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Valuation in Maritime Chapter 11 Cases
Under the U.S. Bankruptcy Code: Genco and “NAV”

Michael B. Schaedle, Alan M. Root, and David G. Meyer*

In this article, the authors discuss the dispute over the valuation of a shipping company in Chapter 11, and how the bankruptcy court determined the company’s value utilizing the net asset value, or “NAV,” valuation method.

Several months after Genco Shipping Trading Limited, a dry bulk shipping company with a fleet of at least 53 vessels, and affiliated entities entered Chapter 11 with a prepackaged plan of reorganization, U.S. Bankruptcy Judge Sean Lane entered a confirmation order overruling objections to the plan from the Official Committee of Equity Holders of the Debtors (Mohawk Capital, Aurelius Capital Partners, and OZ Domestic Partners). In his order, Judge Lane held that the reorganization plan was fair and equitable and did not unfairly discriminate against the equity holders under 11 U.S.C. Section 1129(b) and was brought in good faith as required by 11 U.S.C. Section 1129(a)(3).

DISPUTING GENCO’S CALCULATED VALUE

The main disagreement centered on the debtors’ value used in the plan and the method used by the debtors and the plan’s opponent, the Equity Committee, to calculate that value. A minimum value of $1.48 billion was necessary for the equity holders to recover and not be “out of the money.” The Equity Committee contended that the debtors’ valuation analysis, which produced a value below the $1.48 billion mark, was improper and flawed, while the debtors and supporting creditors responded that the equity holders were fortunate to receive the recovery called for by the plan (warrants covering six percent of the new equity in exchange for the surrender or cancellation of their existing equity interests).

The debtors put on experts that testified that the value of the Genco company was in a range between $1.36 billion and $1.44 billion. The upper end of the range was near the $1.48 million floor, arguably justifying the

* Michael B. Schaedle is a business restructuring and bankruptcy partner at Blank Rome LLP. Alan M. Root is an associate at the firm, focusing his practice on finance, business restructuring, and bankruptcy. David G. Meyer is an associate at the firm, concentrating his practice on litigation related to the maritime shipping and energy industries. The authors may be contacted at schaedle@blankrome.com, root@blankrome.com, and dmeyer@blankrome.com, respectively.
warrant issue to old equity, which was characterized by the debtors as a gift. The Equity Committee put on experts that testified that the value of the Genco company was in a range between $1.54 billion to $1.91 billion. If the Equity Committee was found to be correct, then the debtors’ complex reorganization plan would not be fair to old equity and could not be confirmed.¹

When a shipping line is viable—when any business is viable—then Chapter 11 bankruptcy often becomes a fight over value between stakeholders at different levels of the capital structure; a fight over differing visions of “the present worth of future anticipated earnings” of the debtor corporation.”² And that fight can be messy as “valuation is not an exact science.”³ To quote the U.S. Supreme Court, “[M]ankind’s foresight is limited. The uncertainties of future estimates are recognized.”⁴

VALUATION METHODOLOGIES

Generally, valuation methodologies are various and the precise use of a given appropriate method or appropriate methods will vary depending on the company in question, its market profile, and the proposed use of the valuation in bankruptcy.⁵

¹ There were a number of other issues litigated at the Genco confirmation, including the “good faith” of the plan proposed (an argument that rode largely and practically on the Equity Committee being successful in convincing the court that their position on value was correct) and the extent of third party releases granted under the plan. This article does not address these points.


³ Id. at 242.


⁵ Genco, 513 B.R. at 243; I. Ratner, G.T. Stein, J.C. Weitnauer, Business Valuation and Bankruptcy at 25 (2009) (“When valuing a business as a going concern, [an asset valuation approach, an income valuation approach, and a market valuation approach] should be considered prior to choosing the most appropriate valuation approach (or approaches) to use. Entities that are going concerns are typically valued using the market approach and/or the income approach. However, depending on the industry, the asset approach may also be appropriate. For example, asset-intensive businesses with low profitability relative to their invested capital may be more appropriately valued using the asset approach under a going-concern assumption”); see also Assocs. Commercial Corp. v. Rash, 520 U.S. 953, 955–56 (1997) (method of valuation varies depending on debtor’s use of its assets).
The Genco company, of course, was in bankruptcy because of a balance sheet problem. It was and is a viable dry bulk shipping line with a valuable fleet and substantial cash flow. Genco was and is a going concern, and the challenge before the court was to determine its reorganization value. Generally, in the valuation of such a firm, the court should focus and account fully for the tangible and intangible value of the firm, consider the quality of the Genco management team, and the projected future cash flows.\(^6\)

Judge Lane noted that there are three primary methods for valuing a company in a Chapter 11 reorganization:

1. discounted cash flow analysis ("DCF");
2. market multiple or comparable company approach; and
3. comparable/precedent transaction approach.

However, the debtors' valuation relied on a fourth method: net asset value, or "NAV," which is "based on independent appraisals that incorporate an impartial assessment of the broadest, most concrete consensus regarding future earnings." The debtors did address other methodologies as a "sanity check" to confirm their NAV-based valuation outcome. In contrast, the Equity Committee contended that all four methods should be used together, with DCF weighted most heavily as the methodology that best captured the tangible and intangible value of a reorganizing going concern.

The court did a comprehensive job of describing the methodologies in question. Judge Lane noted that the DCF method finds for the "net present value" of a company by projecting unlevered free cash flows over a forecast period, discounting those cash flows using a rate based on the company's weighted average cost of capital, and then adding in a present value normed "terminal value" for free cash flows after the forecast period. Comparable company analysis refers to comparable company value, norming the values by reference to variables such as revenue, earning, and cash flows, and applying a market multiple. Precedent transaction methodology looks at comparable transactions, weighting varying circumstances and using purchase prices and earnings/cash flow/EBITDA information for a subject company to derive a total enterprise value.

