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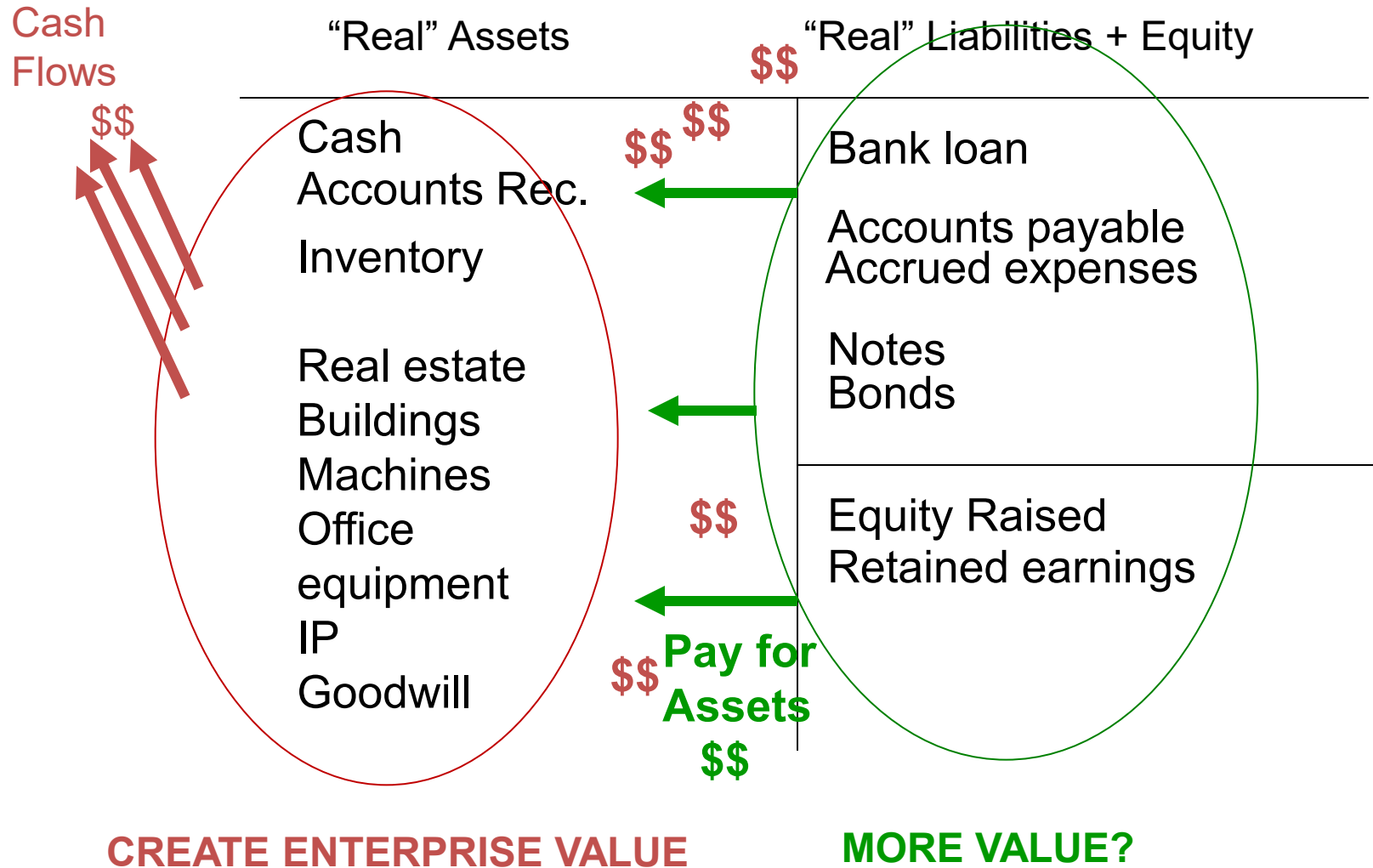


Restructuring in a Nutshell

UVA CRX Club October 2024



Thinking about a firm: A balance sheet perspective



Distressed Restructurings

- All about fixing a broken balance sheet.
- How? Repair the right and left sides of the balance sheet.
 - Right-hand side: “Bad” capital structures (too much debt) or expensive capital structures (rates are too high).
 - Left-hand side: Not generating high enough cash flows (structural or cyclical downturn, defective business model, poor governance, or some other operational challenge).

