To succeed in selling assets under Section 363 of the Bankruptcy Code, the debtor or trustee must show that the sale is in the best interests of the bankruptcy estate and its creditors. A professional valuation is often utilized to provide support for a sale of assets.

SOLVENCY OPINIONS AND EQUITY VALUATIONS

If an enterprise settles with a creditor shortly before entering Chapter 11, the settlement may be challenged during the proceedings as a preferential transfer. Solvency opinions can be used to contest this issue. Reorganization under Chapter 11 may include the issuance of new securities. A

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workout may involve a debt-for-equity swap. An equity valuation assists in planning such actions and projecting their long-term effects. In addition, when new securities are to be issued to a dissenting class of creditors in a cram down, a valuation of the securities' present value is often needed to determine if the cram down meets the "fair and equitable" requirement.

RECENT ENGAGEMENTS

The following are examples of engagements in which Valuation Research was asked to provide valuations during different stages of the bankruptcy process.

- **Major telecommunications company** - For this engagement, we provided a valuation of major asset categories to be used in a liquidation analysis for a prepackaged plan. Major asset categories included machinery and equipment, real estate, leasehold improvements, inventory, and licenses.
- **Cooperative of produce growers** - To confirm the value of the collateral for the lender, we valued machinery and equipment and real estate at 10 canning and packing plants and 11 associated properties. After the bankruptcy proceedings, the lender purchased a portion of the business and used our valuation in its negotiations.
- **Communications company** - Prior to the Chapter 11 filing, the company sold certain non-core assets. We provided the board of directors of the company with a valuation of the assets sold to ensure that the company received a fair price for the assets. In addition, we valued leasing equipment to substantiate the value of the collateral for adequate protection purposes.

LITIGATION SUPPORT AND TESTIMONY

Many of our valuation specialists are experienced in preparing their conclusions and the rationale behind them for use in litigation. In addition, members of our professional staff testify before bankruptcy courts and comparable tribunals regarding not only the values of tangible and intangible assets, but also going concern values, reasonably equivalent value, and solvency analyses.

Objectivity is crucial to valuation analysis in workout and bankruptcy situations. Our workout and bankruptcy engagements are free from conflicts of interest, real or apparent. Our findings are viewed with confidence by lenders, creditors, attorneys, courts, and other third parties. For more information, contact your Valuation Research representative or Robert Schulte at 617/342-7366. **VR**

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