Transcript: Max Frumes and Sujeet Indap – Inside the Sausage Factory of the Caesar's Restructuring (EP.209)

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My guests on today's show are financial journalists Max Frumes and Sujeet Indap, co-authors of "The Caesars Palace Coup," a book detailing the bankruptcy of Caesars Entertainment. Coming off the heels of our Private Equity Masters mini-series, this conversation dives into a private equity deal gone wrong, including some technical aspects of what it takes to emerge from a bankruptcy. We walk through the intricacies, tensions and dynamics of the Caesars bankruptcy, whose stakeholders included Apollo, TPG, GSO, Elliot, Silver Point, Oaktree, and Appaloosa – a literal who's who of giants in private equity and distressed investing. We then turn to applicable lessons for investors, including power dynamics, the unwritten rules of distressed investing, and the role of skill and luck.

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Ted Seides: 01:18 Hello, I'm Ted Seides and this is capital Allocators. This show is an open exploration of the people and process behind capital allocation. Through conversations with leaders in the money game, we learn how these holders of the keys to the kingdom allocate their time and their capital. You can keep up to date by visiting capitalallocators.com.

Ted Seides: 01:45 My guests on today's show are financial journalists, Max Frumes and Sujeet Indap, the coauthors of The Caesars Palace Coup, a book detailing the bankruptcy of Caesars Entertainment. Coming off the heels of our private equity masters mini-series, this conversation dives into a private equity deal gone wrong, including some technical aspects of what it takes to emerge from a bankruptcy. We walk through the intricacies, tensions and dynamics of the Caesars bankruptcy, whose stakeholders included Apollo, TPG, GSO, Elliott, Silver Point, Oaktree and Appaloosa, a literal who's who of giants in private equity and distressed investing. We then turn to applicable lessons for investors, including power dynamics, the unwritten rules of distressed investing, and the role of skill and luck.

Ted Seides: 02:40 Before we get going, I wanted to let you know that we're enrolling the first cohort of Capital Allocators University, a ive

online course that starts on September 21st. Rahul Moodgal and I have put together a course to help train investment professionals on the skills they need to succeed at the most senior levels of their organizations, but that aren't typically taught in investment curriculum. We'll be joined by an all-star cast of past guests on the show to help you learn foundational skills like time management and public speaking, and value added ones like decision-making and networking. Hop on the website and click university in the menu to learn more.

Ted Seides: 03:20 Please enjoy my conversation with Max Frumes and Sujeet Indap. Max and Sujeet, thanks so much for joining me.

Max Frumes: 03:28 Thanks for having us.

Sujeet Indap: 03:30 It's great to be here. Thanks Ted.

Ted Seides: 03:31 For each of you, it would be great, and maybe Sujeet just start of your background to the point where you were in a position to write this book with Max.

Sujeet Indap: 03:39 Yeah, sure. So I have a somewhat untraditional background. I'm not a trained journalist, at least academically, and I came to a career in journalism later in my career. I actually was an investment banker for many years before I made the switch. So I had done a traditional investment banking analyst program after college, dot com era, a great time to be coming out of school and getting into investment banking. I did that for two years at Merrill Lynch in the San Francisco Bay Area. Thankfully I was not a tech maker, I just watched the tech implosion around me and was actually focusing on very boring grocery store chains, which was actually a good place A, to learn, B, to avoid the dot-com implosion.

Sujeet Indap: 04:16 I came to the East Coast to go to business school at Wharton, picked a good year to come out, 2006, another bull market in investment banking. I hadn't been an M&A specialist when I was in Merrill Lynch, so I wanted to do M&A and I wanted to work at a small firm. So it was hard in New York for a few years. I went to a small startup boutique after that. And at some point, not quite midlife crisis, but one third life crisis, I was thinking about what else I could do with my career and things I hadn't done before, and I wanted to try, and by chance, I got this chance to

come to the FTO, which is obviously a great organization to just jump into, right place right time.

Sujeet Indap: 04:52 And so I read a lot about deals, transactions, stuff I had focused on in my investment banking career. I described my beat as the intersection of corporate law and corporate finance. And one of the things I started paying attention to early in my tenure was a series of interesting corporate finance happenings at a company called Caesars, which was a big leverage buyout that was staggering and stumbling maybe in zombie mode. And the owners of that business were doing interesting things to keep value alive and I started paying attention to it around that time, which was 2013 or 2014.

Ted Seides: 05:25 How about you Max?

Max Frumes: 05:26 Yeah, I am more of a traditional journalist background, even though I got my first journalism job before I had gotten any formal training. And it was, I guess the only journalism job I could get. I was reporting on actual trailer park finance, we call it manufactured housing, and it was in this wide array of publications known as B2B publications that focused on some type of niche area of business. And it goes out to people normally in those businesses, full of lots of jargon and esoteric terms, and a little bit more inside baseball. And rode that to a career of niche and specialized journalism. Eventually going back to school at the Medill School of Journalism to get my masters in Chicago, Northwestern, and then continuing to head east from California, but wound up over here in New York with my first job out of school, reporting on private equity for The Deal and The Deal magazine.

Max Frumes: 06:24 From there, I honed in on the corporate debt, that was the key to the private equity model and LBOs. And my career has just been, the more you specialize, the more stable your career is. And I got attention from a publication that focused specifically on all the leveraged loans and high-yield bonds and pricing information in the market, and then the health of those as they trade off into the secondary, and got my first job on the distress debt beat with LCD, Leveraged Commentary and Data, under Standard & Poor's.

Max Frumes: 06:56 And that's where I caught the attention of a businessman who was the author of the Distressed Debt Investing blog, and he

wanted to start a publication. It was very technical, specifically for the hedge funds that invested in distressed debt. After about a year of going back and forth, we launched Reorg Research in 2013 to do that. We ultimately hired bankruptcy attorneys and financial analysts, and wound up being one of these go-to tools for distressed debt investing hedge funds who were following multiple corporate bankruptcies to gauge which security they were going to invest in, what the value was going to be in these different plans among other things.

