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For General Motors, it's all over except for the bankruptcy filing

BY LOU WHITEMAN

United Auto Worker membership on Friday ratified a concession deal between the union and General Motors, the final task on the automaker's to-do list as it readies itself for a bankruptcy filing set to happen as soon as Monday.

Union officials said that the deal, which would save GM at least $1.2 billion annually through modified work rules and other cuts, passed with 74% approval. In exchange for the concessions, a UAW trust fund responsible for retiree healthcare would receive at least 17.5% of the restructured company's equity.

With the union concessions in place, GM is expected to enter bankruptcy—likely in Manhattan—in the days to come. Weil, Gotshal & Manges and Dewey & LeBoeuf are serving as counsel to the company, while teams from AlixPartners, Evercore, Blackstone and Morgan Stanley have been advising the automaker.

GM and its government benefactors are hoping for a quick two- to three-month trip through Chapter 11 for the automaker's healthiest assets, but roadblocks still remain. Disgruntled creditors and dealers who would lose their franchises as part of the reorganization are expected to mount legal challenges that could slow the process even if they prove unsuccessful. ■

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A hearing on the deal was scheduled to conclude late Friday before Judge Arthur Gonzalez. For details on the proceedings, see Pipeline: http://pipeline.thedeal.com

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Counting on trouble

A conversation with Gregory Segall of distressed specialist Versa Capital Management

BY VYVYAN TENORIO

The current environment may be a boon for distressed investors, but for Gregory Segall, managing partner of turnaround specialist **Versa Capital Management Inc.**, it's an all-weather strategy. His five-year-old Philadelphia firm, formerly Chrysalis Capital LP, completed an oversubscribed, $650 million fund last month, its second. Limited partners, such as **Pennsylvania State Employees' Retirement System**, are certainly hot on the sector. And Segall has a long-term view—that the real reckoning is yet to come.

A longtime executive with management consulting firm Sigoloff & Associates Inc. Before founding Versa, Segall now runs a 23-strong team. His firm's current bets include restaurant chain Black Angus Steakhouse, retailer Bob's Stores and Polartec fleece maker **Polartec LLC**. He recently discussed his views on investing opportunities, financing markets and challenging aspects of the current environment:

VERSA MANAGING PARTNER GREGORY SEGALL

The Deal: You began fundraising before the market collapse. How has your analysis changed and how quickly do you expect to deploy this fund?

Gregory Segall: We invested our last fund in a relatively healthy economy. There will always be screwed-up companies with bad management. We do expect to see more cyclical distressed opportunities versus structural distressed ones. But when better-quality companies get in trouble, our risk-reward thresholds will probably be higher. ... We have been choosier, and we've also been very cautious. While dealflow is as busy as it's ever been, an awful lot of them are in advanced stages of distress. It's not really worth trying to save them. ... Ours is a lumpy strategy. We're still seeing values come down, so it wouldn't surprise me if we find ourselves having invested relatively little—or it could be a lot. We're not worried about catching the bottom. This is a multi-year wave up through 2014.

What types of opportunities are you counting on?

I actually think there could be an awful lot of deals that could be happening that are not happening because the major banks are in a virtual state of paralysis. They've been given so much extra capital by the government and at the same time told not to foreclose people out of their homes. The government is incentivizing them to sell their bad assets. But why would you do that when you've got plenty of capital? If you sell it cheaply, you'll just take more losses. So why not sit and wait?

We think there's an awful lot of companies that are just zombies, the walking dead, that have not been traded yet because the banks haven't started moving them. Just because the major restructurings aren't really in the front pages anymore doesn't mean that the banks aren't still dealing with massive internal issues. Pick any two of the banks and figure that they're still sitting there figuring out what they're trying to do with all their loans. Take **Wells** and **Wachovia**. Say they were both lenders to the same company but maybe they have different views on them. Maybe they carried them at different prices. There's so much work

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PRIVATE EQUITY

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for the lenders to do to finish getting their own house in order before they start dividing up the world and say OK, move all these things out.

