Restructuring

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Understanding Financial Distress

Restructuring is a process of helping distressed companies to right-size their capital structure

Causes of Financial Distress

Excessive Debt	• **High leverage** makes it difficult to service debt, especially during downturns or when interest rates rise
Poor Cash Flow Management	• **Insufficient** revenue to cover expenses, often due to **declining sales**
Economic Downturns	• **Recessions** or market declines reduce revenues and create financial strain
Operation Inefficiencies	• **High costs**, **outdated technology**, or **poor management** erode profitability
Competitive Pressure	• Losing market share or failing to adapt to **industry changes**
Unexpected External Events	• Crises like **natural disasters**, **pandemics**, **regulatory changes**, or **geopolitical instability** can disrupt operations and cause financial strain

Types of Default

Financial Default

- Occurs when a company fails to make **scheduled debt payments** (interest or principal)
- Leads to loss of investor confidence, restricted access to credit, and potential bankruptcy

Technical Default

- Happens when a company violates **non-payment-related loan terms** (e.g., failing to meet financial ratios or misusing loan funds)
- Can trigger penalties, increased interest rates, or lenders demanding full repayment

Differences Between Investment Banks and Restructuring-Specific Banks

Economic Growth

Economic Downturns

Full-Service Investment Banks	Restructuring-Specific Banks
Focus on **growth transactions** raising capital, acquisitions, or IPOs • M&A advisory • Capital markets • Wealth management • Trading	Specialize in **distressed situations** advising on bankruptcy, debt restructuring, and distressed M&A Provide **niche expertise**: deep knowledge of distressed debt and asset valuation.

Conflicts of Interest: Traditional Banks may also be creditors to distressed companies, making it difficult to advise on restructuring

Source: RX Interview The Overview Guide

Advising Debtors vs. Creditors & The Role of Restructuring

Balancing Interests: Debtor vs. Creditor Strategies in Restructuring

Advising Debtors vs. Creditors

- **Debtors**:
  - Goal: Help company exit distress, continue operations, and retain value for shareholders
  - Tools:
    - **Selling Core Assets**:
      Offloading non-essential assets to generate cash
    - **Raising New Equity or Debt**:
      Bringing in fresh capital to stabilize finances
    - **Debt-for-Equity Swaps**:
      Exchanging debt for ownership to reduce liabilities

- **Creditors**:
  - Goal: Maximize recovery from the distressed company
  - Tools:
    - **Negotiating Repayment Schedules**:
      Adjusting payment timelines for better recovery
    - **Proposing New Collateral Structures**:
      Securing additional collateral to cover loans
    - **Forcing Sale of Assets**:
      Pressuring company to liquidate assets to pay debts

Role of the Restructuring Group in Investment Banking

Screens
- Monitor industries for distressed companies by analyzing debt levels, liquidity, and cash flow risks

Profiles
- Create detailed reports on selected companies to assess restructuring opportunities

Pitches
- Develop tailored presentations offering restructuring solutions to win mandates from companies or creditors

Live Deals
- Execute restructuring plans, update models, and manage negotiations with creditors and clients

Four Main Sources of Deal Flow

Sponsor Connection: MD leverages relationships with private equity firms to assist portfolio companies needing capital restructuring

Creditor Outreach: MDs engage with creditors of distressed companies to secure advisory mandates.

Existing Client Relationships: Companies with prior restructuring transactions return for additional advisory help (e.g., Revlon's multiple restructurings)

Proactive Screening: Team monitors industries for distressed companies, builds profiles, and initiates outreach to explore restructuring opportunities

Source: RX Interview The Overview Guide

Differences between Debt and Debt Covenants

Debt waterfall defines repayment priority, terms such as pricing, security and maturity and covenant restrictions

Differences between Types of Debt

Revolver
- Drawable and payable at any time
- Pricing Grid based on credit/leverage/usage
- Mainly used for short-term liquidity

Term Loans
- Term Loan A, B, C (Different investors)
- Priced with SOFR + Applicable margin
- Single draw at closing, bullet payment at maturity

Unsecured Debt
- No asset-backed collateral
- Bonds: Fixed interest + Publicly traded
- Loans: Fixed interest (higher) + Private (flexibility)

Subordinate Debt
- Structurally lower than unsecured and secured
- Still has features of bonds
- Higher interest rate for compensation

Mezzanine Debt
- Lowest form of debt in the cap-structure
- Equity components or no cash interest
- Ex. Preferred, PIK, Convertibles

