

The Wharton School – University of Pennsylvania
FNCE 341/841
Distressed Investing and Value Creation

Fall 2019

Preliminary Course Syllabus

(Please note that this syllabus is subject to change over the duration of the course; however, the general structure and content of the course will remain the same.)

Professor Kevin Kaiser

Teaching Assistants

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Classroom & Time

FNCE 341: M/W 9:00 a.m. – 10:20 a.m., JMHH F55
FNCE 841: M/W 10:30a.m. – 11:50 a.m., JMHH F55

Course Description

This course is designed to provide students with an understanding of the issues regarding corporate restructuring and the financial management of distressed situations. In any situation of financial distress, there are two imperatives requiring attention if parties aspire to restructure rather than liquidate: (1) dealing with the restructuring of the various claims on the organization and resolving who will receive what new claim in replacement of existing claims, and (2) ensuring the newly restructured entity is able to successfully manage for value creation and be a viable firm post-restructuring. The interaction of these two imperatives, and how alternative restructuring proposals impact the viability of the newly restructured firm, is key to a successful distressed restructuring. By the end of the course participants should

- be familiar with the legal environment which frames distressed restructurings in the USA
- be familiar with the various parties, and their roles and interests, in a typical restructuring
- have insights into the different legal and negotiating alternatives for resolving differences in interests across parties to facilitate deal conclusion
- be familiar with the tools and methods for anticipating the financial distress of an organization and understand why the firm is in financial distress
- be capable of assessing the impact of the legal/financial restructuring on the viability of the firm,
- be able to assess the extent to which alternative restructuring proposals will succeed or fail to enable correction of the management errors which led to the distress in the first place

- be comfortable forecasting cash sources and uses to assess debt repayment capacity, and understand, from an investing point of view, how to identify the fulcrum security and be able to assess the recovery potential of the different levels of the capital structure
- understand how to assess both the sources and magnitude of the value creation (or destruction) potential of a restructuring event as well as the various transfers of value across parties to the restructuring.

On the legal dimension, this course will explore the highly active and sophisticated deal-making environment that is the hallmark of modern distressed corporate restructuring— both under the supervision of a federal court applying chapter 11 of the United States Bankruptcy Code or through an agreement reached by a company and its creditors in out-of-court negotiations. On the finance and business dimension, this course will consider the determinants of financial distress, the methods for anticipating financial distress, how different negotiated outcomes impact both value to be created and value to be transferred across parties, and the role of alternative restructurings for enhancing the ability of the newly restructured company to thrive *post* restructuring.

The course will comprise three phases: lectures, case discussions, and student-driven learning (interactive and/or research projects and personal reflection).

1. The first phase of the course will be lecture classes. These will focus on establishing the legal framework, including the fundamental rights and obligations of debtors, creditors, and other parties in interest in the various types of major chapter 11 cases, and the conceptual framework for assessing a firm’s financial viability and the causes of financial distress and the value impact of alternative restructurings. This foundation will provide critical insight into understanding the motivations, strategies, and available tools for chapter 11 participants.
2. The second phase of the course will feature a series of case exercises, and classroom discussions and reflection. The case exercises are intended to provide participants an opportunity to work in teams and discuss, analyze, and propose their recommendations for resolving the case situation. Each group must submit a short (maximum one full page) executive summary of their reflections and commentary for each case. These are required for credit but will not be graded. In addition, each group must submit four “long” reports, maximum 3 pages plus exhibits, for four selected case assignments. Each group is expected to **hand in** a hard-copy of their reports **prior to any class discussion**. Supporting computations and tables can be included in an appendix and submitted in Excel format. All of the inputs and formulas used should be provided (preferably as a footnote). Some of the case assignments contain questions that need to be addressed, however you will also be graded based upon how well you identify the relevant questions and issues to be addressed. Therefore, whether there are questions for the case or not, please consider what the relevant questions are in the context of each case and discuss why and then perform the necessary analysis to address these questions. There may be opportunities to have guest speakers¹ who will offer the personal perspectives of key players in the restructuring arena—*e.g.*, corporate managers, investors, bankers, and/or financial advisers

¹ To accommodate the schedules of our guest speakers, scheduled classes, possibly including the due dates of group reports for the case studies, are subject to change.

3. The third phase of the course will involve student-driven learning including a negotiation case simulation, in which students will be assigned participant roles and challenged to apply the lessons to navigate their way through a distressed negotiation exercise. There will also be a group-based research project - participants will be expected to research a particular case/topic/event related to corporate restructuring and submit a 10-page report and prepare a presentation to the class on the topic/event. Finally, each participant (individually) must submit a personal “reflection” on their key learnings from the course.