How do you pick your trouble spots?
We like investing in businesses with a mature operating history. We find it easier to look at a company that, for example, used to make $10 million a year, now they're losing $10 million. That's much easier to underwrite than a company that planned to make $20 million and had not done it before. In this environment, though, the demand destruction is so serious in certain industries. Every factory has a level below which it's not economical. If there isn't a certain volume of widgets going through that factory, no matter how well run it is, it won't survive. You've got some well-run companies waiting for a sales recovery.

How long before the automobile industry gets back to 12 million cars a year? ... That's why we don't wait for the bottom. There's a host of industries that are more defensive, less sensitive to economic cycles, like healthcare or defense-related products. We're aware of a number of healthcare-related financings and sales that were teeing up to go forward, then when Washington put out announcements about changes by the end of the year, everyone freezes. If you're a company looking to refinance debt, and that got put on hold, suddenly you're a special-situation candidate for a fund like us.

So you'd be less comfortable underwriting a sales recovery?
That's always a challenge. There's only two places to improve unit volume: Either you grow the market or grow market share. But in a market like this, you are seeing a lot of consolidation opportunities. When we see two or three weaker players and there's a chance to combine them, maybe take out substantial costs and resolve other problems, that could be a good investment, as long as you're not just taking two drunks helping each other stand up.

How do you determine if it's better to buy in or out of bankruptcy?
If you look at our history, about half of our transactions involved some kind of court-supervised restructuring. It all depends on the state of distress when a company files. There are some that have their filing well-organized, almost prenegotiated, but there are others almost in free fall. We're extremely comfortable in either venue.

We're seeing more prepackaged filings. Is that the way to go now?
Any company contemplating a bankruptcy has to want a prepack if it's obtainable because the current Bankruptcy Code is so unfavorable. Prepacks are conceptually desirable but practically difficult to implement unless you have almost entirely an institutional creditor base and an otherwise stable, well-run business with a relatively modest level of trade debt.

Have things become more complicated given the complex capital structures?
Unquestionably. Look at **General Growth Properties** and how it came very close to avoiding bankruptcy but for a relatively small amount of complex, securitized debt that they couldn't get required consents on. There will be quite a spike of restructurings later this year. If you simply look at debt maturities and multiples, whether it's corporate debt or commercial real estate, there's nowhere for that stuff to get replaced.

While the news is quite dramatic over the last six months for the near defaulting banks, you really haven't seen the consequence of a lot of that downstream. That's like an earthquake that shakes the house—when it's over, the house may still be standing but you'll be discovering damage for years.

How have risks changed for you when you go into these more complex restructurings?
It's a lot of the same risks, some are just a little bit more extreme. The revenue line is often the scariest thing to have to look at. You say, "OK, it's down. Is it done going down?" Costs tend to be something you can underwrite. Raw materials you can deal with. You can close unprofitable retail stores.

Certain kinds of execution risks have increased. We need to understand if we're working on a deal that will actually close. We have a deal we're working on right now with seven banks. There's one lender that owns a large piece, and two or three that own very small pieces. But many of the important decisions require unanimous approval. Many of the small banks are essentially being intractable because they figure they have a lot less to lose than the big banks. So they're trying to get somebody to just take them out. Other execution risks have gotten easier. For example, there used to be plenty of transactions where everyone was always able to hold out and find someone with a better price. Now, a deal would fall into either of two categories—where something has to happen or it doesn't. If it has to happen, people have to take the price they get.

How are you financing your acquisitions?
We're getting financing, but we typically don't use a lot of debt. Keep in mind that speed and certainty are valued, people want to know we're cash buyers. So we just write the whole check for the majority of our transactions, and worry about financing later. When we use financing, we typically use asset-based financing, so we're borrowing against hard assets. Cash flow financing has been significantly damaged.

The most important source of financing right now might be a rollover of existing lenders in a deal. In the seven-bank deal I mentioned, we're not just going to pay them off the current lenders. We're negotiating with them to put some new money and restructure their existing loans. Existing lenders to companies will be an important source of financing. ■