Equity/Common Stock
- Traded on stock market
- Most cases gets nothing in RX
- Lowest on cap-structure

Types of Covenants

Affirmative	Negative	Financial
Specify things borrower of debt must routinely do	**Specify things borrower of debt cannot do**	**Specify things borrower of debt must adhere to**
Financial reporting	Change of Control	Total Debt / EBITDA
Maintain Corporate Existence	Additional debt	Interest Coverage Ratio (EBITDA / Interest)
Payment of Taxes	Acquisitions	EBITDA - CapEx / Interest Expense
Maintain properties and insurance	Restricted Payments	Senior Debt / EBITDA
Compliant with laws	Additional liens	Total Debt / Total Cap
	Asset Sale Proceeds	CapEx Limitations
	Sale / Leaseback	
	Affiliate transactions	
	Lines of Business	

Source: RX Interview The Overview Guide

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Absolute Priority Rule, Different Types of Guarantees, and Example

Understanding the rule of debt recovery and how guarantees could alter seniority of debts

The Absolute Priority Rule & Guarantees

- **Absolute Priority Rule**: part of Chapter 11, requires creditors with higher priority claims to be paid in full before creditors with lower priority claims can receive any payment
- **Guarantee:** a legal commitment by a third party (the guarantor) to pay back the debt if the original debtor fails to do so

Upstream Guarantee

Downstream Guarantee

Cross Guarantee

Guarantees & Creditor Seniority

- Elevates creditors with guarantees to secured/senior status
- Potentially subordinates other creditors

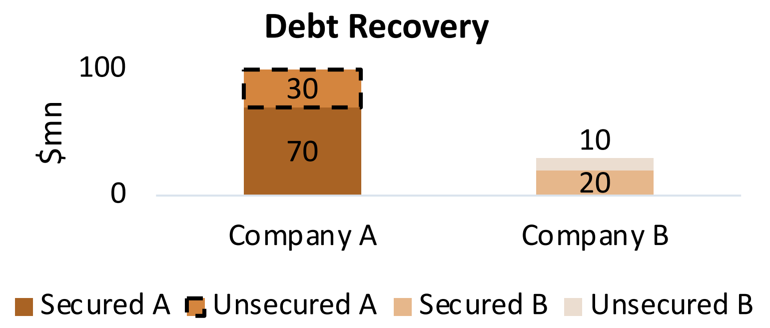
Impact on Recovery: positive for guaranteed creditors, negative for other creditors

Case: Assets & Debt Structure

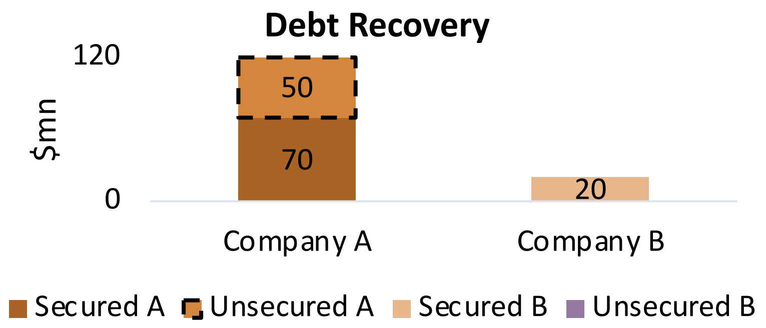
Company A	Company B
• $100mn **Assets** • $70mn **Senior Secured** • $50mn **Unsecured** (upstream guarantee from Company B)	• $40mn **Assets** • $20mn **Senior Secured** • $10mn **Unsecured**

Fulcrum Security

Without Guarantee



With Guarantee



Guarantee increases recovery for Company A's unsecured creditors ($30mn → $50mn, 60% →100%)

Source: Investopedia

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Valuation Methods for a Distressed Company

Why common general valuation methods don't usually work, and some alternative methods used in valuing firms in distress

Common General Valuation Methods

Regular DCF

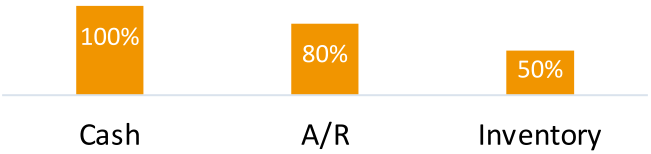
- Would not work as the likelihood of distress is high, access to capital is constrained, and distress sale proceeds are significantly lower than going concern values

Multiples:

- Often uses Revenue & (Adjusted) EBITDA multiples
- Can only choose distressed firms as comparable firms → would only work if there is a large number of distressed firms