Max Frumes: 07:33

And one of our claims to fame was, covering all aspects of the Caesars bankruptcy, where there was multiple forums, a lot going on behind the scenes, just tons and tons of information that was filed onto the bankruptcy docket in Chicago. It required quite a lot of effort to follow all those different moving parts. That was my viewpoint, the front row for a lot of these fights. And after about four years at Reorg, it's a successful company, it was a startup effort, my share was invested, I wanted to do a couple of other things, include, maybe take a step back and write a book. Caesars was by far the best story out there. And then I was about six months after that, that somebody reached out on Twitter and said, "I heard you're writing a book on Caesars, I'd love to talk to you about this." And that person was Sujeet.

Ted Seides: 08:24

To set the stage, and I'm really excited to walk through this story. Sujeet, you mentioned you came out of grad school in '06 and went to banking. So a lot of this starts in this pre-crisis. Why don't you start walking through what the Caesars business and capital structure looked like before the financial crisis?

Sujeet Indap: 08:43

Sure. So a big part of our story is where did this business, which was commonly known as Harrah's come from, and why would these two private equity firms ultimately express interest in buying this company for roughly $30 billion? And so Harrah's, who had been this sleepy regional chain, founded by a guy named Bill Harrah, who started as this bingo hall in Reno in the 1930s. And by the 1990s, early 90s, it was part of a conglomerate of hospitality businesses, and was mostly an also-ran. And at the time the companies that were coming up in Las Vegas and in the gaming generally were built by guys like Steve Wynn and Kirk Kerkorian, or these master P.T. Barnum types who had created casinos around and resorts around explosions and volcanoes.

Sujeet Indap: 09:26

And Harrah's didn't have a trick like that, but by chance, there was this guy named Gary Loveman, who had been a PhD student at MIT in the late 80s, and became a junior professor at Harvard, that he had, early in his career, ideas around customer loyalty and ways businesses could build loyalty amongst the customer base, particularly in competitive fields. And so he started doing these executive education classes that what was then the Harrah's company, it just caught the eye of a CEO at the time, and to make a long story short, he was given a chance to be the executive straight out of never having an office job. Just being a professor at Harvard Business School, implement these ideas around customer loyalty and actually using the rich set of data that casinos collected to see what the revealed preferences of consumers were and give them actually very targeted promotions and advertising. If you will, the first big data project in this industry, which was the forehand, just dominated by family operators and not particularly sophisticated people.

Sujeet Indap: 10:20

And so total rewards ultimately takes off. And as it turns out, when you've got a machine like this, it's perfect for acquisitions. And so Harrah's at the time starts buying up chains in casinos across America and creating this hub and spoke system where visitors in regional casinos can earn points and they can take those points to Las Vegas. And the company knows exactly whether a customer wants a free steak or a free buffet or a free round of golf or gaming credits. And it creates this incredible engine, which turns into this acquisition machine.

Sujeet Indap: 10:49

And so if we get to now, the mid 2000s, Gary Loveman is the CEO of the company. The company is growing like crazy. It's mostly going well, but they're frustrated that the business itself isn't quite getting the valuation that a traditional hospitality company would get. And at the same time in the financial world or on Wall Street, you've got this industry private equity, which is coming into its own as a major player, not just for small broken companies, which was its heritage, but rather these funds like Blackstone, and TPG, and Carlisle, and Apollo, and KKR can raise $10 billion funds and they can pool their money.

Sujeet Indap: 11:24

And they're starting to take on the biggest companies in America. So those are like Toys R Us, and Alltel, and Clear Channel, and ultimately they come knocking on Gary Loveman's door, two of them, TPG led by David Bonderman and Apollo led

by Leon Black and his colleague Marc Rowan, who's an up and coming star at the firm. And so they had a very simple idea. And it's, I think one of the interesting parts of the story of Caesars, is that, again, the typical LBO was of a company that was undervalued or broken and needed operational help or some effort to whip it into shape. Whereas with these big LBOs that were coming into play at the time, 10 billion, 20, $30 billion, they could see it was very simple. They just had these massive funds, they could, Wall Street was willing to fund massive debt packages in the 10s of billions of dollars. And they were just simply putting a lot of leverage on a basically healthy business.

Sujeet Indap: 12:13 And so Harrah's was an investment grade company, and one of the rare ones in Las Vegas that owned a bunch of real estate. And because Apollo and TPG had raised massive funds, and the debt markets would finance massive companies with private equity type leverage, they put together a deal to buy Cesar or Harrah's or almost $30 billion, putting just six billion dollars onto it. So basically, 80% of the purchase price is funded with debt, and they're thinking, "We bought this business, it's basically healthy, it's growing, casinos are recession resistant, and there's basically no way we'll lose money here, simply because the leverage is so massive that it's not conceivable that our profits won't be in the billions of dollars."

Sujeet Indap: 12:53 And so that is the basic backdrop to this transaction, and the other deals of this era, that these typical big public companies did not have private equity type capital structures, but the market was willing to finance those at this moment for the first time.

Ted Seides: 13:06 So clearly we're going into the financial crisis and maybe it didn't turn out the way they had hoped. What did the capital structure look like? So you had this six billion tranche of equity, there's 24 of debt, what were the layers of debt?

Sujeet Indap: 13:19 Yeah, so there is two basic components of the capital structure. So if there's $24 billion of debt, there's one vehicle which we'll call the Caesars or Harrah's opco, where most of the casinos are, and that would raise $18 billion in traditional bank loans and then high-yield bonds. And there was also some pre-LBO Harrah's debt, which the covenants and the documents didn't call for it to be repaid. So all those bonds were unsecured. They we investment grade bonds, so they were relatively low risk at

the time. Since those didn't get refinanced, they were pushed to the bottom of the pile. So they went from very safe investment grade bonds to, at the bottom of an $18 billion capital structure in the so-called Harrah's opco.

Sujeet Indap: 13:59 And then there was just separate propco financing, which at the time was described as a CMBS structure. It was ultimately not quite securitized. It was just essentially a mortgage. And so rather than being financed by traditional cash flows, like in the opco where leverage is measured as multiple of EBITDA, so it's, whatever six, seven, eight times the EBITDA, propco was based on that loan-to-value metric. And so that allowed for even more leverage. In fact, it was, we recall the debt markets were very hot in 2006, so you could put a massive amount of leverage.

