

University of Wisconsin**School of Business****Financial Policy: 755****Fall 2004**

Professor:	Dr. Toni Whited	Office:	5289 Grainger
E-mail:	twhited@bus.wisc.edu	Phone:	(608)262-6508
Office Hours:	MW 2:30-3:30 p.m. and by appointment	Fax:	(608)265-4195

Objective: This course is designed to provide you with a general understanding of a variety of financial restructuring and reorganization techniques. Each topic that we discuss describes a transaction that restructures or reorganizes the firm in some particular way. The specific objectives of the course include: (1) to help build a framework for analyzing various corporate restructuring transactions primarily through techniques of financial analysis; (2) to provide a broad overview of corporate restructuring approaches which can then be critically applied to solve business problems; (3) to establish an economic perspective from which to assess the corporate and social consequences of alternative corporate restructuring and reorganization techniques.

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Readings: The readings for this course consist of (1) a recommended textbook: Takeovers, Restructuring, and Corporate Governance, by Weston, Mitchell, and Hulherin; (2) a packet that includes case studies and three Harvard Business School notes; and (3) published articles on electronic reserve. Although it is not necessary to read these articles in their entirety, I do ask that you familiarize yourself with their content prior to class by reading the introduction and the conclusion.

Grading: Course grades will be based on class participation and attendance (20%), two group case write-ups (20%), two case presentations (30%), and a final project (30%). If you wish, you may do one extra case write-up. If so, I will drop the lowest of the three case grades.

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Contacting Me: The most effective way to contact me is via **e-mail**. I always answer **e-mail** within 24 hours and often answer **e-mail** immediately.

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Web Site: The web page for this course is <http://instruction.bus.wisc.edu/twhited/fin755>. Any materials not handed out in class are posted on the site. In particular, the site contains the lecture notes for the course. You should print these out and bring them to class. The website also contains the spreadsheets for the cases. You should check the website daily, and it should be the first place you want to look for course related information, or if you have questions regarding assignments.

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Class Environment: I encourage class participation, and I expect the atmosphere to be casual but respectful of all involved. Be sure to speak up if you have any questions or insights or other relevant comments. Do not be passive! Learn to communicate effectively and pay attention to how you ask questions and make comments. While the main point is to grasp the relevant material and add to the discussion, this is an opportunity to practice your communication skills.

I will also do a substantial amount of cold calling, especially on case days. If you have not read the case and cannot answer a question, 5 percentage points will be deducted from your participation grade. You will be given two free passes during the semester.

Case Studies: The case studies are placed at the end of a particular topic and are to be used as analytical and discussion tools. The objective in using case studies is to provide examples of companies or individuals that have faced the topic at hand and to apply theoretical tools to real problems. There are nine assigned cases in the course. You may choose any three to write up. Each group will do one case presentation: you will sign up for your cases on the second day of class. The content of the case write-up is as follows:

1. The cases should be done in groups of two to four members. At the end of the semester you will evaluate the members of your group. The allocation of grades among group members will be identical, unless the peer evaluations reveal unusual misallocation of effort.
2. The case write-up is to be a two-page single spaced (maximum) report. The two page maximum does not apply to exhibits such as graphs and tables, but please keep these to a minimum. You may use as many exhibits as necessary to make your but the exhibit must be referred to in your write-up. *The case write-up should be typed in 12 point type with one inch margins.*
3. Included in the syllabus is a list of questions and ideas that you may use as guidelines for analyzing the case. The case questions are designed to help you streamline the issues to be addressed. If you believe that these questions do not effectively address the problems in the case, feel free to go outside the scope of the questions.
4. **It is not necessary to summarize the case situation in your write-up. Summarizing the case is the single most effective way to do poorly on the case.** Do not, however, assume that I know every single number and detail. Use your best judgment on how much of the case to include in your write-up, but remember that no more than one short paragraph is necessary.

5. Case presentations are to be approximately 25-30 minutes in length, preferably in Powerpoint. Please turn in a hard copy of your slides on the day of the presentation.

6. Most importantly, you must take a position regarding the problem in the case and make specific recommendations on how to solve it. Support your recommendation as succinctly and as effectively as you can.

Final Project: Now it's time for some real world analysis! This project will determine 30 percent of your grade. It is because of this large project that there are no tests in the course. You should choose this project with care, as it is expected that you will be spending a large amount of your time working on it.