Grades will be based upon individual and team performance assessed as follows:

1. PARTICIPATION: Individual (20% of final grade)
2. WATERFALL EXERCISE: Individual (15% of final grade)
3. TER NEGOTIATION EXERCISE: Group (20% of final grade)
4. CASE EXERCISES: Group; Long reports for 2 of the remaining 4 case exercises, short reports for remaining cases by all teams (20% of final grade)
5. TOPICAL GROUP RESEARCH PAPER: Group; A research paper on a self-selected topical issue/event related to distressed restructuring to be presented to the class (20% of final grade)
6. INDIVIDUAL REFLECTION PAPER (5% of final grade) Learning is an effortful process and I have added this assignment in place of a final exam. The purpose of this exercise is to ensure that each individual devotes some time (a couple hours or more) to reflecting back on this course and trying to recall and deepen your understanding of the many topics and concepts covered. You are expected to submit (along with the group paper) your individual reflections on what you learned during this course and the insights you gained. It is expected to be between 2-5 pages and address the following elements: (1) Summarize and demonstrate understanding of the concepts taught in this course, (2) Summarize the insights you gained, and (3) Describe how these insights will impact you/your behavior going forward. Please do not be evaluative (e.g., please avoid statements such as "I really loved the session when we talked about..." or "I found the discussion around xxx to be very confusing...") Simply emphasize your learning by structuring your reflections as, "What I learned was" Grading will be based on the depth and quality of your reflections as reflected in the depth and quality of the learning and insights you share in this report.

Note: all written work must be submitted via Canvas in PDF format (or Excel spreadsheet, where appropriate, for example the TER negotiation exercise) and the filename must indicate the individual's name or team number (for group assignments include both team number and names of team members) and title of the assignment. For the Case Exercises, please ensure your submission also indicates (in the filename of the pdf document) whether it is the “long” report or the “short” report in addition to the name of the case.

Draft Course Schedule

Date	Topic	Assignment
Wednesday, August 28, 2019	Course Introduction	no assignment due today
Monday, September 2, 2019	Labor Day - no classes today	no class today
Wednesday, September 4, 2019	Games and setting the stage	no assignment due today
Monday, September 9, 2019	Conceptual foundation - The Colors of Distress	no assignment due today
Wednesday, September 11, 2019	Conceptual foundation - Valuation in Distress	The law and process of restructuring
Monday, September 16, 2019	Intro to the Waterfall - Valuing the Business	no assignment due today
Wednesday, September 18, 2019	Intro to the Waterfall - Valuing the Business	no assignment due today
Monday, September 23, 2019	State of the market and role of advisors	no assignment due today
Wednesday, September 25, 2019	Financial Analysis & Valuation Principles	BG - 1 - Financial Analysis & Liquidity
Monday, September 30, 2019	Forecasting Cash Generation & Valuation	BG - 2 - Forecasted Cash Flow & Valuation
Wednesday, October 2, 2019	Value and Valuation	BG - 3 - Valuation Methodology
Monday, October 7, 2019	Debt capacity & Leverage	BG - 4 - Debt Capacity/Repayment and "Waterfall"
Wednesday, October 9, 2019	Allocating value through capital structure	Final discussion of Bayfield
Monday, October 14, 2019	Chapter 11 primer	no assignment due today
Wednesday, October 16, 2019	I-banking advisors	no assignment due today
Monday, October 21, 2019	Distress Investment/Negotiation Exercise	TER Introduction (pre-negotiation worksheet due)
Wednesday, October 23, 2019	Distress Investment/Negotiation Exercise	TER Negotiation (class time allocated to negotiation)
Monday, October 28, 2019	Distress Investment/Negotiation Exercise	TER Debrief (post-negotiation worksheet due)
Wednesday, October 30, 2019	Distressed Investment Analysis	Caesars Entertainment
Monday, November 4, 2019	Distressed Investment Analysis	Caesars Entertainment (group reports due)
Wednesday, November 6, 2019	Turnaround Management	Rossignol/Crisis at the Mill
Monday, November 11, 2019	Turnaround Management	Rossignol follow-up
Wednesday, November 13, 2019	Dealing with Chapter 11	Fiat Buys Chrysler in 363 Asset Sale (group reports due)
Thursday, November 14, 2019	HOWARD MARKS GUEST LECTURE	HOWARD MARKS GUEST LECTURE
Monday, November 18, 2019	Turnaround Management	Fiat Buys Chrysler, cont'd
Wednesday, November 20, 2019	Dealing with Chapter 11	Pinewood Mobile Homes
Monday, November 25, 2019	Reflection	no case today
Wednesday, November 27, 2019	Thanksgiving break - no classes	no class today
Monday, December 2, 2019	Presentations & Reflection	
Wednesday, December 4, 2019	Presentations & Reflection	
Monday, December 9, 2019	Presentations & Course wrap-up	

