

**New York University
Leonard N. Stern School of Business**

**Corporate Bankruptcy & Reorganization
B40.3198**

**Professor Edward I. Altman
Fall 2005 (1st Half)
Mon/Wed 10:30-11:50 a.m.
Location: KMC Bldg., Rm. 3-90**

This is a unique course in business administration curricula and has evolved in an interesting way over the twenty plus years that I have taught it. The original focus was on discussing and using corporate distress prediction models from an external fixed income security perspective. These statistical-multivariate models, utilizing financial statement and market valuation variables, have become standard analytical procedures in the financial world, especially as financial institutions prepare for **Basel II**. They are now complemented by a number of newer analytical approaches, including option pricing and artificial intelligence models.

While the financial distress prediction aspect is still an important part of the course, perhaps the more important perspective is now the valuation and analysis of distressed firms and their outstanding securities, primarily bonds and bank loans. Indeed, this course can now be followed by a companion mini-course on “*Investing in Distressed Securities*” (taught as an additional mini-course in Spring 2006) as well as a Case course on “*High-Yield and Distressed Debt*”. Discussion and analysis of the high-yield, junk bond market complements the distressed securities materials. Reorganization in bankruptcy cases explore this unique period in a company’s “life.” As a complement to the investment aspects of the course, we also pursue the financial and operating restructuring of ailing firms. All students are given the opportunity to join the NY Chapter of the *Turnaround Management Association*.

The pedagogy of the course includes traditional lectures, case studies, guest speakers in bankruptcy law, turnaround management, corporate restructuring and “vulture” investing and a choice of either a take-home project (usually a complex case study), or a term paper related to the theme of the course. The latter project is discussed early in the course but is not due until the full semester is over. Students have the opportunity to present the findings of their term projects in a special, extra session at the end of the term. Incidentally, Stern has “hatched” at least four dozen vulture investors and traders of distressed securities over the years and this course is oftentimes the “breeding ground” for these successful “birds.”

Call me at (212) 998-0709 and/or visit my website at www.stern.nyu.edu/~ealtman or email: ealtman@stern.nyu.edu

Course Outline

I. General Course Description & Objectives

An in-depth study of practical and theoretical financial aspects and implications of corporate bankruptcy, credit analysis, and leveraged and distressed restructurings. Among the topics discussed are the bankruptcy-reorganization process; techniques and procedures to value firms in distress and/or reorganization; global implications of credit risk, predicting impending problems of various types of companies including manufacturing firms, retailers and commercial banks; the effect of bankruptcy on total share valuation; investment strategies relevant to distressed companies' securities; financial restructuring; high yield "junk" bonds; the emerging-market corporate debt market; and the implications of bankruptcy analysis to financial lending institutions and non-financial corporate management personnel. References will be made to recent corporate failures and cases as well as to empirical and theoretical scholarly and professional studies.

II. Course Requirements & Instructions

The pedagogy of the course includes seminar-type discussion of issues and latest research in the field, analysis of case studies, guest speakers, and student presentations of their case-research reports. The **major written requirement** will be an in-depth report of a significant corporate bankruptcy or a paper related to the theme of the course. Students are encouraged to work in small **groups** of two or three members. See partial list of bankrupt firms and paper themes attached. A take-home final exam is possible as an alternative to the paper. Participants of the course are also responsible for the required readings of each session's discussion and the case studies (**worked on by groups of two-three students**).

This section is given in the first half of the fall semester followed by another mini-course on "*Investing in Distressed Securities*" taught by Professor Allan Brown in Spring 2006. An additional mini-course in Fall 2006, taught by Professor Max Holmes, on "*Cases in High Yield and Distressed Debt*" completes this unique three-course sequence. Students who are interested in the bankruptcy and distressed securities industry are encouraged to consider these other courses.

Required Materials:

- A. Edward I. Altman, **Corporate Financial Distress & Bankruptcy**, 2nd ed., John Wiley & Sons, 1993 or this book combined with selected chapters from **Managing Credit Risk, mentioned below in suggested Books list**. We are currently revising this book and most of the updated material will be available from the powerpoint presentations.
- B. Packet of Handouts and Exhibits (provided in class)
- C. **Suggested** books (If “Investing in Distressed Securities” and/or “Managing Credit Risk” is very important to you)
 - a. E. Altman, **Distressed Securities: Analyzing & Evaluating Market Potential & Investment Risk**, Probus, 1991, reprinted by Beard Books, 1999
 - b. J. Caouette, E. Altman & P. Narayanan, **Managing Credit Risk: The Next Great Financial Challenge**, John Wiley & Sons, 1998
 - c. H. Rosenberg, **The Vulture Investors**, John Wiley & Sons, 2000

IV. Detailed Course Outline

Session

Dates Subject and Readings

- 9/7 **The Corporate Bankruptcy Phenomenon**
- Introduction to Corporate Financial Distress
 - Business failures and bankruptcies – chapter 1, 2
 - Defaults and bankruptcies in 2000-2005
 - Macroeconomic influences on business failures
 - Major players in the reorganization process
 - Valuation theory in a distressed reorganization – review basic concepts
 - Discussion of term projects
- 9/12 **The Bankruptcy-Reorganization Process – Legal & Economic Issues**
- The turnaround management industry – **guest speaker (representative of the TMA) best paper award competition**
 - The chapter 11 process including the new Bankruptcy Act of 2005 – chapter 3 and handout
 - Emerging (emerged) trends – chapter 4
- 9/14 **Managing Credit Risk: A Global Challenge** – power point (PP file),
9/19 book on “Managing Credit Risk” (optional)
- Topic overview – key risk management area
 - Importance in low and high credit risk regions of the world
 - BIS regulatory issues and Basel II

- Default and recovery rates
- Securitized credit instruments
- Traditional and new portfolio management techniques
- Introducing the **Duplan Case** – chapter 13 in text

The Duplan Case should be worked out carefully; it will be discussed and collected on September 28. You must work in teams of two or three students.