1. The reports can vary in length but should be no more than 30 pages including exhibits. Reports should be in 12 point type, double spaced with 1 inch margins. The final reports are due the date of your presentation.
2. The last three class sessions are scheduled for presentations. You are expected to attend class on these days, even if you are not presenting. I will make note of absences. I will take volunteers starting from the beginning for these three dates. If I have no volunteers I will put group names in a hat.
3. You should work on these projects in the same groups for which you work on cases.
4. Presentations should be 20 to 25 minutes in length.
5. You should think of this project as "writing your own case study." You should analyze an experience of an individual company that pertains to one of the topics that is covered in the course. I suggest that you pick a company for whom you have worked or for whom you would like to work.
6. Do not spend too much time describing the situation. I want to know whether you think the company's decision in the case is good or bad and **WHY**. As for the case studies, the single most effective way to do poorly on the project is to spend too much time summarizing the situation. You should spend no more than a third of your write-up summarizing.

Course Outline

Date	Topic
Wednesday, September 8	Separation of Ownership and Control
Monday, September 13	Conflicts Between Bondholders and Shareholders
Wednesday, September 15	Conflicts Between Bondholders and Shareholders
Monday, September 20	Leveraged Recapitalizations
Wednesday, September 22	Case: AHP
Monday, , September 27	Junk Bond Financing
Wednesday, September 29	Leveraged Buyouts
Monday, October 4	Leveraged Buyouts
Wednesday , October 6	Case: Goodyear Restructuring
Monday, October 11	Case: RJR Nabisco
Wednesday , October 13	Reverse LBOs
Monday , October 18	Case: Pinkerton (B)
Wednesday , October 20	Divestitures, Spinoffs and Equity Carve-Outs
Monday, October 25	Divestitures, Spinoffs and Equity Carve-Outs
Wednesday, October 27	Discussion Case: Strategic Capital Management
Monday, November 1	Case: Humana
Wednesday November 3	Case: Eskimo Pie Corporation
Monday, November 8	Bankruptcy
Wednesday, November 10	Case: Massey
Monday, November 15	Case: Cumberland (A)
Wednesday, November 17	Project Finance
Monday, November 22	Case: Airbus
Wednesday November 24	Day off
Monday, November 29	Insider Trading
Wednesday, December 1	Insider Trading
Monday, December 6	Case: Anheuser-Busch and Campbell Taggart
Wednesday, December 8	Final Presentations
Monday, December 13	Final Presentations
Wednesday, December 15	Final Presentations

Detailed Course Outline

I. Introduction and ReviewA. Separation of Ownership and Control [9/8]B. Conflicts Between Bondholders and Shareholders [9/13-9/15]**II. Restructuring with leverage**A. Leveraged Recapitalizations [9/20]

Readings:

Textbook: pp. 329-335, 487-489.

Case: AHP**[9/22]**

Case Questions:

1. The following debt rating guidelines and yields existed at the time:

	AAA	AA	A	BBB
Debt Ratio: (Debt/TotCap ^[1])	0.17	0.24	0.30	0.39
Interest Coverage: (EBIT/Interest)	18.25	8.57	6.56	3.82
Yield (%) as of 12/23/81	14.18	14.44	14.87	15.54

Given the above information, calculate more realistic financial projections for AHP under the three scenarios that AHP increases its debt ratio to 15%, 25%, and 35%.

2. Value Line reports the Beta on AHP to be 0.90 (as of April 9, 1982) and they estimate the growth rate on "cash flow" will be 13%. The yield on the Long-term U.S. Treasury on 12/23/81 was 13.60%. What is cost of equity under the above scenarios? What is the WACC? *Note: the market value of equity at the time was \$4.652 billion (155,068,985 shares times \$30/share).*
3. What would your projections look like assuming AHP's debt rating would be based off of Warner Lambert's rating and financial ratios?
4. Under the above scenarios (and assuming AHP does no restructuring), what is your estimate of the value of AHP as a whole? What is the value of the debt and equity under these scenarios assuming AHP issues debt and uses the proceeds to repurchase equity to attain the debt to capital ratios? What will the wealth impact on current shareholders be under the alternative scenarios from part 3?
5. So far, you have ignored the nonquantifiable aspects of debt usage. What are the important nonquantifiable effects of debt that we should consider in general (basic list). Are these important considerations for AHP? Why or why not?
6. What should AHP do in regards to the debt usage if they wish to maximize shareholder value considering your quantitative analysis and the qualitative concerns from part 5 (i.e., what's your bottom line recommendation)?

