

Distressed Companies Become Creative As Financing Dries Up

By Marie Beaudette

Companies in bankruptcy are devising unusual ways to stay in business amid a crisis that has crippled U.S. credit markets and choked off traditional sources of financing.

To finance bankruptcy restructurings, they're using tax refunds, selling assets and mining all potential sources of cash. Troubled companies are also looking for untapped assets, like foreign receivables, to secure new loans to fund a Chapter 11 case.

"We've never seen a credit market literally closed before, so no one has had to think through how to get companies in and out of Chapter 11 in this type of environment," said Jonathan Henes, a partner in the bankruptcy practice at Kirkland & Ellis LLP. Homebuilders **Tousa Inc.** and **Kimball Hill Inc.** are using tax refunds to fund their restructurings. Frontier Airlines Holdings Inc., a Denver airline pushed into Chapter 11 protection by a dispute with its credit-card processor, is selling some airplanes it no longer needs to raise cash for its bankruptcy.

Companies in distress also are taking unusual steps before a bankruptcy filing to map out a restructuring and win support for creditors. Home-goods retailer **Linens 'n Things Inc.**, which is trying to avoid a Chapter 11 filing, recently moved to begin paying its vendors up front to keep its shelves stocked.

"Fewer companies have the traditional means of generating liquidity for bankruptcy," said Ron Greenspan, a senior managing director at FTI Consulting Inc.

In past periods of high defaults and Chapter 11 filings, obtaining a bankruptcy loan was "almost automatic," said Becky Roof, a managing director at corporate restructuring firm **AlixPartners**. Now, she says, "you no longer will have lenders who will even give a company time to put a business plan together."

Roof said companies, especially those that borrowed a lot of money during the liquidity boom that came to an abrupt halt last summer, are finding that they can't turn to the credit markets for bankruptcy financing. Their existing banks, reeling from losses tied to subprime-mortgage write-downs, aren't willing to cough up new financing either.

"Lenders are stuck with the companies that they lent to, and companies are stuck with the lenders that they have," Roof said.

As the U.S. economy continues to worsen and credit markets remain closed off, companies entering Chapter 11 protection have few options to raise money to fund a restructuring. Even hedge-fund money has become scarce, and the little money that is available comes at a high cost.

For troubled companies, borrowing "goes from difficult to impossible in this environment," said Greenspan.

Kirkland's Henes says the economic downturn and the tight credit markets have made the shelter of Chapter 11 bankruptcy less hospitable. Although Chapter 11 is designed to give companies breathing room to restructure their debts, too many companies simply can't afford to keep operating, even under court protection.

"Since there's not a lot of liquidity out there, the Bankruptcy Code's purpose is being thwarted a bit," he said.

Experts say companies getting ready to seek Chapter 11 protection will need to map out a strategy before filing papers with the bankruptcy court. And, Roof says, they'll have to make sure they have enough of a cash "runway."

Companies are taking advantage of tax laws that allow them to offset past profits with current losses. For some companies, including homebuilders that saw big gains erased when the economy turned and the housing market went bust, the tax break could provide a big cash infusion at a critical time.

Florida-based **Tousa**, which sought Chapter 11 protection in January, dropped its \$135 million bankruptcy loan after receiving a \$207.3 million tax refund from the carryback of losses for 2007. The company was fighting with its creditors over the terms of its bankruptcy financing, but now says it should have enough cash to operate in bankruptcy without the loan.

Kimball Hill, a homebuilder based in Rolling Meadows, Ill., also decided to finance its Chapter 11 case with a \$51.8 million tax refund. In court papers, the company said it had "substantial unencumbered assets," but decided not to borrow on them to preserve value for its unsecured creditors.

Others are selling assets they don't need, paying off any underlying debt and using the remaining proceeds to fund a restructuring. Frontier Airlines is selling four airplanes for \$106 million, a sale that will generate about \$37.5 million in proceeds after it pays off the mortgages on the planes.

Some companies - especially parts makers that play a critical role in the automotive supply chain - can tap their customers for financing.

Customers of **Plastech Engineered Products Inc.**, including major auto makers that propped up the supplier before it sought Chapter 11 protection, floated a plan to fund the company's restructuring. The company is now considering selling one of its main business units to customer **Johnson Controls Inc. (JCI)**.

