Course Content and Objectives

This course exposes students to a broad range of financial restructuring techniques that can be applied to improve business performance. Case discussion and visitors help illustrate how various corporate restructuring approaches may be used to increase firm value and highlight characteristics of potential candidates for different restructuring techniques. The case analysis provides ample opportunity to practice the application of standard corporate valuation methods. Students will gain a basic understanding of corporate governance, with particular focus on agency problems and executive compensation issues.

The first part of the course deals with financial restructuring techniques aimed at strengthening the firm’s competitive situation. Such restructurings can be initiated as a response to poor business performance caused by e.g. changes in technology or customer demand, or to avoid a takeover threat. Topics include divestitures, spinoffs, splitoffs, equity carveouts, tracking stock, leveraged recapitalizations, and leveraged buyouts.

The second part focuses on the restructuring of financially distressed firms. Since bankruptcy provides a threat point for any distressed restructuring, the legal framework of the U.S. bankruptcy code is examined. The topics of this section are private workouts, pre-packaged bankruptcy filings and restructuring in bankruptcy. We will discuss the importance of market mechanisms in resolving bankruptcy, including the role of distressed investors and difficulties in valuing bankrupt firms.

The course is intended for students with an interest in learning about the financial, strategic, and business issues surrounding corporate restructuring. It will be useful for a range of various careers, including investment banking, commercial banking, turnaround
management, general management, strategy consulting, securities analysis, and investment management.

**Visitors**

The class will be visited by the following speakers:

David J. Breazzano  
Co-founder and Principal  
DDJ Capital Management, LLC

James B. Flaws T’73  
Vice Chairman and CFO  
Corning Incorporated

Richard H. Fleming T’71  
Executive Vice President and CFO  
USG Corporation

John E. Foley T’96  
Partner  
Wayzata Investment Partners

Michael E. Koester T’99  
Managing Director  
Goldman, Sachs & Co

Mark W. Peterson  
Senior Vice President and Treasurer  
Cincinnati Bell, Inc.

**Course Materials**

The materials for the course consist of a number of cases and readings contained in the course packet. Additional material and assignments will be distributed in class.

**Supplementary Books**

For students interested in additional readings, the following books are held on reserve at Feldberg:


Written Assignments and Grades
Class participation is a strictly individual effort and accounts for 50% of the total grade. The two projects, which together account for the remaining 50% of the grade, are group assignments that should be analyzed in teams of 4 students enrolled in the same section.

A. Class participation - 50% of grade
All students are expected to attend every class. You should come to class prepared to discuss your analysis of the case, using key insights from the readings, and to show your calculations. I strongly encourage voluntary participation, but I may also cold call on any student to discuss the assignments. I grade class participation after each session on a scale from 0-3 (0 being the lowest grade) and compute a final grade based on the total class participation score. If you have to miss a session, you get a score of –1 for that day.

B. Project I: LBO case study – 20% of grade
Students are asked to value an LBO candidate and to analyze issues related to LBO transactions. The project is based on a real buyout transaction and uses current market conditions. A bid letter and write-up of the analysis in two copies are due at 3 pm on Wednesday 10/11. You should be ready to present your analysis to Michael Koster, Goldman Sachs, on Thursday 10/12.

C. Project II: Term project – 30% of grade
Students will analyze the financial, operational, and governance implications of a recent or potential corporate restructuring transaction. The company and topic should be selected by you, but is subject to my final approval. A one-page description of the term project should be handed in or emailed to me by Thursday 10/19. The final report is due before the presentations in class on Friday 11/10.

Honor Code
Class participation is a strictly individual effort. Students are, however, encouraged to work in groups when preparing for class. You may not use notes or other material from any previous offering of this or a similar course, or discuss the material with students who have already taken the course. This restriction extends to case-related information obtained from other sources.

Laptops
Laptops may not be used in class. Make sure to bring print-outs of any calculations that you may want to refer to in the class discussion. If I see a laptop screen open during class, you will get a class participation score of –3 for that session.
## Course overview, Corporate Restructuring fall 2006

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SCHEDULE
Corporate Restructuring Fall 2006

1. Divestitures
Thursday 9/14

**Case:** Nova Chemical Corporation, HBS 9-290-059

**Case questions:**
1. Should the company divest its Industrial Products Division (IPD)?
2. Is the offered price of $160 million acceptable? Do a DCF valuation of the IPD division. What is the lowest bid Nova should accept?
3. Why did the offer for IPD come as a surprise to management and the board of directors?
4. What implications would a divestiture of the IPD division have for Nova’s future financing needs? Do the financing options have any implication for the decision to sell/not to sell IPD?


