

# The Distressed Debt Report

News, Information, and Analysis of Distressed Debt in the Middle Market

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### NEWS IN BRIEF

A staffing firm for the entertainment industry is liquidated; ComVest is raising capital; United Rentals' case shows how investors are escaping buyout agreements; a military food supplier is bankrupt; Macquarie is expanding its U.S. restructuring business; NewStar and CapitalSource backed an acquisition; and two more auto companies are restructuring.....3

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## BAILING OUT

### Solutia, Genesco Cases Watched for Guidance on MAC Clauses

by Don Dzikowski

Court cases involving footwear retailer **Genesco** and bankrupt chemical company **Solutia** are being closely watched for guidance on when banks can legally terminate funding commitments.

With the current turbulence in the loan syndication market, legal observers are expecting a flood of additional lawsuits in upcoming months as banks seek to disengage from financing agreements that no longer make economic sense. Large banks, hobbled by subprime-related write-downs, fear getting stuck with billions of dollars in additional, unmarketable distressed loans.

In Genesco's case, the U.S. District Court in Manhattan will determine whether **UBS** can bow out of a \$1.5 billion financing for **The Finish Line's** acquisition of Genesco. UBS is arguing that changes in the economy since June, when it committed to the financing, would leave the merged company insolvent.

A pretrial conference has been scheduled in the case for Feb. 26.

On Feb. 25, Solutia announced it reached an agreement with **Citigroup**, **Goldman Sachs** and **Deutsche Bank** to fund Solutia's exit financing package from bankruptcy, following a three-day trial in the case.

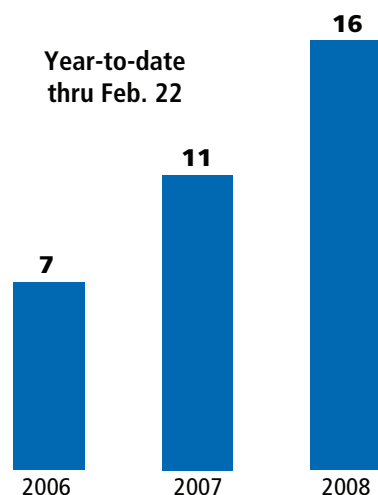
The three banks had sought enforcement of a material-adverse-change (MAC) provision in the commitment letter.

In the settlement reached yesterday, the banks agreed to waive the MAC and continue to provide the \$2 billion exit financing with a larger asset-based portion than was previously agreed to. The financing has a scheduled closing date of Feb. 28. Solutia's reorganization plan takes effective then, and the company will emerge from Chapter 11 after operating under bankruptcy protection since 2003.

Patricia O'Prey, a partner with the New York law firm of **Richards Kibbe & Orbe**,

*Continued on page 13*

## PUBLICLY TRADED COMPANIES FILING FOR BANKRUPTCY



Source: Capital IQ

## SHIFTING STRATEGIES

### Souring Markets Drive Equity Investors into Debt Markets

by Joe Gose

Plummeting markets, recession anxiety and hints of stagflation are influencing investors, companies and investment banks that until recently might have preferred to deal in equity to instead orient corporate financing strategies around structured debt facilities.

At the same time, business development companies and other lenders are expanding middle-market initiatives – or are creating new ones – to invest in what they see as promising growth companies and to grab a slice of a potentially active mergers and acquisitions market.

The maneuvering indicates that capital providers are still eager to put money to work, even in a climate where the 90-day LIBOR and Prime Rate benchmark indexes have fallen some 150 to 200 points over the last 90 days, which for the time being is squeezing yields. But lend-

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## **HEDGE FUND ACCUSES CITI, WACHOVIA OF ABUSING CDS CONTRACTS**

### **Banks Said to Disguise CDO Exposure**

A hedge fund manager is accusing two major banks of wrongfully seeking millions of dollars in payments under derivatives contracts in order to disguise their own exposure to turbulence in the structured product investments market.

VCG Special Opportunities Fund, a hedge fund incorporated in the Channel Islands, filed separate lawsuits against **Citibank** on Feb. 14 and against **Wachovia Bank** in December over credit default contracts the banks had bought to hedge investments in structured product collateralized debt obligations.

VCG, listed in court documents as a unit of **Vanquish Capital Group**, filed the lawsuits in U.S. District Court in Manhattan, alleging breaches of the derivatives contracts. Both were filed by the **Mintz & Gold** law firm in New York.

Wachovia denied the allegations. Citibank representatives did not return phone calls by press time.

In each action, VCG claims it entered into the swap contracts in the spring of 2007, where it agreed to assume some credit exposure for CDO investments made as proprietary investments by each bank.

VCG said it agreed to pay all or a portion of the CDOs' unpaid principal and interest obligations to the banks should the underlying CDOs default.

The Citibank action involved Citibank's \$10 million investment in the junior notes of Millstone III CDO.

In the Wachovia action, VCG took on the risk of Wachovia's \$10 million investment in the senior notes of Forge ABS High Grade CDO Ltd. 2007.

Under each contract, VCG said it put up initial margin payments in the form of collateral representing a small percentage of the \$10 million CDO investments. In exchange, the hedge fund said it was to have received quarterly interest payments,

based on the value of the \$10 million investments, and at maturity of the contract or CDO, the return of the margin payment, as long as the respective CDOs performed.

If the CDO investments failed to perform, VCG would have been on the hook for the amount of any defaulted principal and interest payments to the banks.

The crux of VCG's allegations is that each CDO never failed to make principal and interest payments, and therefore never defaulted. Despite this, Wachovia and Citibank each allegedly demanded that the hedge fund put up additional collateral over several months from the time the swap contracts were entered into in spring 2007 up to when the lawsuits were filed. The banks are alleged to have ultimately demanded \$10 million in assets for each CDS contract.

Each bank then told VCG it would foreclose on its \$10 million in collateral, the hedge fund claims in the lawsuits.

VCG only has about \$50 million under management, the lawsuits say.

The banks are alleged to have acted based on write-downs of the market-to-market values of the CDOs. The demands for additional collateral were meant to "artificially" transfer exposure to the CDOs from the banks' balance sheets to the hedge fund, the lawsuit claims.

Wachovia spokeswoman Christy Phillips-Brown denied the allegations. "We are confident we acted appropriately in our handling of this transaction," she said.

