

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

**Corporate Bankruptcy & Reorganization
FINC-GB.3198.01**

**Profs. Edward Altman/Stuart Kovensky
Fall 2015 (1st Half)
Tue/Thurs 10:30-11:50 a.m.
Location: KMC, Room 2-80**

The subject of bankruptcy and reorganization is both an exciting as well as important area in the study of corporate finance, capital markets, corporate law and investor behavior. In fact, the issue of insolvency has become relevant outside of just the corporate arena with the bankruptcy reorganization of Detroit in 2015, as well as the issues currently facing Puerto Rico and Greece.

Over the term of the course, we will study a number of important areas to help you get an understanding of:

- The origins, purpose and evolution of bankruptcy laws
- The size, scope and growth of the non-investment grade debt markets
- Tools that can be used to predict corporate distress
- Corporate Bankruptcy investing
- Valuation and analysis of distressed firms
- Examples of historical bankruptcies – Enron, GM, Kodak, Dynegy and others
- Municipal and Sovereign Bankruptcies

This is a unique course that focuses on these issues and is jointly taught by Professors Edward Altman and Stuart Kovensky. The course has evolved in an interesting way over the forty plus years that Professor Altman has taught it. Professor Kovensky brings over 20 years of experience to the classroom as an investment professional in the field.

The original focus of the class 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 prepared for **Basel II and Basel III**. 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 high yield and distressed firms and their outstanding securities, primarily bonds and bank loans. The market for these two types of investments has grown considerably over the last twenty years and now stands at over \$3 trillion. In addition, the bankruptcies of corporations like Enron and Worldcom, as well as the credit crisis in 2008/2009 are evidence that given the size and inherent risk in this market, familiarity with bankruptcy and reorganization is essential to truly understanding corporate finance and the capital markets. Indeed, this course can now be followed by a companion course on “*Distressed Securities, FINC-GB.3176*” as well as a Case and Prospectus Analysis course on “*Case Studies in Bankruptcy & Reorganization, FINC-GB.3199.*”

Discussion and analysis of the high-yield, junk bond and sovereign debt market complement 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* at a highly discounted price.

The pedagogy of the course includes traditional lectures, case studies, guest speakers on various topics, such as, valuation in corporate bankruptcy reorganizations, advising a bankrupt debtor and "vulture" investing. Grading will be determined by a combination of your in-class participation, assignments (individual and group) and a group take home project that will be due at the end of the full semester. 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 five- dozen vulture investors and traders of distressed securities over the years and this course is oftentimes the "breeding ground" for these successful "birds."

Call Prof. Altman at (212) 998-0709 or Prof. Kovensky at (914) 450-0581 or email: ealtman@stern.nyu.edu, skovensk@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, commercial banks, municipalities and sovereign nations; 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 and sovereign 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. Students are required to work in small groups of two to four members. 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-four students).

Ideally, students will form their groups early in the term so that they can work together on a few assignments prior to preparing their final report.

III. Additional Practitioner Presentations

There will be several practitioner presentations on class-related subjects. These presentations will be held during our day session course and also during Professor Altman's evening section on Thursday, 6:00-9:00 pm in KMEC 3-120, this term jointly taught with the Honorable Judge James Peck. You are invited to attend or you can view these sessions on the class videos (schedule will be distributed in class).

Required Materials:

- A. Edward I. Altman and Edith Hotchkiss, **Corporate Financial Distress & Bankruptcy**, 3rd ed., John Wiley & Sons, 2006.
- B. Packet of PowerPoint Handouts and Exhibits (Download from “NYU Classes”).
- C. **Suggested books** - If “**Investing in Distressed Securities**” and/or “**Managing Credit Risk**” is very important to you, the following books are recommended:
 - a. J. Caouette, E. Altman, P. Narayanan and R. Nimmo, **Managing Credit Risk: The Great Challenge For Global Financial Markets**, 2nd edition, John Wiley & Sons, 2008
 - b. E. Altman, **Distressed Securities: Analyzing & Evaluating Market Potential & Investment Risk**, Probus, 1991, reprinted by Beard Books, 1999
 - c. S. Moyer, **Distressed Debt Analysis**, J. Ross, 2005
 - d. H. Rosenberg, **The Vulture Investors**, 1st or 2nd edition, John Wiley & Sons

IV. Detailed Course Outline

Session

Dates Subject and Readings

- 9/3,8 **The Corporate Bankruptcy Phenomenon (S. Kovensky)**
- Overview of the Course, Assignments, Projects and Grading
 - Introduction to corporate financial distress
 - Factors that cause firms to enter distress
 - Business failures and bankruptcies - **chapter 1**
 - Defaults and bankruptcies in 1971-2014
 - The credit crisis of 2007-9 (corporate); 2010-2012 (euro-sovereign)
 - Major players in the reorganization process
 - The chapter 11 process - **chapters 2, 4**
 - Trends in bankruptcy reorganization
 - Valuation theory in a distressed reorganization: **review basic concepts - chapter 5**
 - Guest speaker – **Allen Kadish, President, Turnaround Management Association, NY Chapter**

