

ABLs & Hilco: *Fashioning New Strategic Relationships*

In partnering with Hilco, many asset-based lenders see far more than an asset disposition company. As illustrated in the in the CIT/Hilco deals with Cybex and Conbraco, they see a strategic partner with asset knowledge that can be applied in numerous ways to a singular end result: putting the deal together and getting it done.

By Richard Kaye

Cybex International, Inc., headquartered in Medway, MA, is a leading manufacturer of premium exercise equipment for commercial and consumer use. The company sought to refinance its existing debt and obtain additional working capital. They approached several lenders, including CIT Group/Business Credit.

CIT analyzed Cybex's capital structure requirements and circumstances, and decided the opportunity was worth pursuing. However, CIT concluded it would need the participation of another lender to help satisfy Cybex's global financing requirements. They called upon Hilco Capital, the Chicago-based financing unit of The Hilco Organization, to partner with them on the transaction. Hilco Capital specializes in senior bridge and collateral-dependent junior loans, last out senior participations and mezzanine loans. Within a matter of days, Hilco capital's staff had reviewed all aspects of the transaction and delivered a proposal to CIT. Shortly thereafter, the deal was closed and funded, with CIT and Hilco providing working capital and term loans of \$19 million and \$11 million, respectively.

Coincidentally, less than a week later, Hilco and CIT again partnered, this time to refinance the debt of Conbraco Industries, Inc., the Mathews, NC-based manufacturer of brass and stainless steel valves, actuators, water gauges, back flow preventers and safety valves. In this transaction, CIT and Hilco provided senior facilities of \$36.75 million and \$9.50 million, respectively.

These two transactions, and others involving lenders such as Wells Fargo Foothill, GE Commercial Finance, Congress Financial, LaSalle Bank and Fleet Capital, are representative of many more in which Hilco Capital is able to benefit from a broad and deep understanding of value to create additional liquidity through junior debt, thereby helping lenders win new business or retain existing accounts. "Hilco's sweet spot is helping to close deals by filling the gap in a capital structure," says Ted Koenig, CEO of Hilco Capital. "Because we understand asset and enterprise value, we are able to quickly recognize when there is a little more room to maneuver. That is the core competency of the Hilco family of companies, and it's the foundation for a broad array of strategic services Hilco can provide to lenders," adds Koenig.

Understanding Asset Values Underpins Appraisal Services

While it is true that Hilco began life as a buyer and seller of distressed assets, it was the acquired knowledge of asset values in liquidation that led some lenders to suggest to the company that it should develop an appraisal practice. It did, and today Hilco Appraisal Services has become the largest appraisal provider in North America, delivering over 1,000

appraisals per year covering consumer and industrial inventory, machinery, equipment, real estate, accounts receivable portfolios, intellectual property and total enterprise valuations.

Appraisals are fundamental to the growing number of strategic relationships that have evolved and flourished between Hilco and virtually all of North America's leading asset-based and commercial lenders. Of all the supply-side factors affecting today's tight credit market, arguably it is falling collateral values which have had the most adverse effect on the levels of senior debt financing historically provided by financial institutions. That is why lenders are placing increased emphasis on assuring they fully understand asset values in today's ever-changing and highly volatile marketplace. Understanding begins with a reliable appraisal and continues with knowledgeable appraisal professionals who are willing to take the time to help the lender draw meaning from the valuations provided.

"An appraisal is a judgment of value, which is based upon the appraiser's awareness of conditions in the marketplace that affect value. An appraisal is used by a lender to devise exit strategies. Having confidence in an appraisal's quality allows a lender to feel more secure about making credit decisions," says Norm Adler, executive vice president of Hilco Appraisal Services.

"Appraisals have become a cornerstone in Hilco's relationships with lenders," adds Adler. "We cannot and will not advise lenders on how much to advance against collateral, but we find ourselves collaborating more closely than ever with lenders, providing them with guidance as it relates to the strengths and weaknesses of their collateral in a rapidly changing marketplace. We offer our opinions at the time an appraisal is presented, through periodic collateral updates, and in less-formal ways many times thereafter."

Fast service on appraisal work is also critical and central to a lender's ability to compete. "The outcome of an ABL transaction," observes Adler, "often rests on the appraiser's ability to deliver a reliable value opinion in a very compressed time frame." He recalls one particular instance where a lender ordered an appraisal of the M&E and inventory in 13 manufacturing plants, located in 13 different cities, and said they needed a report in less than three weeks or the deal would be lost.

"We were able to meet this deadline," Adler continues, "because we were able to mobilize a very senior, experienced appraisal staff to conduct our research and analysis work following our site inspections. Our appraisers already had an intimate knowledge and understanding of the asset classes involved and our peer review involved people from our asset disposition group who had recently sold similar assets."

Optimizing Value Recovery When Disaster Strikes

Working with a strategic partner who understands asset values and how to optimize recoveries can be a boon to a lender if and when a credit goes bad.

Hilco Real Estate was originally engaged in the Jacobson's Department Store Chapter 11 case to sell or renegotiate the leases on six properties. Hilco was also engaged to provide a desktop valuation of Jacobson's entire real estate portfolio, encompassing 23 leased and owned properties. The properties were located in Florida, Michigan, Ohio, Kansas, Indiana and Kentucky. Thirteen were owned and ten leased. They ranged from 23,000 sq. ft. to 200,000 sq. ft. and included the company headquarters, free-standing stores and mall locations.