Wachovia stated in a defense to the lawsuit filed Feb. 15 that the bank factored in the decimated value of the swap contract itself into its calculations, as the trading values of such contracts have declined substantially on a market-to-market basis in line with the underlying structured product investments. Based on

its estimations, Wachovia filed a counterclaim seeking another \$1.031 million in damages from VCG, on top of the \$9 million of VCG's collateral it has already foreclosed upon and liquidated.

Wachovia also said in its legal filing that VCG/Vanquish principals, who were very experienced in credit default swap contracts, failed to invoke the dispute resolution provision for the first five months of the contract, when they might have been able to mitigate their losses.

—DD

### Axiom Liquidated for \$15M

**Axiom International**, a Hollywood-based staffing firm, is selling most of its assets to competitors in bankruptcy liquidation sales that are not expected to yield any recovery for the company's secured lender or for thousands of client employees.

**Beeline**, a Jacksonville, Fla., unit of **MPS Group**, purchased Axiom's staffing business on Feb. 8 for \$8 million, while **Entertainment Partners** of Burbank, Calif., will close on the payroll business for \$7 million, according to court-appointed trustee Howard Ehrenberg. The buyers assumed none of Axiom's debts or other liabilities, he said.

Axiom filed for Chapter 7 bankruptcy on Jan. 8 in Los Angeles after **GoldenTree Asset Management** seized a bank account containing \$22 million after the company defaulted on a \$140 million loan. GoldenTree, still owed \$87.5 million, filed a lawsuit in Los Angeles last month accusing Axiom's former principals John Visconti and Ron Garber of having pillaged the company's accounts for personal use. The officials treated the company "as their own personal piggy bank to finance their extravagant lifestyles," the lawsuit states.

Ehrenberg said he was conducting an investigation of his own to determine what happened to the money at Axiom, and may join GoldenTree as a plaintiff. Axiom reported sales of \$3.5 billion during 2006, according to bankruptcy documents.

Dozens of clients deposited funds with Axiom that were to have been used to ultimately pay several thousand employees who work for dozens of Fortune 1000 clients, such as Toyota, Southwest Airlines, United Healthcare as well as for film production studios, bankruptcy documents state.

The \$15 million gained from the bankruptcy sales will likely be absorbed by priority administrative expenses and tens of millions of dollars owed to the federal government for payroll taxes. That means nothing for either GoldenTree or the employees. Production on several films across the U.S. and internationally have been placed on hiatus as crews cannot get paid, Ehrenberg said.

Axiom's own 500 employees, who lost their jobs at the time of the bankruptcy filing, also will see nothing owed for past wages. Beeline and Entertainment Partners are expected to only hire "a limited number" of the workers back, as the new business will be mostly handled by existing employees of the two firms, Ehrenberg said. Employees directly hired by the company and clients are collectively owed a yet-to-be determined amount of money totaling in the tens of millions of dollars, he said.

### ComVest Builds Distressed Debt and Small Mid-Market Funds

The **ComVest Group**, a lower middle market investment firm, expects the distressed marketplace will allow its debt hedge fund to double in size this year.

Launched about 18 months ago, the ComVest Capital fund has roughly \$150 million in capital under management, and is expected to reach \$300 million by the end of the year, according to ComVest associate director Chris Muneio.

The fund focuses on senior, one-stops and second-lien positions in \$5 million to \$20 million bites, but generates most of its returns to investors in the high teens to low twenties range from the upside of warrants and other non-control equity

positions, he said. Money is raised on a quarterly basis from investors in line with need.

West Palm Beach, Fla.-based ComVest is targeting small companies of under \$10 million EBITDA needing a single source of financing to tide them over the current downturn, because of temporary earnings shortfalls and inability to obtain financing elsewhere in the tight credit environment.

Selected companies must demonstrate to ComVest that they have in place new management or a business plan showing they can ride the current storm out and reach significant profitability in three to five years, according to Muneio.

ComVest is separately raising a private equity fund also targeting small middle market companies. The fund started making investments during the fourth quarter.

So far roughly 5% of the \$350 million to \$450 million raised for **ComVest Investment Partners III** has been allocated in companies, Muneio said. The PE fund is shooting for a total capital raise of \$500 million.

The fund seeks majority equity stakes but can invest as minority with appropriate controls. Targeted allocations range from \$5 million to \$50 million of equity capital.

"The combination of our debt and equity funds could provide a good source of liquidity for refinancing difficult credit facilities or capitalizing organic and acquisitive growth initiatives," Muneio said.

ComVest's two funds have recently targeted the distressed automotive sector.

In December, the new PE fund paid an undisclosed amount to acquire **Southern Comfort Conversions**, a provider of customized changes to mass-produced automobiles of big OEM clients such as General Motors and Ford, Muneio said. The same month ComVest announced that the debt fund provided \$6 million in the form of a convertible term loan and revolving line of credit to **AfterSoft**

**Group**, which provides software information services to the automotive marketplace.

### Reverse Breakup Fee Sole Remedy in United Rentals Ruling

The recent **United Rentals** court decision has highlighted the tools that market players are utilizing in the current downturn to exit buyout and related financing agreements, according to market observers.

These include “reverse breakup fees” and “material adverse changes” clauses being inserted into buyout contracts.

On Dec. 21, the Delaware Court of Chancery Judge William Chandler III issued a decision refusing United Rentals’ legal bid to force **Cerberus Capital Management** to complete a \$4 billion buyout of the company initially entered into in July. Chandler essentially accepted Cerberus’ understanding of the contract that the fund could call off the buyout simply by paying the \$100 million reverse breakup fee.

A few days after the ruling, United Rentals announced that Cerberus was relieved of the buyout agreement in exchange for the fee.

Ian M. Goldrich of the **Torys** law firm in New York said the decision has drawn attention to the use of reverse breakup fees in mergers and acquisition deals involving private equity firms.

Goldrich, who authored a Jan. 29 paper on the topic, said the market has generally assumed that a private equity fund would not unilaterally use payment of a fee as justification to refuse to close a deal where the agreed-upon conditions have been met.

However, Chandler’s ruling appears to demonstrate “that reverse breakup fees have evolved into giving private equity buyers an option to walk away from a deal” and are being used as the sole and exclusive remedy available for the target company for the buyers decision.

