In Re:

HORSEHEAD HOLDING CORP., et al.

Case No. 16-10287(CSS)

September 2, 2016

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UNITED STATES BANKRUPTCY COURT

DISTRICT OF DELAWARE

Case No. 16-10287(CSS)

- -x

In the Matter of:

HORSEHEAD HOLDING CORP., et al.,

Debtors.

- -x

United States Bankruptcy Court

824 North Market Street

Wilmington, Delaware

September 2, 2016

11:10 AM

B E F O R E:

HON. CHRISTOPHER S. SONTCHI

U.S. BANKRUPTCY JUDGE

ECR OPERATOR: DANA MOORE

Ruling on Confirmation Hearing

Transcribed by: Penina Wolicki

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P R O C E E D I N G S

THE CLERK: All rise.

THE COURT: Please be seated.

Good morning.

IN UNISON: Good morning, Your Honor.

THE COURT: All right. I'm ready to rule on the objections to confirmation and confirmation in general. I am going to be working off an outline which is a little rough, so I'll do my best and I apologize if I jump around a little bit.

Let me start by saying that this is one of the most difficult decisions I've had to make in ten years on the bench and one of the closest calls that I've had to make. I'm in sort of an odd situation, because all of my bankruptcy instincts honed over the years tell me that equity is out of the money in this case, but the evidence makes it a much more difficult call, and frankly, a lot of that rests at the feet of the lenders who've insisted on a no-shop here, and have eliminated market evidence as being a factor in the Court making its decision. And as a result, this is going to come down to the Court's decision based on a battle of the experts on valuation.

And had the lenders taken what I believe would have been a more reasonable position and actually allowed for a true market check in this case, I think we'd be in a very different situation, good or bad, but we'd actually have some evidence

other than expert valuation testimony that the Court could rely on in making this very important and significant decision.

They made their own economic decision based on what they felt was appropriate. It's certainly their call and ability to insist on that. But I think at the end of the day, from an evidentiary standpoint, they shot themselves in their own foot. And that's -- it is what it is.

To frame the issues that are actually in front of the Court, and holding aside the objection of the two remaining mechanics' lien claimants, there are three disputed issues relevant to confirmation that the Court has to decide. They are whether the good-faith prong of the confirmation standards is met; whether the plan is fair and equitable to equity, who are obviously impaired; and that rests on whether the absolutely priority rule is being satisfied here, and specifically whether creditors are receiving too much, whether they're receiving more than their fair share of value.

The sort of corollary of the fact that junior creditors don't get anything until senior creditors are paid in full, is that senior creditors are only entitled to a one hundred percent recovery, before junior creditors. And if they're getting more than that, that's taking money out of junior creditors' pockets.

And the third issue is whether the settlement encompassed in the plan meets the legal standards.

Starting with the good-faith issue first, I do find that the plan is proposed in good faith, and I will overrule the equity committee's objection on that point. The fiduciary duties of the estate professionals or specifically -- excuse me -- the fiduciary duties of the debtor, the debtor's management, do not require a market check or shopping of the company either through a plan or under 363 of the Code. In a reorganization setup, where we have a debtor with plan exclusivity who's negotiating with creditors, it is -- Mr. French would you put that down, please? Thank you.

It is not required that a sort of 363 shopping of the company occur. Debtors are free to negotiate plans of reorganization with their creditors without being required to take whatever deal they reach out to the market to see if it's valid. To the extent that's inconsistent with what state law fiduciary duty would require in a change-of-control transaction, I believe that the Bankruptcy Code alters that or supersedes that in the context of what reorganizations actually require under the Code.

So while I believe that a market check here may have been very positive and helpful, it certainly was not required, and it's not inconsistent with management's fiduciary duties or the debtors' fiduciary duties to go forward as they've gone forward in this case. So there is not a good-faith issue.

But again, there was no market check here sufficient

to establish value, and the no-shop provision creates an evidentiary issue with regard to what the value is. The DIP financing process was rapid. It had to be rapid. The debtors did their best to shop the DIP as quickly as they could. It certainly wasn't sufficient to be a proxy for value evidence or valuation of the debtors. It was a very specific, focused process. I find it not at all surprising that any competing DIP would want to be on a priming basis. I certainly believe, given the time frames involved, any new DIP lender probably was not in a position to come in and do a take-out loan, and any new loan would clearly be a priming loan. And it certainly wasn't inappropriate for the debtors to decide not to do that, but it simply -- I raise it only with regard to whether or not it's evidence of the value here.