Two important concepts

1. Financial Distress

2. Insolvency

Two important concepts

1. **Financial Distress:** In danger of defaulting, or has defaulted on fixed obligation.
 - Examples of defaults: can't make interest payment, can't make principal payment, covenant violation, margin call, can't make payables, etc.

2. **Insolvency**

Two important concepts

1. Financial Distress: In danger of defaulting, or has defaulted on fixed obligation.

- Examples of defaults: can't make interest payment, can't make principal payment, covenant violation, margin call, can't make payables, etc.
- A default is a “tripwire” in under which capital providers can seek a remedy against the borrower.

2. Insolvency

Illustrating Insolvency: *ABC Co.* (date 1)

Assets	Liabilities + Equity	
Market Value, \$871mm	Credit facilities	\$65mm
	Secured notes	\$279mm
	Unsecured notes	\$491mm
	Equity	\$36mm

Total Debt (Face Value) = \$835mm



Illustrating Insolvency: *ABC Co.* (date 1)

Assets	Liabilities + Equity	
Market Value, \$871mm	Credit facilities	\$65mm
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	Unsecured notes	\$491mm
	Equity	\$36mm

Solvent or Insolvent?

Illustrating Insolvency: *ABC Co.* (date 2)


Assets	Liabilities + Equity	
Market Value, \$785mm	Credit facilities	\$65mm
	Secured notes	\$279mm
	Unsecured notes	\$441mm
	Equity	

Solvent or Insolvent?

Illustrating Insolvency: *ABC Co.* (date 2)

Assets

Liabilities + Equity

Market Value, \$785mm	Credit facilities	\$65mm
	Secured notes	\$279mm
	Unsecured notes	\$441mm
	"Impaired." Recovery rate = $441/491 = 90\%$ of face value	
		

Implications?

Combining Financial Distress & Insolvency

- Rich restructuring environment
 - Need to “fix” right-hand side: Can’t meet promised payments.
 - May need to also fix left-hand side: Why is value deteriorating?
- Who calls the shots on restructuring?
 - Equity is “out of the money.”
 - Creditors must coordinate and/or compete to manage through process.
- Who owns restructured entity?
 - Ripe for control play! M&A, debt-for-equity exchange, or something else.

Key Inputs to Restructuring

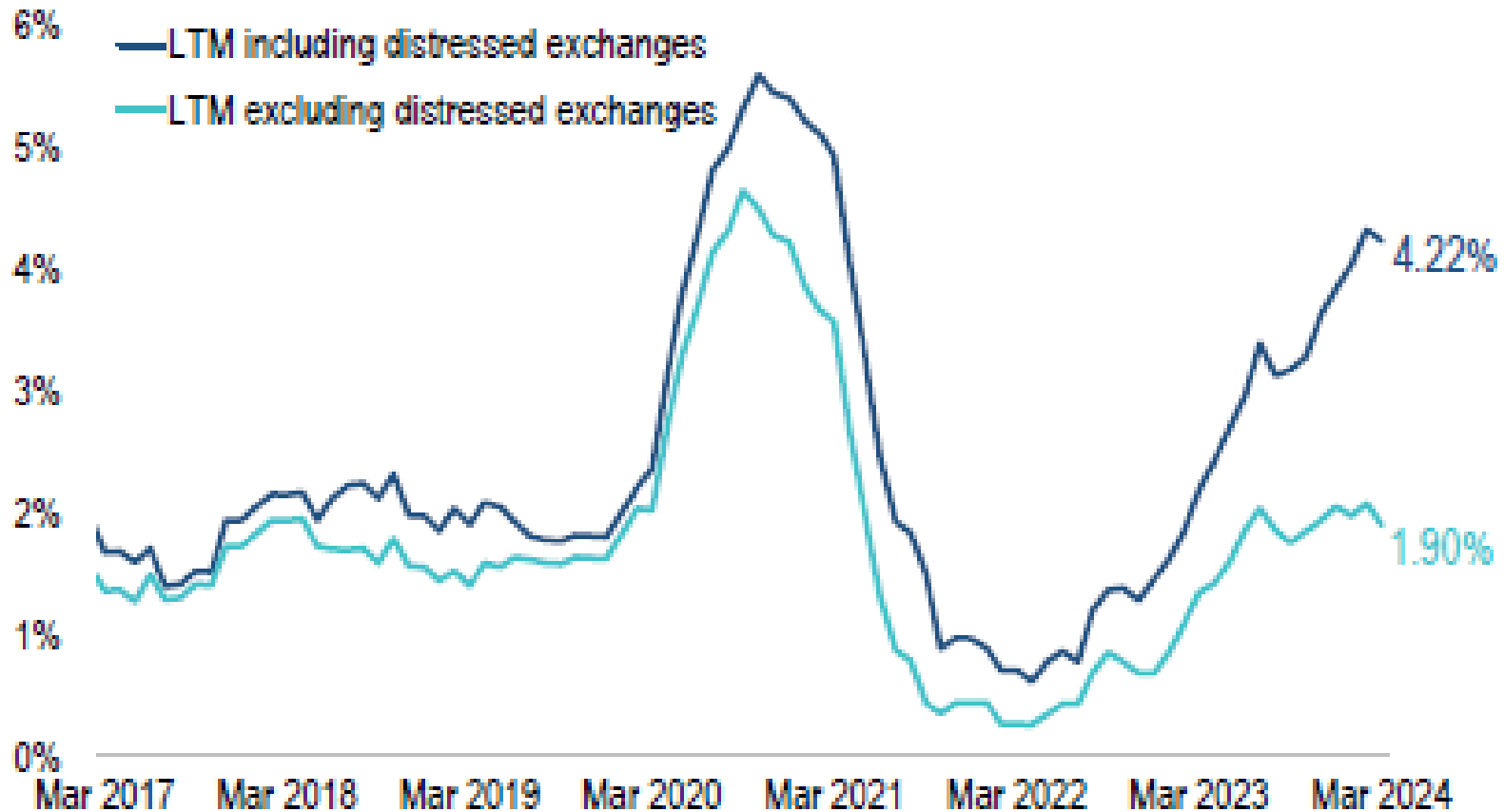
1. Valuation
2. Legal/contractual framework
3. Liquidity
4. Bargaining dynamics – “The chess game”

