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# The Vultures Come to Feast:

A Look at the Role of  
Investment Banks, Claims Traders,  
and Hedge Funds in the Insolvency  
Process

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# The Role of Investment Banks

# What Investment Banks Do

- help develop the restructuring plan
- valuation support
- fairness opinions
- securities market support
- securities market “intelligence”
- negotiation support
- help with the issue of new securities
- conduct sales and capital raising processes

# Who Are They?

- BMO Nesbitt Burns
- CIBC World Markets
- RBC Dominion Securities
- Scotia Capital
- TD Securities
- CSFB
- Crosbie & Company Inc.
- Deutsche Bank
- Dresdner Kleinwort
- Genuity Capital Markets
- GMP Securities
- Goldman Sachs
- Greenhill
- Houlihan Lokey
- Jeffries & Co.
- J.P. Morgan Chase
- Knox & Co.
- Lazard
- Lehman Bros.
- Morgan Stanley
- Needham & Co.
- Rothschild
- Seabury Securities
- UBS

# Where Have They Been?

- AT&T Canada – *Greenhill*
- Air Canada – *Seabury Securities*
- Stelco – *UBS*
- Slater Steel – *RBC DS*
- Ivaco – *UBS*

# The Role of Hedge Funds, Claims Traders and Other Opportunistic Capitalists

# Who Are The “Vultures”?

- What people refer to as “vultures” generally fall into two categories:
  - (a) Claims Traders: the traders of debt, bonds, claims, shares with no real intention of remaining stakeholders in a restructured entity.
  - (b) Opportunistic Venture Capitalists: restructuring and workout specialist firms and individuals who are actually looking for a longer-term interest.

# Claims Traders

## Who Are They?

- Essentially every high-yield bond fund trades in distressed debt; there are hundreds, mostly based in the U.S.
- Generally activity is buying and selling shares, bonds, debentures, subordinated debt and unsecured trade claims at a discount with the expectation of making a significant profit in the restructuring process.
- More willing to consider taking equity in the debtor as part of the restructuring.

# Claims Traders (cont'd.)

## Effect on Process

### (a) Liquidity

- Amongst each other, buying and selling debt creates liquidity – ability to “cash-out”
- Issues as to whether liquidity extends to smaller original purchasers

# Claims Traders (cont'd.)

## Effect on Process

### (a) Liquidity (cont'd.)

- Because of depth of analysis and research, prices are a good barometer of financial health of company
- Arguable that barometer effect can hasten insolvency

# Claims Traders (cont'd.)

## Effect on Process

### (b) Demand for Information

- These players look at all information in depth
- Put much pressure on company and monitor to provide information
- Earlier disclosure is not always in the interest of restructuring

# Claims Traders (cont'd.)

## Effect on Process

### (b) Demand for Information (cont'd.)

- Significant trades in bank or bond debt signify weakness in opposing stakeholders position
- New weapon is legislation on secondary securities market disclosure liability in Ontario and Alberta

# Claims Traders (cont'd.)

## Effect on Process

### (c) Shifting Stakeholders

- Can be positive or negative
- New stakeholders are sometimes more receptive to taking equity in restructured entity

# Claims Traders (cont'd.)

## Effect on Process

### (c) Shifting Stakeholders (cont'd.)

- In some cases, depending on where priorities are over assets, this can work against restructuring
- Raises possibility of conflicts since many purchasers of bank debt also hold positions as bondholders

# Claims Traders (cont'd.)

## Effect on Process

- (d) Development of secondary market for debt has produced significant opportunities for all stakeholders:
- Banks: increased flexibility for recovery including early “exit” strategy.
  - Trade Creditors: permits timely recovery early in restructuring process and thereby avoids potential conflict with debtor during restructuring process with whom they may have an ongoing relationship.

# Claims Traders (cont'd.)

## Effect on Process

- (d) Development of secondary market for debt has produced significant opportunities for all stakeholders: (cont'd.)
- Debtor: provides more flexibility to the restructuring as debt purchasers have bought at a discount and bring a new objective perspective to the restructuring. The negative is that the debt purchasers may see an opportunity of gaining control of the restructured debtor.

# Opportunistic Venture Capitalists

## Who Are They?

- Dozens in Canada
- Western Canada players tend to be backed by dynamic individuals and include companies like Matco Investments, Northpoint Capital, Arc Financial, Trican, Brascan and increasingly some U.S. players; also see other companies and high net worth individuals quite often in relation to oil and gas companies

# Opportunistic Venture Capitalists (cont'd.)

Who Are They?

- In Ontario, companies like Catalyst and Amaranth
- Generally, the issue is how to get the most influential position, with a minimal risk

# Opportunistic Venture Capitalists (cont'd.)

## Effect on Process

### (a) Providing Liquidity to Stakeholders

- probably see more secured positions being bought in the future
- this is mostly a positive effect so lenders can exit early with certainty
- recently seen this preventing companies from filing formal proceedings

# Opportunistic Venture Capitalists (cont'd.)

## Effect on Process

### (b) Providing Liquidity to Company

- providing lending, bridge financing, other forms of financial support in CCAA process
- sometimes debt is just a Trojan horse to getting equity
- cases in which DIP lender really wants to just control process

# Opportunistic Venture Capitalists (cont'd.)

## Effect on Process

### (c) Providing Credibility

- the presence of a sophisticated player immediately changes the dynamic between the company, its lenders, trade creditors and other contractual parties
- often means banks and creditors will forbear, and people will line up to invest

# Opportunistic Venture Capitalists (cont'd.)

## Effect on Process

### (d) Providing Management

- often the biggest barrier to restructuring is existing management
- this is the point at which many of the conflicts occur
- this is often where real value is generated in the long run

# Opportunistic Venture Capitalists (cont'd.)

## Effect on Process

### (e) Providing Expertise

- companies are often not well suited for insolvency proceedings; they don't know the process and how to best take advantage of the process
- the vultures typically are able to make quick decisions in an adversarial situation, something many companies are not well suited to do

# Opportunistic Venture Capitalists (cont'd.)

## Effect on Process

### (e) Providing Expertise (cont'd.)

- hidden value is often only realized by these sophisticated players e.g. tax losses

# Opportunistic Venture Capitalists (cont'd.)

## Effect on Process

### (f) Influencing Sales Process

- pressure of these companies often means a better realization e.g. Fracmaster realization was 30-40% higher

# Opportunistic Venture Capitalists (cont'd.)

## Effect on Process

### (g) Competing Plans of Arrangement

- not something we have seen interest of in Canada; in U.S. it is common with very good results

END