List of Readings

- Chapter 16, “Financial Distress,” from *Corporate Finance*, 4th edition, by Berk and DeMarzo, 2016
- The Costs of Financial Distress, by Kevin Kaiser, lecture note
- “How Costly is Financial (not Economic) Distress? Evidence from Highly Leveraged Transactions that Became Distressed,” Andrade and Kaplan, *Journal of Finance*, October 1998, 1443-1493
- “Coming Through in a Crisis: How Chapter 11 and the Debt Restructuring Industry Are Helping to Revive the US Economy,” Stuart Gilson, *Journal of Applied Corporate Finance*, Fall 2012
- “Managing for Value 2.0,” by Kaiser and Young, *Journal of Applied Corporate Finance*, Winter 2014
- “The Hazards of Growth,” by Kaiser and Young, *Journal of Applied Corporate Finance*, Summer 2015
- Chapters 3 & 4, from *The Blue Line Imperative*, by Kaiser and Young, 2013
- *Distressed Debt Analysis: Strategies for Speculative Investors*, by Stephen G. Moyer, 2005
- Schoenberg, R.; Collier, N.; Bowman, C. Strategies for business turnaround and recovery: a 396 review and synthesis. *European Business Review* **2013**, 25, 243-262
- Douglas G. Baird & Robert K. Rasmussen, *Antibankruptcy*, 119 YALE L. J. 648 (2009-2010)
- James H.M. Sprayregen, *et al.*, *Chapter 11: Not Perfect, But Better than the Alternatives*, 14 J. BANKR. L. & PRAC. 6 (Dec. 2005)
- Statement of James H.M. Sprayregen to the ABI Commission for the Reform of the Chapter 11 of the Bankruptcy Code
- Mike Spector & Tom McGinty, *Bankruptcy Court is Latest Battleground for Traders*, WALL ST. J. (Sept. 7, 2010), available at <http://online.wsj.com/article/SB10001424052748703309704575413643530508422.html>
- James H.M. Sprayregen, *et al.*, *The Race to the Starting line: Developing Prepackaged and Prenegotiated Reorganization Plans to Maximize Value*, in *Navigating Today's Environment*, The Directors' and Officers' Guide to Restructuring (2010)
- Brian K. Tester, *et al.*, *Need for Speed: Prepackaged and Prenegotiated Bankruptcy Plans* (American Bankruptcy Institute), available at <http://www.abiworld.org/committees/newsletters/busreorg/vol9num7/pack.pdf>
- Managing Financial Distress, by Kevin Kaiser, lecture note
- Chapter 5, “Distressed Firm Valuation,” from *Corporate Financial Distress and Bankruptcy*, 3rd edition, by Altman and Hotchkiss, 2006
- Hon. Christopher S. Sontchi, *Valuation Methodologies: A Judge's View*, 20 AM. BANKR.

INST. L. REV. 1 (Spring 2012)

- Chapter 10, Profiting from Financial Distress: The Investor's Perspective, from *Distressed Debt Analysis: Strategies for Speculative Investors*, by Stephen G. Moyer, 2005
- Caesars Entertainment Corporation, Columbia Business School case CU65
- Chapter 11, Corporate Credit Scoring – Insolvency Risk Models, from *Corporate Financial Distress and Bankruptcy*, 3rd edition, by Altman and Hotchkiss, 2006
- Modelling Default Risk, KMV
- Predicting a Firm's Financial Distress – Merrill Lynch, Ivey case W12114
- Chapter 11, Corporate Credit Scoring – Insolvency Risk Models, from *Corporate Financial Distress and Bankruptcy*, 3rd edition, by Altman and Hotchkiss, 2006
- Modelling Default Risk, KMV
- Predicting a Firm's Financial Distress – Merrill Lynch, Ivey case W12114
- Dealing with Distress – Paramount Equipment, HBS case 9-914-557
- Hon. Christopher S. Sontchi, *Valuation Methodologies: A Judge's View*, 20 AM. BANKR. INST. L. REV. 1 (Spring 2012)
- Chapter 8, Causes of Financial Distress and the Restructuring Implications, from *Distressed Debt Analysis: Strategies for Speculative Investors*, by Stephen G. Moyer, 2005
- Pinewood Mobile Homes, HBS case 9-915-547
- The Energy Patch: Where Rights Offerings are 'Sexy' Again, Reuters, Aug. 1, 2017 (<https://www.reuters.com/article/us-usa-bankruptcy-offerings/the-energy-patch-where-rights-offerings-are-sexy-again-idUSKBN1AH408>)
- Rights Offerings in Bankruptcy: More than New Capital, *Journal of the Association of Insolvency and Restructuring Advisors*, Dec/Jan 2011
- "A Primer on Distressed Investing: Buying Companies by Acquiring Their Debt," Stephen G. Moyer, David Martin, and John Martin, *Journal of Applied Corporate Finance*, Fall 2012
- Citigroup Exchange Offer, HBS case, 9-210-009
- Chapter 9, Options for Alleviating Financial Distress: The Company's Perspective, from *Distressed Debt Analysis: Strategies for Speculative Investors*, by Stephen G. Moyer, 2005
- Crisis at the Mill, INSEAD case study, IN1030
- Chapter 12, Dynamics of the Workout Process: The Endgame, from *Distressed Debt Analysis: Strategies for Speculative Investors*, by Stephen G. Moyer, 2005
- Chrysler's Sale to Fiat, HBS case 9-210-022
- Chapter 10, Profiting from Financial Distress: The Investor's Perspective, from *Distressed Debt Analysis: Strategies for Speculative Investors*, by Stephen G. Moyer, 2005