

TOPICS IN INVESTMENTS: INVESTING IN DISTRESSED SECURITIES

Prof. Allan Brown

INTRODUCTION

Hi and thanks for your interest in this class, which I've been teaching at Stern since 1998. A quick synopsis of my background: Degree in Electrical Engineering from UMass-Amherst (I am now qualified to change a light bulb, but only with adult supervision); graduate work in Physics; taught math and statistics at UMass; MBA from NYU Stern; student of Prof. Altman who was instrumental in getting me my first job in distressed debt investing; ran my own hedge fund focused on distressed investing; retired in 2009; serve on a couple of boards; besides that now I golf, sail, ski, travel, play the piano; and teach this class once a year...

There are some classes here at Stern dealing with bankruptcy and distress. Prof Altman's and Max Holmes's are two of them and you will certainly learn a lot from both. My class differs from theirs in that:

- 1) It is first-and-foremost centered on the investment and decision-making process, and builds up the bankruptcy/reorganization knowledge base and skill-set in order to give students the tools to make those risk-reward decisions.
- 2) Everything is in "real-time" and in the "real world." Aside from the first class's hypothetical case, we only look at companies that are currently in distress or in Chapter 11 and all of the case assignments will have students utilizing current SEC filings, bankruptcy court documents, and security prices in order to gather information and make a decision.

So except for our very first interactive session, which sets the stage for what is to come, every semester over the last 25 years that I've been teaching this course has been different. Of course, this makes it A LOT more work for me but it will definitely get you more engaged and better prepare you for what is really out there.

One side note: While this class is focused on distressed investing, the skill sets you will learn and develop here will help you become a better businessperson, period. Trust me when I say you will learn more from analyzing failures than from successes.

You will need to avail yourself of everything you've learned at Stern (accounting, financial statement analysis, corporate finance, investing theory, strategy, management and corporate governance) plus learn something new about corporation and bankruptcy law. So in that respect I think my course is the culmination of your academic experience at Stern. It's also the reason why distressed investing is one of the most intellectually stimulating fields to be in and why it attracts some of the smartest people in the world.

The (quite generic) syllabus is below, along with the (abridged) case studies we looked at last year. Also, although there is no required text for the class, I **highly** recommend that you get Michael Gatto's *The Credit Investors Handbook*. It is exceptional and the book I wish I had written. At \$71 on Amazon, it's the best bargain you'll get in your MBA education. Michael is one of the senior people at Silverpoint and also teaches at Columbia and Fordham.

## NEW YORK UNIVERSITY - LEONARD N. STERN SCHOOL OF BUSINESS

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### Topics in Investments: Investing in Distressed Securities

Spring 2026

Tuesdays 6:00 – 9:00 pm (February 3<sup>rd</sup> – March 24<sup>th</sup>; no class on Feb 17<sup>th</sup> and Mar 17<sup>th</sup>)

Room: UC-24 in Tisch Hall (40 W 4<sup>th</sup> St.)

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Office hours by appointment

Brad Eric Scheler

Fried, Frank, Harris, Shriver & Jacobson

**Objective:** To prepare students to understand, evaluate, and invest in distressed corporate situations and securities. Students will be exposed to the distressed and bankruptcy process from a number of different viewpoints (management, trade vendors, senior lenders, subordinated lenders, legal and financial advisors, DIP lenders, bankruptcy courts, vulture investors, distressed debt traders/brokers, equity sponsors) to better understand the roles, agendas, and objectives of each of the participants and how they affect investment results.

#### Course Prerequisites

- Basic accounting and financial statement analysis
- Basic knowledge of fixed-income and equity securities and related mathematics
- Basic corporate finance (discount cash flow analysis)
- Basic common sense
- Extraordinary enthusiasm and effort

#### Optional textbooks and reference materials

- The Credit Investor's Handbook  
Michael A. Gatto (Wiley, 2024)
- Corporate Financial Distress and Bankruptcy  
Edward I. Altman and Edith Hotchkiss (3<sup>rd</sup> Edition, Wiley, 2005)  
(and 4<sup>th</sup> Edition with Wei Wang, Wiley, 2019)
- Distress Investing: Principles and Technique  
Martin J. Whitman and Fernando Diz (Wiley, 2009)
- Distressed Securities  
Edward I. Altman (Beard Books, 1999)
- Distressed Debt Analysis; Strategies for Speculative Investors.  
Stephen G. Moyer (J. Ross Publishing, 2004)
- The Vulture Investors (revised edition)  
Hilary Rosenberg (Wiley, 1993, updated 2000)
- Bankruptcy Investing – How to Profit from Distressed Companies  
Ben Branch and Hugh Ray (Beard Books, 2007)
- Creating Value Through Corporate Restructuring: Case Studies in Bankruptcies, Buyouts, and Breakups  
Stuart C. Gilson (Wiley, 2001, 2<sup>nd</sup> Edition 2010)
- The Dark Side of Valuation: Valuing Young, Distressed, and Complex Businesses. 3rd Edition  
Aswath Damodaran (FT Press, 2015)
- The Art of Distressed M&A; Buying, Selling, and Financing Troubled and Insolvent Companies  
Peter Nesvold, Jeffrey Anapolsky, Alexandra Reed Lajoux (McGraw-Hill, 2011)
- Quantitative Analytics in Debt Valuation & Management  
Mark Guthner (McGraw-Hill, 2012)
- Bankruptcy Code and Rules  
(Thompson West, updated and revised every year)
- A good online site to reference the code is: [law.cornell.edu/topics/bankruptcy.html](http://law.cornell.edu/topics/bankruptcy.html)
- Other materials and case studies will be distributed in class