Forum for Restructuring?

- Out of court. All negotiations by and among creditors and the borrower are completed privately.
- In court (Chapter 11). Some, or all, negotiations occur within a U.S. bankruptcy court presided over by a judge.

Large Restructurings Today: Lots of out of court

Dual-track US loan default rate: issuer count



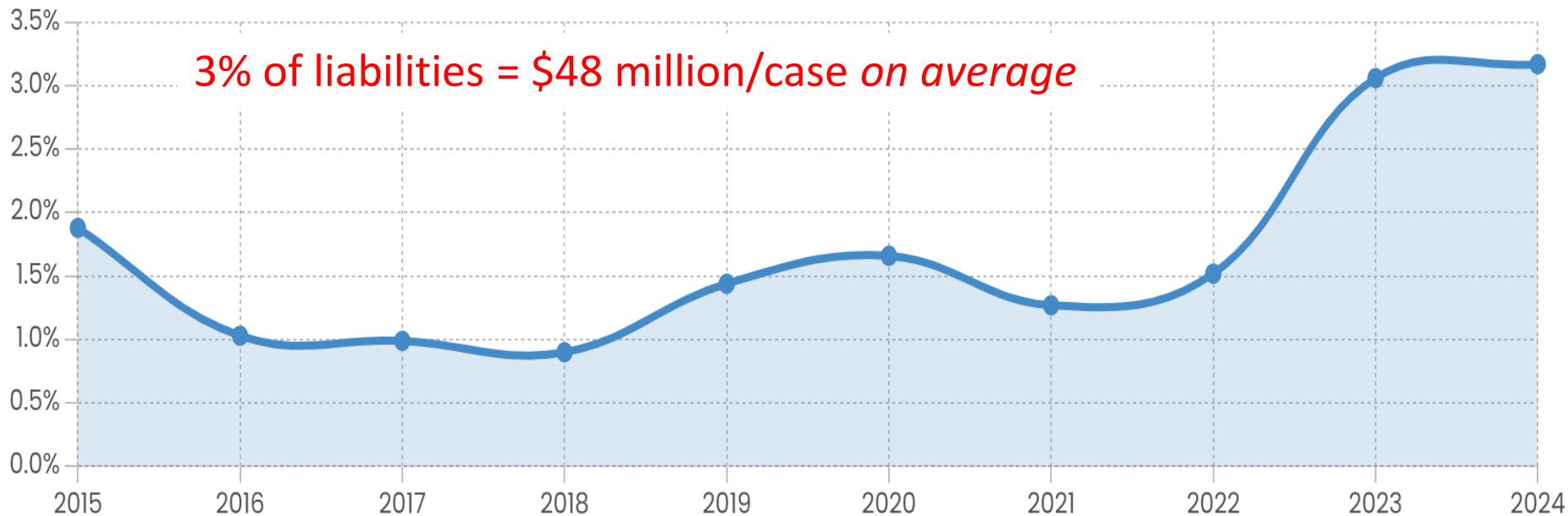
Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through March 31, 2024

