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December 10, 2012

Distressed Debt Market Condition

US economy is improving, so a distressed play in 2012 would play out well in 2013. A lot of distressed debt securities trading at 50-75, especially in Europe. The security pool ranges from $500B to $1.2T. As long as perceived risk is greater than actual risk, there is an investment waiting to unfold in favor of the investor. If one invests in senior secured debt, can ride out the volatility in Europe, since worst case would be recovery of the net asset value, and with the seniors trading at 50-75, there should be ample coverage. A famous debt investor believes Europe will take 2 years to play out. Recently, Greece's government offered to repurchase the bonds at 35. A lot of hedge funds entered the trade at the bottom, around 17, so the hedge funds made a decent profit, but they are holding out for a higher offer from the government.

QE and bailouts have allowed investors to kick the can further down the road, which is unnatural and frustrates distressed investors, who may be waiting for a co.'s debt to become cheaper, or cover a short position. But a day of reckoning will come-maybe not 2013, nor the fiscal cliff. However, the tower constructed from unsupported excess credit will collapse, as the fundamentals can't sustain the bloated structure. FCF is king and if a co. can generate FCF during the tough times, then the investment in debt is wise. The capital structure protects the investment, also with the assets on hand.

Lehman distribution is a large pool, about $65B, so a lot of investors have a stake in the pot. The first round of distributions will be about $22B.

"The plan treats subsidiary creditors better than those of the parent. For instance, it calls for creditors of Lehman's Specialty Finance unit – the heart of the failed investment bank's derivatives business – to get more than 30 cents on the dollar, thought it limits how much they can claim. Bondholders of the Lehman parent are getting less: about 21.1 cents on the dollar.

Lehman, in a statement, also said it will keep about $6bn in cash for itself so it can cover operating and non-operating expenses, as well as paying post-bankruptcy claims and making anticipated investments.

The failed investment bank's historic $65bn creditor payback plan was approved by Peck late last year. The $65bn figure is a "gross recovery" number, and not the amount of cash that Lehman creditors will eventually be paid."