Distressed Value Investing

(** Tentative spring 2017 syllabus: All information below is subject to change**)
COURSE DESCRIPTION

The course will focus on evaluating and investing in the credit markets with a focus on investing in the bank debt and bonds of distressed/turnaround situations. Through the use of real world case studies, the course will examine the actual step-by-step process undertaken by a hedge fund/private equity professional when considering providing a loan or buying bank debt or bonds in the secondary market of a distressed company. By the end of the program, the students will develop an understanding of distressed debt investing and be able to perform a full credit/capital structure analysis and valuation of a distressed company in order to formulate trade recommendations.

Investing in distressed debt situations combines the intricacies of corporate organizational structures and legal frameworks with fundamental business valuation and securities selection. Given these nuances, the case studies will provide a gateway for students to experience and learn the different ways distressed debt investors make money in a classroom environment that promises to be interactive and fun. In order to further integrate practical investing insights into the classroom, there will be multiple guest lecturers that will supplement the coursework. Strategies explored will include:

- **Fundamental value plays.** Buying bank debt and bonds at market levels that imply valuations of the company significantly below its intrinsic value. For example, out-of-favor industries in secular decline such as the yellow page directories.
- **Legal structure plays.** For example, Enron and Lehman had multiple legal entries with bonds having different guarantors. Those investors that could figure out the legal structures quickly were highly rewarded.
- **Bankruptcy process plays.** We will learn about bankruptcy issues such as substantive consolidation, preferences, fraudulent conveyance, etc and examine how understanding these issues can lead to attractive trade ideas.
- **Distressed for control.** Buying bank debt or bonds with the intent of converting to the equity of the company.
- **New money lending.** We will go through examples of how investors made money lending into a distressed situation including Debtor in Possession (“DIP”) financing.
- **Off the run plays.** Buying trade claims or providing vendor puts.
- **Distressed M&A.** Buying a distressed company with the intent on monetizing the position through section 363 sale of the assets in bankruptcy.
- **Capital structure arbitrage.** Purchasing one instrument within the capital structure of a company and selling another instrument within the capital structure of the same company.
- **Asymmetric upside/downside plays.** Investments where the trading levels of the credit are such that there is limited downside in a liquidation but significant upside in turnaround.
- **Negotiations and game theory.** A large element of distressed investing is managing through conflicts. The course will also go through basics negotiating strategies, which students will practice as part of the case studies.

COURSE OBJECTIVES

By the end of the program the student can produce for a future employer a full corporate credit/capital structure analysis and make trade recommendations.
We will set up an investigative framework that permits the systematic and comprehensive assessment of a firm’s capacity to pay its financial obligations in a timely manner. In addition, we assess the recovery prospects for specific financial obligations should the firm become insolvent.

**Skills to be learned:**

- Industry analysis
- Financial Statement Analysis
- Cash Flow modeling
- Valuation techniques
- Liquidation analysis
- Legal issues / Documentation
  - Comparison of bank debt versus bonds
  - Structural and contractual subordination
  - Covenant analysis
  - Make whole and call protection
  - Change of control puts
  - Lender liability
  - Other
- Bankruptcy issues
  - Chapter 11 versus Chapter 7 & comparison to other legal jurisdictions outside US
  - Plan of Reorganization Overview
  - Priority of claims in a bankruptcy
  - Debtor in Possession (DIP) financing
  - Preference claims
  - 363 sale
  - Fraudulent conveyances
- Capital Structure arbitrage (purchasing one instrument within the capital structure of a company versus selling another instrument within the capital structure of the same company)
- Understanding credit default swaps as an investment tool

**ASSIGNMENTS**

Assignments will be handed out and emailed to students after each lecture. The assignments will be an integral part of the course and will vary from group projects (type A) to individual work only (type C).

**METHOD OF EVALUATION**

**Subject to change.**

<table>
<thead>
<tr>
<th>Component</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Participation</td>
<td>15%</td>
</tr>
<tr>
<td>Homework and cases</td>
<td>40%</td>
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<tr>
<td>Final exam</td>
<td>45%</td>
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</tbody>
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CLASSROOM NORMS AND EXPECTATIONS

- There will be substantial cold calling. Students will need to come to class prepared to discuss their views.

Miscellaneous:

- Laptops cannot be used during class regardless of purpose, except where specifically permitted in advance by the professor, as shown on the calendar. They tend to be distracting to the speakers and professor. Please don’t ask if I will make an exception for you.
- **No recording devices of any kind are allowed.**
- Please turn cell phones off.
- No guests are allowed for any portion of any class without professor’s permission in advance.
- Please start the subject line of any emails you send with “Distressed Class” so that the professor and TA can periodically go back and screen for emails we may have missed.