Asset-Based Approach (Liquidation Value)

- Considers the break-up value of the company's assets
- Assumes a forced sale within a short timeframe
- Worst-case scenario in which the company is unable to continue operating as a going concern
- Typically, different asset classes are valued independently:



PP&E: Land and building market values, equipment close to book

Intangible Assets: case-by-case

Modified Discounted Cash Flow Method

$$\text{Expected Cashflow}_i = \text{Cash Flow}_i \times \left(1 - \text{Probability of Distress}_i\right)$$

Cost of Equity	• Uses levered beta
Cost of Debt	• Uses expected instead of promised cash flow • Lower than YTM
Weights	• Current weight for 1st year, adjust debt levels to healthier levels afterwards

DCF Alternative

$$\text{Value of Equity} = \text{Going Concern DCF} \times \left(1 - \text{Probability of Distress}\right) + \text{Probability of Distress} \times \text{Distress Sale Proceeds}$$

Going Concern DCF:
- Considers only scenarios where the firm survives
- Expected cash flow higher than in modified DCF

Probability of Distress:
- Cumulative over the valuation period
- 3 ways to estimate:
1) Statistical approach,
2) Bond ratings, 3) Bond Price

Distress Sale Proceeds:
- Same as the asset-based approach

Source: NYU Stern, Chicago Booth

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Out-of-Court Restructuring

Debt restructuring strategies without judicial involvement to reduce costs and increase flexibility

Alternative Goals in Out-of-Court Restructuring

Reducing Leverage

Exchange Offer
Swap old debt for new/ better terms

Buying Back Debt
Repurchase debt at a discount

Open Market Purchase
Buy debt directly from the open market

Increasing Liquidity

Asset Sale Leaseback
Sell assets and lease them back to free up cash while retaining operational use

Fraudulent Conveyance
Debtors may be accused of intentionally selling assets to avoid repayment

Pushing Back Maturity

Amend & Extend
Renegotiate debt terms to extend maturity dates, delaying payment obligations

Covenant Default
Address leverage ratio test or remove covenant temporarily

Liability Management

Drop-Down
Transfer assets to a new subsidiary

Up-Tier
Prioritize certain debt obligations by moving them to a higher repayment tier

Double Dip
Structure debt to secure claims

Cost and Benefits in Out-of-Court Restructuring

Avoidance of costly court fees

Not time consuming

Confidentiality

Consensus required

Lack of automatic stay

Limited scope

Holdout Problem – Prisoner's Dilemma
A single creditor could object, extend the duration of negotiations, and force the company to file for bankruptcy as the company is required to receive each creditor's approval before proceeding

Solution to the holdout problem

1. Moral Coercion
2. Coercive structural devices like stripping covenant protections for non-tendering bonds

Source: Moyer's Guide; Restructurinterviews.com

In-Court Restructuring

Judicial restructuring processes including Chapter 7 liquidation and Chapter 11 reorganization

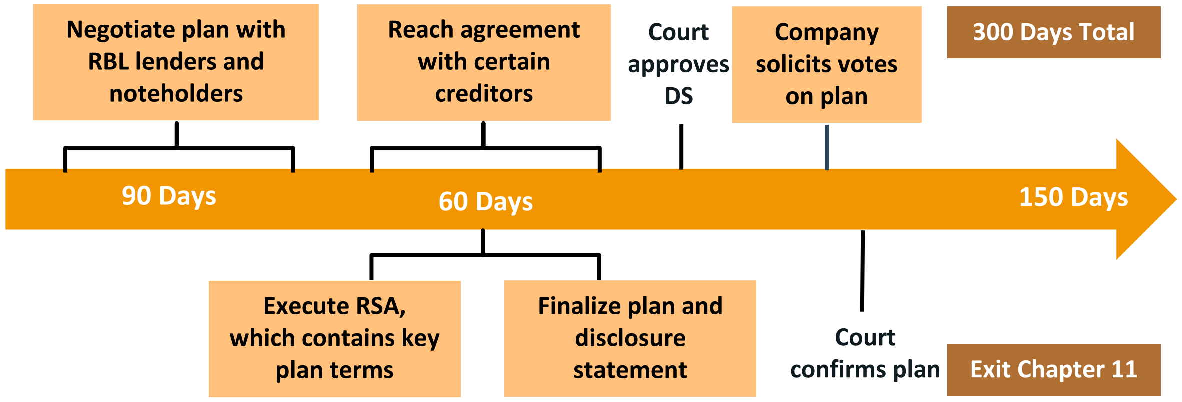
Overview of In-Court Restructuring

	Chapter 7	Chapter 11
Purpose	Liquidation	Reorganization
Unsecured Debt	Eliminated	Reorganized and paid back over time
Secured Debt	Nonexempt assets sold off	Restructured and paid back over time
Time	4-6 months	6 months – 2 years
Control	Appointed trustee	Debtor-in-Possession