## Topics in Investments: Investing in Distressed Securities

Structure: The course will use a combination of lectures, case discussions, reading assignments, and guest lectures.

### Lectures:

Lectures will focus primarily on the bankruptcy/reorganization process, valuation methods, and special issues including, for example, issues related to claim seniority/subordination and stepdowns, estimating rejected executory contract claims, indenture analysis, and industry specific considerations. Recent academic research relevant to the area will also be discussed.

### Case Analyses: 3

Case studies will be distributed in class. Cases will be based on recently concluded or pending distressed situations and utilize a combination of consolidated facts and actual financial and bankruptcy court documents. Each case will stress a key evaluation aspect. Write-ups can be a maximum of 2 pages of text (single space with generous font and margins) plus unlimited exhibits, and will address specific case questions. Group write-ups are perfectly acceptable (maximum of 3 persons in a group, please); keep in mind that a group of x people submitting a write-up should demonstrate a proportional increase in effort. Group papers can be a maximum of 3 pages in length (plus maximum of 6 pages of exhibits). As a final point, please realize that quality and quantity are mutually exclusive (i.e. don't feel the need to fill up the page with fluff). Feel free to work on cases solo, if you wish.

### Tips for good case studies (in my opinion, if that matters)

- Try to deliver a professional-looking work product
  - It's a reflection of the effort you put into the project
  - It indicates that you're serious
  - It's usually easier to read
- Make sure your conclusions and statement make common sense
  - Don't rely on quantitative output of a model if the results seem out of line; take a step back and ask yourself if everything makes sense
  - Double-check for simple calculation errors and modeling mistakes; here it's only your grade; out there, it could be your job that's at risk
- If the case asks specific questions, make sure you give specific answers
- In exhibits, use arrows, circles, bold font, and comment boxes to point out relevant information that supports your case or that you'd like to emphasize
  - The less effort it takes me to find it, the happier I will be
- General Format (for investment recommendation)
  - Please start out with 2-4 sentences summarizing your investment recommendation
    - Investment recommendation should include:
      - What to do (e.g. buy, short, or hedged trade) and at what price
      - Target price => Expected absolute total return (%)
      - Timeframe => expected annualized return (%)
    - Rest of text
      - Investment rationale supported by data, evidence, and exhibits
      - Identification of risks to your thesis (try to quantify)
      - Other potential ways to structure trades

Reading Assignments: Current topics and primers. Students are expected to be able to discuss..

### Guest Lectures:

Prominent professionals in the industry will discuss a variety of topics related to distressed investing. **ATTENDANCE IS MANDATORY AND WILL BE RECORDED.**

Grading:	Case summaries	100%
	Class participation*	+/-
		100% (+/-)

## Topics in Investments: Investing in Distressed Securities

**Lecture and Case Study Schedule (subject to change)**

1	<p>Introduction to investing in distressed securities  Distressed vs. Defaulted Securities  Example of a distressed investment from start to finish  <b>Case 1 distributed: Evaluating a distressed bond; enterprise valuation; distribution to creditors</b></p>
2	<p>Historical Perspective  The high yield and leveraged loan markets  Distressed Investing – Overview  Life cycle of Corporate Distress and Reorganization  Investment Strategies – Choices and Drivers  Distressed Credit Analysis  Trading Conventions  Analytical tools      EBITDA vs. GAAP accounting      Evaluating the corporate and capital structure of the firm      Market value of the enterprise      Interest coverage ratios; cash vs. non-cash interest expense      Liquidity measures and availability      Estimating normalized operating numbers of the going-concern      Estimating debt capacity      Estimating the liquidation value of a firm.      Using DCF and cash-flow multiples to value the enterprise  <b>Case 1 discussion</b>  <b>Case 2 distributed: Indenture and Credit Agreement Analysis</b></p>
3	<p>Indenture and Credit Agreement analysis: What to look for as an investor and implications for security valuation      History of the Trust Indenture      Evolution and purpose of covenants      Typical affirmative and negative covenants      Modifications, supplements, and waivers      Events of default  Liability Management Exercises (LMEs)  Defaulted Credit Analysis      Valuation      Debt Capacity      Capital Structure Analysis          Capital Structure Arbitrage          Contractual vs. Structural Subordination      Guarantees      Examples  Balance sheet restructuring</p>