Sujeet Indap: 14:28 As we talked about in the book, there's this 14-month gap between signing and closing from December of 2006, so essentially the peak of the market, to really 2008 when the financial crisis is just on the doorstep. And so there is a lot of agitation in the leveraged finance market at the time, and many of these LBOs end up getting, hung is the word, or the debt is difficult to syndicate, and some of those deals got canceled and litigated or retraded. There was obviously, as we described in the book, some heartburn around getting the Caesars or Harrah's deal done. It ultimately happens, but it is safe to say that the business plan that this called for and this deal was financed on in late 2006, suddenly looks very different by the time the deal closes in 2008.

Ted Seides: 15:07 So the business isn't doing well, and you have Apollo and TPG who own the equity and obviously have a set of incentives to keep things going, so what happened from there, in between, I guess, that point in time, and ultimately there's a bankruptcy proceeding a couple of years later?

Sujeet Indap: 15:26 Yeah, so the deal closes in 2008, January of 2008, 14 months after being announced in late 2006. And so what's interesting about the 2009, 2010 era is, obviously, the economy has collapsed, Vegas is not immune from the great recession, the convention business, which had been relatively stable, obviously collapses with the collapse of Wall Street, Atlantic City is under siege, and so the business falls apart.

Sujeet Indap: 15:52 But simultaneous with that, and we all remember this, was, there was a massive amount of liquidity injected into the economy by the federal reserve, interest rates go basically to zero. And so there's all this money out there to refinance debt, if you want to. And if the core business is in bad shape, there's this incredible firefighting effort from Apollo and TPG. And Apollo is a master of capital markets in these kinds of transactions, and so, there's the usual debt exchanges, exchanging debt for a discount, refinancing debt, issuing new debt, pushing out maturities, all the stuff to just keep the auction alive, kick the can down the road, and hope for an operational turnaround. And so they do this in 2009, 2010, 2011, very traditional so-called liability management transactions.

Sujeet Indap: 16:42 But then there is this very fateful question, and this is something that confronts all sorts of private equity firms at the time is, do we actually want to put in, we, the private equity firm, put in more money into this deal to provide a bridge? And that's always a fraught decision because capital, even at these big firms, is constrained and you have partners who want money for their new deals when they don't want to throw good money after bad, but at the same time, if you feel good about a business, do you just put in more money to be that bridge to the actual operational turnaround?

Sujeet Indap: 17:12 Maybe the most famous example of this is the Hilton transaction, which was a similar, almost $30 billion LBO executed by Blackstone. Obviously, it gets hammered by the financial crisis, and ultimately there's a very tense restructuring of that business out of court. The creditors get beat up a little bit. They take a discount. Blackstone puts in a bunch of more money into the Hilton Complex. And within a few years, the business snaps back and Blackstone goes on to make $14 billion or something like that, and it's arguably from a gross dollar value of the British Private Equity Investment ever. And so that kind of decision confronts the owners of Harrah's, now Caesars, Apollo and TPG, do we put in more money, and how do we do that?

Sujeet Indap: 17:52 And so that's where the story actually gets interesting. Apollo has this idea and TPG have this idea that we will put more money into this business, but we're going to not just put it into these existing Caesar structures, we're going to create new

structures where we'll capitalize these vehicles, which will buy casinos and proper assets from the existing Harrah's and Caesars property or boxes, if you will. And that will give them the necessary liquidity. And these properties which need a lot of capital will go into these entities that are, for lack of a better phrase, bankruptcy remote.

Sujeet Indap: 18:24 And so that starts like the most interesting portion of the story, which is, Apollo and TPG executed a series of these complex asset deals, asset transfers, financial engineering, where more money is put in the business. They buy casinos from the existing Caesars and Harrah's opco, all in attempt extensively to keep everybody's investment alive.

Sujeet Indap: 18:43 The question is, what were the terms of those transactions? Apollo is sitting on and TPG are sitting on both sides of these deals, what's the corporate governance around them? What are the directors doing in these transactions? What are the bankers doing? What are the lawyers doing? And ultimately, those transactions, they do kick the can forward, but as we get into 2014, it's clearly not going to be enough to avoid some kind of reckoning, some kind of debt restructuring, either in court or out of court. And by this moment, amongst the various tranches of Caesars debt, which is bank debt, senior bonds, junior bonds and secured bonds, those creditors are now the most sophisticated hedge funds in the world. And they're starting to think about how are they going to play against Apollo in this chess match?

Ted Seides: 19:25 Well, Max, I want to turn it over to you now, because it's not just a couple of pools of capital and some players in this particular case that show up. We had this capital structure, we know we have Apollo and TPG moving some assets around, who else shows up for the dance and what happens from there?

Max Frumes: 19:41 In distressed debt investing and corporate restructuring, what generally happens is, distressed debt investment, hedge funds take a position in a certain tranche of debt, and they will organize with other creditors in that same tranche of debt and form what are called ad hoc groups. And then get legal counsel and financial advisors that then can concentrate on how to position themselves, A, with respect to the company and the company's financial advisors and legal advisors, and B, with respect to other creditors. And this is what really starts to

happen in 2014. Some of these creditors have been in and out of the company's debt because it started trading at a discount almost immediately after the LBO. In 2009, they started doing distressed exchanges, there was, Oaktree was probably the main example of a large fund with multiple investments in Caesars from the very beginning, and by 2014, one of their largest position was in the second-lien bonds.

Max Frumes: 20:40 Another fund that is known for distressed investing is also California Los Angeles based-bond, Canyon Capital Partners, a couple of Drexel alumnus run that fund as well. And they held up a large position in the second-lien bonds as well. And they start coordinating with Oaktree, and at least just analyzing their position, they hired very fortuitously, a law firm by the name of Jones Day, who's had a restructuring. It was, not only a great negotiator but a very savvy litigator, which become key later on in the case. And at this time they've seen a lot of these assets go out the door in their minds.

