

Restructuring Options

for Oilfield Service Companies

By MARK E. CHESEN
SSG Capital Advisors, LLC

Mark Chesen of SSG Capital Advisors and colleagues discuss restructuring alternatives for companies, both inside and outside of bankruptcy.

Oilfield service companies continue to struggle from the fallout of plunging oil prices. Many companies that have managed to stay afloat now face dwindling cash reserves and must act quickly to preserve their options. The following roundtable discussion includes some of the top legal minds in bankruptcy and energy today.

Chesen: *What restructuring options are available for oilfield service companies and manufacturers today?*

Hughes: First, it's important to be proactive in addressing the situation, speaking from both the perspective of being a debtor company or a creditor company. If you wait too long your financing or other restructuring options will be greatly restricted. Second is to get expert help, and that's an option you should act upon early in the process. That may be in the form of a Chief Restructuring Officer (CRO) candidate who can help a debtor make the hard decisions that need to be confronted—such as where the problems are and how you can try to minimize them—to an investment banker type who can help a debtor evaluate options for both raising capital or selling off operating businesses. For creditors, it can mean how to structure payments to minimize avoidance later, or to act to ensure other parties are not preferred. The third decision is getting

legal help so you can understand your options and risk factors, both in addressing things from the debtor or creditor standpoint.

Sparacino: I agree; you need to identify the problem well in advance of a bank maturity or a bank default. Your options are going to depend on what the capital structure looks like. If there's only senior secured debt, companies really need to get in front of their lender as soon as possible. There really aren't very attractive refinancing options out there now for companies in

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the energy space. So they've got to work with their lender, and to some extent the lender is going to be the person that decides the path. Companies really need to slash expenses and hunker down. It may be time to consider selling non-core and potentially even certain core assets of the business. However, as much as the lender has significant control, we're also in an environment where the lenders don't want to foreclose. They want a performing credit, even if it's one for which they have to waive certain defaults, forbear from remedies, or extend maturities and payment

obligations. So work with your lender. If all else fails, the likeliest restructuring option for some companies will be a lender-assisted Chapter 11 process that will lead to a Section 363 sale process. And so, they would need lender or some debtor-in-possession financing support from a lender to proceed down that path.

Hughes: One of the things that I'm less enthused by is the concept that these situations are preordained

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to have to result in what's called a Section 363 sale process, which is essentially the option where the debtor company has to merge or sell itself off because it has no future. Invariably that often is the case because the company may have waited too long to act, or lack the financing availability or cash flow to sustain itself in a process, but that's part of the analysis that has to go on in order for the owners to evaluate and take care of their equity structure, as well as consider whether

restructuring alternatives may present themselves to allow the company and its core business to survive and not be forced into a liquidation scenario.

Sparacino: True, it's not a preordained result. A company needs to come up with a plan and understand the situation vis-à-vis their secured lending facility, and they need to be proactive with their lender. Lenders, believe it or not, are willing to listen and work with their borrowers so long as the borrowers have a cogent, rational, logical plan, and understanding of the predicament that they are in and can present the lender with some path out of the situation that makes sense. If that's not available, one of your options is to hand the keys over to the lender, which the lender doesn't really want.

Forshey: I have three thoughts. I agree the first is to be early and proactive, recognize the problem. It's like a disease: the quicker you identify and treat it the greater your likelihood of a cure. Second, get outside help. Go get a professional, a CRO. It's very difficult for many organizations to implement what are really tough choices about cutting their workforce, closing locations, and other cost-cutting measures. Get an outsider who's more dispassionate and can offer an outsider's perspective. It's also very important to get in front of your creditors, including both your big secured creditors and your big suppliers. Let them try to be a part of your solution, not part of your problem. If you play it right, particularly if you've got a good CRO that can be your spokesperson to these creditors, it really helps your chances of success.

