

Deaths-R-Us

Deaths-R-Us is struggling with too much debt and a weaker market. It expects a turnaround in a couple of years, **but now must work out the amount of debt it can carry.**

Based on last year's performance, management estimates EBIT at 24 m
 Discussions with the banks show that in order to avoid violating covenants
 a minimum EBIT interest coverage ratio of 2.6 must be maintained
 The company expects growth of 3.50% and pays taxes of 32%
 Currently US treasurys pay 6.5%
 It currently has debt of 150 m of which 30 m comes due next year
 What is the company's debt capacity?
 What is the company's debt capacity if it must repay 20% of its debt every year?

Estimating borrowing capacity

Given:

EBIT	\$ 24
Min EBIT int coverage ratio	2.6
Interest capacity	\$ 9.2
Interest rate	11.25%
Debt capacity	\$ 82
Available to repay next year	\$ 10.6
Revised debt capacity	\$ 53

EBIT/Cov. ratio

From table

Int Cap./rate

For smaller and riskier firms

If interest coverage ratio is

>	≤	Rating is	Spread is	
-100000	0.499999	D	14.00%	
	0.5	0.799999	C	12.70%
	0.8	1.249999	CC	11.50%
	1.25	1.499999	CCC	10.00%
	1.5	1.999999	B-	8.00%
	2	2.499999	B	6.50%
	2.5	2.999999	B+	4.75%
	3	3.499999	BB	3.50%
	3.5	4.499999	BBB	2.25%
	4.5	5.999999	A-	2.00%
	6	7.499999	A	1.80%
	7.5	9.499999	A+	1.50%
	9.5	12.5	AA	1.00%
	12.5	100000	AAA	0.75%

Deaths-R-Us Vol. 2

Deaths-R-Us is struggling with too much debt. It expects to resume a growth rate of 7% soon, **but now must renegotiate its capital structure**

Based on last year's performance, management estimates EBIT at 24 m
 Discussions with the banks show that in order to extend credit, they insist on
 a minimum EBIT interest coverage ratio of 2.6
 Currently US treasuries pay 6.5% Cost 16.5
 The company has ten-year debt of 150 m paying 11.0% Coverage ratio:
 The enterprise is estimated to be worth 6 x EBIT 1.45
 What is the debt worth?
 What is the company's debt capacity?
 What new capital structure could be negotiated with the banks?
 As an acquirer, how much would you be willing to pay for this company?

Estimating borrowing capacity

Given:
 EBIT 24
 Min EBIT int coverage ratio 2.6
 Interest capacity \$ 9.2
 Interest rate 11.25%
 Debt capacity \$ 82

Possible capital structure

	Before	After
Enterprise value	144	144
Debt	150	82
Equity	-6	62
Total financing	144	144
Pre-restr debt value:		\$111
Banks happy? with	Debt	82
	Equity	40
	Value	122

For smaller and riskier firms

If EBIT interest coverage ratio is

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2.5	2.999999	B+	4.75%
3	3.499999	BB	3.50%
3.5	4.499999	BBB	2.25%
4.5	5.999999	A-	2.00%
6	7.499999	A	1.80%
7.5	9.499999	A+	1.50%
9.5	12.5	AA	1.00%
12.5	100000	AAA	0.75%