9/21 Credit Scoring Models: Predicting Financial Distress

- Chapter 8 – Z-Score and Z''-Score analysis
- Chapter 9 – ZETA, KMV, Neural Networks, etc.
- For emerging markets-expanded version of Z''-Score

9/26 Implications & Applications of Financial Distress Prediction Models

- For investors – chapter 7
- For bankers – chapter 10
- For managers – the corporate renewal process – chapter 11 (in book)
- Enron/WorldCom discussion

9/28 Discussion of the Duplan Case

Chapter 13 (Case should be handed in; you must work with one or two other students).

10/3 Corporate Restructurings: Leveraged & Deleveraged (Chapter 6)

- Asset and liability restructuring
- Leveraged management buyouts
- Linking theory with practice
- Lessons from the 1980's and 1990's

10/5 Adding Value through Restructuring

- Debt for equity swaps
- Leverage management buyouts
- Deleveraging strategies

10/10 No Class

10/12 Guest Speaker on Corporate Distressed Restructurings from an IB firm standpoint: Barry Ridings, Managing Director, Co-Head Restructuring Group, Lazard Freres

- Distressed financial restructuring
- Investment bankers and turnaround management
- Current issues and career opportunities
- Recent Case Studies

10/17 **Guest Speaker on Turnaround Management from a Turnaround Manager's standpoint: Holly Etlin, Principal, XRoads Solutions Group, and President, TMA (International - Tentative)**

10/19 **The High Yield Bond and Distressed Securities Markets**

- Evolution and current status of the market
- Risk and return analysis
- Traditional default and mortality rate methods
- Estimating the probability of default
- Major players and distressed investing strategies

10/24 **Guest Speaker on "Distressed Investing" –Marti Murray, President, (*Murray Capital*)**

- Are they really vultures?
- Selected case studies
- Some recent prominent situations
- Career opportunities

12/12 **Take-home final due (for those not doing term paper)
and**

12/12, 14 Student presentations (optional) of term reports: all reports due

- Attendance mandatory for all students, unless conflicting with other courses
- Date is tentative

Grading: Will be based primarily on the term project/take-home exam with smaller weights for cases and in-class contribution. Term project discussed in handout packet.

Office Hours/Location: Monday/Wednesday: 3:00 – 5:00 p.m.
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POSSIBLE BANKRUPTCY PAPER TOPICS

Sample Themes

Abuses of the Bankruptcy Code
Accountants' roles in bankruptcies
Airline deregulation & bankruptcies
Airline industry prediction model
Argentina bank crisis
Asset management companies (AMCs)
Auto Supply & Automotive Industry
Bankruptcy in the telecommunication industry
Bankruptcy as a business strategy
Bankruptcy and pension plans (PBGC)
Bankruptcy and reorganization in the airline industry
Bankruptcy expert systems
Bankruptcy in Central and Eastern Europe
Busted convertibles
Chapter 22s, 33s
China's bankruptcy Laws & NPLs
Claims purchases as a takeover technique
Climate change and the Insurance Industry
Computer and Electronic Industry
Corporate abuses and bankruptcy
Corporate fraud and indirect bankruptcy costs
Crisis in Japanese banking
Critical events analysis and bond price reaction
Debtor-in-possession (DIP) financing
Distressed Firm Control Strategy
Emerging market corporate debt models
Emerging Equity Investing
Equity performance after bankruptcy
European Distressed Debt Market
Fallen angels (e.g., GM & Ford)
FASB 107 Disclosures
Financial reporting consolidation (captives) & Z-Scores
Fraudulent conveyance
Highly leverage transactions (HLT)
Investing in bankrupt equities
Japanese Rating Agencies
Macro-default models
Macro-influences model
Municipal defaults
New Bankruptcy Act of 2005
Option pricing default models
Power companies and public utilities
Pre-packaged bankruptcies
Rating Agencies
Rating downgrade triggers
Retail industry prediction model
Roll-Up Strategy from Bankruptcies
S&L debacle
Telecommunications industry prediction model
The Corporate Bankruptcy Restructuring Industry
The new BIS regulation on credit assets
Z-Scores and investing

Sample Companies

Adelphia
Allegheny International/Sunbeam
Allied & Federated Department Stores
Arch Wireless
Armstrong World
Bethlehem Steel/International Steel Group
Boston Chicken
Braniff International (Chapter 33)
Caldor
Canary Wharf
Chamber Communications
Collins & Aikman
Columbia Gas System
Continental Airlines (Chapter 22)
Delta/Northwest Airlines??
Dow Corning
Eagle Picher Industries
Enron
Euro Tunnel (1 and 2)
Gillette Holdings
Global Crossing
Globalstar
Grand Union (Chapter 33)
Greyhound
Hillsborough (Jim Walter)
Iridium
ICO Global Communications
Johns Manville
Kaiser Aluminum
Kmart/Sears
Loewen
Loral Space & Communication
Mirant Energy
Montgomery Ward
Olympic & York
Pacific G&E
Parmalat
Polaroid
R. H. Macy & Company
Revco Corporation
Spectrasite
Southland
Swissair
Tower Automotive
Trump Hotels & Casinos
United Airlines
USAirways (Chapter 33?)
Winn-Dixie Stores
WorldCom
Xerox Corporation
Zales Jewelers