Ted Seides: 21:20 So Max, let me just make sure I understand where we are now. So we started with an operating company, an opco and a propco. And then through these series of transactions, those are new entities. And Apollo and TPG took some of the assets that were in the opco and capitalize those new entities and bought those assets at some transfer price. All along there's a parent, top of the holding company, that has a guarantee on all the debt that supports all of those businesses. I get that right?

Max Frumes: 21:54 That's exactly right. Ostensibly, they're all connected. This is all one big organization working together. And that's when we arrive in early 2014, Apollo, mainly Marc Rowan along with his deputy, and one of the key Apollo executives leading the case on this, David Sandberg, start negotiating with some of the term loan lenders who perform a transaction called the B7. The B7 term loan, essentially, at that point there's term loan debt and that sat at the top of the capital structure of the opco. The credit documents allowed for additional senior debt to be raised. So at the time, they had, between 1.75 and two billion dollars of capacity to raise more first-lien debt under credit docs.

Max Frumes: 22:35 But who's going to want to lend to this company that seems like it can't make its interest payments. And in order to do that, they started negotiating with a gentleman by the name of Ryan

Mollett, who's the point person for the Caesars Investment, for the credit investing arm of Blackstone called GSO. And along with GSO is another firm, one of the hugest asset managers out there, BlackRock, that also owns some of the term loan. And they offered them very, very generous fees among other things to participate in this transaction that accomplishes three things.

Max Frumes: 23:07 One, it's going to give them some liquidity to refinance out some of their other debt. Two, it's going to remove the most onerous covenant that they have, and essentially, the only maintenance covenant that they have, which is the senior secured leverage ratio. And three, they're going to release the parent guarantee. Something that all the junior bondholders have been afraid of. And in order to do this, they needed to do several things at the same time. But first, they had to get a couple of commitments from GSO and from BlackRock, which I think they committed to about half of this $1.7 billion. They do financing, the seventh tranche of this loan, and they got something like $220 million in fees, total, for that transaction, which is very expensive.

Max Frumes: 23:52 And the term loan owners, they agreed to a guarantee of collection. So they felt they still had a guarantee, and so simultaneous to this transaction of this new term loan-

Ted Seides: 24:04 How did the rules work in such a way that you've got a parent guarantee supporting, call it 24 billion of debt, and you can issue a less than two billion billion tranche that wipes out that entire guarantee?

Sujeet Indap: 24:19 The release of the guarantee is not just from the financing, there was a couple of things that happened. As a part of the financing of the B7, the company, Caesars, also sold stock in the opco. So the opco is a 100% where the casinos are, is a 100% wholly-owned subsidiary of the parent. And so, the guarantee can go away according to the dentures through three different conditions. One of those conditions is, if the opco is no longer a wholly-owned subsidiaries. So if they sell 5% or some portion of the opco stock to third parties, the guarantee goes away. And so that is how the guarantee is ultimately released. There's this transaction to sell a portion of the stock to a set of hedge funds.

Sujeet Indap: 25:00 But the problem with that transaction is obvious, right? The opco itself is deeply insolvent to this point. There is no equity

value. The debt is all distressed, so therefore there's no equity value. And so, this transaction to sell equity, whose purpose is to release this guarantee, it feels like a sham to the creditors. And in fact, the hedge funds that bought the stock in opco were all hedge funds who had debt positions, who were benefiting for the release of that guarantee. And then if you look at the analysis from the investment bankers at Blackstone, which is the firm representing the Caesars parent, they were saying, "There's no traditional value here. It's all option value. It was all smoke and mirror." And your question is the right one, Ted, this all feels like a sham. And ultimately that's the view the remaining creditors stake and it ends up being heavily litigated when we get to the bankruptcy.

Ted Seides: 25:44 So Max, now we're going through the bankruptcy, and you're going to have two sides. You're going to have the equity holders, Apollo and TPG saying, "Hey, there were no covenants. We followed through this covenant light documents," and the debt holder is saying, "You just stole all these assets from us." How does it play out?

Max Frumes: 26:01 A couple of steps before we get to the bankruptcy, because this was key. And there was several different ways that they tried to release the parent guarantee. And so before Caesars files for bankruptcy, this group of aggrieved hedge funds hires a smaller law firm known as Drinker Biddle at the time, now is Faegre Drinker Biddle, a lawyer by the name of Jim Millar, he has an argument that says that, this violated a depression era law that govern securities known as the trust indenture act. And this is essentially the sacred rights of all high-yield ventures, that everyone is guaranteed the right to payment plus interest at a certain maturity. And in order to amend those, you're going to need to get a 100% of the creditors on board, and if you don't, then that's a violation there.

Max Frumes: 26:45 He starts to get traction with this lawsuit right before they file. The Apollo and TPG meanwhile, lockup just one tranche of creditors. And this is significant, and if we hadn't quite gotten to who the so-called ally was for Apollo and Caesars was going into bankruptcy, which is the holders of the first-lien notes. So the first-lien notes at this point fall just under the term loan in terms of priority. So the first-lien notes now, trading at a discount, and could claim to be what we call the fulcrum security, going into a bankruptcy, which is the first tranche of

debt that is compromised or trading below par what wouldn't be paid off in full.

Ted Seides: 27:24 Who owned those first-lien notes?

Max Frumes: 27:26 And the biggest holder of those first-lien notes was Elliott Management. And this investment was led by savvy investors as one of the heads of the distressed debt investing, Dave Miller. And he had been running very tough negotiation with Apollo, and struck a very, very tough deal because he knew that Apollo needed an ally really badly. And so he got all sorts of goodies, including a convertible preferred security, as well as one of these well-known secrets in the industry, getting an agreement from Apollo to file for bankruptcy on a certain date, so that his CDS position would pay off. Where he'd taken up a CDS position that Caesars was going to file in the first half of 2015, even though they had enough liquidity to make it beyond that, that was the deal that was struck that led to this January, 2015 bankruptcy filing.

Max Frumes: 28:15 They couldn't quite get there with the term loan holders. There was a lot of drama. The term loan holders saw this deal that Dave Miller in Elliot had gotten, and they were looking at that and saying, "It looks like they're going to get more than we got. We demand more cash payment. We don't want to take back paper if Apollo is going to be designing it." So they want all these goodies, they can't get to an agreement with them. Second-liens are just, at this point, they're way out of the game, they're trading at 20 cents on the dollar.