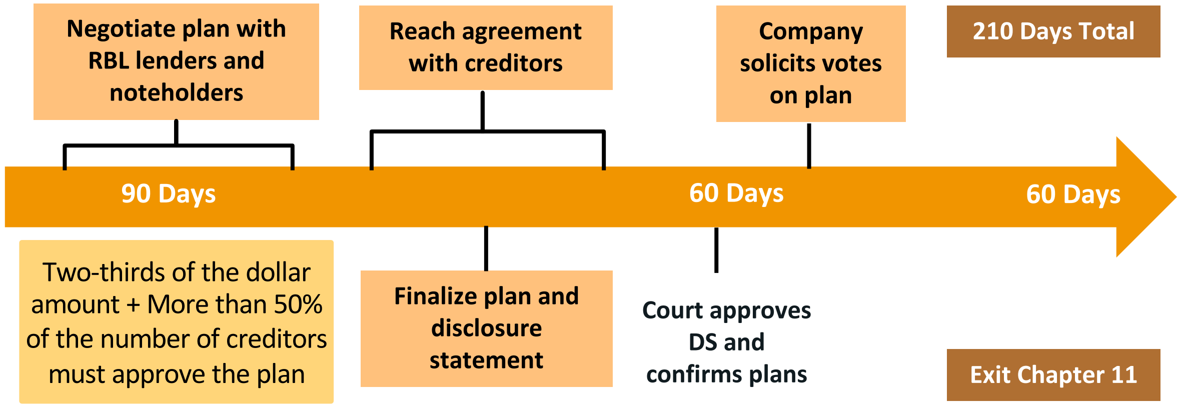
Chapter 11 Benefits

- Automatic Stay
- DIP Financing
- No Fraudulent Transfer
- Stalking Horse Break-Up Fee

Pre-Arranged Chapter 11



Pre-Packed Chapter 11



Free-Fall Chapter 11

No Pre-Negotiation
Begins without any creditor agreements in place

Increased Court Involvement
Court becomes more significant in arbitrating disputes between debtors and creditors

Cramdown Option
Can approve POR over the objection of dissenting creditors

Extended Timeline
Court-supervised negotiation typically takes longer time, 1.5 – 5 years

Source: Moyer's Guide; Restructurinterviews.com

Amend-Extend Case: ATI Physical

Debtors seek to extend maturity dates for secured debt, compensating creditors through increasing interest and additional terms

Background information

- **ATI Physical Therapy**, a provider of outpatient physical therapy services has cap structure consisted of:

  $555mn first lien term loan (1L TL) + **Undrawn revolver**
- Both due in 2023, so they needed to figure out how to refinance them

(USD $ in millions)	Amount
Liquidity	
RCF Commitments	$70.0
Less: Borrowings	-
Less: Letters of Credit	(1.2)
RCF Availability	$68.8
Plus: Cash and Equivalents	66.1
Total Liquidity	**$134.9**
Leverage	
Total Secured Debt	$557.10
EBITDA (LTM from 9/30/21)	$80.90
EBITDA (2021A)	$39.80
Leverage Ratio (LTM)	**7x**
Leverage Ratio (2021A)	**14x**

Restructuring Solution

New Capital Structure:
- **New Term Loan (TL)**: Issued at a **higher interest rate** and maturity extended to 2028.
- **New Revolver**: Also maturing in 2027, with enhanced terms.
- **Preferred Stock**: Issued **$165mn in perpetual preferred stock** with a 12% PIK dividend.

Interest Rates:
- **Grid Pricing**: New TL priced at **SOFR + 675-725 bps**; flexes based on leverage.
- **PIK Option**: In the first year, ATI can elect to pay **12% interest in PIK**, increasing the overall rate by **0.50%**.