2. Spinoffs and equity carveouts
Friday 9/15

**Case:** Cytec Industries’ spin-off (A): sink or swim? HBS 9-897-053

**B-case, HBS 9-897-054, will be distributed in class.**

**Case questions:**
1. Why did American Cyanamid spinoff Cytec? Was it a good idea? For whom? Why a spinoff instead of an equity carveout or a divestiture?
2. If you were Darryl Fry or Steve Crum would you jump at the opportunity to run Cytec or would you want to stay with Cyanamid? What are the implications for Fry's or Crum's career if Cytec fails?
3. Analyze the structure of the spinoff agreement, including Cytec's equity structure and the balance sheet, from both the parent's perspective and Cytec's.
4. What organizational changes were made at Cytec prior to and after the spinoff? How did these changes affect performance? Why weren't such changes made years earlier under Cyanamid?
5. Assuming Cytec's stock trades at multiples that are average for its industry, how can the pessimistic analyst's valuation of $3 per share be justified? What about the market's $12 to $16 valuation?
6. Why didn't the market pay much attention to Cytec? Should it have? Why did managers care whether Wall Street noticed the company?
7. What would you predict Cytec's stock would trade for two years after the spinoff? What assumptions about the organization and the stock market underlie your predictions?

3. Splitoffs

Wednesday 9/20

Case: E.I. du Pont de Nemours and Company: the Conoco split-off (A), HBS 9-202-005
B-case, HBS 9-202-006, and C-case, HBS 9-202-007, will be distributed in class.

Case questions:
1. Do you believe DuPont management’s claim in early-to-mid 1998 that Conoco was dragging down DuPont’s value?
2. Assuming DuPont’s stock price was in fact undervalued, was the October 1998 IPO of Conoco the best way to address this problem? Would any other approaches for divesting Conoco have been preferable, for example a divestiture?
3. As a DuPont shareholder presented with the proposed split-off transaction in July 1999, what factors would you consider in deciding whether to exchange your shares for Conoco Class B shares?
4. Does it make sense for DuPont management to have structured the second-stage divestiture of Conoco as a split-off rather than as a conventional spinoff?
5. The Limited’s splitoff of its Abercrombie & Fitch unit was structured as a “modified Dutch auction”. Do you think this would have been a superior way to structure DuPont’s split-off of Conoco?

Please note: The closing trading prices of DuPont and Conoco Class A common stock on July 8, 1999 were $68.625 and $27.375, respectively.


4. Tracking stock

Thursday 9/21

Case: USX Corporation, HBS 9-296-050

Case questions:
1. In 1986, then-chairman and CEO David Roderick described USX as possibly one of “the most restructured corporations in America”. Even so, Carl Icahn believed that further restructuring of the company was still necessary. In late 1990, what operating and/or strategic problems, if any, do USX’s two main businesses still face that would warrant some form of additional restructuring?
2. Does past ROA and stock performance indicate that USX is poorly managed or underperforming? What about a multiples analysis?
3. Do you think there is any merit in Carl Icahn’s claim that problems in USX’s steel business are depressing the value of its energy business? As a USX stockholder, how credible a spokesperson do you consider Icahn to be on this issue?
4. Which restructuring option – Icahn’s spinoff proposal or the company’s tracking stock proposal – will create the most value for shareholders? For creditors? For the firm’s other stakeholders?
5. Should the company seriously consider any other options besides doing a spinoff or issuing tracking stock?
6. If the company decides to go ahead with the tracking stock issue, what specific provisions or features should the stock contain to ensure maximum value creation? How closely would you model USX’s tracking stock on GM’s alphabet stock?

5. Breaking up Corning
   Wednesday 9/27

Visitor: James B. Flaws T’73, Vice Chairman and CFO, Corning Incorporated.

6. Leveraged recapitalizations
   Thursday 9/28

Case: Sealed Air Corporation’s leveraged recapitalization (A), HBS 9-294-122
B-case, HBS 9-294-123, will be distributed in class.

Case questions:
1. Why did Sealed Air undertake a leveraged recapitalization? Do you think that it was a good idea? For whom?
2. How much value was created? Where did it come from?
3. Is pursuing a program of manufacturing excellence such as World Class Manufacturing (WCM) inconsistent with “levering up”?
4. Why did Dermot Dunphy, the CEO, feel it was necessary to change the company’s priorities and incentive structure following the recap?
5. Why did Sealed Air’s investor base turnover completely after the recap? Is this something managers should be concerned about?
6. Was the constraint imposed on capital expenditures under the bank lending agreement good or bad for the company? Do you think managers will be able to successfully renegotiate this covenant?
7. Would a similar increase in leverage be good for all companies? Why or why not?


7. Restructuring Cincinnati Bell
   Wednesday 10/4

Visitor: Mark W. Peterson, Senior Vice President and Treasurer, Cincinnati Bell, Inc.

