SRVP DEALSIGHT™

CARVANA
DEBT RESTRUCTURING

AUGUST 3, 2023

SRV PARTNERS

CARVANA DEBT RESTRUCTURING

OVERVIEW

Last month, markets reacted favorably to the announcement of Carvana's consensual debt restructuring. Last week, Carvana delivered a crucial component of the deal by raising the required amount of equity via an at-the-market offering. On August 2, 2023, Carvana launched the exchange and tender offers that are a part of the overall transaction.

In this inaugural issue of SRVP DEALSIGHT™, we will examine various aspects of the Carvana debt restructuring transaction.

The deal consists of the following components:

- **Carvana will execute an "uptier exchange," swapping $5.225 billion of senior *unsecured* notes into three tranches of secured take-back notes with extended maturities and a combined face value of $4.275 billion (82% exchange rate; 13% premium to market price);**[1]
- **Carvana must tender in cash for $500 million of unsecured notes due 2025 agreeing to pay $425 million (85% exchange rate; 3% discount to market price);**
- **Carvana needed to raise no less than $350 million through a new equity offering — otherwise the noteholders had a right to terminate the transaction (this component of the transaction has been essentially fulfilled); and**
- **Unless Carvana had raised $700 million (or more) through the new equity offering, up to $126 million in new equity proceeds would have had to come from the Garcia parties.**

The proposed transaction demonstrates creditors' support of Carvana's recovery efforts. Indeed, the company has been able to improve its performance, achieving a positive EBITDA of $131 million in the first half of 2023 after a dismal 2022 (a negative EBITDA of $1 billion).

The new debt structure, which features paid-in-kind (PIK) interest during the first two years (second year with a cash toggle on two of the three tranches of the new debt), eliminates approximately $420 million in interest payments per year (for the next two years with year 2 PIK).

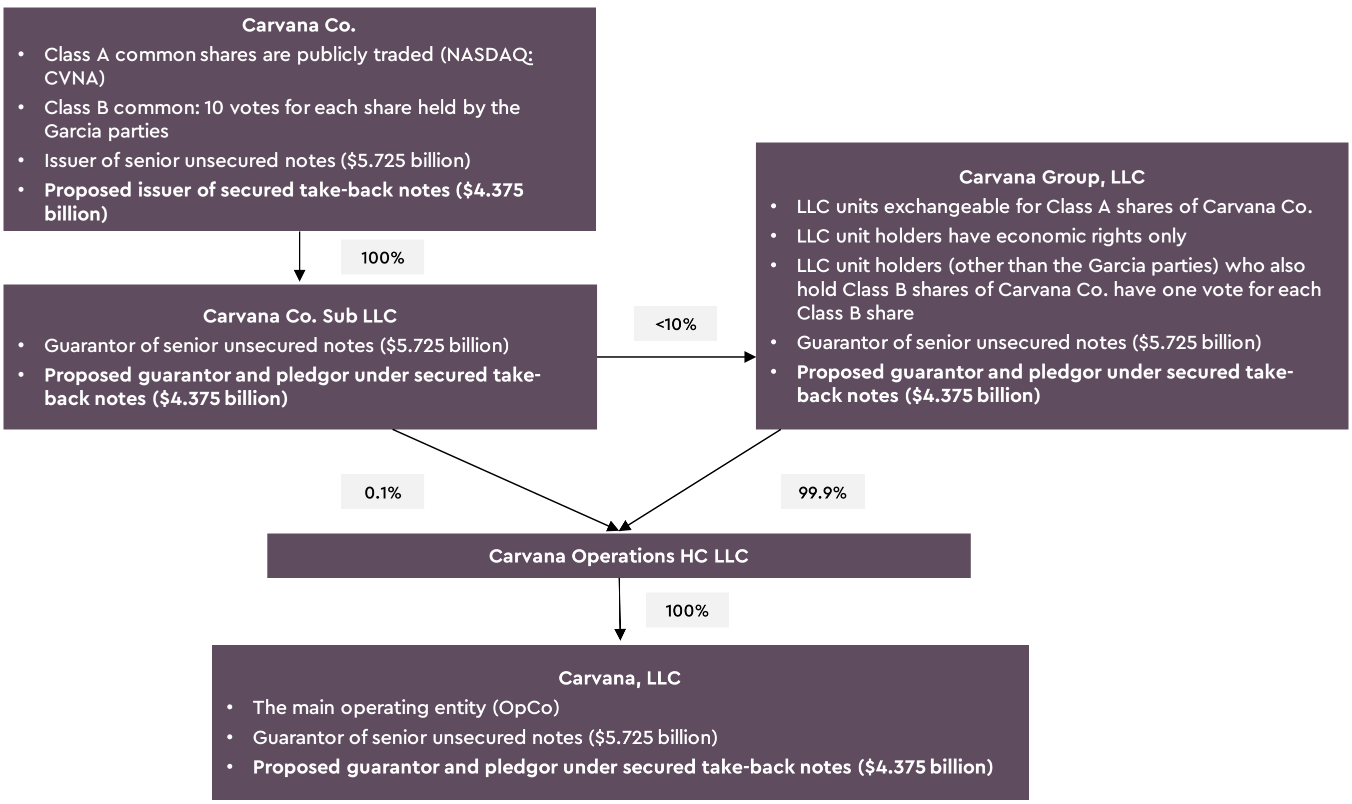
Some could argue that the restructuring does not de-lever Carvana's balance sheet enough, and that there is a high risk of Carvana not being able to generate sufficient cash flows (more than double its 1H2023 annualized EBITDA) before the $473 million in annual cash interest on the secured take-back notes becomes payable in year 3.