... continued on page 6

COMPANIES TO WATCH**Hawaiian Airlines To Get \$52.5 Million In Settlement**

Hawaiian Airlines will get \$52.5 million from Mesa Air Group to settle claims that Mesa's low-cost carrier misused confidential business information to undercut its competition, the Associated Press reported.

The settlement announced Wednesday concludes a legal battle over Phoenix-based Mesa's go! airlines' entry into the Hawaii air market, which set off a three-way price-cutting frenzy and eventually led to the recent closure of Aloha Airlines.

Also Wednesday, Hawaiian also announced that its interisland fares are being raised up to \$20 each way starting Thursday, with its lowest one-way fares increasing by \$5, from \$49 to \$54.

Hawaiian had won an \$80 million judgment against Mesa in October based on allegations that Mesa used confidential information and trade secrets obtained during Hawaiian's Chapter 11 bankruptcy proceedings before launching go!.

"This settlement is the last chapter in the legal dispute over Mesa's misuse of Hawaiian's confidential information. We were delighted with the award of damages and this settlement," said Mark Dunkerley, Hawaiian's president and chief executive.

Mesa did not admit wrongdoing in the settlement, according to a statement. Its go! airlines will continue to fly between the islands as before. A go! spokesman said the company had no additional comment.

Mesa will be returned \$37.5 million of the \$90 million bond it had been required to post while the appeal was pending.

U.S. Bankruptcy Judge Robert Faris had ruled that Mesa breached a confidentiality agreement when it failed to return proprietary information to Hawaiian or destroy it following Hawaiian's 2004 bankruptcy. Hawaiian has since come out of bankruptcy.

The judge also found Mesa used the information to gain a competitive advantage when it decided to enter the Hawaii interisland market by launching go! in June 2006.

The \$80 million in damages represented the court's view of losses suffered by Hawaiian since go! launched. Hawaiian had sought \$173 million.

Before go! arrived in the islands, the market had been dominated by Hawaiian and Aloha for decades.

Now that Aloha has collapsed, Hawaiian and go! will rule the skies.

Hawaiian's announcement of increased fares also includes a \$25 fee each way for checking a second piece of luggage on flights between Hawaii and the U.S. mainland.

"The sudden shutdown of airlines locally and nationally these past few weeks shows how critically

important it is for Hawaiian to cover its costs," Dunkerley said.

Meanwhile, Hawaiian's parent company, Hawaiian Holdings, Inc., reported losses Wednesday of \$19.9 million, or \$0.42 per share, on total operating revenue of \$251.2 million for the three months that ended March 31. *DRR*

Editor's Note: Inclusion of a company in this feature is not meant to imply that it will reorganize, dissolve or enter bankruptcy, or that the company will be unable to meet its obligations as they come due. §

Distressed (continued from page 4)

Douglas Himmel, managing director of life-settlement broker Melville Capital, is urging troubled companies to consider selling life insurance policies they hold for their top executives. Many companies take out large term-life insurance policies for executives, but don't realize they can get cash for the policies when they're no longer needed.

The cash generated from the sale of the policy "could be the lifeline," he said.

Although some companies seeking Chapter 11 bankruptcy protection amid the economy's downturn can find a way to fund a restructuring, a growing number are being forced to sell - either because they can't obtain financing or because lenders are forcing quick sales in exchange for a small amount of new funding.

Lenders to South Carolina plastics manufacturer Wellman Inc. gave the company until mid-August to sell its assets or reorganize in exchange for a \$225 million bankruptcy loan. Gadget retailer Sharper Image Corp. last week announced it would sell its assets after failing to obtain financing.

"There just seems to be less room to maneuver these days," said Marcia Goldstein, who leads the bankruptcy-law practice at New York's Weil, Gotshal & Manges LLP.

There are few indications that credit conditions will ease up any time soon. The Federal Reserve, which cut its key interest rate by 25 basis points on Wednesday, said financial markets remain "under considerable stress."

"Tight credit conditions and the deepening housing contraction are likely to weigh on economic growth over the next few quarters," the Federal Open Market Committee said Tuesday.

FTI's Greenspan agrees. "There's no big sign out there that we're at the bottom of this," he said. "It's still very difficult to get credit." *DRR*