“This case will cause targets to reconsider the potential impact of the [breakup fee] provision,” Goldrich said.

Cerberus emphasized in its defenses to the lawsuit that the ability to walk away from the transaction was not in any way conditional on any material adverse change (MAC) in the marketplace.

However, Richard P. Eckman, chairman of the financial services practice group of the **Pepper Hamilton** law firm in Wilmington, Del., said Cerberus’ expert witnesses testified in the case they made the decision not to invoke a MAC clause due to the difficulty in legally defining the provision as it was written, as well as the intent of the parties when it was inserted into the contract. Eckman said he closely followed the case in having represented a hedge fund stock investor in United Rentals who was interested in the outcome.

For Eckman, the case represented the ambiguity of the MAC provision.

The MAC is usually heavily negotiated between the company and the buyers or financial institutions providing the financing. “In a negotiated situation, you do not get everything you want. You only get half of what you want. That is what causes the ambiguity.”

“The lesson of the case from a legal practitioner’s perspective, Eckman continued, “is the need to be extraordinarily precise in terms of drafting these (MAC) clauses. You have to anticipate what could happen in the future and make it as clear as possible.”

But Eckman asked, “How can anyone predict the future and all the circumstances that come up when one party backs out of a transaction?”

### Military Food Supplier Chokes

A leading supplier of food rations to the U.S. military filed for bankruptcy on Feb. 14.

The **Wornick Co.** cited “significant expenses” related to the 2006 launch and cancellation of a new consumer food product line called “Eversafe,” which was

designed as “a commercial variant” of the military food.

Other losses resulted from the relocation of manufacturing facilities from McAllen, Texas, to the Cincinnati headquarters in late 2006, and poor operating performance thereafter, the company said in documents filed in U.S. Bankruptcy Court in Cincinnati.

Wornick said sales to the U.S. Department of Defense made up 44% of business last year, with 52% of sales resulting from extended shelf-life products manufactured with other companies and sold to big food concerns such as Kraft, Gerber and NutriSystem.

The Defense Department has just awarded Wornick a \$10.2 million contract to provide Meals Ready-To-Eat (MREs) for military and federal use, according to a Feb. 13 report in the *Business Courier* of Cincinnati. An April 21, 2006 report in the same newspaper stated that the government agency then gave Wornick a similar MRE contract totaling \$164 million.

The bankruptcy filing will allow Wornick to reorganize under a prepackaged plan to sell all of its equity or assets to **DDJ Capital Management** via a Rule 363 sale. Affiliates of DDJ control 85% of \$125 million in 10 7/8% senior secured notes due on 2011 originally issued in June 2004. Wornick is presently owned by equity group **Veritas Capital**. DDJ entities also hold revolving and term loans amended last November to allow for up to \$27.5 million in financing.

Wornick said it is in default on the secured notes, the loans, and unsecured notes issued to Veritas in 2005. Forbearance agreements entered into last year for the loans and secured notes were set to expire this month, the company said in court papers.

“Wornick has been operating with a highly leveraged balance sheet since July of 2004,” according to chief executive Jon Geisler in a news release posted on the company’s website.

## Macquarie Expanding Distressed U.S. Business

**Macquarie Capital**, a unit of Australia's Macquarie Holdings, plans to significantly beef up staff of its U.S. restructuring operations.

The firm is looking to make several hires of analysts through director levels in its restructuring and special situations unit at its Chicago headquarters, as well as at branch offices in New York, Los Angeles, Atlanta and Troy, Mich.

"We plan to significantly add to our staff in the context of increasing the market for restructuring advisory services," said Mick Solimene, who oversees the North American business from Chicago.

Macquarie wants to build that business it entered into the first time through the acquisition of **Giuliani Capital Partners** last April. Regarding only the combined restructuring and special situation operations of Macquarie and Giuliani, the group currently employs about 50.

Solimene declined to offer specific numbers for the planned staffing surge.

Macquarie also announced on Feb. 4 the hire of Michael Bruder to head up the New York office. Prior to joining Macquarie, Bruder was head of restructuring at **CIBC World Markets** in New York, where he founded and built the middle market debtor-side focused group.

Solimene anticipated opportunities opening up in a broad range of industries over the next 12 months as targeted companies in the middle to upper middle market range struggle to obtain financing. A pick-up is also expected in cross-border distressed M&A. A few recent engagements involved foreign buyers interested in distressed U.S. assets, he said.

"With more prepacks and pre-planned deals, the restructuring market has become more complicated. The capital structures are also more complicated. Unlike the last cycle of 2001 to 2003, we have a preponderance of hedge funds and special situation investors in the capital structure," Solimene said.

## NewStar, CapitalSource Back HCPRO Holdings Acquisition

**Halyard Capital**, a New York private equity fund, closed on the acquisition of health care services concern **HCPRO Holdings**.

**NewStar Financial** and **CapitalSource** provided financing for the acquisition, HCPRO said in a Feb. 13 announcement. NewStar said on Feb. 14 that it acted as lead arranger and syndication agent for the senior credit facilities and that **GE Capital** signed on as administration agent for the facilities. Financial and other terms were not disclosed.

The sellers of Marblehead, Mass.-based HCPRO were **Bariston Partners**, **BIA Digital Partners** and **The Riverside Co.**, according to data provider Capital IQ.

Halyard has over \$600 million of capital under management and specializes in middle market media, communications and business service companies, according to the NewStar release.

HCPRO provides informational, training and advisory services in health care compliance, regulation and management areas. Revenues were \$49.1 million last year.

## Auto Vendor Code Blue Despite Emergency Injection

**Blue Water Automotive Systems** said it was required to file for bankruptcy reorganization on Feb. 12 after the secured lenders blocked use of an accelerated payment it needed to continue operations.

The small, Marysville, Mich., maker of thermoplastic components for large auto industry OEMs said it has been crippled by the downturn in the domestic auto market and rises in raw material costs, according to documents filed in U.S. Bankruptcy Court in Detroit.

It was recently required to negotiate with its largest customer Ford Motor Co. for the receipt of a \$7.7 million "accelerated progress payment" for engineering designs and tooling services that was needed to make payroll and pay suppliers.

