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 to 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 studying the financial, strategic, and business issues surrounding corporate restructuring. It will be useful for students who consider careers in such diverse areas as investment banking, general management, strategy consulting, securities analysis, turnaround management, commercial banking and investment management.

Visitors
The class will be visited by the following speakers:

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

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

Michael E. Koester T’99  
VP  
Goldman Sachs

Matthew Mannelly  
President  
Cannondale Bicycle Corporation

Mark W. Peterson  
Senior VP and Treasurer  
Cincinnati Bell, Inc.

Anne Whitman D’93  
Principal  
Longroad Asset Management, LLC

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 supplementary 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 3-4 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 zero score 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 9 am on Tuesday 10/11. Presentations will be made in class to Michael Koester, Goldman Sachs.

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 10/20. The final report is due at 9 am on Tuesday 11/15. Projects will be presented to the class in the last two sessions.

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 2005

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SCHEDULE
Corporate Restructuring Fall 2005

1. Divestitures
Thursday 9/15

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 9/16

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 9/21

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 9/22

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. Restructuring Corning
Wednesday 9/28
Visitor: James B. Flaws T’73, Vice Chairman and CFO, Corning Incorporated.

6. Leveraged recapitalizations
Thursday 9/29
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. Leveraged buyouts
Friday 9/30 (note the day!)
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?


8. Restructuring Cincinnati Bell/Broadwing
   Wednesday 10/5

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

9. Technology buyouts
   Thursday 10/6

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
    Wednesday 10/12

Student presentations of the Lubrano Can case. Write-ups are due in two copies at 9 am on Tuesday 10/11.

Visitor: Michael Koester T’99, Vice President, Goldman Sachs.

11. Financial distress: workouts and prepacks
    Thursday 10/13

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 for 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. Restructuring USG
   Wednesday 10/19

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

13. Bankruptcy: the US Chapter 11
   Thursday 10/20

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?


14. Distressed investing
   Wednesday 11/2

Visitor: Anne Whitman D’93, Principal, Longroad Asset Management
15. The role of distressed investors in bankruptcy
Thursday 11/3

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 the company was financially troubled prior to its $70 million write-off in March 2002?
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?
   To answer this question, assume you are a holder of Finova’s 7.25% Notes due 11/08/04.
   In early June the total principal amount of the notes was $997.1 million. By the time Finova was expected to leave Chapter 11, there would also be $59.6 of accrued and unpaid interest on the notes. (In Exhibit 5, the notes were “trading flat,” which means that the quoted price excludes accrued interest on the bonds since the last interest payment date. The buyer pays the seller the flat price plus any accrued interest.)
4. As one of Finova’s shareholders, would you find Berkadia’s offer attractive?
5. 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?

Please note: The precise terms of the competing GE/Goldman proposal were not made public. For purposes of questions 3 and 4, assume that, following heated competition between the two bidders, the terms of the Berkadia and GE/Goldman proposal are essentially the same (same amount of new debt financing, same percentage of equity ownership given to the investors, etc.).


16. Bringing a brand back to life after bankruptcy
Wednesday 11/9

Visitor: Matthew Mannelly, President, Cannondale Bicycle Corp.

17. Student term paper presentations
Wednesday 11/16

Term papers are due Tuesday 11/15 at 9 am.

18. Student term paper presentations
Thursday 11/17