Liquidity Buffer (Financial Maintenance Covenant):
- Maintained **$30mn liquidity buffer** (cash + revolver availability) through March 2024 to avoid bankruptcy risk.
- To be replaced by more traditional maintenance covenant starting with 7x secured leverage ratio, but to step-down overtime to 6.25x by March 2025 (Common for distressed companies)

Advisors
- **ATI Physical :** Evercore
- **1L TL lenders:** PJT Advisors

Source: RX Interview The Overview Guide

Amend-Extend Case: ATI Physical

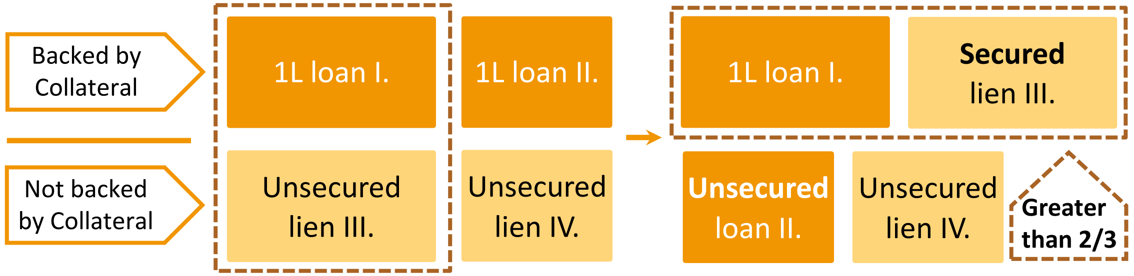
	9/30/2021		12/31/2021		Pro			EBITDA Multiple		Cash Interest	
(USD $ in million)	Amount	Adj.	Est. Amounts	Adj.	Forma	Maturity	Rate	2021A	PF	2021A	PF
Priority Secured Debt											
New $50mn Payment Priority Revolving Credit Facility due 2027	$0.0		$0.0		$0.0	2/23/2027	SOFR+350-450			$0.0	$0.0
Total Priority Secured Debt	**$0.0**		**$0.0**		**$0.0**						
Secured Debt											
$70mn Revolving Credit Facility due 2023	-	-	-	-	-	5/10/2023	L+400-450			-	-
First Lien Term Loan due 2023	557.1	(2.0)	555.0	(555.0)	-	5/10/2023	L+350			25.0	-
New $500mn Term Loan due 2028				500.0	500.0	2/23/2028	SOFR+675-725			-	41.3
Total Secured Debt	**$557.1**		**$555.0**		**$500.0**			**14.0x**	**12.6x**		
Total Debt	**$557.1**		**$555.0**		**$500.0**			**14.0x**	**12.6x**		
Less: Cash and Equivalents	(66.1)	17.5	(48.6)	(77.0)	(125.6)						
Net Debt	**$491.0**		**$506.4**		**$374.4**			**12.7x**	**9.4x**		
Cash/PIK 12% Series A Perpetual Preferred Stock	-	-	-		165.0		12%				19.8
Total Preferred Stock	**$-**		**$-**		**$165.0**			**12.7x**	**13.6x**	**$25.0**	**$61.1**
Net Debt + Preferred Stock	**$491.0**		**$506.4**		**$539.4**			**12.7x**	**13.6x**		
LTM Company Adj. EBITDA	$80.9		$39.8		$39.8						
Liquidity											
RCF Commitments	$70.0		$21.0		$50.0						
Less: Borrowings	-		-		-						
Less: Letters of Credit	(1.2)		(1.2)		(1.2)						
RCF Availability	$68.8		$19.8		$48.8						
Plus: Cash and Equivalents	66.1		48.6		125.6						
Total Liquidity	**$134.9**		**$68.4**		**$174.4**						

Liability Management

Creative out-of-court strategies for company to enhance liquidity distressed and challenging financial conditions

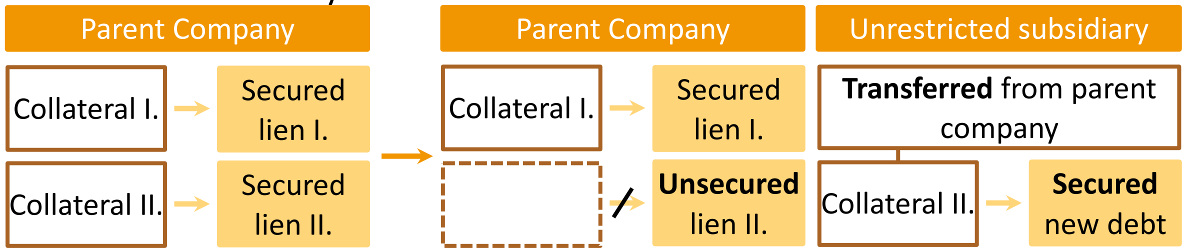
Uptier Transactions

- Borrower teams up with **a majority of (greater than 2/3)** its financial creditors and amends the existing financing agreements to permit the issuance of new senior priming debt