However, the secured lenders, affili-

ates of **CIT Group**, required \$5 million of the payment to be placed into a reserve account, essentially eliminating an ability to utilize the funds. Blue Water characterized the action as "an unjust improvement in the lenders' position to the prejudice of debtor's unsecured creditors, mostly trade creditors."

Blue Water petitioned the bankruptcy court for an emergency ruling to allow use of the funds, while the Chapter 11 filing would allow breathing room to restructure operations.

Documents indicate the CIT affiliates are owed \$17.5 million on a revolving facility and \$14.5 million on a term loan, both of which were originated in 2006. Another \$5 million is owed on a \$5 million secured loan from **KPS Special Situations Fund** issued in July 2007. Trade creditors are owed \$35 million, the papers state.

## Carb Maker Out of Gas

**Holley Performance Products** announced on Feb. 11 that it has filed for bankruptcy under a plan to lighten the company's capital structure by converting a majority of the company's debt into equity.

Papers filed in U.S. Bankruptcy Court in Delaware state the Bowling Green, Ky.-based company has votes from the majority of secured creditors to approve the proposed prepackaged bankruptcy. The proposal would give second lien secured bond holders 90% control of the company. Holley owes another \$40 million to banks led by **Wells Fargo Foot-hill**, which would ultimately be replaced by exit financing, the bankruptcy court documents indicate.

Holley makes fuel pumps, carburetors, and other engine parts for racing cars and marine power boats.

## Correction

An article in the Feb. 12 issue of *DDR* incorrectly stated when **Kohlberg Capital** issued a recent collateralized loan obligation. The deal priced during the fourth quarter of 2007. ■

The following tables include data about publicly traded companies that have filed for bankruptcy and that have defaulted on debt in the 30 days through Feb. 21. Data is provided by Capital IQ.

### Public Company Bankruptcies

Company (Ticker)	Date	Enterprise Value (M)	Market Cap (M)	Revenue (M)	EBITDA (M)	Net Income (M)	Total Debt (M)
Sharper Image (NasdaqNM:SHRP)	Feb 19	76	8.41	422.4	-93.3	-70.7	68.4
Electro-Chemical Technologies (OTCPK:ELCH)	Feb 19	-	-	-	-	-	-
Charys Holding Co. (OTCPK:CHYS)	Feb 14	204.3	0.71	77.3	-24.1	-309.1	208.4
Impart Media Group (OTCPK:IMMG)	Feb 14	2.85	0.17	7.88	-5.27	-8.31	3.2
Orbit Petroleum (OTCPK:OBPT)	Feb 13	0.98	0.78	-	-	-	0.56
Electro-Chemical Technologies, Ltd. (OTCPK:ELCH)	Feb 12	-	-	-	-	-	-
Manchester Inc. (OTCBB:MNCS.E)	Feb 7	122.1	5.14	91.1	-8.03	-12.8	118
SIRVA Inc. (OTCPK:SIRV)	Feb 5	590	0.35	4,044.00	30.6	-63.3	562.8
Endovasc Inc. (OTCPK:EVSC)	Feb 3	-1.5	0.37	0.28	-0.46	-0.19	0.14
Summit Global Logistics (OTCBB:SGLT)	Jan 30	114.1	7.67	257	-0.88	-32.5	110.3
TOUSA Inc. (OTCPK:TOUS)	Jan 29	1,770.20	13.1	2,457.90	110.6	-1,061.50	1,746.80
Nuevo Financial Center (OTCBB:NVFN)	Jan 28	1.83	0.64	2.54	-0.85	-1.19	1.35
Pegasus Wireless (OTCBB:PGSW)	Jan 28	3.71	0.05	112.8	1.1	-2.26	0.56

### Debt Defaults

Company (Ticker)	Date	Revenue (M)	EBITDA (M)	Total Debt (M)
Crossfire Energy Services (TSXV:CFE)	Feb 20	37.9	3.34	17.6
Industrial Enterprises of America Inc. (OTCPK:IEAM)	Feb 19	52.8	5.98	10.7
HouseRaising Inc. (OTCBB:HRAI)	Feb 11	2.12	-4.08	7.28
W Technologies (OTCBB:WTCG)	Feb 6	5.87	-1.01	0.85

The following table lists the 98 North American publicly traded middle-market companies with the highest ratios of debt to capital as of Feb. 25. *DDR* defines a middle-market company as one that generates less than \$500 million in annual revenue. The table also excludes companies with enterprise values of less than \$10 million. Data is provided by Capital IQ.

High Debt to Capital							
Company (Ticker)	Enterprise Value (M)	Total Debt/Capital %	Revenue (M)	Market Cap (M)	EBITDA (M)	Net Income (M)	Total Debt (M)
Rival Technologies Inc. (OTCPK:RVTI)	18.7	113.0	0	18.8	(0.602)	(0.648)	0.509
CPI Corp. (NYSE:CPY)	192.2	100.0	362.2	115.2	36.3	2.71	113.0
Talon International, Inc. (OTCBB:TALN)	18.7	99.4	42.2	8.02	0.762	(3.94)	13.0
Osiris Therapeutics, Inc. (NasdaqNM:OSIR)	357.1	99.3	12.2	353.2	(41.5)	(45.0)	26.2
Warnex Inc. (TSX:WNX)	19.1	99.3	25.2	8.21	3.19	(12.8)	14.3
LOUD Technologies Inc. (NasdaqSC:LTEC)	131.2	99.0	204.1	34.4	8.79	(11.2)	101.0
Trailer Bridge Inc. (NasdaqNM:TRBR)	225.3	98.8	115.7	123.9	24.3	8.68	103.9
Alliance Imaging Inc. (NYSE:AIQ)	1,057.7	98.5	444.9	501.6	152.4	16.2	670.8
Archon Corp. (OTCBB:ARHN)	272.6	98.2	45.5	228.6	11.6	1.7	87.1
Champion Parts Inc. (OTCPK:CREB)	14.8	98.0	16.8	0.256	0.43	(1.19)	14.6
Intrepid Technology & Resource Inc. (OTCBB:IESV)	11.9	97.8	0.107	3.62	(1.5)	(2.2)	8.6
RAM Energy Resources, Inc. (NasdaqSC:RAME)	409.1	97.6	68.0	288.4	31.3	6.15	147.7
SMF Energy Corporation (NasdaqSC:FUEL)	33.1	97.6	223.8	7.72	(1.83)	(9.24)	25.5
General Environmental Management Inc. (OTCBB:GEVI)	24.4	97.5	28.2	16.7	(7.53)	(26.9)	7.69
Javo Beverage Company Inc. (OTCBB:JAVO)	88.6	97.3	12.4	88.3	(2.25)	(7.3)	10.7
MedAssets, Inc. (NasdaqNM:MDAS)	1,325.5	97.1	171.6	779.6	46.5	8.37	329.3
AmeriChip International Inc. (OTCBB:ACII)	12.5	96.8	1.69	6.42	(13.9)	(14.6)	6.12
Sunrise Energy Resources, Inc. (OTCBB:SEYR)	31.2	96.6	2.69	23.1	0.074	(1.32)	8.16
Great Lakes Aviation Ltd. (OTCBB:GLUX)	95.0	96.5	93.5	30.3	15.4	16.6	69.3
NaturalNano, Inc. (OTCBB:NNAN)	14.5	96.4	0.009	13.5	(4.14)	(5.58)	2.03
Viskase Companies Inc. (OTCPK:VKSC)	163.3	96.3	210.4	33.9	15.1	1.61	109.9
American Community Properties Trust (AMEX:APO)	386.5	96.3	89.5	99.4	28.2	0.33	305.7
Raven Gold Corp. (OTCBB:RVNG)	51.4	96.2	0	48.9	-	(0.367)	2.5

