January 26, 2012, The Deal Pipeline

DIP: Crystallex International Corp.

by Aviva Gat

Crystallex International Corp. is headed to an auction early next month, but the winner won't be acquiring any assets. Rather, the victor will get to provide debtor-in-possession financing for the Canadian gold mining company.

Crystallex seeks a loan of at least C$35 million ($34.7 million), convertible into an exit loan, that it could use through Dec. 31, 2014. The DIP would be secured by a first-priority lien on all of the company's assets, which includes an open pit mine in Uruguay and three gold mines in Venezuela, court papers show.

Under bidding procedures approved Jan. 5 by Justice Frank J.C. Newbould of the Ontario Superior Court of Justice, DIP proposals are due Feb. 1, and Crystallex will choose a winner on Feb. 6. An auction could follow the selection, but Crystallex does not anticipate holding an auction.

Court papers show Crystallex decided to formalize the auction process because it had two competing financing offers and wanted to ensure it received the best financing terms.

"They must be very confident in the collateral that they have," says Lawrence Perkins of restructuring firm Conway MacKenzie Inc.

DIP financing becomes more competitive based on the value of the collateral securing the financing, Perkins explains. In Crystallex's case, that collateral is the gold in its mines, making a postpetition lender very secured.

A high asset value alone, however, is not enough to spur a DIP auction. Perkins says the debtor would also have to have enough liquidity to sustain operations during an auction process, which takes much longer than private negotiations between advisers and investors. For example, manufacturing companies, Perkins says, would not be able to hold a DIP auction because their operations would be undercapitalized while the debtor ran the process.

"There are two reasons companies file for bankruptcy: lack of liquidity and to fix their balance sheets," Perkins says. "Only ones that are good companies with bad balance sheets could hold a DIP auction."

Perkins brought up real estate companies as ones that could potentially withstand a DIP auction process, as they don't usually need constant cash for operations.

Daniel C. McElhinney, managing director of corporate restructuring for Epiq Systems Inc., agrees, noting the oddity of a company filing when it still has cash for operations.

“The thought of getting a DIP after filing for bankruptcy means you have enough money,” he says.

Indeed, Crystallex solved any immediate liquidity problems by securing a C$3 million bridge loan from Tenor Special Situations Fund LP. Newbould approved the loan on Jan. 20.

The combination of available liquidity and good collateral necessary for a debtor to stage a DIP auction makes them rare events. In fact, according to The Deal Pipeline, only one other debtor has held a formal auction.

Real estate developer Lauth Investment Properties LLC staged such a process in 2009, even naming LIP Lenders LLC as stalking-horse bidder to provide a postpetition loan. LIP Lenders, a new entity composed of insiders, on July 21, 2009, offered a $15 million DIP that could have expanded to $25 million. Lauth obtained a rival DIP commitment -- which it kept confidential -- just a few weeks later. Lauth, though, eventually chose to go with the stalking horse’s DIP.

Still, even given ample liquidity and solid collateral, something else must be behind Crystallex’s formal auction, says Scott D. Cousins of Cousins Chipman & Brown LLP.

“There has to be a backstory to why they’re shopping so publicly,” he says. “It may be an effort to get a concession from the DIP lender they already lined up.”

Cousins notes that financing DIPs is a competitive process to begin with because DIP lenders usually get priority status over other claims.

Like Lauth before it, Crystallex has one prospective loan with public terms. Byron Capital Markets Ltd., GMP Securities LP and Macquarie Capital Markets offered to underwrite C$135 million in notes prepetition that were to accrue pay-in-kind interest of 20% per annum. The potential lead investor in the deal, which considered contributing up to $50 million, preferred such a deal take place in court as postpetition financing.

Crystallex said in documents, however, that it received a second offer, which it kept private, from a second investor. Existing noteholders have also said they could bid to be the DIP lender, court papers show.

McElhinney said he isn’t surprised that Lauth and Crystallex both did not release their competing offers. Potential lenders could offer better terms if they don’t know their competition -- reducing potential criticism of the loan’s terms. Prepetition lenders, he says, must be comfortable with the winning party in the auction.

Indeed, documents show Crystallex's prepetition noteholders had some undisclosed concerns about the auction. The debtor tried to address the concerns in its bidding procedures.

Newbould will consider the DIP auction results on Feb. 15, and Judge Peter Walsh of the U.S. Bankruptcy Court for the District of Delaware in Wilmington will weigh the DIP on Feb. 21 as part of the company's Chapter 15 proceeding. The debtor expects the loan to close by Feb. 23.