Drop-down Transactions

- Borrower uses basket capacity under existing investment and restricted payment covenants to move collateral from restricted entities to an "unrestricted subsidiary“ in order to issue new debt, often secured by the transferred assets



Debtor-in-Possession (DIP) Financing

- Debtor-in-possession (DIP) financing allows companies that have filed for bankruptcy protection under Chapter 11 to borrow capital to restructure and continue trading. DIP loans usually have priority over existing debt, equity, and other claims

Feasibility: The debtor must prove that their company will be able to raise enough revenue to cover expenses

Fair and Equitable: Secured creditors must be paid the value of their collateral. The debtor is unable to retain any equity interest until obligations are paid in full

Good Faith: The reorganization plan must follow the law

Best Interest of Creditors: In the case of “best interest,” the debtor must pay the creditor as much as they would if the plan were converted to a Chapter 7 liquidation

Double-DIP Components	
	New Debt: A new secured debt issuance out of a non-guarantor entity
	First Dip: An intercompany loan by the new money borrower to the existing credit group, secured paripassu on existing credit group assets
	Second Dip: A guarantee of the new-money by the existing credit group assets

Source: Investopedia, Dechert LLP, CFI

Deal Walkthrough: Spirit Airlines "Triple DIP"

First example of triple DIP financing in corporate restructuring

Background Information

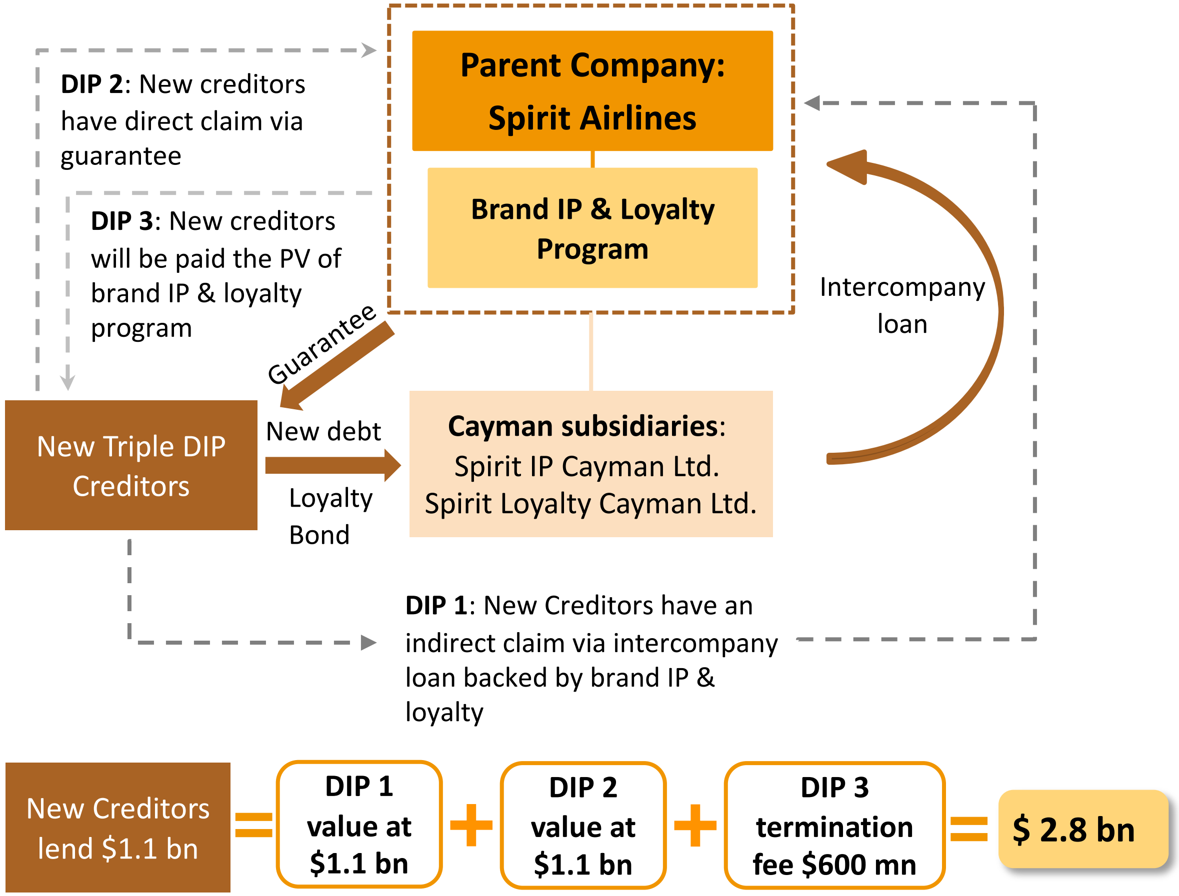
- Spirit Airlines' restructuring deal arises from its blocked merger with JetBlue and ongoing cash burn, which have pushed the ultra-low-cost carrier towards a liquidity crisis. Spirit faces over $1.1 billion in debt maturities due in 2025
- A key element of the restructuring focuses on Spirit's **8% secured notes**, which are backed by the company's loyalty program and brand IP
- Akin Gump and Evercore introduced a "triple dip" recovery strategy

