



Like us on  | Follow us on  | Link us at  | Subscribe to us  | Watch us on 

VOLATILITY IN STANDARD COSTING FOR INVENTORY ABL LOANS

Within Asset-Based Lending to manufacturers that utilize standard costing methodologies, it is critical to minimize potential exposure by knowing when companies update their standards and how it can impact previously established advance rates. When an inventory valuation is performed, it is based on a point-in-time and the company's costing methodologies as of that date. Manufacturers that utilize a standard costing methodology for labor, overhead and raw materials typically update these standards at least once or twice a year. Over the last 12 months we have encountered two situations that can have potentially dramatic impacts on these standard adjustments and ultimately their potential impact on established advance rates within a borrowing base. The first situation we have seen with numerous companies over the last 12-months is a sharp increase in production levels coming out of the financial downturn; this can



result in labor and more specifically overhead standards to be significantly understated as you now have more product to spread over certain fixed expenses. The second situation has been the significant volatility in certain raw materials. Take cotton, which over

the last 12 months, has gone from \$1.64 a pound in June 2011 to around 88 cents in May 2012; for textile



manufacturers that utilize significant quantities of cotton within their operations, depending on timing, there could be a potentially large

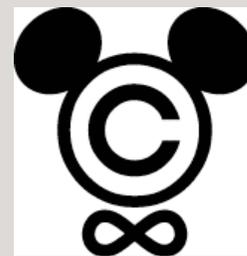
adjustment of inventory balances. We have seen similar volatility for other raw materials such as copper which, within the last 12 months, has ranged from a peak of \$4.45 a pound to as low as \$3.10 a pound; these large swings in value can have a tremendous impact on manufactures of wire, cable, alternators and other copper-rich products.

Whenever a significant standard adjustment is made, it is very important to compare and contrast the impact to the current inventory cost basis and the revised cost basis to determine if the advance rates need to be adjusted accordingly.

FLEXIBLE LIVES OF INTANGIBLE ASSETS

Unlike hard assets such as inventory or machinery and equipment, which can have an infinite life (metal) or limited useful life (a truck), certain intangible assets such as patents and copyrights also have a statutory life, with laws that limit the extent to which their owners have sole use of those assets. The finite life of these assets adds a wrinkle compared to other types of asset valuations under which owners generally have unlimited use of the assets. A lender considering using a patent or copyright as collateral must be fully cognizant that the value of the collateral is limited by

remaining statutory life of the assets (be it one more year or 100 more years). Patents have a current life of 20 years; and, per the Copyright Term Extension Act of 1998 (sometimes called the Mickey Mouse Protection Act due to the lobbying and financial support from Disney), copyrights last the shorter of the life of the author plus 70 years; or for works of corporate authorship, 120 years after creation or 95 years after publication. This relatively recent extension of the life of copyrights in 1998 (essentially adding an extra 20 years) gave a valuable boost to their owners as it gave them additional time to profit solely from their creations; likewise, it provided a strong boost



to their use as collateral as the additional time increased their value as collateral. Patent holders have often pushed for an extension of patent lives to increase the value of their patents. Copyright holders have done the same; and it is expected that, as the end life of certain valuable copyrights approach in the next decade (Mickey Mouse, amongst others); experts expect a big surge to extend their lives even further.

HILCO SERVES RESTAURATEURS' REAL ESTATE NEEDS



Hilco provides a range of services related to restaurant real estate, including valuation, lease mitigation, and disposition, among other advisory services. One example that highlights the range of services is Lone Star Steakhouse and Saloon. Hilco was engaged by a private equity fund to value 150+ owned properties consisting of Lone Star Steakhouse & Saloon, Texas Land & Cattle, Sullivan's Steakhouse and Del Frisco's. Hilco provided an opinion of value on each location detailing market rent, vacant value and sale/leaseback potential. Subsequent to the valuation work, Hilco structured a sale/leaseback of the portfolio using the market information from the valuations to maximize value. The original portfolio consisted of 131 locations. The company ultimately decided to include 35 locations in the transaction. Hilco successfully sold the portfolio for in excess of \$65 million. Hilco used a sealed bid deadline to focus on the logical buyers and maximize the value of the portfolio. Hilco's real estate appraisal unit also appraised more than 150 locations for various parties for use in decisions regarding financing. Other restaurants Hilco has been involved with include Applebee's, Max & Erma's, Starbucks, Claim Jumper, Giordano's, Macaroni Grill, KFC, Burger King, Taco Bell and Krispy Kreme, among others.