Max Frumes: 28:41 Company goes to file for bankruptcy. And at this point, because the second-liens have been shunted from the negotiations, they have a plan to file an involuntary bankruptcy, which is very rare. They pushed that two days prior to the bankruptcy that Caesars is filing, and this all winds up in what we call a split screen first day bankruptcy hearing, where both hearings are going on at the same time, one in Chicago and one in Delaware. And then we tried to capture the drama of that day. And ultimately the Delaware judge, which is a well-known judge, that knew all the characters and the players and the lawyers, ultimately, he sided with the debtor. It was Caesars choice to file in Chicago. They filed it in Chicago. They got a wildcard judge, that kicked off one of the, if not, the most exciting chapter 11 bankruptcy that the restructuring world has ever seen.

Ted Seides: 29:36 So, Sujeet, take me back now. We've got this bankruptcy filed. There's a bunch of people around the table. We've got Apollo and TPG, we've got the term loan holders, GSO, we've got Elliot in the first-liens, we've got Oaktree in the second-liens, what happens from here and the twists and turns of this case?

Sujeet Indap: 29:55 What's fun about this world, and I think why we've written this book or why we think it deserves a book as you pointed out that there's all these diverse players, and it's this complicated multi-party negotiation, and they're all playing their own chess match with each other and their allies one minute, adversaries the other, and you never know when a part is going to flip. And so the way to think about the Caesars cases, there's these two competing forces. The typical chapter 11 restructuring is about reorganizing the company as quickly as possible, reducing debt, and minimizing the standard bankruptcy so you can get out of bankruptcy and just shut debt and avoid all the high costs of lawyers, which long, drawn out cases often are about.

Sujeet Indap: 30:36 And so there's this effort by Apollo, who obviously is the junior claim holder in the Caesars capital structure, being the equity holder, they are junior but they control the situation because it's their company, they own it. And so they try to exploit that advantage by trying to come up with a plan to restructure the company, sign up as many creditors as they can. They go into bankruptcy with this deal with Elliot, they just very quickly get a deal with the GSO group, and that is supposed to create all kinds of pressure on the most junior debt holder, which is the Oaktree, Appaloosa, second-lien bondholder group.

Sujeet Indap: 31:09 And so even if Apollo was most junior, they think they control this case because they control the company, and their restructuring plan has them staying in control because they're going to put in new money into the reorganized Caesars to buy it cheaply. And so if you're in the Oaktree, Appaloosa group, the junior second-lien bondholders group, you're about to be, what's known as crammed down, which means you're just going to get run over. Everyone else is going to sign up a deal and cooperate and impose this horrible restructuring on you where you get essentially wiped out. Again, Apollo is going to do well here because they're putting in new money to capitalize the new business and they stay in control and they're ultimately going to have all the upside of the new Caesars. And so that's one path here.

Sujeet Indap: 31:46 The other type of bankruptcy, and if we think about cases like Purdue Pharma or PG&E, which are high-profile recent cases, those bankruptcies are about resolving a mass tort or some kind of massive wrongdoing. In the case of PG&E, its wildfire victims in California, in the case of Purdue Pharma, it's opioid victims and communities who have been hurt by the opioid crisis. And so those bankruptcies are about finding the value of these claims and these wrongdoings in these torts, and then settling those through the bankruptcy process in an efficient way.

Sujeet Indap: 32:17 And so the tension in Caesars is around this traditional corporate restructuring, reducing debt and getting out quickly versus resolving a mass tort. But the mass tort in the case of Caesars is the accusation of fraudulent conveyance in these transactions where many of the top properties of the Caesars opco ended up in these affiliated entities where Apollo owned them and they were out of the hands of the creditors. And so again, Apollo signs up these senior creditors to restructurings, which are attractive. There's enough money in Caesars at this point where you can pay those guys off. It's at 150 cents essentially, and so you've got this then the ultimate battle royal in the case, which is this fight between Apollo on one side, and then Oaktree, Appaloosa on the other over the same pot of money.

Sujeet Indap: 32:57 And again, it's over the idea of, "Are we going to actually figure out if there was a mass tort here? And if there are billions of dollars of fraudulent conveyance claims?" Or is the judge going to say, "You know what, we've got a good deal on the table. We don't have time to drive this out. We're just going to impose some kind of 10 or 15% of recovery on these junior creditors and then we're all going to move on with life." And so that is the main intention of this bankruptcy case, that fight between restructuring this company quickly against figuring out was there actual wrongdoing before the bankruptcy.

Ted Seides: 33:25 So in this case, you've got huge well-resourced players on both sides. You've got Apollo, TPG on one side, you've got Oaktree, as you said, Appaloosa comes in on the other side. I'm curious as this goes through, and let's take a step back from this restructuring, generally, and look at all restructurings, how much does the size and the power of the individual players make a difference in the outcome?

Sujeet Indap: [33:50] That's an interesting question. I think you have to look at cases that are either in chapter 11, which is a formal bankruptcy and those cases that are not. And so, that kind of balance of power, I think makes a big difference when you're trying to do something out of court, afford a bankruptcy filing where large players take big stakes in capital structures. And because they have big stakes, it's easier to negotiate with counterparties on the other side of the table and also that impose your will on smaller players.

Sujeet Indap: [34:16] So if you think about what I think are the two most important players in the distressed debt world, those are, in my view, Elliot and Appaloosa, both of who were key players in Caesars, although in different parts of the capital structure. What both those firms do is, they take massive positions in particular securities and then they develop a very strong point of view and they have a lot of conviction. And when those two firms take a position, everybody knows that it's going to be a very difficult, if not painful, if they're going to actually fight those guys. So size, I think definitely does matter. And I think at the time, since Caesars is more and more of these handful of firms that are dominating the space and they're dominating because they have bigger and bigger funds and they're taking bigger and bigger positions.