Individual Assignment Handout – Form Project Groups and individually prepare Key Terms in Bankruptcy and Creditor Recoveries

Corporate Restructurings - Leveraged and Deleveraged (S. Kovensky)

- Why do companies become leveraged - financial and operational
- Steps in the restructuring process
- Transactional leverage vs creeping leverage
- Remain calm/all is well
- Houston, we have a problem
- When to reorganize vs liquidate

Introduction to Group Assignments – Dynegey, GM/Chrysler, Enron, Puerto Rico and Detroit

9/10, **The High Yield Bond Market – Chapters 8,9 and 2015 Salomon Center Report** 17 **(E. Altman)**

- Evolution and current status of the market (review introductory materials)
- Risk and return analysis
- The raw material for the distressed securities market
- Traditional default and mortality rate methods
- Estimating the probability of default
- Are historically based models still relevant?
- Comparing 2007 with 2014/2015: Credit Market - Is it a Bubble?

The Sovereign Debt Market - Predicting Sovereign Debt Defaults

- Assessing default risk from the bottom-up
- Private sectors risk analysis
- Current & future troublespots
- The European Financial Crisis

9/22 **The Distressed Debt Market (E. Altman)**

- Size, scope, players
- Evolution and current conditions
- Historical returns/risk
- A new ETF concept
- Preparing for the next Distressed Cycle

9/24 **Investing in Distressed Securities (S. Kovensky)**

- The bankruptcy process and investing
- Techniques/opportunities to invest
- Debt vs equity, or both
- Growth in number and size of restructurings

Introduction to Kodak Assignment – History of Case, Background to Filing, Drivers of Case, Creditor Positioning

- 9/29 **Credit Scoring Models: Predicting Financial Distress – Chapters 11, 12 (E. Altman)**
- Z-Score, Z''-Score and Z-Metrics analysis – **chapter 11, Z-Metrics White Paper (Blackboard)**
 - KMV, Neural Networks, etc. – **Chapter 11**
 - For emerging markets-expanded version of Z''-Score – **Chapter 12**
 - Enron/WorldCom and GM/Ford discussion
- 10/1 **Implication & Applications of Financial Distress Prediction Models – Chapters 13, 14 (E. Altman)**
- For investors – **Chapter 13**
 - For bankers – **Chapter 13**
 - For managers – the corporate renewal process – **chapter 14**
 - The GTI corporate turnaround – **Chapter 14**
 - How to avoid Chapter 22
- 10/6 **Analyzing Distressed Securities/Credit Investment Strategies (S. Kovensky)**
- Financial and operational analysis required
 - Why is a company stressed or distressed?
 - Who are the creditors/stakeholders/key players?
 - Can/should it reorganize?
 - What is it worth?
 - How should it be capitalized?
 - How will the new value compensate existing creditors?
 - What are the downside risks?
 - Are there opportunities for upside?
- 10/8 **Z-Score in Practice (Kodak Case)**
- Recent Issues/trends in the Market for Municipal Bonds (S. Kovensky)**
- The size and scope of the municipal bond market
 - Differences between the municipal and corporate bond market
 - Reorganization in the municipal bond market
- 10/15 **Guest Speaker – Holly Etlin, Managing Director – Operational Restructurings, Alix Partners**
- 10/20 **Final Project Summary/Update Presentation**
- This is an opportunity to provide a summary overview of your project, the key issues that you will cover, the various stakeholders involved and the specific factors that make it a worthwhile example of either a complex corporate bankruptcy or a worthwhile theme topic (see last page for ideas for theme topics)

POSSIBLE BANKRUPTCY PAPER TOPICS

Sample Themes

Evolution of The Bankruptcy Code
Chapter 22, 33 and 44
Debtor in Possession Financing
Municipal Bankruptcies
Equity Performance Post Bankruptcy
Fraudulent Conveyance
History of Airline Bankruptcy
DIP Financing
Shadow Banking
Predicting Default in Specific Industries
Detroit
Puerto Rico

Sample Companies

Lightspeed
General Growth Properties
Caesar's Entertainment
Energy Future Holdings
Las Vegas Sands (How did they avoid Chapter 11)
Dow Corning as compared to Owens Corning
American Airlines
Lyondell Basell
Realogy
Theater Industry Bankruptcy
Enron
GM/Chrysler/Ford
Dynegy