## High Debt to Capital

Company (Ticker)	Enterprise Value (M)	Total Debt/ Capital %	Revenue (M)	Market Cap (M)	EBITDA (M)	Net Income (M)	Total Debt (M)
Gulf & Pacific Equities Corp. (TSXV:GUF)	30.0	96.0	3.96	2.9	2.1	(0.616)	27.3
Cardtronics Inc. (NasdaqNM:CATM)	762.7	95.9	337.2	283.1	52.3	(17.5)	408.9
Revenue Properties Co. Ltd. (TSX:RPC)	680.1	95.5	121.2	122.9	47.3	(29.3)	574.0
Thunderbird Resorts Inc. (OTCPK:THRS.F)	162.8	95.4	90.1	60.3	18.7	(2.4)	107.4
iDNA, Inc. (OTCBB:IDAI)	16.0	95.4	15.2	1.79	(2.29)	(3.35)	14.5
Mecachrome International Inc (TSX:MCH)	549.6	95.4	412.7	160.3	83.1	(16.7)	370.1
2020 ChinaCap Acquirco Inc. (AMEX:TTY)	75.7	95.4	0	75.6	-	(0.011)	0.127
Redex Inc. (TSXV:RDX)	21.1	95.1	1.79	3.77	0.007	(1.76)	17.6
Insight Health Services Holdings Corp. (OTCBB:ISGT)	290.9	95.1	276.1	17.3	52.3	130.9	298.1
ITC^DeltaCom Inc. (OTCBB:ITCD)	530.9	94.8	489.9	272.8	67.9	(180.4)	302.7
Hybrid Technologies, Inc. (OTCBB:HYBR)	16.6	94.7	1.44	14.5	(9.55)	(10.1)	2.27
Bluefire Ethanol Fuels, Inc. (OTCBB:BFRE)	127.4	94.4	0	127.7	-	(8.34)	1.09
ISIS Pharmaceuticals Inc. (NasdaqNM:ISIS)	1,338.8	94.4	56.8	1,292.6	(40.1)	(143.5)	172.2
IAS Energy, Inc. (OTCBB:IASC.A)	16.9	94.4	0.021	16.6	(0.046)	(0.109)	0.585
Granville Pacific Capital Corp. (TSXV:GE)	33.5	94.3	7.97	3.0	1.01	0.582	32.9
Global Diversified Investment Grade Income Trust (TSX:DG.UN)	1,432.4	94.0	83.3	36.7	-	3.44	1,327.8
Manchester, Inc. (OTCBB:MNCS.E)	122.1	93.9	91.1	5.14	(8.03)	(12.8)	118.0
Inphonic, Inc. (OTCPK:INPC)	43.6	93.8	371.3	0.48	(90.4)	(118.3)	65.7
Danka Business Systems plc (OTCBB:DANK.Y)	494.1	93.7	433.2	22.0	10.9	(37.2)	126.5
MDwerks, Inc. (OTCBB:MDWK)	12.8	93.6	0.45	11.0	(9.45)	(11.4)	2.4
New England Realty Associates LP (AMEX:NEN)	117.7	93.6	32.3	13.5	16.1	0.792	113.9
Portsmouth Square Inc. (OTCBB:PRSI)	68.2	93.5	34.3	25.7	2.45	(1.77)	48.0
Charys Holding Company, Inc. (OTCPK:CHYS)	204.3	93.5	77.3	0.713	(24.1)	(309.1)	208.4
Hungarian Telephone and Cable Corp. (AMEX:HTC)	1,060.9	93.4	311.9	262.4	112.8	(62.2)	823.5
Carrington Laboratories Inc. (OTCBB:CARN)	13.6	93.1	23.6	5.48	(5.84)	(9.25)	11.4

