Distressed Debt Restructuring

Qualitative Analysis

What are the problems?

Can they Be fixed?

Restructuring plan

Financial and operating risks

Liquidity

Long term cash flow

Identifying the Problems

INDUSTRY-WIDE OR COMPANY-SPECIFIC?

Cyclical vs Secular

- **ECONOMIC CYCLE**
  - Mitigate
  - Wait it out
- **MARKET DYNAMICS**
  - Reason to exist

Operations

- **REVENUES**
- **COSTS**
- **INVESTMENTS**

Does management have a plan or are they part of the problem?

Can the Problems Be Fixed?

COST CUTTING
Cyclical
EASIEST

MANAGEMENT
Working Capital/Capex
MODERATE

REVENUES
Secular Issues
DIFFICULT

Is there a sustainable business plan?

Restructuring Options

1
Room under existing facilities?

2
Additional Borrowing
Cash flow-based debt capacity

3
Can the company be sold?

4
Can the assets be sold and the debt holders be paid?

FINANCIALEDGE

Restructuring Options

Debt Restructuring

- **Debt forbearance** / write off
- **Extension of maturity** / change in interest rate terms (usually increase, with significant PIK interest component)
- **Debt for equity swap**
- All accompanied by potential provision of new financing to give the company a new start

OR

Fire Sale

- Sale at a discounted price

OR

Liquidation

- Worst case scenario

FINANCIALEDGE

Additional Borrowing: Cash Flow Based Debt Capacity

MULTIPLE × **VALUE DRIVER** = **DEBT CAPACITY** (TOTAL DEBT)

Can be Maximum **(Leverage)** or Minimum **(Coverage)**

Typically **LTM** or Proj. **Year 1 EBITDA**

Multiple	Value Driver	Debt Capacity
Debt/LTM EBITDA = 5.0x	LTM EBITDA = $1,000	Total debt = $5,000 (5.0 x $1,000 = $5,000)

Market Prefers EBITDA but Lenders Love Cash Flow

The debt service coverage ratio **(DSCR)** is regularly used in analysis as it factors in other cash flows such as **capex** and **taxes.**

$$\frac{\textbf{(EBITDA – Capex – Taxes)}}{\textbf{(Required Interest + Principal Repayments)}}$$

Minimum coverage of **1.1x to 1.8x** depending on industry or company.

DSCR Example

LTM EBITDA	1,000.0
Unlevered cash taxes	(250.0)
Capex	(200.0)
Unlevered free cash flow (UFCF)	550.0
Cash conversion (UFCF/EBITDA)	55.0%
DSCR ratio (from market or precedent)	1.3x
Interest rate (after-tax)	5.0%
Amortization in first year	5.0%
Total debt service as %	10.0%

DEBT CAPACITY
(EBITDA-Capex- Taxes)/DSCR/Total debt service as %

DEBT CAPACITY
550/1.3x/10% = 4,231

IMPLIED DEBT/EBITDA
4,231/1,000 = 4.2x

Using Cash Flows to Value a Loan

	[illegible]	[illegible]	[illegible]R 2	YEAR 3	YEAR 4	[illegible]
Term	[illegible]	[illegible]	[illegible]			
After-tax cost of debt	[illegible]	[illegible]	[illegible]			
DSCR	[illegible]	[illegible]	[illegible]			
Free cash flow	[illegible]	187.5	191.2	197.8	202.1	208.2
Cash flow after DSCR (1.2x)		156.3	159.3	164.8	168.4	173.5
Loan amount	**704.3**					
Debt amortization schedule						
Beginning balance		704[illegible]	[illegible]	[illegible]	[illegible]4	164.8
Interest paid		(37[illegible]	[illegible]	[illegible]	[illegible]3)	(8.7)
Debt repayment		(118[illegible]	[illegible]	[illegible]	[illegible]	(164.8)
Loan balance	704.3	585[illegible]	[illegible]	[illegible]	[illegible].8	**0.0**

This is an **NPV calculation** of the 5-year cash flows post-DSCR discounted at the after-tax interest rate.

The **cash flows** would be sensitized using a bank/ downside case **OR** by applying a DSCR as done here.

Amortization based on available cash after DSCR is applied (a cash sweep). Loan repaid in 5 years.

Sale of the Company: Comparables

Aim to establish what **multiple of earnings** or other important **metric similar assets** trade at.

Getting **comparable companies** and calculating a multiple in a completely **consistent** way.

TRADING COMP = VALUE / VALUE DRIVER

Value driver must be consistent with value number!