8. Leveraged buyouts
   Thursday 10/5

Case: Wisconsin Central Ltd. Railroad and Berkshire Partners (A), HBS 9-190-062
B-case, 9-190-070, will be distributed in class.
Case questions:
1. What are Wisconsin Central Railroad’s competitive advantages, if any? Why would this company be a good candidate for a leveraged buyout?
2. How is the deal structured? What is the reason for this particular structure?
3. Is the LBO a good deal? For whom? Compute the value of the LST division to WCA, using a DCF analysis.
4. Why did the budget crisis occur?
5. How do you think the problems facing Burkhardt and Ferenbach should be resolved?


9. Technology buyouts
   Wednesday 10/11

*Case:* Seagate Technology Buyout, HBS 9-201-063

*Case questions:*
In answering the following questions, assume that the transaction is expected to close on December 31, 2000.

1. Why is Seagate undertaking this transaction? Is it necessary to divest the Veritas shares in a separate transaction? Who are the winners and losers resulting from the transaction?
2. What are the benefits of leverage buyouts? Is the rigid disk drive industry conducive to a leveraged buyout?
3. Suez Acquisition Company plans to finance their acquisition of Seagate’s operating assets using a combination of debt and equity. How much debt would you recommend that SAC use? Why?
4. Based on the scenarios presented in Exhibit 8, and on your assessment of the optimal amount of debt to be used in Seagate’s capital structure, how much are Seagate’s operating assets worth? For both of the assumptions listed below, estimate the value of Seagate’s operating assets. (a) Assume that SAC plans to maintain its debt at a constant percentage of the firm’s market value. (b) Assume that SAC plans to pay down its debt as cash flows permit until a terminal debt level of $700 million is reached.


10. LBO case presentation
   Thursday 10/12

Student presentations of the Lubrano Can case. Write-ups are due in two copies at 3 pm on Wednesday 10/11.

*Visitor:* Michael E. Koester T’99, Managing Director, Goldman Sachs.

11. Financial distress: workouts and prepacks
   Wednesday 10/18

*Case:* The Loewen Group Inc., HBS 9-201-062
Case questions:
1. How serious are Loewen’s financial problems?
2. Are Loewen’s problems inevitable? Was the rollup strategy a fundamentally flawed concept? Is financial distress a reason to shun high leverage?
3. What did Loewen do wrong?
4. What options does the company have fore dealing with its problems? Which of these options is most or least desirable?
5. What does the capital market believe will happen to Loewen?
6. How will the restructuring process affect Loewen’s business? What impact will the restructuring have on Loewen’s stockholders and creditors? Why?


12. Bankruptcy: valuation and negotiation
Thursday 10/19

Case: Flagstar Companies Inc., HBS 9-299-038

Case questions:
2. What do you think of DLJ’s and Jefferies’ competing valuation analysis?
3. Do you see any merit in the junior creditors’ objections to the debtor’s proposed reorganization plan?
4. As the debtor or senior sub debt, what legal tactics and negotiation strategies would you recommend for dealing with the junior sub debt?
5. As a “vulture investor,” do you perceive any opportunities to make money by trading in Flagstar’s debt and equity claims?


Note: A one-page description of the term project is due in class.

13. Bankruptcy and distressed investors
Wednesday 11/1

Case: The Finova Group Inc. (A), HBS 9-202-095
B-case, HBS 9-202-096, will be distributed in class.

Case questions:
1. Were there any indications that Finova was financially troubled prior to its $80 million write-off in March 2000?
2. What financial return can Berkadia expect to make on its proposed investment in Finova?
3. As an unsecured creditor in Finova, would you find Berkadia’s offer attractive? What alternative options do you have, and how attractive are they relative to Berkadia’s offer?
4. As one of Finova’s shareholders, would you find Berkadia’s offer attractive?
5. As a distressed investor, what securities would you acquire in order to try to gain control of the firm? What opportunities are there to make money in this situation?
6. How is the outcome of this case likely to be affected by the presence and participation of distressed investors in Finova’s debt and equity claims?


14. Distressed investing

Thursday 11/2

Visitor: David J. Breazzano, Co-founder and Principal, DDJ Capital Management

15. Identifying opportunities in distressed debt

Wednesday 11/8

Visitor: John E. Foley T’96, Partner, Wayzata Investment Partners

16. Taking USG through bankruptcy twice

Thursday 11/9

Visitor: Richard H. Fleming T’71, Executive Vice President and CFO, USG Corporation

17/18. Student term paper presentations

Friday 11/10

Term papers are due before class. Note that this session run over 3 hours on a Friday (Section 1 from 9-12 pm; Section 2 from 1-4 pm). You should work your calendar so that you can attend.