LENDING "OUTSIDE THE BOX": IN-PLACE VALUATIONS

Today's Asset Based Lending environment continues to get pushed beyond the traditional structures. As a result, lenders find it more difficult to meet growth objectives, deploy additional capital, and differentiate themselves from their competitors. As such, a key distinguishing factor among lenders has become their willingness to utilize the value of certain intangible assets within their loan structure. As a matter of practice, intangible assets have historically been viewed as "boot collateral," or as a way of stretching advance rates on traditional assets. This thought process, however, ignores the fact that certain intangible assets have true liquidation value. As such, loan structures should take into account the potential amounts that can be realized upon the liquidation of these intangible assets. Additionally, certain intangible value is often attached to the borrower's property, plant and equipment and/or other tangible assets. These situations require a lender to approach a potential term loan considering an In-Place Value.

Hilco Appraisal Services ("HAS") has utilized this In-Place Value concept with many financial institutions across numerous industries, including transportation, logistics, energy and construction. The concept is applicable in situations where fixed assets are tied to mid- to long-term contracts that are transferable upon change of control. The true value to a lender is not just the fixed asset, but the cash flows the fixed asset is able to generate bound by the specific terms of the contract. The Client using the asset does not care if the Debtor or Lender owns the asset. As long as the Client is able to extract their utility, they will pay according to the terms of their contract. This "bundle of assets" is perfect collateral for a Lender to consider when creating large, competitive loan structures.

HAS recently applied this concept to a well-known trailer leasing company. The Lending Group was determined to develop the facility solely based on the trailers. However, we felt strongly that considering a pure liquidation scenario where deployed trailers were removed from customer locations and transported

to a central location for liquidation was a misrepresentation of how the assets would be sold, and more importantly, a misrepresentation of the true value of the assets themselves. A sudden liquidation (traditional NOLV) of the Company's trailer fleet would result in a void in the marketplace that would be disruptive to customers' operations, impossible to execute logistically within the time constraints of the NOLV definition, and create an oversupply on the used market. This scenario would also breach the contracts already in place with customers, making it legally infeasible. Additionally, the market would not have the capacity to fill that hypothetical void in a short period of time. Consequently, the most likely scenarios would involve the purchase of some of the trailers by the existing customer base and/or the purchase of the fleet by a strategic or financial buyer. It would be cost-prohibitive to remove and consolidate these assets prior to rental contract termination. In liquidation, it would be highly inefficient to wait for these assets to come off of rent, move them from the customer locations to central locations, and then sell them. In addition, the amount of time it would require to liquidate these assets in a traditional NOLV setting would be outside the acceptable holding time of any lending institution in the asset based lending space. Rental income associated with the rental contracts is relatively predictable. Selling the trailers in-place at customer locations to a potential buyer would result in better financial recovery on the asset.



The Lending Group not only appreciated and agreed with our perspective, but they were able to develop a new credit facility that worked for the Debtor.

SENIOR ADDITIONS TO HILCO APPRAISAL EUROPE TEAM

Hilco Appraisal Europe (HAE) is delighted to announce that Brent Osborne and Alan McLaren have joined the company as Consultants.

Until recently, Brent and Alan were Joint Managing Directors of Landsbanki Commercial Finance, responsible for a portfolio in excess of £1 billion. Prior to this, both held senior leadership positions with GMAC Commercial Finance.

Chris Hall, CEO of HAE commented, "Brent and Alan are highly respected operators in the ABL community globally. We are looking forward to leveraging their vast experience in ABL transactions, and their extensive contacts within the Sponsor, Investment Banking, Corporate and Advisor professions.

Brent Osborne stated, "We know the HAE team well, having regularly engaged them, and consider the team to be market leaders. I am confident that Alan and I can help add to the team's success in the coming years".

HAE is a full-service appraisal company servicing major financial institutions, investors and corporations in the UK and

across Europe. HAE is focused on asset valuation and disposal, with two main services:

(1) "Front End" appraisals for sponsors, lenders, advisors and corporations, to include consumer goods and industrial stock, plant, machinery and equipment, accounts receivable, intangibles including IPR, and real estate and;

(2) "Back End" services for corporations and insolvency practitioners and restructuring firms to include valuation and disposal of assets - by auction or private treaty. HAE directors are experienced asset appraisers and plant and machinery auctioneers. They lead a team of equally experienced valuation analysts, writers and asset disposition experts, all of whom have provided highest quality services to the business community for more than a decade. Hilco Appraisal Europe understands the requirements of corporations, lenders and insolvency professionals, and is geared to respond in very short timescales. Both Alan and Brent look forward to helping in the team's continued success stories over the coming years.