VALUATION IS FORWARD LOOKING SO EARNINGS SHOULD BE NORMALIZED

FINANCIALEDGE

Sale of the Company : DCF

		YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5
WACC	7.00%					
Long term growth	2.00%					
Exit multiple (EBITDA)	10.0x					
Free cash flow		187.5	191.2	197.8	202.1	208.2
Terminal value						2,165.7
PV of free cash flows	806.3					
PV of terminal value	1,443.1					
Enterprise value	2,249.4					
Net debt	(750.0)					
Equity value	**1,499.4**					

FINANCIALEDGE

Sale of the Assets: Liquidation Value

Book Value × **% Recovery Rate** = **Liquidation Value**

Inventory
Accounts Receivable
Investments
Fixed Assets
Intangibles

OWC accounts tend to be **70-80%**
PPE usually **0-40%**
Fixed assets can **be > 100%** if real estate/other investment.

Whatever the asset recovery is, it will be applied to the outstanding debt according to the creditors' place in the capital structure!

FINANCIALEDGE

Case in Point: Verso Corp

- **1. Company and Industry Analysis**
- **2. Debt Capacity**
  Can the debt be restructured?
- **3. Company valuation for fire sale**
- **4. Liquidation value**

FINANCIALEDGE

Case Study Debrief: Distressed Debt Restructuring

Verso Corp.

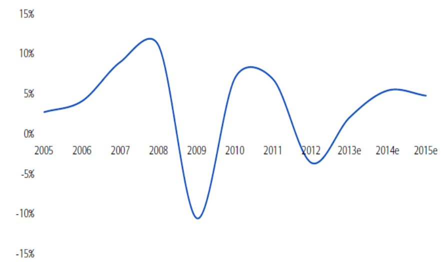
Contents

1. Industry drivers and risks
2. Verso specific risks
3. Restructuring options
4. Cash flow-based capacity
5. Comparables valuation
6. Liquidation analysis

Industry Risks

- The industry is highly cyclical; paper consumption is directly linked to GDP
- Highly volatile prices
- Commoditized market
- Intense competition both domestically and abroad
- Foreign exchange fluctuations
- High fixed costs
- Structural decline across the whole sector due to pressures on end users, rise of alternative media, and increasing postal rates
- Environmental pressures

Global Paper and Pulp Price Evolution*



**Source: HIS Global Insights*

Cyclicality

Stable revenue streams and less cyclical end markets

1 2 3 4

High Operating Costs

Cost management, including

Ability to source raw materials, lack of dependence on suppliers is key

Ability to manage and diversify energy sources

1 2 3 4

Leverage

Manageable or low leverage

1 2 3 4

Environmental Challenges

Ability to innovate and cope with environmental challenges

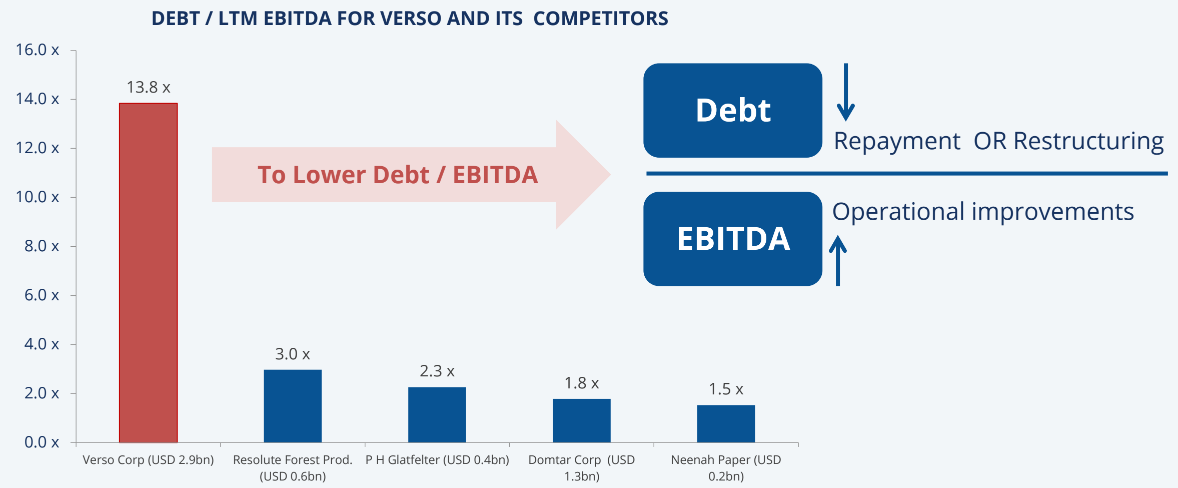
1 2 3 4

Risks to Verso's Restructuring

OPERATIONAL RISKS	• Lack of product diversification • High customer concentration • Limited exposure to markets other than the U.S. • Highly unionized employee base • Ability to realize synergies from NewPage deal
FINANCIAL RISKS	• Leverage and willingness of all debt tranche holders to compromise • Sufficient liquidity • Long term sustainable cash flow generation including ability to make required operational investments to stay competitive