Triple DIP

First DIP	**Intercompany Loan**: Bondholders claim access to the $1.1 billion intercompany loan made from the Cayman subsidiaries
Second DIP	**Parent Guarantee**: Spirit Airlines parent provided a guarantee for the bonds issued by the Cayman subsidiaries. In bankruptcy, bondholders assert that they should be able to tap into this guarantee for recovery
Third DIP	**Termination Damages from Brand IP License**: If Spirit terminates the licensing agreement for its brand and loyalty program (due to bankruptcy or other events), bondholders are entitled to damages equivalent to the present value of future license payments

Source: CreditSights

Deal Structure



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Pre and Post Transaction (Hypothetical) Capital Structure

	Pre-Transaction Capital Structure	Post-Transaction Capital Structure (Hypothetical) – Scenario 1: Restructuring and debt reorganization	Post-Transaction Capital Structure (Hypothetical) – Scenario 2: Liquidation
Secured Debt	8% Secured Debt – **$1.1 bn** backed by brand IP & loyalty program Other secured Debt – Aircraft financing or asset-backed loans	Remaining 8% Secured Debt – After partial conversion to equity **$1.1 bn** Loyalty Bond; **$1.1 bn** Interco Loan; **$600 mn** Termination Damage — $2.8 bn claim	Secured creditors paid first
Unsecured Debt	Convertible Notes – **$500 mn** issued in 2021	Convertible Notes – May stay unchanged	Unsecured creditors paid second
Equity & Assets	Common Shareholder; $850 mn unencumbered hard assets; $1 bn Cash	Existing shareholder + converted; $850 mn unencumbered hard assets; $1 bn Cash	Equity holders would likely be wiped out

Source: CreditSights

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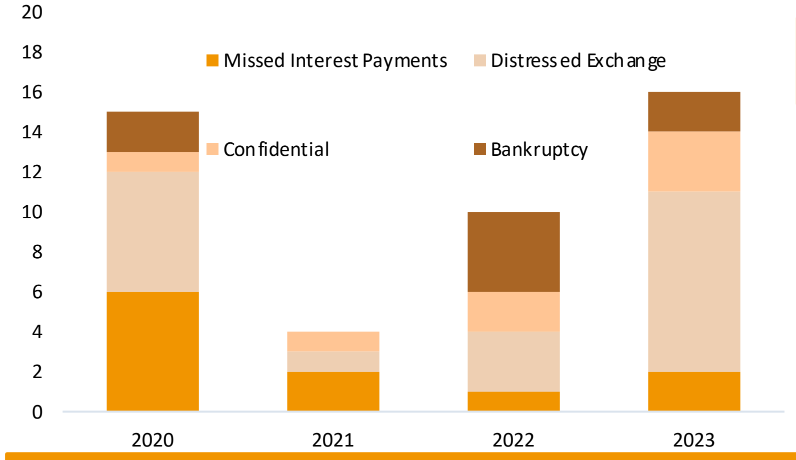
Current Outlook in Restructuring

Rising defaults and restrictive debt terms drive sector-specific bankruptcies

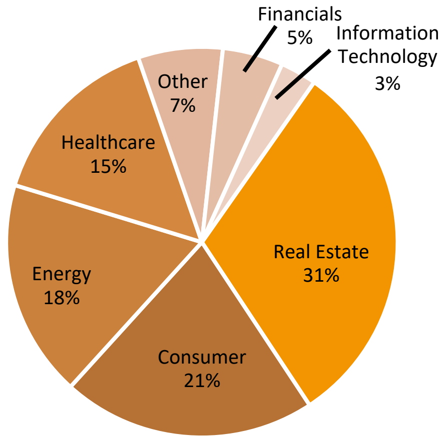
Global Corporate Defaults by Type Since 2020