## High Debt to Capital

Company (Ticker)	Enterprise Value (M)	Total Debt/ Capital %	Revenue (M)	Market Cap (M)	EBITDA (M)	Net Income (M)	Total Debt (M)
PGMI, Inc. (OTCPK:PGMC)	60.9	93.1	23.1	0.433	7.55	(3.29)	61.5
Boardwalk Real Estate Investment Trust (TSX:BEI.UN)	3,877.6	93.0	379.8	2,014.7	217.0	(60.1)	1,912.9
United Refining Energy Corporation (AMEX:URX)	511.0	92.9	0	510.8	-	(0.012)	0.3
Pachinko World, Inc. (OTCPK:PCHW)	30.9	92.8	31.4	2.0	13.9	0.437	37.9
NaviSite Inc. (NasdaqSC:NAVI)	287.4	92.8	133.7	146.9	16.9	(27.6)	120.8
American Spectrum Realty Inc. (AMEX:AQQ)	223.8	92.6	30.4	36.1	14.0	(7.96)	184.4
Halo Technology Holdings, Inc. (OTCPK:HTHO)	29.8	92.5	31.3	0.161	(5.54)	(11.7)	22.7
GVI Security Solutions Inc. (OTCBB:GVSS)	33.5	92.3	45.1	25.9	3.06	(5.56)	8.37
OSG America L.P. (NYSE:OSP)	963.8	92.1	286.1	471.0	86.5	15.7	493.0
Sun Communities Inc. (NYSE:SUI)	1,556.9	91.9	216.9	376.0	105.3	(25.0)	1,129.1
Silicon Graphics Inc. (NasdaqSC:SGIC)	226.4	91.9	414.5	174.5	(37.5)	(138.3)	85.0
Overland Realty Limited (TSXV:OVL)	63.2	91.7	1.56	10.6	0.127	(0.877)	51.9
RepeatSeat Ltd. (TSXV:RPS)	18.9	91.6	5.16	12.3	(1.7)	(4.14)	7.65
InterGroup Corp. (NasdaqSC:INTG)	157.4	91.6	47.6	42.1	7.19	(1.28)	121.3
Graymark Healthcare, Inc. (OTCBB:GRMK)	35.6	91.5	14.0	7.16	1.61	(1.44)	29.5
Human Genome Sciences Inc. (NasdaqNM:HGSI)	1,375.8	91.5	39.3	848.1	(198.4)	(236.5)	753.5
Alexander's Inc. (NYSE:ALX)	2,098.6	91.2	205.9	1,568.7	67.6	6.05	1,058.0
Across America Real Estate Corp. (OTCBB:AARD)	40.6	90.8	7.47	13.6	(2.35)	(2.87)	28.7
Steakhouse Partners Inc. (OTCBB:STKP)	14.9	90.8	47.7	0.531	(1.3)	(5.28)	14.4
Fountain Powerboat Industries Inc. (AMEX:FPB)	24.0	90.6	69.6	6.32	1.91	(3.85)	19.1
Avalon Correctional Services Inc. (OTCPK:CITY)	40.7	90.6	27.4	10.1	7.0	(5.11)	41.0
Enzon Pharmaceuticals Inc. (NasdaqNM:ENZN)	549.8	90.5	185.6	366.4	26.2	83.1	347.4
Mainstreet Equity Corp. (TSX:MEQ)	450.8	90.4	43.8	188.7	19.1	(6.47)	275.9
Morgan's Foods Inc. (OTCBB:MRFD)	51.7	90.3	93.6	20.5	9.22	2.2	36.5
SonnenEnergy Corp. (TSXV:PWR)	35.1	90.2	18.8	23.1	2.1	1.16	12.3

## High Debt to Capital

Company (Ticker)	Enterprise Value (M)	Total Debt/ Capital %	Revenue (M)	Market Cap (M)	EBITDA (M)	Net Income (M)	Total Debt (M)
Marshall Holdings International, Inc. (OTCBB:MHII)	11.6	90.1	6.7	0.98	0.898	0.428	10.4
Innovex Inc. (NasdaqNM:INNVX)	52.9	89.8	82.6	6.35	(10.9)	(33.7)	54.3
Tidelands Oil & Gas Corp. (OTCBB:TIDE)	15.2	89.8	2.63	8.64	(8.71)	(15.1)	7.41
Document Capture Technologies, Inc. (OTCBB:DCMT)	13.7	89.7	14.5	11.1	(4.38)	(5.56)	3.35
Penson Worldwide Inc (NasdaqNM:PNSN)	2,267.5	88.9	404.8	266.2	211.4	26.8	2,122.2
Ambient Corporation (OTCBB:ABTG)	10.6	88.9	3.4	9.88	(6.63)	(15.2)	1.81
Metal Storm Ltd. (NasdaqSC:MTSX)	34.1	88.7	2.92	41.8	(6.4)	(11.8)	9.88
Caspian International Oil Corporation (OTCBB:CIOC)	24.4	88.5	15.4	5.05	(0.532)	(3.87)	19.1
Baseline Oil & Gas Corp. (OTCBB:BOGA)	46.4	88.3	6.07	11.4	-	(6.9)	35.1
Home Equity Income Trust (TSX:HEQ.UN)	777.3	88.3	52.5	136.2	39.7	(2.3)	686.5
World Racing Group, Inc (OTCBB:WRGI)	72.5	87.9	19.6	11.3	(9.38)	(12.7)	13.5
Plazacorp Retail Properties Ltd. (TSXV:PLZ)	355.0	87.6	30.4	163.0	-	2.22	186.2
SBA Communications Corp. (NasdaqNM:SBAC)	5,138.6	87.4	396.0	3,398.2	191.2	(73.3)	1,905.0
Global Employment Holdings, Inc. (OTCBB:GEYH)	57.2	87.2	158.7	16.0	8.37	19.3	37.6
Liberator Medical Holdings, Inc. (OTCPK:LBMH)	40.1	87.0	3.7	38.2	(2.15)	(2.43)	1.97
Pacific Energy Resources Ltd. (TSX:PFE)	780.0	87.0	59.7	288.2	6.92	(49.5)	501.4
American Apparel, Inc. (AMEX:APP)	806.3	86.9	322.8	688.3	38.7	10.1	124.5
Summit Global Logistics, Inc. (OTCBB:SGLT)	114.1	86.8	257.0	7.67	(0.88)	(32.5)	110.3
Vion Pharmaceuticals Inc. (NasdaqSC:VION.D)	17.0	86.7	0.022	31.0	(31.3)	(31.9)	54.0
ISTA Pharmaceuticals Inc. (NasdaqNM:ISTA)	125.7	86.6	52.0	133.7	(32.2)	(34.8)	47.8
Titan Machinery, Inc. (NasdaqNM:TITN)	407.7	86.5	381.8	263.3	18.5	6.33	144.0
Sun River Energy, Inc. (OTCBB:SNRV)	10.8	86.3	0	4.52	-	(1.03)	6.32
Camden Learning Corp. (OTCBB:CAEL)	58.0	86.1	0	58.9	-	(0.037)	0.189
Enwin Resources Inc (OTCBB:ENWN)	17.8	86.1	0	17.6	-	(0.257)	0.298
Avanir Pharmaceuticals (NasdaqNM:AVNR)	35.2	86.0	9.19	51.8	(14.7)	(12.8)	12.0

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ers are compensating for uncertainty and compressed returns by building in larger risk premiums – they’re demanding equity kickers, for example, or increasing interest rates over the life of a loan.