Sujeet Indap: [34:57] But the wildcard is, when you actually are in bankruptcy things change a little bit in terms of the power dynamic, because there is now a judge who's overseeing the entire case. And that judge not only cares about size, he cares about the equities of the case and applying the law. And so, one of the twists in Caesars is that, there are a series of small players in this land of giants of Elliot's and Appaloosa, and Oaktree and Silverpoint and Blackstone and others, where they are able to use the levers of a formal bankruptcy process, including judicial hearings and a judge to actually exercise their own form of power through what they think is the proper application of the law.

Ted Seides: [35:37] In the case, we got these big guys fighting against each other. And Max, why don't you equip through the highlights here of what the twists and turns are and where it ends up?

Max Frumes: [35:45] The case starts off with, I guess the second-liens trading at 10, 15, 20 cents on the dollar. First-lien bonds trading, let's say 75, 80, and then the term loans around 90. Throughout of course

the case, there's, like Sujeet mentioned, a lot of pressure around whether or not they're going to allow these lawsuits to go forward or not. And ultimately an injunction is put in place in up until the threat of it being lifted forces, everyone to come to the table for certain negotiations. Meanwhile, the company is improving without paying two billion dollars interest. They're able to invest in new renovations for the casinos, capital expenditures to make improvements that then start bringing the business back, the economy starts picking up. And so over time the actual results are improving, so this debt starts picking up in the secondary and they're constantly, just 10 cents apart between Apollo's offer to the second-liens and what the second-liens actually want.

Max Frumes: 36:45 The most important thing that happened in the case was the examiners report. We joke that he's their co-author. And Richard Davis is a former Watergate prosecutor, chosen as an examiner at the beginning of the case and gets deep access, interviews, 75 different people who were designing and behind these transactions, goes through millions of documents with a team of advisors. And ultimately comes out with an 1800-page report that does say, "Indeed, there's about five billion dollars worth of potential claims against Caesars, Caesars executives and the private equity executives who were behind it." And not only the firms, but potentially only the people who were involved, they're personally liable. And that, while it's not legally binding, is a watershed moment in case, it influences how the judge sees the case.

Max Frumes: 37:32 Ultimately, the judge permits this motion by the second-liens attorney seeking the disclosure of the personal financials for the Caesars' executives and the private equity executives involved, including Marc Rowan and David Sambur from Apollo, David Bonderman from TPG and Gary Loveman from Caesars. And that's enough to put pressure on those parties, along with all the other things that were going on to come to a deal.

Max Frumes: 37:58 And ultimately, both the prologue of our book and then the scene later on where there's a resolution, the main parties come into a room at Kirkland Ellis' law firm. They start shouting at each other about trying to just basically bridge $130 million gap. I would add that this stranger than fiction tale, where the interactive gaming business that is just chugging along, wasn't even allowed to pursue online gambling and just wound up

being sort of a not-for-gambling poker game on your cell phone with the world series of poker brand, winds up becoming a four-billion-dollar business sold to a Chinese conglomerate that gives Caesars this huge pile of cash to then settle the case.

Max Frumes: 38:43 That comes in and it allows them to bridge the gap without Apollo losing more than it had put in of its initial investment, but ultimately with all that was hanging over them, they agreed that they would give up all of their initial equity investment. Which is what Appaloosa and Oaktree and the second-lien creditors were demanding, not just for the profit, but in their eyes for justice.

Max Frumes: 39:04 They get to this settlement number, are able to bridge the gap and it's made a lot of people a lot of money. And you're talking about there was a 66 cents settlement for the second-liens, but that came with equity options that ultimately took that above par. For the first-liens, they were paid out at par plus these convertible preferred that brought that well above par. The term loan debt got everything that they had wanted, par plus accrued for the entirety of the case, which is what they were asking for from the beginning, with a decent amount of that being in cash.

Max Frumes: 39:35 And it's an enormous success for the distressed debt investing world. And while it was a huge loss for Apollo and TPG, their reputations of being able to fight for their LPs allowed them to, immediately after the conclusion of the bankruptcy and the confirmation in 2017, two years later, they raised the largest private equity fund ever up to that time. That's a great place to, I jump off there is, what were some of the lessons for investors in private equity and in hedge funds in those investment vehicles learn from this case?

Ted Seides: 40:08 Yeah. It's an amazing story, and somehow, as I told you guys, somehow it's imminently readable despite the technical nature of it. Let's dive into some of those questions about what this means in the scheme of things. And so, let's start with the process itself. And there's this question of, what are the rules in these games? So in distressed investing, there's legally what you can do. And you can think about that now where there's no covenants. And then there's this question of, what's the right thing to do? Etiquette, if you're playing tennis with someone and there's a ball on the court, you pick it up. It seems like some

of these players just play by different rules. How does that play out less so much necessarily in Caesars, but broadly in the distress business?

Sujeet Indap: 40:52

Yeah, so one thing that I think is an interesting change in the norms and conventions of this rule is that we'll just start with the most basic one. There was a time, if you were a private equity firm and your investment went south and some trouble in your equity was worthless that it wasn't close to having a chance to ever be recovered, you would just very kindly, very politely just hand over the keys to the creditors and tell them, "Good luck to you. We wish you well." And you would tell your own LPs that, "This is a risk of private equity. We invest a dollar, we can lose a dollar, but the reality is often we're going to turn one dollar into three dollars or four dollars and four dollars. And so we do that enough times, it doesn't matter if every so often we lose one dollar on a one-dollar investment."

Sujeet Indap: 41:33

Now the attitude is that these documents, over the last decade plus, were very loose. They give us all this flexibility to keep kicking the can so we can keep doing various liability management transactions to keep the auction alive. And you don't have to mark down the investment, and we can hope that we strike gold or there's a lightning strike down the road, and on occasion, that happens. But that has also led to an erosion that you say of the norms of what you could and should do with counterparties, in this case, creditors. And creditors now have made their own debt companies with these loose documents and they have gone to these transactions eyes wide open.