## Topics in Investments: Investing in Distressed Securities

### Lecture and Case Study Schedule

(continued)

4	<p>Bankruptcy and Insolvency Law  Brief history of bankruptcy  Cost of Bankruptcy  Chapter 11 Process  Bankruptcy and Consumer Protection Act of 2005  Operating as a Debtor in Possession; DIP Financing  The automatic stay  Executory contracts and unexpired leases  Exclusivity  Adequate protection and post-petition interest  Creditors' committee(s)  Cramdown  Best interests test  Plan of Reorganization and Disclosure Statement  Emerging from Chapter 11; Exit Financing; Credit Bidding, Rights offerings and other capital infusions  Chapter 7 liquidation</p> <p><b>Case 2 discussion</b>  <b>Case 3 distributed: Evaluation of a Plan of Reorganization and Disclosure Statement</b></p>
5	<p>The Bankruptcy Code in more detail; implications for investors  Equitable subordination  Substantive consolidation  Recharacterization  Fraudulent conveyance and Preferences  Jurisdiction  Tax issues  Pension plans and other post-retirement promises  Issues related to current employees: retention and emergence bonuses  Trustees and Examiners in Chapter 11  International Insolvency Laws</p>
6	<p>Discussion of the distressed securities industry (players, returns, investors)  Applications to portfolio management  Correlation to various benchmark indices  Investment and trading strategies  Bank Debt and Trade claims  Credit Derivatives  Hedging strategies and shorting securities  Leverage; The Role of a Prime Broker  Blocking positions  Acquiring control of the firm through distressed debt  Exit strategies  Academic research on distressed investing  Recovery rates  Performance of equities of firms emerging from Chapter 11  Not so great ideas: what we can learn from bad investments</p> <p><b>Case 3 discussion</b></p>

**RXT US** \$ **↑ 2.63** +0.25 \$2.62 / 2.63S 23 x 61


On 31-Jan Vol 1,700,319 0 2.41Q H 2.645K L 2.3536D Val 4.342M

**RXT US Equity** Report Contact IR Page 1/5 Security Description: Equity

Profile Issue Info Ratios Revenue & EPS ESG

**RACKSPACE TECHNOLOGY INC** FIGIBBG00W0JYQQ4  
 Classification Infrastructure Software

Rackspace Technology, Inc. provides information technology services. The Company offers colocation, managed cloud and hosting, compliance assistance, enterprise security, and data protection services. Rackspace Technology serves customers worldwide.

<b>8) Price Chart   GP »</b>  <b>Px/Chg 1D (USD)</b> 2.63/+10.5% <b>52 Wk H (11/13/24)</b> 3.4088 <b>52 Wk L (04/02/24)</b> 1.45 <b>YTD Change/%</b> 0.42/19% <b>Mkt Cap (USD)</b> 598.5M <b>Shrs Out/Float</b> 227.6M/64.2M <b>SI/% of Float</b> 4.3M/6.74% <b>Days to Cover</b> 5.4	<b>9) Estimates   EE »</b> <b>Date Aft-mkt (C)</b> 02/20/25 <b>P/E</b> N.A. <b>Est P/E</b> 12/24 <b>T12M EPS (USD)</b> -1.21 <b>Est EPS</b> -0.28 <b>Est PEG</b> N.A. <b>12) Dividend   DVD »</b> <b>Ind Gross Yield</b> N.A. <b>No cash dividends</b>	<b>13) Corporate Info</b> <b>14) www.rackspace.com</b> <b>San Antonio, TX, US</b> <b>Empls 5,800 (12/31/23)</b> <b>15) Management   MGMT »</b> <b>16) Amar Maletira</b> Chief Executive Officer <b>17) Kellie Teal-Guess</b> Chief Human Resources Offi... <b>18) Kathleen Schneider "Kathy"</b> Chief Marketing Officer <b>12M Tot Ret</b> 59.39% <b>Beta vs SPX</b> 2.14
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# **Rackspace Technology (RXT)**

## **Case #1 questions (Part 1 – Individual)**

- What are the qualitative positives (opportunities) and negatives (risks) of the business? (If you to add some high-level quantitative things, I won't stop you.)
- SWOT analysis
- What's the problem??
- Format: 3 pages maximum. (Bullet points or other fancy presentations helpful.)
- BE PREPARED TO DISCUSS IN CLASS!
  
