

DEBTOR-IN-POSSESSION FINANCING GUIDE



JAN 2021

A grayscale, high-contrast image of a modern building facade with a grid of windows, viewed from a low angle looking up. The image is partially obscured by a dark diagonal band that runs from the top right towards the bottom left.

Legalist



GETTING STARTED

WHAT IS DEBTOR-IN-POSSESSION FINANCING?

Debtor-in-possession (or "DIP") financing is funding provided to companies that have filed for chapter 11 bankruptcy.

The Bankruptcy Code permits secured DIP financing, including the grant of "priming" liens senior to all pre-bankruptcy secured debt and "superpriority" claims senior to all other post-filing obligations.

CAN SMALL BUSINESSES ALSO OBTAIN DIP FINANCING?

Because of the time and expense inherent in traditional DIP underwriting, lenders have historically focused on debtors with assets/liabilities in excess of \$100 million and financing needs of at least \$25 million.

Legalist, in contrast, focuses exclusively on lower middle-market debtors, specializing in the \$1 - 10 million range.

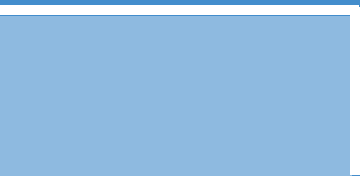
HOW DO COMPANIES USE DIP FINANCING?

DIP financing permits a company in chapter 11 to fund the costs of reorganizing or selling itself as an operating business.

In the case of a bankruptcy sale process, a debtor uses DIP financing to preserve enterprise value and fund a value-additive sale process. Debtors use DIP financing to maximize creditor recoveries while preserving jobs and operations as a going concern.

In the case of a bankruptcy plan process, DIP financing offers a debtor the "breathing spell" needed to effect an operational and financial reorganization and exit bankruptcy as a restructured, viable entity.

In both cases, proceeds of DIP loans are used to supplement a debtor's cashflows from operations, fund retention of restructuring professionals, provide interim distributions to critical prepetition creditors, and otherwise finance the costs of bankruptcy.



PROCESS

WHAT MAKES A DEBTOR IN POSSESSION A SUITABLE DIP LOAN BORROWER?

DIP lenders typically evaluate a borrower's cashflows from operations and the assets it has available to serve as collateral, together with its restructuring goals.

Legalist focuses its DIP lending on companies with substantial hard assets and a concrete timeline for a sale or plan process.

WHEN CAN A COMPANY APPLY FOR DIP FINANCING?

Customarily, DIP financing is arranged pre-bankruptcy (often from a debtor's existing lenders) through extensive and time-consuming negotiation, then presented for court approval at the outset of the debtor's case.

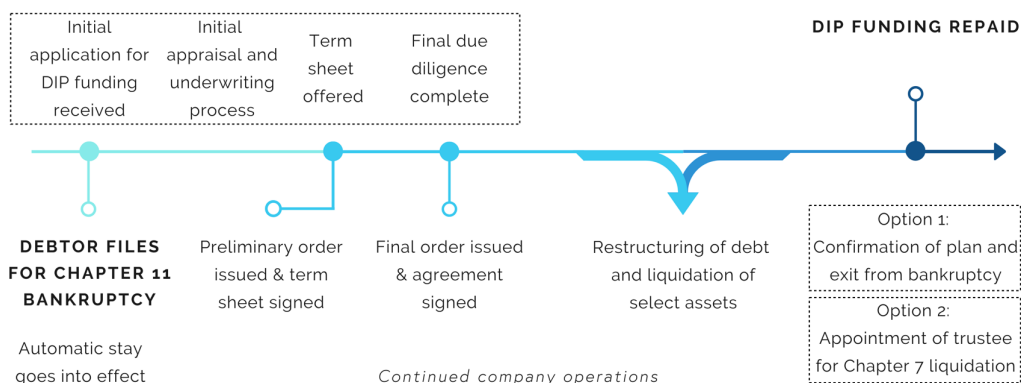
Legalist focuses its DIP lending on companies already in chapter 11 that need to access capital on an expedited basis to preserve going-concern value.

HOW IS DIP FUNDING TYPICALLY STRUCTURED?

The typical DIP lender is able to extract various "loan-to-own" concessions from a borrower that position to control its bankruptcy process and, frequently, acquire the company or liquidate its assets piecemeal.

Legalist structures its DIP facilities to protect its investment while ensuring borrowers are given sufficient runways to achieve their restructuring goals. Legalist is not in the business of owning or operating companies and does not want to be.

WHAT IS THE GENERAL PROGRESSION OF DIP FINANCING?



Traditional DIP Funders

Slow-moving, with burdensome underwriting processes and time-consuming investment decision making.

Bureaucratic and expensive, requiring multiple sets of outside counsel, agents, bankers, and financial advisors -- all of which are paid for by the borrower (and, indirectly, its creditors).

Focused almost exclusively on debtors with at least \$100 million in assets/liabilities and funding needs of at least \$25 million.

Wearing multiple hats, with exposure to one or more parts of the company's prepetition capital structure and, often, ulterior motives with respect to the company's post-bankruptcy ownership.

Are consumers of value, seeking to ensure that their slice of the pie is as large as possible -- even if it means shrinking the pie (e.g., layoffs, fire sales, and liquidations) in the process.

Legalist

Runs lean and is able to move as quickly as bankruptcy does.

Has invested in bringing experienced bankruptcy attorneys and analysts in-house, allowing to underwrite, negotiate, document, and close on loans without hiring outside help.

Limits its lending to smaller and middle-market debtors, with typical DIP loans in the \$1 million to \$10 million range.

Lends to companies in bankruptcy on a short-term basis, funding their restructuring and preserving enterprise value. It has no goal beyond timely repayment of its investment.

Loans money only on a value-accretive basis, funding sales and reorganizations that maximize creditor recoveries and preserve going concerns.

Legalist is a tech-enabled legal assets firm founded in San Francisco.

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