Case in point: In mid-February, investment manager **Ingalls & Snyder** took the lead in buying \$20.8 million in non-convertible senior secured notes from **Focus Enhancements** with a handful of other investors. The financing, however, netted the issuer only \$9.3 million in new cash; the remainder restructured an \$11.5 million outstanding balance related to a senior secured convertible debt financing in 2006, which was also led by Ingalls & Snyder. Focus Enhancements, a digital video production, management and presentation technology firm based in Campbell, Calif., exchanged the outstanding convertible notes for non-convertible notes.

The transaction includes a term of two years and 11 months as well as an initial interest rate of 12% payable semi-annually that rises to 15% on Oct. 1. Under the loan’s terms, Focus Enhancements must make all interest payments in cash, although it has the option of making the first two by issuing additional notes.

The deal also includes three year warrants to purchase 26 million shares. The warrants feature an exercise price of 80 cents a share – a 90.5% premium to Focus’s stock price at closing – and additional warrants to purchase up to 3.3 million shares if the company issues more notes to cover its first two interest payments. Ingalls & Snyder led the latest financing with a \$3.7 million participation. The deal was the fund’s first non-convertible debt play after making seven convertible debt investments and one common stock placement in the PIPE market since 2002, according to PrivateRaise, which tracks private investments in public equity of more than \$1 million.

Ingalls & Snyder representatives did not return phone calls, but debt and equity experts expect similar structures to become more prevalent in the coming weeks, particularly if the broad equity markets continue to tumble. The Dow Jones Industrial Index has fallen roughly 7.4% since the beginning of the year, for example, while the Nasdaq Composite Index has dropped about 13.3%.

In fact, **Bakers Footwear** in St. Louis, a company that has completed two PIPEs in the last few years, also closed an equity-enhanced deal in early February. The company issued a \$7.5 million subordinated secured term loan to **Private Equity Management Group** and threw in 350,000 shares of common stock as additional consideration. The loan bears an interest rate of 15%, with principal and interest payable monthly, and matures in February 2011.

Meanwhile, investment bank **Rodman & Renshaw**, the most active placement agent in the PIPE market over the last several years, is marketing equity-enhanced debt deals to PIPE funds in addition to more conventional private placement offerings. John Borer, senior managing director of the firm, anticipates closing the first such deal within days. He compares the comfort level that the product provides investors to that of special purpose acquisition companies, or “SPACs.” SPACs are publicly traded acquisition funds that return their IPO proceeds to shareholders if they fail to find an acquisition that shareholders approve.

“People want something they can understand, where the downside is manageable and there’s a decent embedded equity option,” Borer says. “That’s a SPAC, and we’re trying to offer investors the same thing: A vehicle that has debt attributes but also equity features. If it doesn’t work out, they get their money back; if it does work out, they get an equity option.”

## Tailoring Strategies

Traditional debt providers that toil outside of the PIPE arena are tweaking loan constructs and practices, too, to address market challenges and uncertainty as well as to seize opportunities. **Hercules Technology Growth Capital**, a Palo Alto, Calif.-based business development company that provides venture debt to high-growth technology and life science companies, has beefed up its portfolio of company warrants over the last couple of quarters, for example.

Additionally, while Hercules executives fund companies in three phases of maturity – emerging growth, expanding and established – they increasingly consider their sweet spot to be with middle-market companies with \$20 million to \$100 million in revenue and upwards of \$15 million in annual EBITDA. Large banks and traditional asset-backed lenders generally ignore these companies, says Manuel Henriquez, co-founder and CEO of Hercules.

“There’s a void in the market that we’re selectively and cautiously looking to service,” he said. At the end of the fourth quarter, Hercules had a total investment portfolio of \$530 million, nearly double the size a year earlier.

While the company typically invests in private companies and avoids straight equity transactions, it recently committed \$25 million in two debt tranches to Canadian life science company **Labopharm**, listed on the Toronto Stock Exchange and Nasdaq. Late last year, Labopharm drew down on the first tranche of \$15 million, which features an interest rate of almost 11%. The company can draw down on the balance between May 15 and Oct. 15. The entire loan matures in late 2011. The deal also includes warrants to purchase about 1.5 million common shares at roughly 99 cents each, a slight premium at closing.

The loan marked the second time Hercules provided capital to Labop-

harm, another departure from the business development company's standard practice. Still, a few elements made the deal appealing: Hercules had a previous relationship with Labopharm, and – in Henriquez's opinion – investors had beat down Labopharm's stock price for no good reason.

### New Efforts

Beyond introducing new structures or tweaking existing practices, some investors and lenders are beginning to hunt for transactions in the middle market for the first time or are raising capital to foster additional deal-making in the sector. In late 2007, **GE Commercial Finance** and **Allied Capital** launched the \$3.6 billion Unitranche Fund to make combined first and second lien loans of up to \$270 million in companies with EBITDA between \$15 million and

\$90 million. In late February the fund made its first debt placement, providing private equity firm **Carousel Capital Partners** with \$65 million for its buyout of **Brassler USA**, a maker of dental and surgical products.

On the other end of the scale, New York-based business development company **Ameritrans Capital Corp.** is ramping up a middle market platform after spending years making Small Business Administration loans to taxicab drivers and other entrepreneurial small company owners. The company's executives are making senior loans in the space but are exploring ways to finance the new business line – Ameritrans' corporate loan portfolio grew 60% in the second quarter to only \$10 million.

Still, Ameritrans' middle market portfolio companies have average EBITDA of \$40 million and underlying common

equity of \$120 million, according to the firm. "We anticipate that terms, structure and pricing will continue to move in our favor," said Michael Feinsod, president of Ameritrans, in a fourth-quarter statement discussing the initiative. ■

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said that Solutia and Genesco are among the recent cases where the MAC clauses have become an issue because of the turn in the credit markets.