B. Junk Bond Financing

[9/27]

Readings:

1. History and Analysis of the High-Yield Debt Market, Harvard Business School Note, 9-297-002 .

Case: Goodyear Restructuring

[10/4]

Case Questions:

1. How did Goodyear become a target of a takeover? What stock price evidence do you have to support your answer?
2. What is the core problem facing Goodyear? Hint: Analyze the acquisition of Celeron

3. Analyze Goodyear's restructuring attempt to thwart the Goldsmith bid and give **specific** recommendations on what the firm has to do to keep Goldsmith from acquiring the company.
4. If the restructuring is successful, what advice do you have for Goodyear, in the long run, in order to remain profitable as well as not to attract the attention of another takeover specialist? (Hint: Be very specific in your recommendations.)
5. Who wins if Goodyear restructures according to your recommendations?

C. Leveraged Buy-Outs

[10/6-10/11]

Readings:

1. Kaplan, "The Staying Power of Leveraged Buyouts," *Journal of Applied Corporate Finance*, Spring 1993, 15-24.
2. Kaplan and Stein, "The Evolution of Buyout Pricing and Financial Structure (Or, What Went Wrong) in the 1980s," *Journal of Applied Corporate Finance*, Spring 1993, 72-88.
3. Textbook: Chapter 16.

Case: RJR Nabisco

[10/13]

Your job is to prepare the case as if you were going to argue **either** Management's **or** KKR's position. In doing so, you need to address the following:

Case Questions:

1. What is the difference between your strategy, both operationally and financially, and (i) the current RJR structure and (ii) your opponents? Note: You do not need to take the projections in the case as set in stone.

2. Numerically support your answer.
3. Find the highest price you are willing to pay for the firm. (APV is the easiest method.)
4. Argue why the special committee should take your bid.
5. Consider what strategy your group would use to make sure your bid is accepted over your opponent's. (You do not need to write this up in the case.)

D. Reverse LBO's

[10/13]

Case: Pinkerton (B)	[10/20]
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Case Questions:

1. Is \$16 per share a fair price for Pinkerton to receive for its common stock?
2. How expensive is the Berkeley subordinated debt?
3. Assume that the January 1990 IPO refinancing does not take place. Can Pinkerton service its existing debt and stay within the debt covenants? If permitted by MHTC, could Pinkerton pay dividends so that Wathen could solve his financial problems?
4. In view of your analysis of the questions above, what is your recommendation regarding the JPO? As management? As the principal shareholder?

III. Divestitures, Spinoffs and Equity Carve-Outs

[10/25/10/27]

Readings:

1. Cusatis, Miles and Woolridge, "Restructuring Through Spinoffs: The Stock Market Evidence," *Journal of Financial Economics*, 1993, 293-311.
2. Schipper and Smith, "Equity Carve-Outs," *Journal of Applied Corporate Finance*, Spring 1986, 23-32.
3. Textbook: Chapter 11

Discussion Case: SCM

[11/1]

Case: Humana

[11/3]

Case Questions:

1. Do you think Humana's problems are serious enough to warrant some form of restructuring?
2. How much extra value would be created by separating the hospital and health plan segments through a spinoff? What are the sources of this additional value and how should the spinoff be structured for Humana to realize the maximum benefits from the spinoff?
3. Do any of the other options considered by management represent a more sensible solution to Humana's problems than the spinoff?

Case: Eskimo Pie Corporation

[11/8]

Case Questions:

1. What is the estimated value of Eskimo Pie Corporation as a stand-alone company?
2. Why would Nestle want to acquire Eskimo Pie? Are there potential synergies? Is Eskimo Pie worth more to Nestle than it is worth as a stand alone company?
3. As an advisor to Reynolds, would you recommend the sale to Nestle or the proposed initial public offering?