- PLUS:
  - Dig up one (just one!) story from Bloomberg, Forbes, Barrons, WSJ, FT, anywhere about bankruptcy, restructuring, or distressed debt (corporate, municipal, sovereign) that you find (or you think I'll find) interesting and summarize it in ONE PAGE. --- EMAIL THIS TO ME ON BY END OF DAY, MONDAY, FEB 10th AND BE PREPARED TO DISCUSS IN CLASS.

## **Case #1 questions (Part 2 – Group)**

- What are the qualitative and quantitative positives (opportunities) and negatives (risks) of the business?
- What value would you place on the business? Using what methodology?
- How do you think situation will play out? Recover under the current capital structure? A Chapter 11 or other restructuring? What do you think the timing will be?
- Provide an investment recommendation:
  - e.g. Would you recommend any of the term loans, Notes, or stock here? If yes, what is your target price and investment return? Over what period? If no, at what price (under current conditions) would you be a buyer? Would you short the bonds or stock here? Recommend a trade with multiple legs (e.g. buy one issue and short another)?
- Justify all conclusions
- Format: 3 pages maximum of text, + 6 pages max of tables, and analysis. Bullet points helpful. Be sure to highlight important things in tables with bold print or comment boxes. (i.e. make it easier for me to read...)

## **Case #2 – Rackspace Technology Indenture Due for submission and discussion March 11, 2025**

Refer to the following documents (posted on Brightspace)

- Indenture for the 5.375% Senior Notes due 2028

**FOR THE PURPOSES OF THIS ASSIGNMENT, YOU SHOULD ASSUME A BALANCE SHEET AS OF 9/30/24 (i.e. from the most recent 10-Q; also posted on Brightspace)**

QUESTIONS:

1. If the issuer wanted to redeem the entire issue of 5.375% Senior Notes today, how much would it cost? What are some other ways the company could redeem or retire some or all of the Notes?
2. Based (only) on the Indenture, what is the maximum the company can borrow (all types of debt) over and above current outstanding amounts at 9/30/24?
3. Unsecured debt holders are always concerned that the company will issue debt that is senior (in ranking) to them or that is secured. Can the company issue any debt that is senior to the 5.375% Notes? Can they issue other secured debt? How much?
4. Based on the Indenture, how large a cash dividend can the company pay out to shareholders at 9/30/24?
5. In order to further increase the liquidity of the company, Betsy Atkins, one of the Directors of the company, has graciously offered to loan the company \$75 million at a 15% annual rate for 2 years. She proposed that this loan be secured by a 2nd lien on all assets securing the Super Senior debt. Can this loan be made by Ms. Atkins? Can the loan be made if it is unsecured and pari-passu with the Senior Notes? Can it be made if it is unsecured and subordinated to the Senior Notes? Can it be made if it's only for \$20 million?

**Be sure to fully describe the logic behind your answers and reference all applicable sections or definitions of the relevant document(s) that apply in your answer.**

Spring 2025

NYU Stern School of Business

Allan Brown

Investing in Distressed Securities

Case #3: Party City: Plan and Disclosure Statement

Due for discussion and to hand in on Tuesday, March 18, 2025



**Party City filed for Chapter 11 on January 23<sup>rd</sup>, 2023, emerged as a reorganized entity on October 12<sup>th</sup>, 2023, and then filed for Chapter 11 again on December 21<sup>st</sup>, 2024 with the intent to orderly wind-down and liquidate.**

- 1) Understand the framework of the Plan and be prepared to discuss in class.
- 2) Refer to NOTICE OF AMENDED EXHIBIT TO DISCLOSURE STATEMENT SUPPLEMENT filed on 7/23/23 (saved as “Amended DS Financials” on Brightspace).
  - a. Comment on the projections and assumptions. Are they reasonable?
  - b. How would you have valued the reorganized entity based on these projections.
- 3) Under the bankruptcy code, Section 1129 (a), The court shall confirm a plan only if all of the following requirements are met:  
...  
(11) Confirmation of the plan is not likely to be followed by the liquidation, or then need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.  
...
  - a. How could the financial advisors (and creditors that negotiated the plan) been so wrong?
  - b. Would the company have been better off to just liquidate in 2023? What would the recoveries have been to the Senior Secured Notes been if they had?
  - c. Could there have been a less leveraged capital structure on the reorganized entity that would have prevented a second Chapter 11? What would that have looked like?
- 4) We often ask: Does this company need to exist? What’s the problem? Can it be fixed? Hindsight is 20/20, obviously, but look at the pre-petition company, its operations, capital structure, etc., and try to answer those questions.

REFERENCE MATERIAL (All on Brightspace):

Amended DS Financials

DS fort First Amended POR

Supplement to DS for Third Amended POR

10K for 12-31-2022 (Has Chapter 11 info in there also)