\(^6\) *Genco*, 513 B.R. at 247 (noting that the Equity Committee argues that an asset-based valuation methodology violates what Judge Lane likewise regards as a generally accepted reorganization valuation approach and thus is inappropriate; Judge Lane nevertheless focused on the specific characteristics of the dry bulk carrier sector in the maritime industry and as developed further in the opinion, found the "NAV" approach the best method for Genco, its plan, its reorganization, and its sector).
UNDERSTANDING THE “NAV” ANALYSIS

The “NAV” value is as described above, and is a sum of fleet component appraisal values and other asset values (investment property, cash, and key contracts). The debtors’ expert on vessel values did not appear to have physically inspected Genco’s fleet vessels. Rather, the expert evaluated each vessel by reviewing three sets of fleet appraisals (including a set from his own firm and from the firm that was analyzing cash flow information) and then applying three assessment tools to find a final value:

1. Econometric modeling (based on the expert’s own proprietary models and algorithms and the normed earning power of each vessel, yielding a $1.215 billion fleet value);
2. Time series analysis (market vessel price averages, yielding a $1.26 billion value); and
3. “Last done” analysis (reports on recent sales and “market intelligence” on comparable vessel sales, yielding a $1.121 billion value).

The debtors’ expert also evaluated survey data, operational history, vessel age, and similar factors, which adjusted these measures, yielding a “charter free market value” for the debtors’ vessels of $1.211 billion. Then the Blackstone firm, the debtor’s primary strategic/financial advisor, took the vessel expert’s NAV vessel analysis and combined the vessel value with attributed values for net working capital, investment property, service contracts, and some other fixed assets to create the final NAV range of $1.364 billion to $1.444 billion with a $1.393 billion median.

In fighting the plan, as noted, the Equity Committee largely relied on a DCF analysis, which supported a $1.661 billion to $2.274 billion valuation range for Genco. The Committee had their expert on charter rates create adjusted rate projections, which were then used by Rothschild, the Committee’s primary strategic advisor from the financial side, to calculate a terminal value based on certain factors, and to otherwise assert the valuation range above.7

THE COURT’S DETERMINATION

Judge Lane found that DCF was not an appropriate method for the Genco case “largely due to the highly speculative nature of rate projections for the dry

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7 The debtors had Blackstone create a parallel DCF analysis, which, unsurprisingly, yielded a valuation range similar to that identified by the debtor NAV model. Id. at 255 fn. 32.
bulk shipping industry.” Instead, he found NAV to be appropriate as the main driver of a valuation analysis in the Genco case given the unique nature of the dry bulk shipping business, in combination with the comparable company analysis and to a lesser extent comparable transaction, and agreed with the debtors in concluding that the proper valuation does not reach the $1.48 billion mark. Based on the foregoing, under Judge Lane’s order, the equity holders would be “out of the money” by approximately $87 million and only entitled to receive the warrant package under the approved plan.

The court carefully considered the evidence presented by the debtors and the Equity Committee on valuation, and its decision is thoughtful and detailed—well worth reviewing in contexts where fleet valuation is an issue. A number of key themes emerged in the court’s decision:

• According to the court, the Equity Committee “did not question [the debtors’ vessel valuation expert’s] methodology,” but relied on argument and expert opinion that NAV is the wrong method to value an ongoing business in Chapter 11. Testing an expert’s informational sources to identify biases, hearsay, and comparable data set variances is critical in assisting a court in evaluating and weighing such testimony.

• The debtors’ primary valuation opinions were sourced from experts who were not key debtor strategic advisors. The Equity Committee’s primary valuation opinion was offered by one of its key strategic advisors, the Rothschild firm. Use of a strategic advisor in this capacity can enable broad discovery on client goals and approaches, which can inform how a court approaches testimony and opinions on value.

• When each team put up experts to address charter rates (the key to the Equity Committee’s DCF-based valuation), the Equity Committee used an expert who is an industry leader, a former shipping concern CEO with a strong market-making reputation, whereas the debtors

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8 Id. at 244. The decision conceded that DCF is a “traditional” analysis often used to determine reorganization value, but noted that DCF only works when a company accurately project future cash flows. On cross examination, the Equity Committee’s experts conceded that dry bulk shipping rates are “volatile and the industry can be characterized as cyclical.” Id. at 255. Blackstone, the debtors’ strategic advisor and NAV valuation aggregator, concluded that “[i]n the global drybulk shipping industry, charter rates are inherently volatile and can change drastically on a daily basis. This makes charter rates difficult to predict and cash flow projections inherently unreliable.” Id. Accordingly, on what it described as largely undisputed testimony, the court ruled that the dry bulk market was fragmented, with low barriers to entry, and little opportunity for market participants to differentiate themselves. This leads to a context according to the Judge where daily market supply and demand conditions determine rates on a daily basis, constraining the ability to project cash flows in DCF analysis. Id.
used a firm that forecasts shipping rates as a core part of its business. This court responded more favorably to the deeper quantitative grounding of the debtors’ expert’s opinions on rates, as opposed to the qualitative expertise of the Committee’s expert in evaluating such forecasts.

- When the court evaluated all other valuation methodologies, the debtors smartly led the court back to how NAV values either mirrored certain results or was a methodology used in a related process, like the giving of a transaction fairness opinion.
- The court found that it was notable that no player on the Equity Committee was willing to buy into the debtors’ capital structure post-emergence at the valuation levels suggested by the Committee.