

# History of success – marvel

[Entertainment](#), [Movie](#)



We think that Marvel filed for Chapter 11 mainly due to its bad business strategy. Three of its six business lines, Trading cards, Stickers, and Comic Books started facing a decline in sales after the year 1993. There were two main reasons for this decline: First, these businesses increasingly had to compete with alternative forms of child entertainment (mainly video games). Second, the decline in sales was driven by disappointed collectors who had viewed comic books as a form of investment and stopped buying them as the company stopped increasing the prices. We believe that the company should have foreseen these events while performing market research and forming a long- term business and financial strategy. The three unpromising business lines accounted for 61% of the total revenues of a company in the year 1995. At the same time, the company's financial strategy was based on highly optimistic business expectations and was not suitable for the unfavorable turn of demand for entertainment products towards video games.

Due to its high leverage (52%), the company was not able to serve all the debt in case of sharply declining revenues. It is obvious that the company did not anticipate the change in customers' preferences and was wrong in the prediction market trends, focusing on cards, stickers, and publishing business lines and leveraging itself. Moreover, in 1995 Marvin continued its leveraged expansion into the entertainment cards business - acquiring Skybox. This decision was extremely imprudent, as the company was already on the threshold of financial distress and should have sought high growth opportunities to expand in order to boost its revenues instead of adding debt to buy a business that produces non- demanded products. While their

operating margins were deteriorating and their leverage coverage ratio (EBITDA/Interest) were falling, they should have acquired a different policy. For all the above-stated reasons, we believe that the company's financial problems were caused mainly by bad strategy and poor management. Evaluate the proposed restructuring plan. Will it solve the problems that caused Marvel to file Chapter 11? As Carl Icahn, the largest unsecured debt holder, would you vote for the proposed restructuring plan? Why or why not? We believe that the restructuring plan can only solve part of the problems that Marvel is facing. We also believe that the proposed restructuring plan will not solve the actual problems that Marvel is facing but only provide temporary relief to the company that is not sustainable.

The proposed restructuring plan aims at providing liquidity to Marvel, lifting its debt burden, and expanding its existing toy business. This is to be achieved by means of a recapitalization of the company through the emission of 427mn additional shares of common equity for a total value of USD 365mn. Additionally, the outstanding public debt of the company shall be retired with debt holders being paid in the shares that acted as collateral for their loans. With the proceeds of the emission and the lowered debt burden, Marvel is then supposed to acquire the remaining stake in ToyBiz, its toy manufacturer subsidiary. The recapitalization through the issue of 427mn new shares would solve the acute liquidity problems of the firm and the retirement of the firm's public debt would lower the debt burden of the firm significantly. However, we believe that Marvel, under the proposed plan, would use its newly gained liquidity and flexibility to the wrong end. The

acquisition of the remaining shares of ToyBiz would mean the continuation of an already ill-fated strategy that led to the current crisis.

We, therefore, believe that the restructuring plan can only solve part of the problems that Marvel is facing. More precisely, the plan offers a solution for the symptoms of the underlying problems only. It solves the liquidity problem that caused Marvel to violate some of its debt covenants and it also lowers the company's debt burden. The core problem in our view, the business strategy of Marvel, is not abandoned but even pursued further. I would not you vote for the proposed restructuring plan. The shares being pledged to their bonds as collateral is valued largely lower now than they were when the bonds were first issued, which result in they can only recover a fraction of the face value of their bonds in the form of equity now and breaking even again seems questionable. This argument does not necessarily hold for the investors who bought the deeply discounted bonds but given the valuation of Bear Stearns it is questionable whether they will recover their investment either.