Krasoff: As an investment banker, the one thing that we're seeing with oilfield service companies is that they really do need a CRO in there to help them make the

hard decisions. Some of the service companies are now EBITDA-negative based upon their current structure. And it's really difficult for legacy management to make the tough decisions about what should and shouldn't stay. The faster they can get a fresh face in there to help make those decisions, the better off they are.

Chesen: *If a company has decided to file for bankruptcy, what are the key things they should consider?*

Krasoff: Many oilfield service companies that I have dealt with have said that they can't sell their companies because of stipulations in their master service agreements (MSAs). One thing they should consider when restructuring in bankruptcy is to work with their suppliers and be aware of any restrictions in their MSAs.

Forshey: If a company has decided to file for bankruptcy, one of the key things they should consider is cash. Cash is king. Leading up to the bankruptcy case, carefully examine and analyze your cash needs. That's probably where you're going need a CRO type to work with your lawyers, creditors and bankers so you can reorganize. If you don't figure out the cash needs, it probably fails.

Sparacino: I would echo that. You need some cash on hand to fund the process. Also, be prepared for the openness that a Chapter 11 process brings. Lastly, be

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open, be direct and have those hard frank conversations with your employees, with your vendors, with your customers, with your creditors. Be prepared to answer plenty of questions from all of those constituents.

Hughes: From the debtor's perspective, I would also evaluate early on what adequate protection you can provide your secured creditors, whether equipment, financing or bank loan creditors. Don't fail to pay your tax obligations, particularly trust fund taxes. You'll just make a bad situation worse and incur some potential personal liabilities. Also from the debtor's perspective, you have to evaluate your long-term contracts and, as

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Jay mentioned, evaluate whether or not you have long-term obligations under your MSAs. Don't hesitate to try to negotiate with counterparties if you haven't done so already. And then, last, but not least, when you're dealing with your trade, evaluate what opportunities you'll have for critical vendor status. From the creditor perspective, you want to get organized early on, make sure you preserve your rights. You also want to be very proactive and protective about any kind of immediate financing request made in a bankruptcy case, because those cases can sometimes be over in the first 30 days if a financing order has terms in it that essentially dictate the outcome. Evaluate whether or not you have reclamation or enhanced recovery rights in the case and make sure those are protected.

Krasoff: So often we see these companies with payout plans where they negotiated these unsecured payout plans to a bunch of different vendors prior to them going into bankruptcy. And the sooner they can shut those things down and start preserving cash it's very critical. You know if they've made the decision to go into Chapter 11 they just really need to stop paying a number of payout plans that they've been attempting to keep up with.

Hughes: In addition, what you're seeing right now is a phenomenon of a whole lot of E&P companies drawing

down their bank lines of credit, and banks may not be able to prevent that because a default hasn't yet occurred. But, what you're seeing is companies trying to build and preserve cash. And they're going to start really scrutinizing who and what they pay because that's an important element of succeeding in a case.

Chesen: What if someone is interested in acquiring a troubled business either inside or outside of bankruptcy? What should the acquirer know in advance?

Sparacino: I think any interested buyer would need to understand the reasons for the distress in the business they're looking at. Is it operational? Is it just balance sheet or debt burden issues that are causing the distress? Is it a combination of both? So, you need to really understand that, and you need to understand how you as the owner would address those issues. Also, in an out of court scenario, as a buyer you really need to have bankruptcy counsel assess the fraudulent transfer risks and concerns that might come with any acquisition and your payment of cash into what then might be a shell defunct entity after they distribute the cash. What happens next to your seller after you've concluded the transaction? In bankruptcy you need to understand that it's going to be a public and a more open process than you might be used to if you've bought and sold assets previously. It's going to be a fairly quick process. You may be provided a limited opportunity to perform due diligence. You might not get the level of due diligence

Be open, be direct and have those hard frank conversations with your employees, with your vendors, with your customers, with your creditors.

that you would otherwise like. You're not going to get reps and warranties typically. You're not going to get any indemnification. Basically, when the deal is done, the deal is done, and there's no revisiting issues after the sale is concluded and the dollars are gone. Again, get competent counsel. You'll need to understand the stalking horse issues, the pros and cons. You'll need to understand in many Section 363 sales these days, the requirement for a backup bidder where you're essentially locked in even if you're not the chosen winner if you submit a bid.