Litigants in those cases argued “either that their lenders will not provide financing in light of changed economic conditions, or that the banks cannot syndicate loans because the markets for such syndications have dried up,” O’Prey said. “As the crisis continues to spread throughout the credit markets, we can expect to see MAC clauses invoked in still other contexts.”

Another context where MAC clauses have been an issue has been in leveraged buyouts.

**Cerberus Capital Management**, for example, invoked a MAC clause as justification for backing out of its \$4 billion takeover of **United Rentals** in December. Cerberus paid a breakup fee to the equipment-rental giant of \$100 million.

### Solutia

A main point of contention in Solutia was whether there had been an “adverse change” in market conditions between late October when the commitment letter had been signed and Jan. 30 when the banks opted not to honor it.

Solutia argued in a Feb. 20 court filing that the funding commitment was “unquestionably ambiguous” in failing to clearly define what constituted an adverse change while clearly specifying that successful syndication is not a prerequisite to the banks’ funding of the exit facility.

Based on prior New York case law interpreting MAC provisions, Solutia argued that its situation did not meet the standard for an adverse change. The tumultuous market after October was not only foreseeable, but was a continuation of the severe credit crunch that had already begun prior to the time the banks signed the letter, Solutia said.

Had the court allowed the lenders to walk away from their “firm commitment” to finance Solutia’s emergence

from four years in bankruptcy, it could have devastated shareholders, employees, retirees and creditors, Solutia said. The company said that delays could have derailed a \$250 million back-stop commitment that expires on Feb. 28 for a planned equity offering, and jeopardized refinancing of a debtor-in-possession facility maturing at the end of March.

The three banks argued in a Feb. 20 filing that the adverse market change provision was “clear and unambiguous.”

“Even Solutia’s own chief executive and expert” have acknowledged in court testimony evidence of a dramatic worsening market during the three-month period, the banks stated.

The banks argued that the MAC provision was not “mere boilerplate” to induce the company to enter into the financing commitment. The provision was negotiated “amidst challenging markets” to alert Solutia to the risk of any adverse market change after the commitment letter went into effect on Oct. 25, the banks said in the statement.

In addition, the banks said the letter allowed them to decide whether severe market changes materially impaired the syndication of the exit financing. The banks said that they attempted to syndicate the facilities in January, but failed to attract firm orders for more than a quarter of the \$2 billion financing, even at a significant discount of 91 cents on the dollar.

Under the agreement that was reached, the banks will provide the financing. It will include a \$450 million asset-based revolving facility, increased from an originally planned \$400 million. The banks will also provide a \$1.2 billion senior unsecured loan facility at LIBOR plus 500 basis points with a minimum LIBOR floor of 350 basis points for the first four years. Additionally, the exit financing includes a \$400 million senior unsecured bridge facility.

Andrew Cardonick, a principal with the **Goldberg Kahn** law firm in Chicago, said last week that Solutia would

likely have had a tough time defeating the banks’ argument that the markets had demonstrably changed for the worst since late October. From Oct. 25 through Jan. 30, the Federal Reserve Board reduced the Federal Reserve Rate from 4.75% to 3%, and cut the Discount Rate from 5.75% to 4%.

Cardonick said it would have been “a bad idea” for the New York court in Solutia to hold banks accountable for a loan they ultimately could not syndicate.

“The court has to be careful about making decisions that could dramatically impact the lending marketplace,” Cardonick said before Solutia reached its agreement with the banks.

If this case had ended up forcing lenders to make loans, lenders might have become more hesitant to sign commitment letters, Cardonick said. If that had happened, some companies like Solutia might not have been able to obtain credit.

Mark Indelicato, a partner with **Hahn & Hessen** in New York, said last week that the court had faced a tough challenge in Solutia in gauging the precise timeframe in which the market collapsed, in the context of the MAC provision addressed in the case. The banks had sought to invest significant funds into a syndication market “decimated literally in six to eight weeks” in the second half of the year with the downslide still continuing.

No precedent exists of a similar downturn “in the 23 years I’ve been practicing in relation to finance,” Indelicato said. “I have not seen an economy this volatile.”

### Genesco

In Genesco’s litigation, legal guidance might have already been established for some MAC clauses, observers said.

The Tennessee Chancery Court ruled in late December that Genesco had not suffered a material adverse effect, and therefore refused The Finish Line’s and UBS’s effort to abandon the deal.

Genesco filed the lawsuit in September

to order the two parties to close the deal prior to the Dec. 31 termination date.

Judge Ellen Hobbs Lyle wrote in the decision that Genesco has not faced an adverse change in conditions exclusive to the footwear retailer. Such a finding would have been necessary in order for the MAC used in the buyout and financing agreements to be enforceable.

Instead, Lyle found, Genesco's changes in performance were not out of proportion to peers in the industry and reflected broader economic conditions.

These types of changes in general economic conditions were excluded from the MAC, Lyle wrote.

Lyle concluded that the merger had "a reasonable chance of succeeding" despite economic changes since June for the reasons Finish Line and Genesco had each pursued the acquisition in the first place. They sought the combined synergies of

greater diversity in product offerings to an increased customer base.

However, the judge left it up to the U.S. District Court in Manhattan to make the next necessary decision towards resolving the dispute.

UBS filed the related federal lawsuit against The Finish Line and Genesco in November. UBS wants the court to rule that the combined entity would be unable to generate sufficient cash flow to service its new highly leveraged debt load due to the market changes since June. As a result, UBS said it should be allowed to walk away from the financing as specified in the solvency terms of the commitment letter.

Finish Line filed a defense on Jan. 25 arguing that UBS never asked for a solvency opinion and that one is not due until the date the acquisition closes.

In addition, if Finish Line ultimately cannot issue a solvency certificate for the combined entity at the \$1.5 billion pur-

chase price, the severance clause of the merger agreement would require Genesco and Finish Line to renegotiate the merger consideration at an agreed-upon lower price to make the deal economical. In this event, UBS' claim of insolvency would be moot and it would be obligated to comply with the obligations under the debt commitment letter.

Stephen B. Selbst, a partner in the law firm of **McDermott Will & Emery**, said the Genesco case is being closely watched as more banks are expected to pursue similar legal strategies to UBS to escape financing commitments as the market worsens.

Genesco represents "another case of a bank acting preemptively to extricate itself from a lending commitment now found to be wildly unprofitable," Selbst said. ■

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