

# DISTRESSED INVESTING REPORT



HIGHLIGHTS FROM TMA'S AND  
THE DEAL'S 2009 DISTRESSED  
INVESTING CONFERENCE  
MAY 2009 VOLUME 1 ISSUE 3

## BRIGHT STARS AMONG DARK CLOUDS LEADERS IN DISTRESSED INVESTING STRATEGIZE

It wasn't all gloom and doom at the "Distressed Investment Fund Founders" panel, but it sure began that way.

The moderator, David Resnick, the head of Rothschild's global restructuring advisory business, kicked off the discussion with an outlook for 2009.

"Without question, 2009 will be a challenging environment for all investors," he said, "especially those focused on turnarounds

and companies with financial difficulties." Resnick explained that, in past years, investors could concentrate on companies' operating challenges, assured of financing for a deal; but now, as the financing markets suffer, the situation is more complex. "Lenders are guarding their capital carefully, and the terms on which they provide it, with respect to both costs and covenants, are extraordinarily high."

So what do these admittedly gloomy days mean for distressed investors? "In the past," Resnick said, "this environment is one in which distressed investors have made serious money." He said that a default rate of 15.1%, which is Moody's prediction for 2009, "means many targets."

With that happy introduction, David Shapiro, a co-founder of KPS Capital Partners, took the microphone. Shapiro remembered the days of old for distressed investors: "We would go into a company, lock it up with a letter of intent fairly quickly, get exclusivity, do the due diligence, bring the financing source along with us, and close. It all seemed so orderly and neat. Unfortunately, those days are over."

As companies weaken, Shapiro said that, at a time when there's a temptation to focus only capital structure, it's important to emphasize due diligence, to turn the focus back to looking at what a given company actually does and how a distressed investor can make it better.

Shapiro also preached the importance of patience. Explaining why KPS was reluctant to do deals in 2008, he said: "Our perspective has always been that, at the front-end of a downturn, you're going to see a lot of tempting transactions, but you probably ought to get out of the way and let somebody else do those deals."

Then Shapiro drilled down on the all-important topic of financing, drawing a distinction between "volunteer" lenders and what he referred to as "hostage" or "resident" lenders. "The idea of bringing in a volunteer lender and having them walk through the old school transaction process with you is just not going to happen anymore," he said. "But if you have a bank group that is resident in the company today, your best chance is to work with that bank group and come up with some way of restructuring the



David Shapiro of KPS Capital Partners



Siskin, Cross, Shaprio, Heisley and Resnick; a cross-section of accomplished investors

facility that the resident banks already have.”

That may be because of the changing nature of bank relationships. Bringing a good restructuring adviser in early is crucial, he said, because “in this environment, you will die quickly. Banks are merciless. There’s no such thing as a relationship anymore. I’ve been in this business for 20 years and felt very proud of having cultivated dozens of good banking relationships. They’re worthless today. Everybody’s looking out for themselves. Banks are taking every opportunity they can to re-price or renegotiate deals.” Shapiro added, somewhat ominously, “You have no friends out there.”

Veteran investor Mike Heisley, the co-founder and principal of Stony Lane Partners, sounded a much more upbeat note. Heisley said he believes that “great fortunes are made during times of war and internal dysfunction.” However, he added, “I’m not so sure that having a lot of capital to employ right now is a huge asset, because it might not necessarily be the solution to your problem.”

The panelists agreed that having a management team that knows how to guide a company through tough times like these can, indeed, solve many problems. “There is a world of difference,” said Heisley, “between someone that can manage a distressed company and somebody that can manage a company.”

Shapiro elaborated. He said one must have a management team that’s actually seen tough times before so it won’t adopt the posture of a deer-in-the-headlights. “To me, though, as a lender, one of the biggest challenges is having a private equity fund as an investor who has no experience in a recession. Over the last five years, the private equity funds have been living through go-

go times. Many of the partners are at an age where they really haven’t been through a recession.” Private equity funds are often “clueless” as to how to implement a turnaround plan, he said.

Interestingly, Shapiro’s skepticism of private equity investors paralleled a view offered at the 2007 Distressed Investing Conference. There, Scott J. Davido, then executive vice president, chief financial officer and chief restructuring officer of Calpine Corp., said that the easy capital available during the days of old meant that a new class of distressed investor had entered the market.

“You see a lot of people playing in the distressed investing space just because they’re looking for places to put money to work,” Davido said back in 2007. “In situations that would have scared the living daylights out of more traditional investors a decade ago, people now embrace these investments even without a lot of distressed experience—or even without a lot of industry experience in some cases.”

The 2009 panel concluded with the moderator, David Resnick, asking the speakers which industries will see the most activity in 2009.

Heisley urged investors to look at those industries “which have an inherent viability that goes beyond the cycle”—such as commodities, and companies that have large amounts of money invested in infrastructure, like the oil and steel industries. “The reason for that,” explained Heisley, “is that nobody knows where the bottom is in this market. So you better be investing in industries which have an inherent viability, that you know will come out on the other side. Because if it goes deep enough, there are going to be a lot of companies that don’t come out on the other side.” ■



AS FEATURED IN

**The Deal**

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