We think that in a potential near-term in-court restructuring, the unsecured noteholders would have fared much worse. In our view, the option being acquired by the noteholders, especially given the uptier and the high PIK interest rate, is well worth the reduction of the face value of the debt.

At the same time, the transaction comes at a price for the company. In two years (assuming year 2 PIK), the accrued interest on the take-back notes will increase the balance to $5.6 billion. In the near term, we estimate that the transaction will have a negative impact of $105 million on the company's cash due primarily to the 2025 notes tender.

CARVANA DEBT RESTRUCTURING
UPTIER EXCHANGE

To illustrate how much the exchanging noteholders stand to improve their position, we take a closer look at Carvana's corporate structure:



First, and the most obvious benefit, the participating noteholders will get ahead of the general unsecured creditors of Carvana, LLC (the OpCo).

As part of the deal, the new holders of the secured take-back notes will get a second lien on the senior lender's collateral and a first lien on all other assets of the OpCo, the issuer, and other grantors.

As of June 30, 2023, Carvana reported approximately $890 million in accounts payable and other non-funded obligations. The holders of these unsecured claims (previously *pari passu* with the unsecured noteholders via the OpCo guarantee) will find themselves behind $4.38 billion of the newly issued *secured* debt.

Second, through the PIK feature, the holders of the secured take-back notes will have a substantial claim in two years (when the company must begin making cash interest payments).

The following chart shows balances due on the secured take-back notes assuming no cash toggle in year 2 and simple annual interest accrual ($ in millions):

Take-Back Secured Notes Principal Balance – PIK Scenario

	Yr. 1			Yr. 2	
	Beginning Balance	PIK Interest Rate	Ending Balance	PIK Interest Rate	Ending Balance
2028 Secured Notes	1,000	12%	1,120	12%	1,254
2030 Secured Notes	1,500	13%	1,695	13%	1,915
2031 Secured Notes	1,876	14%	2,139	14%	2,438
Total	**$4,376**		**$4,954**		**$5,608**

Even if the company elects the cash toggle in year 2, the total outstanding balance on the secured take-back notes will still exceed $5 billion ($ in millions):

Yr. 2 Cash Toggle Scenario & Yr. 3 Cash Interest

	Yr. 2				Yr. 3	
	Beginning Balance	Cash Interest Rate	Cash Interest Payment	Ending Balance	Cash Interest Rate	Cash Interest Payment
2028 Secured Notes	1,120	9%	101	1,120	9%	101
2030 Secured Notes	1,695	11%	186	1,695	9%	153
2031 Secured Notes	2,139	n/a	n/a	2,438	9%	219
Total	**$4,954**		**$287**	**$5,253**		**$473**

Notably, there is no cash toggle option on the largest tranche (the 2031 secured notes), and that tranche also carries the highest PIK interest rate of 14%.

If an in-court restructuring cannot be avoided in two years, the holders of the secured take-back notes will have a secured claim against Carvana ranging between $5.25 and $5.61 billion. This will not only place them in the fulcrum position (which is where they would have been without the uptier exchange), but also make available to them a partial roll-up, cross-collateralization, and other useful tools widely used by prepetition secured lenders in chapter 11 cases.

