Question 1

Financial distress is the situation that companies / individuals cannot meet their financial obligations due to insufficient cash inflows. Bankruptcy is one resolution; to avoid bankruptcy, one could consider options either in-court or off-court including liquidation or capital reorganization.

Question 2

Based on Exhibit 11:

EV = market value of equity + debt + preferred stock – cash

= 7.6m + (308.7m + 2097.8m) + 308m – 164.8m = 2557.3 m

Question 3

Seniority: Secured > senior unsecured > junior notes

FV-Secured = 1110m, FV-Senior = 400m

If holding junior notes only, value of junior notes remains zero if EV changing from 1.25b to 1.4b; if holding some of the senior unsecured debt, value will increase (essentially the total value of senior notes will increase from 140m to 290m)

Question 4

In the case of $2bn EV, SFTP and SFO will be fully repaid, and SFI has a recovery amount of $490m out of a total of $868m. Given this belief, a profitable strategy will be longing the SFI debe since it is significantly discounted.

Question 5

We can consider the valuation based on EV/EBITDA ratio. Based on the management projection, 2009 EBITDA will be $213.1m which implies a ratio of 5.86 – 6.57, a bit higher compared with deals of Sea World and Busch Gardens, Universal Orlando, and Cedar Fair in 2009. Based on this criterion the valuation is a bit higher compared with the market but not too far.

Question 6

If senior bond holders participate to the rights offering, they will pay additional capital now and become shareholders of the post-reorganization company, thus increasing their risk exposure to the company itself. They have to evaluate the situations of the company and the industry carefully. If they believe that after restructure, the company will be able to maintain good financial situation and earn a growing profit so that they will be able to secure the senior debt and earn additional capital gain from the firm’s equity, then they may take the rights offering.

Question 7

* EV =1.25bn:
  + 7% equity is given to senior bondholder (SFO) and 1% equity is given to junior bondholder (SFI).
  + SFO recovery = (1250-600) \*7%/400 = 11%
  + SFI recovery = (1250-600) \*1%/868 = 0.7%
* EV=1.4bn
  + SFO pays 450m
  + 93% equity is given to senior bondholder (SFO) and 7% equity is given to junior bondholder (SFI).
  + SFO recovery = [(1400-660) \*93%-450]/400 = 60%
  + SFI recovery = (1400-660) \*7%/868 = 6%
* EV = 1.7bn
  + SFO bonds were to remain in place ($400 M; around 28% of EV) and 85% of equity is given to junior bondholder (SFI).
  + SFO recovery = 100%
  + SFI recovery = 0%
* If EV = $1.4 bn or $1.7 bn, I would prefer the new reorganization plan:
  + New reorganization plan:
    - SFO recovery = [(1400-660) \*93%-450]/400 = 60%
  + Exchange offer
    - SFO recovery = (1400-600) \*7%/400 = 14%
* If EV = $1.2 bn, I would prefer the management exchange offer
  + New reorganization plan:

SFO recovery = [(1250-660) \*93%-450]/400 = 25

Question 8

Close the position now: This option should be executed as the risk and return of this option are fair. H partners has earned a significant return since restructuring. And the price of the senior bond increases back to a high-level price compared with the pre-petition price. Moreover, Six Flag’s historical performance is poor, and the volatility of the market can further increase the risk of the debt. Though the default risk on senior bond is relatively small, closing the position and saving the funds for other investment is fair in terms of risk and return balance.

Participate in the plan: This option can be executed if H partners is willing to bear the risk. Since they are still holding the senior bonds, the risk is relatively low and this position can be maintained.

Buy SFIs: This strategy is too risky to be executed.

Expand positions in equity: This strategy is also too risky. Since in default, equity holders are the most junior ones to get paid.