Contact Details

Brent Osborne bosborne@hilcoeurope.com +44(0)7917687442

Alan McLaren amclaren@hilcoeurope.com +44(0) 7917687443

HILCO PROFILES - METALS SPECIALTY PRACTICE



Michael Sullivan joined Hilco in August 2007, after spending more than twenty years in all phases of steel manufacturing and processing. Michael started in the melt shops of a fully integrated steel mill and finished as the General Manager of a steel processing facility. In addition to running operations, Michael oversaw the decommissioning of one facility and assisted in the closing of a second processing facility; experience which provides a practical viewpoint on inventory appraisal.

Michael is a degreed structural engineer and designed structures with steel beams, channels and angles long before he started valuing them. Michael also has an MBA in Operations and Logistics from Michigan State University which, combined with actual experience, gives him unique insight into process industries and the practical considerations that would come to play in the event of an orderly liquidation.

Michael has combined the skills from his academic training and practical experience to lead the appraisals of three very large spin-offs in the aluminum and stainless steel industries where parent companies separated operations in the U.S., Europe and Brazil, from ongoing operations. The Hilco team played a key roll in establishing ABL financing for the new entities.

From metal casting, to coils, to beams, to plate; from manufacturers to distributors to fabricators; from aluminum to copper to steel to stainless; the Metals group at Hilco has the experience to handle any question and provide accurate and practical liquidation values.

Contact Michael at 847-313-4714 or
Email msullivan@hilcoappraisal.com



Marc O'Neill is a Senior Appraiser specializing in metals. Having appraised over 300 firms, he is an industry expert in the steel, aluminum, copper, alloys, foundry and forging industries along with downstream consumers of metal products. Additionally Marc has appeared as

the lead expert witness in the bankruptcy reorganization of a major steel tube producer. In today's robust energy markets, Marc also has appraised many specialty pipe and tube firms involved in OCTG manufacture and distribution.

His work experience prior to joining Hilco in March of 2009 included investment banking and over a dozen years with U S Steel. This work experience has given him comprehensive knowledge to understand complex structured financing in the metals industry. Marc is a graduate of Villanova University with a degree in finance and attended the Executive Program at the Kellogg Graduate School of Management at Northwestern University.

Contact Marc at 412-613-6739 or
Email moneill@hilcoappraisal.com

UPCOMING SALES & AUCTIONS



ELIMINATE UNCERTAINTY

MACHINERY & EQUIPMENT APPRAISALS

ANDY DAHLMAN 847.849.2936

CEO

TOM GRECO 847.849.2961

CANADA/NATIONAL EXECUTIVE

JOHN JEFFERSON 416.587.6600

INVENTORY APPRAISALS

ED ZIMMERLIN 847.313.4720

MARKETING

JIM GLICKMAN 847.849.2931

EAST REGION

FRED RACCOSTA 215.307.7454

RETAIL APPRAISALS

TIM ANDERSON 781.471.1229

LITIGATION SUPPORT

JEFF LINSTROM 847.849.2909

WEST REGION

JOSEPH TOUROUK 818.437.6439

REAL ESTATE APPRAISALS

TODD HANEY 847.504.2454

CHAIRMAN

ARNIE DRATT 847.849.2903

MIDWEST REGION

ADAM EVANS 847.849.2955

IP AND ENTERPRISE VALUATIONS

JASON FRANK 847.504.3263

HILCO STREAMBANK

GABE FRIED 781.444.4940

SOUTH REGION

JOHN TINNELL 704.905.9559

COLLATERAL REVIEWS

ELAINE ODELL 781.471.1234

UK/EUROPE

CHRIS HALL +44 (0)8453 130 140

Contents of this Newsletter were contributed by:
Jarrod Anderson, Jason Frank, Chris Hall, Todd Haney,
Marc O'Neill, Michael Sullivan and Ed Zimmerlin, Jr.

Like us on | Follow us on | Link us at | Subscribe to us | Watch us on