CARVANA DEBT RESTRUCTURING

CASH IMPACT

Initially, the exact impact of the proposed transaction on Carvana's cash position was difficult to ascertain due to a wide swing of the expected at-the-market equity raise.

On July 27, 2023, Carvana reported that it had raised $225 million in the equity market. Together with the contracted $126 million Garcia backstop (to be funded within 20 days of the commencement of the uptier exchange), the company will achieve the requisite $350 million. Failure to reach this threshold would have given the noteholders the right to back out of the exchange.

The following is our estimate of the sources and uses of the entire transaction ($ in millions):

	Sources	Uses
Cash on Hand (as of 6/30/2023)	541	
Equity Proceeds (Public)	225	
Equity Proceeds (Garcias)	126	
Equity Underwriters' Fees (7%)		(16)
Tender for 2025 Notes		(425)
Transaction Fees (Estimated)		(15)
Total Sources & Uses	**$892**	**($456)**
Cash Position post-Transaction	**$436**	
Net Cash Increase/(Decrease)	**($105)**	

Carvana announced that it had suspended the at-the-market program (likely to avoid further underwriters' fees), stating that the company's liquidity position is strong.

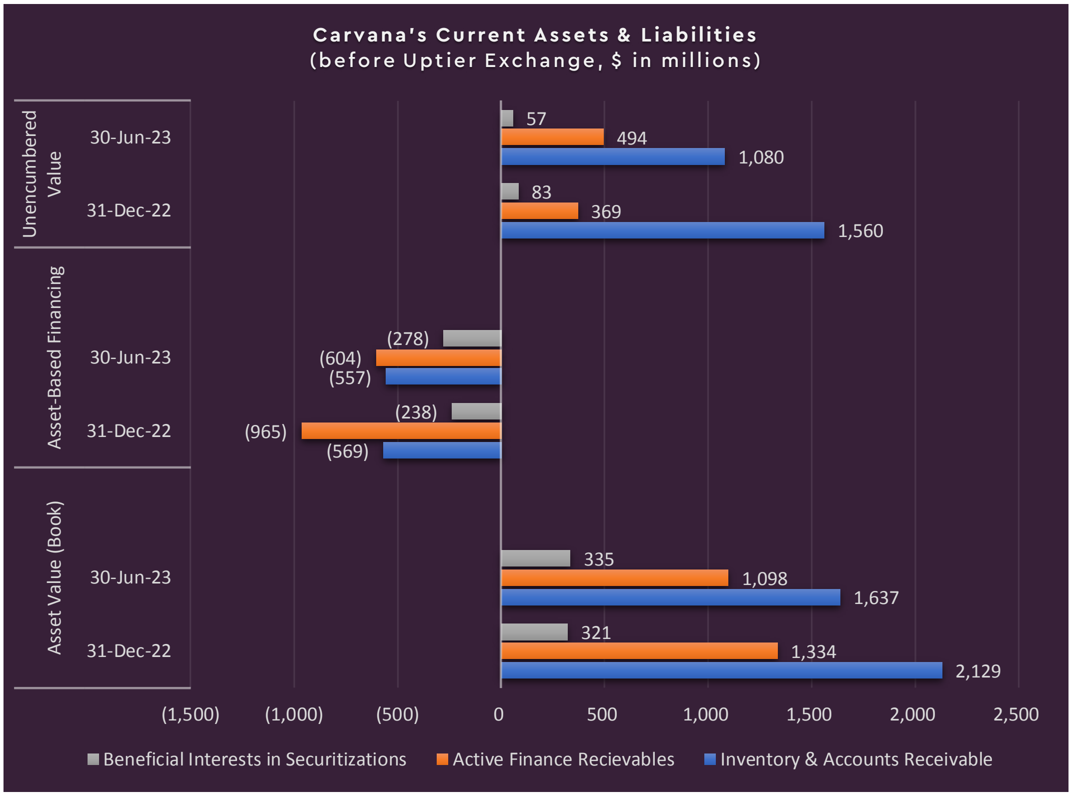
We must defer to the company's business judgement. Although some commentators would argue that boards should strike while the iron is hot (as it has been for Carvana since it announced the transaction), we suspect that the company decided to refrain from further diluting the existing equity base.