Also, the debtors' vigorous response after July 7th to inquiries, including engaging fully with all of the potential purchasers identified by the equity committee -- and I think the evidence is solid that the debtors fully engaged and were vigorous -- but the combination of the time frame involved and the fact they are responding to and not actively shopping the company, in this case, is insufficient to establish value.

So what we have here, at the end of the day, is a battle of the experts with Lazard versus SSG, with at least, on a rebuttal basis, the participation of FTI.

I believe that the Lazard 435-million-dollar ramp-up

value is a relevant inquiry here. I don't think it's reasonable to assume under the facts of this case, that management won't take the committed equity contribution to try to fix the plant. I think the basis of the reorganization thesis here is a ramp-up scenario. And I view a non-ramp-up scenario to be really, in effect, a liquidation analysis.

These companies, other than Mooresboro, can be sold in pieces. There are obviously parties that have expressed interest in Zochem, in INMETCO, and in the EAF recycling business. The issue here and the reorganization thesis here is how do you fix Mooresboro and expand this business. So I think that's the appropriate inquiry.

Talk a little bit about burden of proof. The question here, as I view it, is whether it's more likely than not that equity is out of the money. If I'm going to confirm this plan, I have to make a finding that it's more likely than not equity is out of the money. If I can't figure that out, if it's a tie, or if equity's thesis is more likely, then the plan can't be confirmed.

Talking just briefly about Lazard's valuation, since most of the focus really was on the equity committee's valuation, but talking just a second about Lazard, Lazard used a comparable companies methodology in addition to a discounted cash flow methodology, and there was some back-and-forth about whether that was appropriate.

I believe that the evidence supports that use of a comparable companies methodology was not required here, but using it was certainly reasonable. Even though this company had no LTM EBITDA, use of a comparable companies methodology based on forward-looking LTM, forward-looking EBITDA projections, is allowable under the literature, supported by the case law, and reasonable.

The flip side of that is the equity committee did not use a comparable companies methodology, and of course neither expert used a precedent transaction methodology. But the equity committee used solely a discounted cash flow method.

Now, while it is certainly true that there are advantages and preference to using several different methodologies and to triangulate value, that is not necessarily required. Any valuation professional makes his or her judgment under the unique circumstances of each case. And as Lazard -- it was reasonable for Lazard not to use a precedent transaction analysis here, I don't think it was at all unreasonable for SSG to just use a DCF methodology.

So let's focus -- wait a minute. I am going to say a little something about Lazard's beta, but I'm going to do that in just the context of talking about the equity committee's valuation. All right. So where we are. So the equity committee came in with an amended, updated valuation with a midpoint value of 842 million dollars. So that's where we'll

work from.

So taking the issues I already addressed, the DCF methodology only being okay, let's turn to zinc prices. I think it was reasonable for SSG to accept all of the business plan other than the zinc price numbers. I think it's important to note that management didn't pick the zinc data that it used, Lazard picked that data. The use of the MB Apex report was just as reasonable as Lazard's only black-box choice of analysts from their London office.

I think that the analyst at Desk 7 that we spent a lot of time on is a red herring for a couple reasons. One, importantly, that analyst was not used in predicting zinc prices for the terminal period, and of course, as in any DCF, but particularly in this one, the terminal period is the 800-pound gorilla in the valuation.

I would also point out that this idea that they used the mean and not the median, and clearly that was a problem, I don't think has any weight. Professionals use mean and median in different circumstances at different times, and Lazard used the mean in several instances in its own valuation in various places.

At the end of the day, the delta on all of that effort about Analyst number 7 is ten million dollars. While not insignificant -- it's real money -- in the context of the broader valuation, I don't believe that it's problematic. So I

think the use of the zinc prices under the MB Apex report was reasonable.

Now, we also have -- the next issue is the change in capitalization ratio for the perpetuity period. And I do find that that is not reasonable under the facts and circumstances of this case. Now, this is probably -- this is probably the sub-piece closest call, because based on my experience with hedge funds and private equity firms, I think it is certainly possible to assume that if the debtor meets these projections, that the lenders will ratchet up the debt on this company. And as Mr. Victor said, it happens every day in his business.