Successful restructuring ?

Risks to Verso: Verso's Leverage vs. Its Peers



FINANCIALEDGE

Restructuring Options

Debt Restructuring

- **Debt forbearance /** write off
- **Extension of maturity /** change in interest rate terms (usually increase, with significant PIK interest component)
- **Debt for equity swap**
- All accompanied by potential provision of new financing to give the company a new start

OR

Fire Sale

- Sale at a discounted price

OR

Liquidation

- Worst case scenario

FINANCIALEDGE

Cash Flow Based Debt Capacity Analysis

Verso Corp's Cash Flow-based Capacity

Year		Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Free cash flows		126.6	78.2	115.0	129.6	126.5	128.5	133.7
Debt capacity based on cash flows								
Debt term (years)	7.0							
Pre tax cost of debt	8.0%							
Marginal tax rate	35.0%							
Post tax cost of debt	5.2%							
Present value	682.3							
Haircut	10.0%							
Principal amount	614.0							
Implied LTM EBITDA multiple	3.0 x							

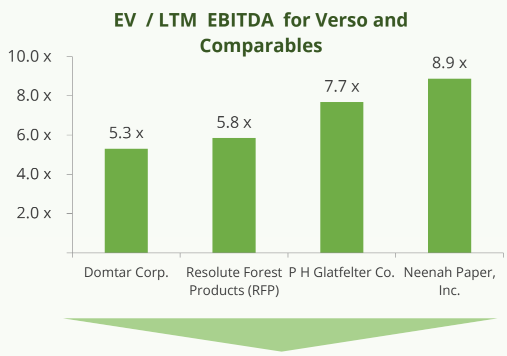
Debt capacity established by NPV at post tax cost of debt A haircut can also be used

Principal raised should be paid off by year 7 assuming all cash flows are used

Verso's cash flows can support debt of 3.0x debt / EBITDA based on the free cash flow forecast. The multiple is in line with the peers and much lower than the company's current leverage

FINANCIALEDGE

Comparables Valuation and Fire Sale Value



KEY ASSUMPTIONS

- Maximum multiple of 8.9x for Neenah Paper
- Minimum multiple of 5.3x for Domtar Corp.
- LTM EBITDA of USD 208 million
- Balance sheet data as of 31-December-2015

Resulting in enterprise value and non-core assets of USD 1.1 – 1.9 billion and a fire sale price USD 0.9 – 1.5 billion

FINANCIALEDGE

FINANCIALEDGE

Liquidation Valuation

Book Value × **% Recovery Rate** = **Liquidation Value**

	Value
Liquidation value	979.8
– Liquidation costs	(120.0)
= Liquidation proceeds	**859.8**

FINANCIALEDGE

Debt Restructuring Options

SENIOR SECURED DEBT TRANCHES	Revolving credit facilities, 3.71% - 4.36%, USD 349 million → Maturity extension by 1 year, interest hike to 5%, 16% equity upon emergence from restructuring	Senior 1st lien claims other than RCFs, 9.50% - 11.75%, USD 1,783 million → Maturity extension by 2 years, interest hike from 9.5% to 10% (3% cash + 7 % PIK), from 11.75% to 15% (5% cash + 10% PIK), 83.6% equity upon emergence from restructuring
OTHER DEBT CLAIMS	1.5 - 2nd priority notes, 8.75% - 13.00%, USD 636 million → Should be forgiven	Subordinated debt, 11.38 -16.0%, USD 129 million → Should be forgiven

