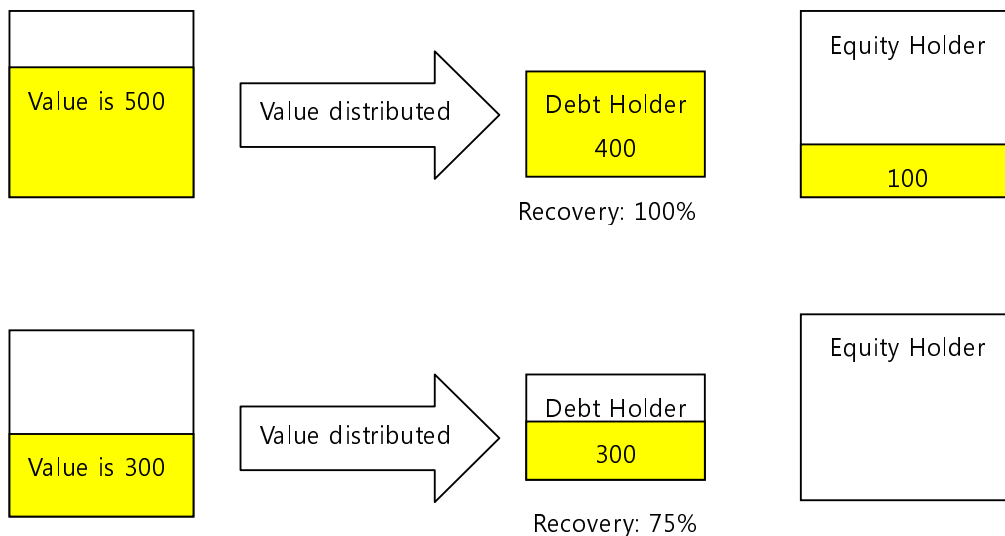


**Valuing Distressed Debt**  
**Courtesy: DDI**

Operating Value of the company (not taking into consideration cash or debt, namely capital structure)  
 +Cash (cash balance - operating cash burn - admin fees)  
 - Debt outstanding (Pre-bankruptcy loans + bonds)  
 Value of residual equity

In the case the Operating value of company, it is typically calculated by using an EV/EBITDA multiple derived from a peer comp table. Ownership of the value of a company, composed of the **1) operational value and 2) cash holdings**, is distributed on a pari-passu, or debt and equity investors are on the same footing, with the same rights. Debt holders have the first claim on the value of a company, so the equity holders are left with the residual.

The below illustration reveals the principle of "residual equity" value. The inherent value of the **1) operational value and 2) cash holdings** are essential in valuing the overall enterprise value.



The below calculation reveals the methodology for calculating the residual equity or whether there will be a fulcrum situation, or enterprise value is less than the value of outstanding debt.

<u>Value of the firm (Accuride)</u>				
	<u>Low</u>	<u>Base</u>	<u>High</u>	<u>Notes</u>
EBITDA	120	130	140	Conservative estimate; not current year if future EBITDA will fall
Multiple	5	5.5	6	Based on comps
<b>Enterprise Value</b>	<b>600</b>	<b>715</b>	<b>840</b>	<b>Value of Entire Company</b>
Cash at filing	45	45	45	Cash before filing bankruptcy
New money DIP	50	50	50	DIP Loan cash infusion
Convertible rights offering	140	140	140	Sell convertible rights to investors for cash
Redemption of Last-out TL	-75	-75	-75	Last out Term Loan; bottom tranche of term loan
Op cash gen/(burn)	-25	-10	0	Cash burn, or operating loss
Admin fees	-72	-36	-18	Pay lawyers, custodian, misc fees associated with bankruptcy
Less DIP interest	-7	-4	-2	Interest payable on the DIP Loan
<b>Net cash build/(burn)</b>	<b>56</b>	<b>110</b>	<b>140</b>	<b>Cash balance including DIP loan</b>
DIP redemption	-50	-50	-50	
<b>Cash to new entity</b>	<b>6</b>	<b>60</b>	<b>90</b>	<b>Cash Balance after paying back DIP Loan</b>
Revolver	56	56	56	Revolver loan; like a credit card
Term Loan	225	225	225	Contracted loan; like a mortgage
IRB	3	3	3	Industrial Revenue Bond
<b>Total Debt</b>	<b>284</b>	<b>284</b>	<b>284</b>	<b>Total pre-bankruptcy debt outstanding</b>
<b>Net Debt</b>	<b>278</b>	<b>224</b>	<b>194</b>	<b>Value - debt + cash, or Value - net debt</b>
<b>Implied Equity Value</b>	<b>322</b>	<b>491</b>	<b>646</b>	<b>Residual value left after paying debt for equity investors</b>

The model becomes more interesting once the total debt overshadows the enterprise value+cash balance. Then we look into analyzing which debt security has a higher seniority. Assuming the debt securities are listed in the order of their seniority, we can see the revolver will receive full recovery and the Term Loan ranges from 22% to 100% If the debt is trading at 10%, then it would be a decent bet to purchase the term loan. Yet, there may be a reason for the discount on the Term loan, where the market consensus is assuming lower EV value or a lower cash balance. Typically, it would be a lower Enterprise value.

Value of the firm (Accuride) - Residual Equity Value is zero; Fulcrum Security

	<u>Low</u>	<u>Base</u>	<u>High</u>
EBITDA	100	100	100
Multiple	1	1.5	2
<b>Enterprise Value</b>	<b>100</b>	<b>150</b>	<b>200</b>
Cash at filing	45	45	45
New money DIP	50	50	50
Convertible rights offering	140	140	140
Redemption of Last-out TL	-75	-75	-75
Op cash gen/(burn)	-25	-10	0
Admin fees	-72	-36	-18
Less DIP interest	-7	-4	-2
<b>Net cash build/(burn)</b>	<b>56</b>	<b>110</b>	<b>140</b>
DIP redemption	-50	-50	-50
<b>Cash to new entity</b>	<b>6</b>	<b>60</b>	<b>90</b>
Revolver	56	56	56
Term Loan	225	225	225
IRB	3	3	3
<b>Total Debt</b>	<b>284</b>	<b>284</b>	<b>284</b>
<b>Lost value for Debt Investors</b>	<b>-178</b>	<b>-74</b>	<b>0</b>
<b>Implied Equity Value</b>	<b>0</b>	<b>0</b>	<b>6</b>
	<b>Recovery</b>		<b>Recovery</b>
Revolver - 1st Tranche	100.00%	56	100.00%
Term Loan - 2nd Tranche	22.22%	50	68.44% <span style="color: green;">▲</span>
IRB - 3rd Tranche	0.00%	0	0.00%
<b>Total Debt</b>	<b>37.32% <span style="color: green;">▲</span></b>	<b>106</b>	<b>73.94% <span style="color: green;">▲</span></b>
		<b>210</b>	<b>100.00%</b>