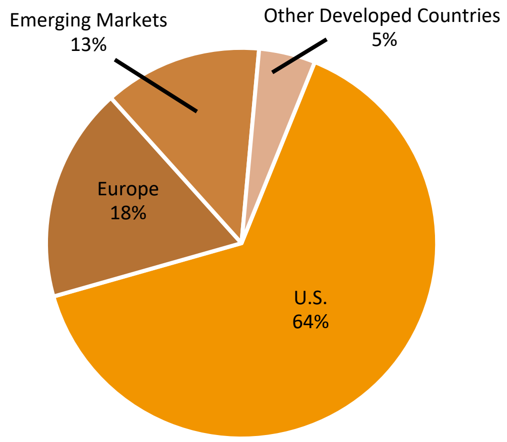


Liability management's popularity leads to repeat transactions

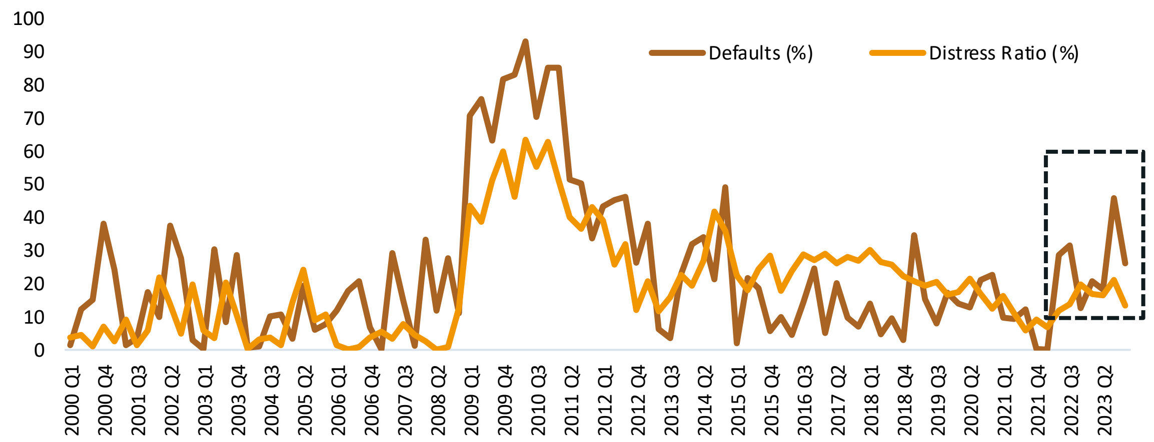
Companies are being required to accept increasingly restrictive debt documents

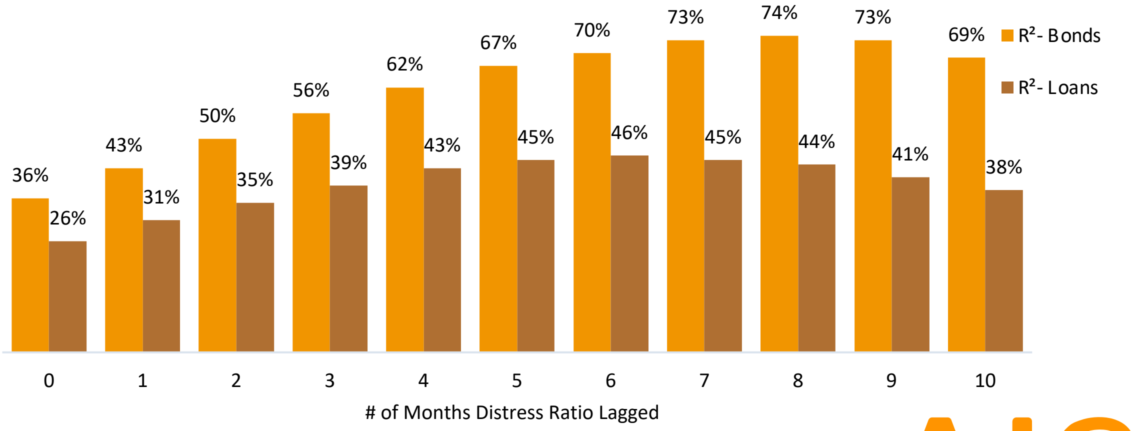
Restructuring Activities in 2023





Disconnection Between Distressed Debt Levels and Default Activities





Source: Guggenheim; FTI Consulting;PWC

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Q&A

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