IN REALITY, DEBT RESTRUCTURING IS SUBJECT TO NEGOTIATION

FINANCIALEDGE

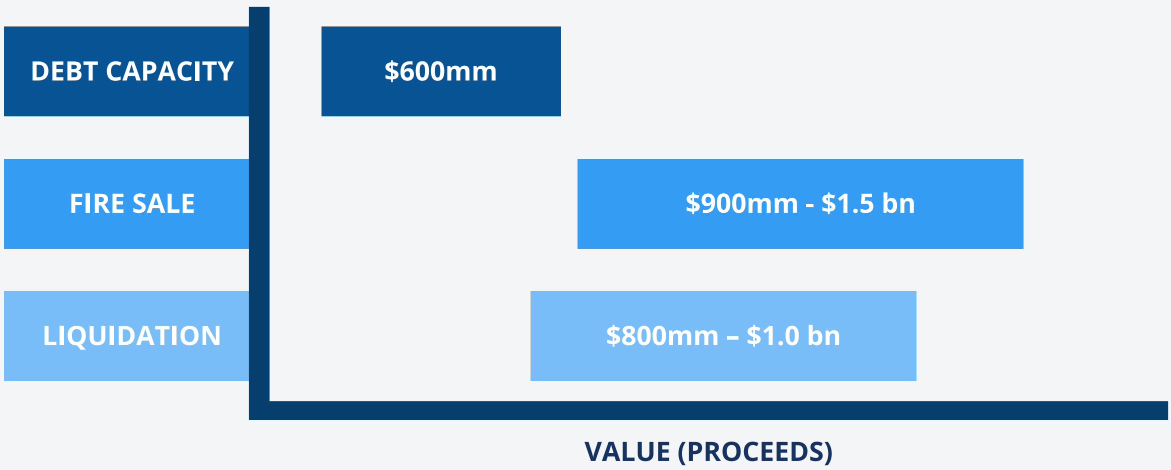
Liquidation: Debt Recovery Rates

VERSO CORP'S CASH FLOW BASED CAPACITY

Current debt and liquidation value				Amount	LTM EBITDA multiple
Total debt instruments				2,897.0	13.9 x
Liquidation proceeds				859.8	n/a
Debt capacity				614.0	3.0 x
	31-Dec-15	31-Dec-15	31-Dec-15	Recovery	
	Maturity	Interest rate	Balance	Amount	%
Revolving credit facilities	May 2017 - Feb 2019	3.71% - 4.36%	349.0	140.7	40.3%
Senior 1st lien claims other than RCFs	Jan 2019 - Feb 2021	9.50% - 11.75%	1,783.0	719.1	40.3%
1.5 - 2nd priority notes	Jan 2019 - Aug 2020	8.75% - 13.00%	636.0	[illegible]	[illegible]
Subordinated debt	Aug 2016 - Aug 2020	11.38 -16.0%	129.0	[illegible]	[illegible]
Total debt			2,897.0		
Equity			(1,183.0)		

Senior debt tranches are treated on a pari passu basis and are the only tranches eligible for recovery

Summary



In Closing

VERSO

Verso Corporation Positions Company for Long-Term Success
By Initiating Process to Restructure Debt

Verso Corporation and its Subsidiaries File Voluntary Petitions under Chapter 11 of U.S. Bankruptcy Code and Expect To Reach Agreed-Upon Terms for Pl... Certain Creditors and to Obtain up to $600 million in Debtor-in-Posse...

Normal Operations to Continue

MEMPHIS, Tennessee – January 26, 2016 – Verso Corporation (OTCPink: VRSZ... the company and its subsidiaries have filed voluntary petitions with the Unite... in the District of Delaware to reorganize under Chapter 11 of the U.S. Bankruptcy Code. Verso's board of directors authorized the filing of the Chapter 11 cases to facilitate a debt restructuring necessary to strengthen the company's balance sheet and to position Verso for long-term success. Verso expects today's announcement will have virtually no impact on the day-to-day operations of the company.

"While filing for Chapter 11 protection was a difficult decision, we are pleased that we enter this process with strong creditor support. We have worked together with a broad spectrum of financial creditors to develop a restructuring plan to eliminate $2.4 billion of our outstanding debt and to exit the Chapter 11 process in a short timeframe," said Verso President and CEO David J. Paterson. The expected agreement on terms for a plan of reorganization is with creditors holding at least a majority in principal amount of most classes of funded debt of Verso and its subsidiaries. Verso anticipates that upon finalizing agreed-upon terms, the plan of reorganization would result in the holders of its funded debt receiving equity of Verso in exchange for their claims.

$375mm Asset Backed Loan
$220mm Term Loan Facility

FINANCIALEDGE

FINANCIALEDGE

www.FE.training

Please do not redistribute these materials without the express permission of Financial Edge Training.

FINANCIALEDGE