But based on the evidence here and specifically this business, the history of this business, the weight of the comps, the nature of commodity companies, it is too speculative to switch to a fifty-fifty capital structure in the terminal period. The effect of that is to reduce the valuation of SSG by 95 million dollars, which takes us from 842 to 747.

Talking about beta. I think that SSG's use of a 0.99 beta is reasonable. Averaging the metals and mining database of Damodaran, which is not stale, given its use of both two- and five-year historical beta, and SSG's comps, most of which are Lazard's comps, is an appropriate way to calculate beta.

Here, I would also say that I think Lazard's beta strikes me as being way too high for a commodity company like the debtor; and I'm particularly bothered and troubled and

question its use of Barra beta based on the case law and some of the academic literature, which is again, a black box and very suspect.

Having said all that, I do think that the use of the Chelyabinsk comp was not reasonable. It was too thinly traded to serve as a proper beta. I believe its R-squared was 0.01, if I remember correctly. And this reduces value by 10 million dollars, to a figure of 737.

Turning to the perpetuity growth; and this is a big issue. The perpetuity growth of 3.5 percent is based on the ability to go from 155,000 tons to 170,000 tons in the terminal period, and I think that's not reasonable. Basically, it's not supported by the facts. Notwithstanding debtors' previous statements, which they continue to make, I think it's highly speculative whether they'll be able to achieve that increase. I think the costs involved in achieving that increase are unclear. I think the improvements in efficiency are speculative, and importantly, limited by the science.

So I think the facts here belie making it reasonable to use as a basis for future projections, this tick up from 155,000 to 170 -- it's not at all clear we're going to get to 155,000 tons in this case. The debtors have never gotten close.

Now, I have no issue with this academic debate on whether the use of perpetuity growth model for a ten-year

increase as opposed to a perpetual increase is appropriate. I think the math, if you do the math, makes this a nonissue. The delta here between having done a perpetuity growth and having done a ten-year DCF for the terminal period is miniscule. However, reducing -- correcting the error on the perpetuity growth reduces the valuation by an additional 84 million to a revised number of 653.

So 653 million is roughly equivalent to the 650 million dollars in claims, which appears to put the equity committee, at the very least, on the cusp of being in the money, although barely. However, that ignores the 85 to 100 million dollars of new capital that's going to be required to achieve the ramp-up scenario, which is the entire basis of the equity committee's valuation. You simply cannot get to the equity committee's conclusion without that new money, and it has to come from somewhere.

Thus, in order for the equity committee to be in the money and for the plan to violate the absolute priority rule, I believe the value must exceed at least 735 million dollars, which it does not.

So for that reason, I'm overruling the equity committee's objection on the absolutely priority rule.

So we turn to the global settlement. At this point, given the valuations, this is the creditors' recovery to forego. They've agreed to the releases and doing so is

reasonable under the Martin factors.

As an aside, I think that the equity (sic) committee in this case settled on the cheap, but that's not the test; that's not my call. The question is whether that settlement meets the lowest range of reasonableness, and it does.

Critically, the class action is fully preserved for equity. That may be worth up to possibly fifty-five million dollars, minus, of course, attorneys' fees. I would not approve a settlement that did not preserve the class action. So I'm going to overrule this portion of the equity committee's objection.

That leaves us with the objections of the mechanic liens claimants. I'm going to overrule that. The interest is going to be paid if the claim isn't paid on the effective date. Liens are being preserved. Funds are available to pay the claims. Those creditors are unimpaired. And stay relief at this point is both an empty threat, frankly, but would require a motion. So that's an issue for another day.

Now, this is not the result that the shareholders were looking for. However, I believe more than ever that the appointment of an equity committee has been fully vindicated in this case. As I mentioned back in May, the issue here is valuation. Now, the lenders refused to allow for a market check, that's their call. And the creditors' committee settled. Someone had to show up and stand up under the facts

and history of this case for the shareholders to challenge the valuation proposition; and appointing an estate funded fiduciary to do that was appropriate.

I think that the equity committee professionals have acted within the confines of their mandate and didn't go on any frolics or detours. So I am going to lift the limitation on the equity committee's fees and expenses in this case. I will, of course, evaluate any fee applications under the applicable standards, but I am going to reduce the artificial limit -- or eliminate the artificial limit that I had previously put on their fees and expenses.