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Forshey: Also, get a CRO to help advise you with the process. If you're buying it outside of bankruptcy be careful. There are a lot of pitfalls and the possibility of fraudulent transfer liability. And finally, if it's in bankruptcy get ready to move fast and get people to advise you that know more than you do to understand the process.

Hughes: The other problems you encounter is that your diligence needs to be extra careful because sometimes there are problems out there that just don't emerge until after a bankruptcy smokes them out. So you have to be very cautious about inheriting a problem that you didn't realize was there. The other thing you have to worry about is whether you can convey the assets free and clear. There may be lien rights that come into play. And last, but not least, you have to be worried about whether the equity might come in and somehow claim after the fact that the deal was too good to be true, and, therefore, you have to pay twice. Post-bankruptcy, you have to always be worried about collusion. You don't ever want to put yourself in a posture of having any transaction that you're involved in where you appear somehow collusive with others, whether an insider or another competing buyer. And you want to be cognizant that a lot of your diligence costs might be able to be absorbed through a stalking horse diligence fee or some sort of bid protections, that if you're outbid you at least get paid for the trouble and expense you've gone through.

Chesen: What factors should companies consider when selecting a bankruptcy attorney?

Hughes: You really do want a candid assessment of what your options are so that you can be proactive and make a decision. Also, they should be familiar with the court and the people who will be involved in the case. Experience and relationships can help pave the way to solve problems and get information more quickly and for less cost.

Sparacino: You need to understand the firm's capacity to staff it properly. There are going to be a lot of firms out there that are getting a lot of big debtor cases, and the firms may not have the time or capacity to give your company and your case the attention it needs. And then, echoing what Pat said, knowledge of other participants in the deal, knowing the lawyers in the deal, knowing the judges in the venue where the case will be filed, those are important process considerations.

Forshey: On selecting counsel, you want somebody that's independent minded. You do not want somebody that's just going to be a yes man or woman just telling you what you want to hear. 📢

ABOUT THE AUTHOR: Mark E. Chesen is a founding partner and managing director of SSG Capital Advisors. He has completed over 100 investment banking transactions involving the sale, private placement or financial restructuring of middle market companies in North America and Europe.



Mark Chesen

ABOUT THE ROUNDTABLE PARTICIPANTS: Jay Krasoff is a managing director of Chiron Financial Group, Inc., a Houston-based investment bank and SSG Capital Advisors strategic partner for the energy sector. He has over 30 years of investment banking experience and has spent most of his career advising clients in the energy industry on mergers, acquisitions, divestitures, restructurings and capital raises.



Jay Krasoff

J. Robert (Bobby) Forshey is a partner in the Fort Worth office of Forshey Prostok, LLP and practices in the areas of bankruptcy, business reorganizations and workouts, and creditor's rights. The firm's scope of representation includes handling complex business reorganizations, enforcing of creditor's rights, leading commercial and bankruptcy-related litigation, overseeing creditors' committees, directing workouts, and closing bankruptcy acquisitions.



Robert Forshey



John Sparacino

John J. Sparacino is a partner in the Houston office of Vorys, Sater, Seymour and Pease LLP. John has over 25 years of experience representing businesses, lenders, creditors, equity holders, directors and officers, and buyers and sellers of assets in distressed and bankruptcy situations.



Patrick Hughes

Patrick L. Hughes is a partner in the Denver and Houston offices of Haynes and Boone, LLP. Patrick has represented countless business debtors, secured creditors and court appointed committees in numerous bankruptcy cases throughout the country. Patrick also has had an active business litigation practice, and he has also counseled boards and management teams on a variety of transactional and litigation matters which arise out of restructuring situations.



Cell 432/413-9384
3202 Salisbury Ct.
Friendswood, Texas 77546
spete672@aol.com

Pete Sandel
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