During the Chapter 11 proceedings, a joint venture group made a global bid to purchase all of Jacobson's 23 remaining owned properties and leases. Having recently completed the appraisal, Hilco recognized immediately that the package bid would not come near to matching the recoveries available through disposition of the properties and leases on an individual basis. Hilco executives were successful in convincing Jacobson's creditors to reject the package bid and engage Hilco to dispose of all 23 remaining properties.

On September 18 and 25, 2002, Hilco conducted auctions in Detroit and Louisville. Twelve owned properties and three leases brought \$44.125 million. A number of the more desirable properties, including the company headquarters, were deliberately withheld from auction. It was decided that significantly higher recoveries could be attained through aggressive marketing and negotiated sales on the individual properties.

Says Mitchell Kahn, CEO of Hilco Real Estate, "In the final analysis, Hilco recovered \$13 million more on the sale of individual properties than would have been realized on the package bid. We could not have been so cavalier about recommending the rejection of a sizable package bid had we not been very confident about our value assessment and recovery numbers. Jacobson's was a classic case where our dual competencies as appraisers and disposition professionals worked to everyone's benefit."

Putting A Deal Together By Taking It Apart

Lenders involved in financing mergers or acquisitions, or who are banking a client that decides to divest a business unit which also happened to be a part of the borrowing base, can look to Hilco for yet another service tied closely to the company's understanding of asset values. Asset Disaggregation is the process whereby Hilco, acting as a third-party buyer, acquires the non-strategic assets from a transaction either prior to, at or immediately following closing.

In a typical merger, acquisition or divestiture transaction, it is highly probable that certain assets will be declared by the prospective buyer as redundant or non-strategic. As a consequence, the buyer will likely discount the value of those assets, usually below the seller's book value or at least below what the seller believes is the fair market value. The disparity in value between what a buyer is willing to pay and what a seller expects to receive is often the difference between completing a deal and, at the very best, entering into long, costly and often contentious negotiations with no certainty for a positive outcome.

Enter Hilco. Acting as a principal buyer, using its own capital, Hilco can commit to acquire the redundant or non-strategic assets either from the seller prior to closing the deal, or from the buyer after closing. Either way, asset disaggregation assures the seller of a reasonable value for assets the buyer has discounted, and the buyer is assured that its overall acquisition price will be reduced, as may be its leverage requirements.

Phar-Mor, Inc., a former retail drugstore chain, once operated stores in 24 states under the names Phar-Mor, Pharmhouse and RX Place. Phar-Mor entered bankruptcy in 1992 and closed more than 200 stores before emerging from Chapter 11 in 1995. The company re-entered bankruptcy in 2001 and decided to liquidate entirely.

The retail supermarket chain, Giant Eagle, wanted to purchase a portion of Phar-Mor's inventory, prescription lists, and store leases. However, as another party had submitted a bid to purchase substantially all of Phar-Mor assets, the Bankruptcy Court and Creditors' Committee were not interested in having a company "cherry-pick" the assets.

At this point, Hilco approached Giant Eagle and offered to partner with the company to make a competitive bid for all of Phar-Mor's assets. The strategy, if successful, would enable Giant Eagle to retain the strategic assets it desired while leaving the remaining non-strategic and/or redundant inventory, leases, FF&E and prescription lists to Hilco for subsequent disposition. A percentage of the disposition recovery would go to Giant Eagle.

Ultimately, the Hilco/Giant Eagle joint venture bid, valued at \$135 million, won the deal in a Court-approved auction, and all parties derived benefit from the outcome. The Creditors' Committee was satisfied with their total recovery; Giant Eagle was able to acquire all of the assets it wanted; Giant Eagle's lenders were able to structure, close and fund an acquisition financing package; and, Hilco succeeded in generating excellent net recoveries on the remaining assets, a portion of which went to further benefit Giant Eagle.

This asset disaggregation solution was possible only because reliable values could be placed on the myriad of asset classes and categories involved in the transaction. Hilco understood what was reasonable for Giant Eagle to pay for the assets they would retain, and what recoveries could reasonably be expected for the remaining assets in an orderly disposition. Armed with this information, a financially-sound yet aggressive bid package was structured, submitted and accepted.

The Differential Advantage

In the final analysis, the most successful asset-based lenders offer more than competitive rates. They offer creativity, striving to find innovative new ways to meet their clients' business objectives. They offer responsiveness, moving aggressively to accommodate their clients' time constraints in a business environment that will not tolerate bureaucratic delay or worse, procrastination. And, they offer superior expertise, providing advice and counsel on the most advantageous ways to structure a borrowing package.

Fundamental to providing creativity, responsiveness and expertise is an understanding of the value of underlying assets as well as the business enterprise within which they exist. To many lenders, this is not typically among their core competencies, which is why they have taken a second look at Hilco and, today, see far more than an asset disposition company. They see a strategic partner with asset knowledge that can be applied in numerous ways to a singular end result: putting the deal together and getting it done. **abfj**

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