I think, frankly, they brought tremendous value to the process. This was a difficult case for the Court to decide. At the end of the day, I think that we had something where everyone had a full and fair opportunity to present the facts and law in front of the Court. The Court was presented with tremendous professionalism by all parties, and was put in the position of having to make a decision based on the facts and law. I've done that. And frankly, I think at the end of the day, the process was fair and we get to a fair result. The process cost money, and it's appropriate for that money to be spent in this instance.

So that's my ruling. I would open it up to any questions or comments. Mr. Stearn?

MR. STEARN: For the record, Bob Stearn from Richards,

Layton & Finger, on behalf of the equity committee. Your Honor, thank you very much for ruling so promptly and so thoroughly. We really appreciate it.

Just one question or point of clarification. As you were discussing the settlement, I think you said words in word or substance, something about the equity committee settling cheaply. Is that what you meant to say?

THE COURT: No, I meant the -- if I said that, I meant the creditors' committee.

MR. STEARN: Thank you, Your Honor for the clarification.

THE COURT: I apologize. That was absolutely not what I meant.

MR. DAHL: Your Honor, for the record, Ryan Preston Dahl. Logistically, we're finalizing some changes to the confirmation order. If it please the Court, we could complete that process and either submit it under certification of counsel. I think it may take a little bit of time today to just wrap up those changes.

THE COURT: All right. Well, yes, I will confirm the plan, overrule all objections to the plan. And I will do that subject, obviously, to receiving an order under certification of counsel. It's a holiday weekend. I'm not going to be here any later than absolutely necessary. So if you don't get it to me today, rather promptly, it'll be Tuesday before you get your

order. I hope that's okay, because that is what it is. That's what's going to be.

MR. DAHL: Certainly, Your Honor.

THE COURT: All right.

MR. DAHL: Your Honor, may I just confer with counsel to the equity committee briefly?

THE COURT: Yes.

MR. DAHL: Your Honor, sorry, one additional point. We have related to confirmation, the debtors' motion to enter into the unit purchase agreement, which is part and parcel of the plan. After conferring with counsel to the equity committee, we understand that that's now been resolved as a function of the Court's ruling on confirmation, and we --

THE COURT: Right.

MR. DAHL: -- could also submit that order as well.

THE COURT: Yes. Thank you for clarifying that and bringing that to my attention. Yes, I will, for the reasons already stated, overrule that objection and allow and approve the entry into the unit purchase agreement.

MR. DAHL: Thank you, Your Honor.

THE COURT: You're welcome.

Mr. Stearn, I'm going to ask you a question while Mr. Dahl's talking. I think I built that -- I think I built that limit in your retention order or the -- where did I build that limit? Was it in the committee --

MR. STEARN: Retention order, I believe, Your Honor.

THE COURT: All right. I'm comfortable with my oral ruling, but if you would like a court order changing that, why don't you submit something under certification of counsel.

MR. STEARN: I think that's a good idea. We'll do that, Your Honor.

THE COURT: Okay.

MR. STEARN: Thank you very much.

THE COURT: Okay. Very good. And that should cover Mr. Bifferato and SSG as well.

MR. STEARN: Right. And I suppose --

THE COURT: And --

MR. STEARN: -- Nastasi, too?

THE COURT: Yes, although they've resigned.

MR. STEARN: Right. But --

THE COURT: Yeah.

MR. STEARN: -- yes.

THE COURT: They have money in the case. I understand. Yeah.

Mr. Dahl, I was just -- you may not have heard. I was just -- we were having a colloquy about submitting something under certification of counsel with regard to the retention orders that removes the limit that the Court had previously set on the fees.

MR. DAHL: Understood, Your Honor.

THE COURT: Okay. Anything you want to talk about after that colloquy?

MR. DAHL: No, Your Honor.

THE COURT: Okay. All right. Very good. Thank you very much. We're adjourned.

MR. DAHL: Thank you, Your Honor. Have a good weekend.

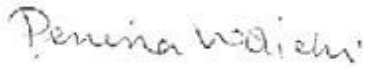
(Whereupon these proceedings were concluded at 11:39 AM)

I N D E X

RULINGS

C E R T I F I C A T I O N

I, Penina Wolicki, certify that the foregoing transcript is a true and accurate record of the proceedings.



September 4, 2016

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