IV. Bankruptcy**[11/10]**

Readings:

1. Note on Bankruptcy in the United States, Harvard Business School No. 9-292-062.
2. Textbook: pp. 342-347.

Case: Massey Ferguson**[10/15]**

Case Questions:

1. Assess the product-market strategy and financial strategy Massey pursued through 1976. Where possible, compare Massey's strategy with those of its leading competitors.
2. What went wrong after 1976? How did Massey respond? How did its competitors respond? What were the consequences for Massey? What could Massey have done

differently?

3. Assess the various alternatives at the current stage of Massey's difficulties. What options are available for alleviating Massey's financial problems?
4. As a financial adviser to Massey's management, what refinancing plan would you propose? Give particular attention to the various interested parties: shareholders, lenders, employees, governments, and management.
5. Why, fundamentally, did Massey get into financial trouble? Were a refinancing plan successfully executed, what would be the outlook for Massey's future? What alternative actions by management would have reduced the severity of Massey's financial difficulties?

<p>Case: Cumberland (A) [10/17]</p>
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Case Questions:

1. What are the principal financial problems confronting the management of CW at the time of the case? Were these problems brought about primarily by bad luck, or did poor decisions play a major role?
2. Are the financial markets, as reflected in the trading prices of CW's securities, accurately assessing the Company's prospects? Is there money to be made by investing in CW's securities? Specifically, does the market value of the right hand side of the holding company's balance sheet fully reflect the liquidating value of its assets? If not, why not?
3. Senior management seems to be convinced that the best way to build value for CW's claimants is to invest significant amounts in the rejuvenation of CR. What are the value implications for the claimants if the rejuvenation plan is successfully implemented? (At the time of the case, the yield on long-term Treasury securities was 8%; CR's long-term borrowing rate, as an independent company, would have been 10%, and its beta would have been 1.1) What risks are involved in the plan to rejuvenate CR?
4. Would you support management's plan for CR as a bank lender, as Sam Adams, as a preferred stockholder, as a common stockholder?
5. If CW goes into Chapter 11, how would you expect its business and prospects to be affected? How would you expect to fare in the bankruptcy proceeding as a bank lender, as Sam Adams, as a preferred stockholder, as a common stockholder?
6. Evaluate Morton's recapitalization plan. Would it, if implemented, result in a capital structure that meets the ongoing needs of the business? Which claimants would find it

appealing, which unappealing? As a bank lender, would you subscribe to Morton's premise that all of the claimants must share the pain of the restructuring?

7. If you were advising Morton on the restructuring effort, what changes, if any, would you recommend in his recapitalization proposal? How would you recommend that he deal with the problem of getting Sam Adams to waive or modify its covenants?

V. Project Finance

[10/22]

Readings:

1. Esty, "An Overview of Project Finance."

Case: Airbus 3xx	[10/24]
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Case Questions:

1. Why is Airbus interested in building the 3xx? What are its objectives?
2. How many aircraft does Airbus need to sell in order to break even on the investment? Is this number greater or less than your estimate of the demand for very large aircraft (VLA) over the next 20 years. (Hint: Consider all capital providers as a single entity and calculate the break even return to them collectively. To calculate the break-even number of planes, calculate the present value of the required investment, and compare it to the present value of a growing perpetuity of cash flows from plane sales beginning in 2008. Use an equity risk premium of 6%.)
3. As Boeing, how would you respond to this situation? How does your answer depend on what you think Airbus is likely to do?
4. Should Airbus commit to build the A3XX? How many orders should Airbus have before committing to develop the plane.

B. Insider Trading

[10/29-12-1]

Readings:

1. Meulbroek, "An Empirical Analysis of Illegal Insider Trading," 1992, *Journal of Finance*, December 1992, 1661-1699.

Case: Anheuser-Busch and Campbell Taggart

[12/6]

Case Questions:

1. Did insider trading cause the price run-up in Campbell Taggart? Provide specific evidence of your claim.
2. Is Thayer actually guilty of insider trading? Why or why not?
3. Did Anheuser Busch pay too much for Campbell Taggart because of insider trading? How would assess monetary damages in this case? Are there any other factors, other than monetary, you would consider in assessing damage?
4. Should Anheuser-Busch sue Paul Thayer or anyone else? If so, for how much?

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^[1] TotCap is the book value of debt plus, book value of common equity, plus the book value of

preferred. While we would prefer to use market-based figures, we do not have them for the ratings criteria. Thus, for the purposes of determining the debt rating we must compute the debt ratio consistent with the given debt ratio.