In 1996 Moody's downgraded Marvel's public debt. After that, Marvel had announced that it would violate specific bank loan covenants due to decreasing revenues and profits. The downgrading of debt increases the change of default. After downgrading of debt, the process of probability to default increased substantially. The low credit rating indicates a high risk of defaulting on a loan and, hence leads to high-interest rates or the refusal of a loan by the creditor. Investors realize this risk and therefore would demand a higher default premium. The increased default premiums raised the cost of capital for the holding company. Given the increased risk premium and

default possibilities, Marvel and other companies in the MacAndrews and Forbes holding group would have more difficulties issuing new debt in the future. Debt holders and creditors were raising questions about the integrity of the judicial decisions from Perelman. Judge Balick approved Marvel did not discriminate unfairly against non- affecting creditor classes and provided it was fair and equitable to all classes. In reaction, a lawyer challenged the Bearn Stern's conclusions and insinuated Bearn Sterns had multiple levels of conflicts due to the contingency fee provided by Perelman. In the end, even the Vice - Chairman of the Andrew group had to come with a statement to overcome all the negative sounds in the market. Anyhow, it looks like Perelman's reputation was damaged already. Why did the price of Marvel's zero-coupon bonds drop on Tuesday, Nov 12, 1996? Why did portfolio managers at Fidelity and Putnam sell their bonds on Friday, Nov 8, 1996? On Nov 12, 1996, Marvel's zero-coupon bonds fell by more than 50% when the spokesman for the Andrews Group announced the details of the proposed restructuring plan.

According to the announcement, Perelman was to purchase, through Perelman- related entities, 410 million shares of newly- issued Marvel common for \$0. 85 per share, 81% discount to the then prevailing market price of \$4. 625. The newly- issued stock would not be subject to the pledge of Perelman- owned Marvel stock that otherwise secured the bonds. The announcement of this self- dealing transaction was in no way foreshadowed by Marvels' prior public statements and conflicted with the covenants in the indentures to the bonds. Therefore, the market prices of the bonds to decline suddenly as the collateral that supported the bonds. Perelman's Marvel

common stock holdings pre- proposed transaction was diluted from 80% of the equity in Marvel to less than 16%. The terms of the prospective transaction required Marvel to increase the number of its outstanding shares to approximately 511. 6 million shares from 101. 8 million, diluting Marvel common stockholders and greatly reducing the value of the shares that were pledged as collateral for the bonds. So it greatly impaired and reduced the value of the bonds. In fact, Marvel bondholders were divested of virtually the whole of their collateral while Perelman would maintain 80% ownership of the firm, purchasing the newly- issued shares at grossly sub-market prices while preserving the ability to write off Marvel's losses against the reported income in his other consolidated enterprises due to the maintenance of his 80% ownership of the firm. The price of Marvel's zero-coupon bonds dropped also due to it did not meet the expectation of the debt holders, who analyzed the bond by fair value or future growth of the firm.

In addition, the public would predict that the restructuring plan could not be settled down so that the firm would have a very uncertain future, even bankrupt. Thus, the price declined because a lot of debt holders could not bear the risk of getting anything and sold out their debts. On Nov 8, 1996, Howard Gittis, vice chairman of Andrews Group, called Fidelity Investments and Putnam Investments, two of the largest institutional holders of Marvel's public debt, and asked them what they would like to see in a restructuring plan. Portfolio managers at Fidelity and Putnam decided to sell more than \$70 million of Marvel bonds at a price of \$0. 37 per dollar of face value on the next day. The main reason for selling by the managers is the conversation between Howard Gittis and them, which caused the managers

to consider the result of the restructuring plan. They believed the plan would disappoint the public depending on their professional judgment. Perhaps, during this conversation, they got some detailed information on the plan which proved the present value of Marvel's bonds was overvalued. It gave the chance for them to avoid tens of millions of additional losses in diminished value that would have followed and suffer the time they continued to hold the bonds already existing facts were revealed. On the other hand, the managers may be worried about the downgrade of the bonds because of the requirement of their portfolio allocation which constrained the percentage of the lower graded bonds or prohibited buying such bonds. Therefore, the bonds have to be sold to meet the requirement.