CARVANA DEBT RESTRUCTURING

LIKELY ALTERNATIVE

To demonstrate the benefit of the uptier exchange and related transactions, we will discuss the most likely alternative. Carvana would have had difficulty meeting its interest obligations, which would likely have led to an in-court chapter 11 restructuring. Here, we examine the main sources of recovery to unsecured creditors in what is now a hypothetical, but previously very likely, scenario.

In chapter 11, plan value would have been dictated by Carvana's reorganized enterprise value based on long-term projections. Here, we assume a hypothetical distressed sale in chapter 11. We focus primarily on Carvana's current assets because (a) they would have been the primary sources of creditor recovery, and (b) they offer the best insights into Carvana's business.



Aside from cash, Carvana's current assets consist of three main categories:

1. Inventory and Accounts Receivable

These assets, totaling $1.64 billion as of June 30, 2023 ($1.3 billion in inventory and $335 million in accounts receivable), are pledged as collateral under a $2 billion "floor plan" facility with Ally Bank. As of the end of Q2 2023, Carvana had $557 million outstanding and approximately $1.4 billion available under this facility.

During the first half of 2023, Carvana was able to reduce this category by nearly $500 million, while keeping the borrowings under the floor plan facility essentially flat. This is a highly positive development.

Under the terms of the floor plan facility, outstanding balances related to vehicles held in inventory for more than 150 days require monthly principal payments equal to 10% of the original principal amount of that vehicle until the remaining outstanding balance is equal to the lesser of (i) 50% of the original principal amount or (ii) 50% of the wholesale value.

The fact that after selling off $500 million of inventory the borrowings under the floor plan facility remained unchanged suggests that Carvana was able to offload primarily older inventory. To the extent that new, more financeable inventory was acquired, the inventory turnover helped to free up working capital (consistent with a $100 million increase in cash during the first half of 2023).

At the same time, Carvana maintains "only" a little over $1 billion of equity in this asset class. Although that is not an insubstantial amount, marketability of the vehicles constituting most of this asset class would have been key to generating a meaningful recovery in a hypothetical chapter 11 sale.

2. Active Finance Receivables

This asset ($1.1 billion as of June 30, 2023) represents auto loans made by Carvana to its retail customers before such loans are sold to a third-party purchaser or into securitization vehicles. Carvana holds these finance receivables in bankruptcy-remote special-purpose entities (SPEs). These receivables are encumbered by several financing facilities with various lenders (not easily identifiable in the company's recent public filings), with approximately $600 million outstanding. Carvana holds approximately $500 million of equity in those SPEs.

The ability to sell finance receivable is key to minimizing exposure to borrowers' defaults. To that end, arvana also largely depends on Ally Bank. Ally has committed to purchasing up to $4 billion of finance receivables from Carvana. As of June 30, 2023, the purchase facility had $2.3 billion of unused capacity. It matures in January 2024.

Unsold finance receivables are likely performing due to their early life cycle. Accordingly, Carvana's equity in these receivables would likely have been a source of recovery in a hypothetical chapter 11 sale.

3. Beneficial Interests in Securitizations

Carvana also sells finance receivables into securitization trusts, in which it maintains a first-loss position. Carvana reports the value of such beneficial interests as marked-to-market. Net of encumbrances, Carvana's equity in these assets was $57 million as of June 30, 2023.

Carvana relies on nonbinding broker quotes to determine market value of the beneficial interests in securitizations. Needless to say, these valuations are highly suspect due to the risk associated with borrowers' defaults on used car financing. Therefore, this asset class would be an unlikely source of recovery in a hypothetical distressed sale.

Other Assets

In addition, Carvana reported approximately 2 billion in unencumbered real estate assets. The market value of such a substantial, and highly specialized, real estate portfolio is hard to estimate. Suffice it to say that in a distressed scenario, Carvana's real estate would likely be valued at a deep discount to its reported book value.