Distressed Exchanges = Out of Court Restructuring

Chapter 11: Pluses and Minuses

- **Minus: Chapter 11 is expensive and getting more so!**

Legal Fees as a % of Liabilities (Over \$150 million) on Annual Basis For All Cases ▾



Source: Creditor Rights Coalition *Data Download*

Chapter 11: Pluses and Minuses

- **Minus: Parties constrained by additional laws, rules and regulations; involvement of court.**
- **Plus: Bankruptcy rules can help bargaining and cleaning up of balance sheet**
 - Automatic stay on all collection efforts.
 - Creditor voting procedures that give some weight to smaller investors, but prevents them from holding up process.
 - Debtor-in-possession (DIP) financing
 - Sale of assets free and clear of liens.
 - Assume or reject leases and other “executory” contracts.

ABC Co. =

QUIKSILVER



Assets

Liabilities + Equity

Market Value, \$871mm	Credit facilities	\$65mm
EMEA credit facilities \$26.8mm	2018 7.875% Notes	\$279mm
ABL credit facility \$38.2mm	2017 8.875% Euro Notes	\$268mm
	2020 10.00% Notes	\$223mm
	Equity	\$36mm

As of October 10, 2014

QUIKSILVER



Iconic surf (or “boarding”) apparel company started in 1970s
Struggled with variety of challenges during 1990s and 2000s
Acquired out of bankruptcy by Oaktree Capital in 2016
Closed on \$1.25B sale to Authentic Brands Group in March 2023



Quiksilver, July 2013-July 2014

(\$ in millions)

	10-K	10-Q	10-Q	10-Q	10-Q	LTM
	10/31/2013	10/31/2013	1/31/2014	4/30/2014	7/31/2014	7/31/2014
Operating Summary						
Total Revenue	\$1,819.54	\$450.62	\$392.61	\$408.22	\$395.66	\$1,647.10
Cost of Goods Sold	943.97	\$240.15	192.78	209.34	207.72	849.99
Gross Profit	\$875.57	\$210.46	\$199.84	\$198.87	\$187.94	\$797.10
% Margin	48.1%	46.7%	50.9%	48.7%	47.5%	48.4%
EBITDA	\$55.65	\$17.05	\$5.71	(\$9.12)	(\$165.13)	(\$151.49)
% Margin	3.1%	3.8%	1.5%	-2.2%	-41.7%	-9.2%
Interest Expense	\$71.05	\$19.98	\$19.42	\$19.24	\$18.77	\$77.41
Capex	(52.18)	(12.32)	(10.56)	(23.02)	(38.52)	(84.42)
EBITDA - Capex	\$3.46	\$4.73	(\$4.84)	(\$32.15)	(\$203.65)	(\$235.91)