Sujeet Indap: 42:10

And so we talked about the Caesars case, there was all this novel financial engineering and aggressive corporate governance, and we end the book in the epilogue saying Caesars ended up being less of a cautionary tale and more of a roadmap. And the reason for that I think is very simple. People realized that after this deal Apollo raises a $25-billion fund and the LP community didn't really penalize them. And maybe if they can face modest consequences for what was apparently aggressive behavior in the Caesars case, maybe if we TPG can be aggressive in J. Crew, which is another high-profile transaction sentence, or even Marcus, where you have private equity owners and some very aggressive financial engineering.

Sujeet Indap: 42:50 And so, between the kind of breakdown in traditional decorum and loose documents, there really is an attitude now of being as aggressively as possible. But there is the sense that the courts and other gatekeepers have had a difficult time keeping up with the innovation and the attitudes and behavior in this world. The reality is there isn't great traditional distressed debt investing opportunities at the moment, because there's so much liquidity in the market and companies that probably deserve to go under are able to kick the can and avoid reckonings. Whereas the traditional bankrupt company of late has been a bad company without the capital structure, which has led to these really brutal and seemingly pointless legal fights

Ted Seides: 43:29 So Max, in these situations, the LPs might want to reward an Apollo and a TPG for being aggressive, but I don't quite understand why if you were, let's say a GSO or a BlackRock who are lending and are at risk of that aggressive behavior, you wouldn't find a way to increase the cost of capital to those private equity firms relative to others that might not take such a hard line? How does that play out in the markets over time?

Max Frumes: 43:55 You hit the nail on the head. It's really difficult to impose your will as a creditor in these markets, because of the proliferation of CLO funds and capital going towards leveraged loans has exploded. So there's so much demand for leveraged loans because of CLO funds and then the increasing amount of high-yield funds that are also looking for bond debt that these more sophisticated investors or someone who would know or has the lawyers to negotiate for better documents, can't do it. They're all very loose. They're all covenant light and there's increasing loopholes. Even in post pandemic right now, we're seeing companies that are pretending like 2020 never happened. And just using 2019 EBITDA as a gauge for where their actual leverage is going to be going forward and they're able to raise debt.

Max Frumes: 44:44 And so it's very difficult in that environment, even though, you know what's coming to have negotiating leverage with a leverage loan or a bond issuer. So we'll see these funds that are looking for maybe smaller privately negotiated loans, the ESG factors, anything that maybe is non-ESG or go off the run, provide a huge loan to a cannabis-oriented business, or start investing some side pockets into SPAC deals and playing some SPAC arbitrage, how flexible their fund is, even though they

know it's coming, they can't do anything about asking for stricter documentation because somebody else is going to fund it.

Ted Seides: 45:21 With all the twists and turns coming into and then through the bankruptcy, how do you think about skill versus luck of each of the participants along the way?

Max Frumes: 45:32 I guess, luck favors the prepared in these cases, and it's combination of both. That's why they call them hedge funds. They're going to have multiple bets, they'll put money towards as much asymmetric risk reward deals as they can, and if they have success, they'll continue to try it. Just like Dave Miller, a home run with this incredibly innovative convertible preferred instrument that he just slipped into the RSA and continued to get re-upped as Caesars case went on, it probably aid Elliot nine figures. They looked for similar types of deals later on, I think in Claire's and elsewhere, and it wasn't the same. It's more difficult to continue to do.

Max Frumes: 46:11 I think that it's that level of sophistication and putting a weighting on how likely these legal claims are to be successful and then having the conviction to go with that. It's going to be a combination of the two, but ultimately I think a fund like David Tepper, you're going to have someone who is not only lucky and skilled, but is unflappable. And I think that's where a lot of distressed investing gains probably a good reputation, for being able to not show fear at these times when there's incredible uncertainty, if they feel they really know the market. And that's what happened here.

Ted Seides: 46:48 It feels like a lot of the stress that you expect it to be some type of skill. So it's David Tepper's temperament to be able to fight to the end, where does luck come into play in this market?

Sujeet Indap: 47:02 Yeah, so there's the expression that you would rather be lucky than good. I think the real expression is, you'd probably be lucky and good. And then there's the question, can you make your own luck? And so, one of the reasons I would say there is a book about this case is because there are all these really odd balls, serendipitous moments. There's a judge in this case who was very untraditional, does not have the experience in big cases, so he gives the lawyers for the creditors unusually wide berth, there's this weird lawsuit about the guarantee, which hovers

over the case. And I think there's an appeal, and that doesn't come until the very end of the case. And that if it had come any day earlier, it would have changed the outcome. There's this developing asset that now is worth four billion dollars in this case, which creates enough money to figure it out.

Sujeet Indap: 47:43 You cannot overlook how much, not just luck but randomness, plays into this role, particularly when it is so much legally based, just guessing what a judge is going to do. You never know how a judge is going to feel about a certain issue on a certain day. As Max said, it is about trying to hedge your bets and doing as much analysis as you can. And if you look at distressed debt returns, they're uneven and they're not great over time. And if you look at the firms that either were successful in Caesars, it was more generally because dominant players in this world, they've definitely had rough go's, in that they have had big losses in other cases.

Sujeet Indap: 48:19 And this is a profession where the people don't sleep well and they're always just one step away from disaster. There's all these traditional long-only buyers of debt, whether its loans or bonds who bought Caesars paper along the way, starting in 2007 and 2008, and they ultimately sold their paper for huge losses. And they sold it to the likes of Elliott and Appaloosa who do well in this case, but all those players were, I guess, for lack of a better phrase, victims in the Caesars, they don't benefit from all this good fortune at the end. So everyone's always a step away from disaster here, and the thoughtful players in this world acknowledge that.

Ted Seides: 48:54 As you're both viewing this and reporting on it, there's a whole another side, which is the investors in these funds, the LPs, who are outside of all the machinations of this happening. And I'm curious what your thoughts are on, how should an LP view this with all these people battling each other in some form of zero sum game?

Max Frumes: 49:14 One of the funds investing in Caesars has this quote they like to say that, "Structure determines behavior." I like that in terms of no one is all bad or all good. I don't personally think that there's anyone that inherently is out there to take advantage of their fellow man for the sake of it, but the incentives aren't there. And LPs, at the end of the day, if someone is making them money consistently, are going to continue to give those ones

money, that somebody is going to. There's no question about it. No matter what amount of bad behavior there may be, if that doesn't affect funds performance, I've never seen that fund struggle too terribly much. And so until that incentive structure changes, there's going to be no major incentive to be any less hard ball.