Hypothetical Unsecured Creditor Recoveries

The following chart summarizes our best illustrative estimate of unsecured creditor recoveries in a hypothetical chapter 11 sale, with a midpoint being the most likely outcome. All book values are shown net of first-lien encumbrances. Non-restructuring administrative expenses are assumed to be covered by operating cash flows ($ in millions):

		Low Estimate		Midpoint		High Estimate	
	Unencumbered Book Value	Recovery	% of Book	Recovery	% of Book	Recovery	% of Book
Cash	541	541	100%	541	100%	541	100%
Inventory & Accounts Receivable	1,000	750	75%	850	85%	950	95%
Active Finance Recievables	500	250	50%	325	65%	375	75%
Beneficial Interests in Securitizations	57	0	0%	6	10%	14	25%
Real Estate	2,000	1,000	50%	1,200	60%	1,400	70%
Total	**$4,098**	**$2,541**		**$2,922**		**$3,280**	
Restructuring Fees		**($100)**		**($100)**		**($100)**	
Total Available to Unsecured Creditors		**$2,441**		**$2,822**		**$3,180**	
Senior Unsecured Notes (at par)		5,725		5,725		5,725	
Trade and Other General Unsecured Claims		900		900		900	
Total		**$6,625**		**$6,625**		**$6,625**	
Unsecured Creditor Recovery		**37%**		**43%**		**48%**	

As evident from the above, in a likely alternative to the uptier exchange, the unsecured noteholders would likely have to settle for less than 50% recovery. Importantly, their claims will have to share in that recovery with general unsecured creditors.

CARVANA DEBT RESTRUCTURING

TAKEAWAY

Clearly, the noteholders believed that, unlike the cars that it sells, Carvana is worth more as a whole than as the sum of its parts. Once the uptier exchange is completed, the holders of the take-back secured notes will likely be undercollateralized, but that did not prevent (nor should it have prevented) them from agreeing to the exchange.

The proposed transaction has been lauded as the next chapter in the world of corporate reorganizations, a solution to creditor-on-creditor violence and many other ills plaguing today's restructuring. We are not convinced that is the case because Carvana differes from a typical distressed business in several ways.

First, unlike many corporate debtors, Carvana's recent turnaround efforts show that it is capable of turning around its business. Importantly, it applied those efforts in a timely manner.

Second, Carvana is controlled by the Garcias. Their willingness to put their money where their mouth is has few precedents in today's restructuring. The deal would have been unlikely without their $126 million backstop.

Third, in our view, Carvana has a winning business model. It has been able (or at least is endeavoring) to uberize one of the most feared and despised consumer activities, buying a used car. In the increasingly transactional world of the millennial and Gen Z generations, buying a used car through an app is a winning idea.

We will continue to observe and analyze its execution.

1. Each of the existing tranches of unsecured notes will be treated as follows ($ in millions):

	Current Face Value	Treatment	Price	Take-back Face Value	Cash Price	Premium to Market
2027 Senior Unsecured Notes due April 15, 2027 ("2027 Notes")	600	Exchange	76.7%	460	0	13.0%
2028 Senior Unsecured Notes due October 1, 2028 ("2028 Notes")	600	Exchange	66.8%	401	0	13.0%
2029 Senior Unsecured Notes due September 1, 2029 ("2029 Notes")	750	Exchange	65.0%	488	0	13.0%
2030 Senior Unsecured Notes due May 1, 2030 ("2030 Notes")	3,275	Exchange	89.3%	2,926	0	13.0%
Total to Be Exchanged	**$5,225**		**81.8%**	**$4,275**	**$0**	

KEY CONTACT

ARKADY GOLDINSTEIN
Managing Director
agoldinstein@srv-partners.com
t: 201–490–1107

BIO

Arkady is the founder and Managing Director at SRV Partners. He is a veteran of two of the leading firms in the restructuring field, Alvarez & Marsal and Weil Gotshal & Manges. He has extensive experience in guiding companies and other parties-in-interest through complex restructurings and turnarounds.

Arkady has worked on major restructurings, including those of Revlon, Sears, Ditech, Tops Markets, Abengoa, Green Field, and School Specialty, among others. His expertise spans a broad range of industries, including financial services, retail, telecommunications, consumer products, oil & gas, and construction.

Throughout his career as a restructuring advisor and bankruptcy lawyer, Arkady has focused on complex situations and key issues, where his analytical skills and strategic focus have enabled him to deliver tangible results to his clients.

Arkady began his career in investment banking helping to execute transactions involving leveraged real estate portfolios and loan securitizations. He subsequently cofounded and ran one of the first independent high-speed internet service providers in New York City.

Arkady is a graduate of the Wharton School of the University of Pennsylvania and of the University of Pennsylvania Carey Law School. He resides in the Saddle River Valley region of northern New Jersey with his wife and two daughters.

SRV Partners, LLC

50 Tice Blvd, Suite 340

Woodcliff Lake, NJ 07677

t: 201–614–5500

f: 201–690–9454

www.srv-partners.com