Performance problems by mid 2014

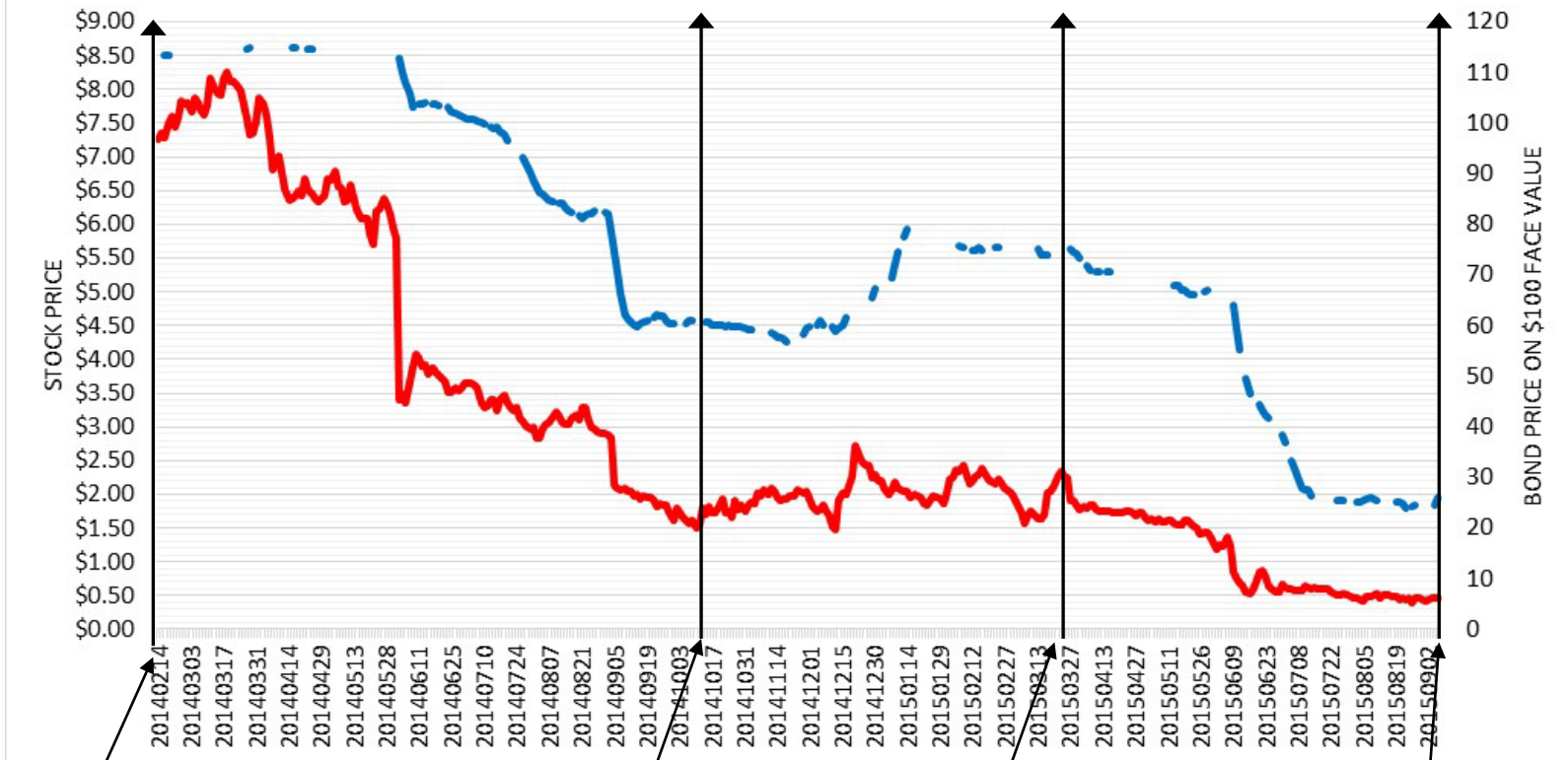
Profitability craters!

QUIKSILVER



Quiksilver, Inc. (ZQK)

— ZQK Stock Price — 2020 10% Notes



2/14/14
CEO Andy Mooney 8
Months into "PIP" makeover

10/10/14
Activist investor Ryan Drexler
calls for sale of company

3/27/15
CEO Mooney fired

9/9/15
Company files
Ch. 11 bankruptcy

ABC Co. =

QUIKSILVER



Assets

Liabilities + Equity

Assets	Liabilities + Equity
Market Value ?	Credit facilities \$65mm
EMEA credit facilities \$26.8mm	2018 7.875% Secured Notes \$279mm
ABL credit facility \$38.2mm	2017 8.875% Euro Notes \$268mm
	2020 10.00% Notes \$223mm
	Equity

Oaktree owns 73% of 7.875% secured notes

As of September 9, 2015

Plans to “fund” Ch. 11 reorg, including DIP financing, debt-for-equity Exchange, and equity offering at exit.



Assets

Liabilities + Equity

Estimate Market Value, \$580mm

New Credit facilities \$168mm

New Euro Notes \$191mm

New Equity \$221mm

As of February 1, 2016

New operating plan

New capital structure

February 11, 2016: Company exits bankruptcy

New equity owned by Oaktree Capital

March 2017: Company renamed "Boardriders, Inc.", 7% profit margin

Restructuring Advisors: 2 Primary Groups

1. *Financial advisory firms.* Focus on managing and advising capital structure renegotiations (Right-hand side of balance sheet)
 - Mostly investment banks, with “boutiques” playing a big role
 - Hire folks from undergrad and higher
 - Examples: *Houlihan, PJT Partners, Guggenheim, Lazard, Moelis, Evercore*
2. *Turnaround specialists.* Focus on improving company operations (Left-hand side of balance sheet)
 - Provide advisory services, expertise, and managers-for-hire (restructuring officers, CFOs, CEOs)
 - Typically don’t hire undergrads without industry experience
 - Examples: *AlixPartners, Alvarez & Marsal, FTI Consulting*