Max Frumes: 50:05

And I would say the one exception is, is when there's going to be criminal laws that are broken that implicates the heads of funds, but even so someone could step into their shoes if there is something like that, if that fund continues to perform. I'm very curious to see if there's a way that, that evolves. Wither there's some sort of collective trade association that incentivizes better behavior. I listen to a lot of fund managers, they are designing these things to have incentives, to be not only profitable, but to be socially conscious and environmentally conscious. That would be great to see. And then some type of regulatory shift.

Max Frumes: 50:48

Recently, there was a fund manager who was prosecuted, and he's going to prison for six months for a criminal infraction in a bankruptcy case. It shocked everyone because of how rare that was. So if there's more examples to be made of people and a regulatory shift in that direction, it would be interesting to see what types of incentives that creates for LPs to keep their money with the most aggressive investors here.

Ted Seides: 51:13

So Max, along those lines, when you sent me a copy of the book, you had written in the inscription, "I wonder if this story will figure into how money managers allocate capital one day." And I was wondering what you meant by that.

Max Frumes: 51:26

If you read this and you see how the sausage is made, you're not going to want to invest in the sausage factory. And I'd be curious, I would love to see you like, "Oh, okay." If there's pension funds and they were considering a huge allocation to any one of these funds involved and they liked, or didn't like how these people were acting behind the scenes, I'd be curious to see if that is a factor. I know that they're very thoughtful about who they do ultimately give their money to.

Ted Seides: 51:52

But I do want to ask you both a couple of closing questions. I have a bunch of them. And so maybe we'll just go back and

forth. You guys can choose who's going to answer it. What's your favorite hobby or activity outside of work and family?

Max Frumes: 52:03 So I'm a big runner. And I got into ultramarathon running while I was also helping build up Reorg. And they really went hand in hand because for me as a journalist, you don't necessarily have to be that good or skilled, just as long as you're able to persist over time and endurance and mental toughness. So that's been something that I've had as a hobby and finished 100-mile race, four different times. I would say between that and finishing this book, that was a lot easier.

Ted Seides: 52:37 Here's one for both of you, and Sujeet why don't you take it first? Which two people have had the biggest impact on your professional life?

Sujeet Indap: 52:44 So I'll start with my dad, and that's a little bit of a cliched answer, but I'll explain that to you what I mean by that. I had a career in finance before I became a journalist, and I had this deep love of reading and curiosity about the world, and actually just the news. And I think I get that from my dad because he, himself an avid news reader. We had all sorts of newspapers and weekly magazines at our house. And I guess I became this news junk kid. So I had this job now where I'm doing what I would be doing, even if I wasn't in this profession, which is reading the news and picking up every scrap of information I can. And now that's my job to do that. I read a lot. I talk to interesting people, and I write a little bit what could be better as a career.

Sujeet Indap: 53:26 The second person, I would name is a vice-president I worked with when I was an analyst in investment banking at Merrill Lynch, which was my first job out of college. And this person was really, really smart, and showed me that a job just couldn't be just a job, but you could find a way to pursue intellectual curiosity and just constantly view learning. And I think many people would view a job as just something like a series of tasks rather than something to be passionate about. And so that, in its own way, I think inspired me to do a job where I am enjoying what I love to do and something I can be excited about.

Ted Seides: 54:01 Max?

Max Frumes: 54:03

I had assorted career before, a little bit before journalism, where I got fired from a marketing job. And then I was selling used cars to try to make ends meet. And my boss, who was this Guadalajaran immigrant who was just this outsize personality, who was such a ball-buster. And he would come in and yell at people for no reason. I just remember him being incredibly tough on us. He only spoke to us in Spanish and he was like, Max [foreign language 00:54:35]. It was a lot of pressure. And I've never had a worst experience in my life, but for some reason it was just being able to get through it. It made me able to talk out a lot of different situations that I think journalism ultimately threw at me.

Max Frumes: 54:52

And then I'd say the person who hired me away from him and gave me my first journalism job, Michelle, the executive editor at Crittenden Research. She just plucked me out of there and gave me a job as a copy editor and said, "Go give it a shot."

Ted Seides: 55:05

All right, great, one more. What life lesson have you learned that you wish you knew a lot earlier in life? Sujeet, all right, go ahead.

Sujeet Indap: 55:11

As your growing up, you think about collecting credentials, and doing as well as you can in school, and going to the right schools, and colleges, and getting the right job and resume, building that often is seen in related circles. And obviously now, I write about people who are advanced, who have fancy credentials, and that's something that is the currency of this world. But being successful, being good at your job and respected is important, but it cannot be one sole focus. So I think one, you have to be humble and curious enough to accept things you don't know, and always be wanting to learn, and not resting on your walls. And two, learning from other people who may not have necessarily impressive credentials on paper, but in fact, have personal habits and characteristics that one can learn from them. And just the idea that you constantly have to be learning and growing and be humble about what you do and don't know, and always trying to get better, no matter whatever you think you may have accomplished or whatever station.

Max Frumes: 56:14

I would say that you could lead a lot more fulfilling life being of service to others instead of yourself. That's something that, I don't know, was not top of my mind earlier in my career, and maybe that's by design. You're just younger and you need to be

a little bit more self-involved. But later on, it's just that I find it to be more fulfilling, to be part of teams, to help others and see others succeed, to make that a goal in terms of how you find fulfillment in life.

Ted Seides: 56:42 Well guys, this is an amazing story, and I really enjoyed the book. I hope everyone gets a chance to read it. Thanks so much for taking the time.

Max Frumes: 56:49 Thanks so much, Ted, for having us.

Sujeet Indap: 56:51 Thanks for having us, Ted. This was great.

Ted Seides: 56:53 Thanks for listening to this episode. I hope you found a nugget or two to take away and apply in your besting and your life. If you'd like what you heard, please tell a friend, and maybe even write a review on iTunes. You'll help others discover the show and I thank you for it. Have a good one and see you next time.