



NEW YORK UNIVERSITY - LEONARD N. STERN SCHOOL OF BUSINESS

B40.3176.10

Topics in Investments: Investing in Distressed Securities

Fall 2000

Tuesdays 6:00 – 8:50 pm (October 31 – December 12)

Henry Kaufman Management Center, 44 West Fourth Street, New York, NY 10012, Room 3-60

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Objective: To prepare students to understand, evaluate, and invest in distressed corporate situations and securities. Students will be exposed to the distressed process from a number of different viewpoints (management, trade vendors, senior lenders, subordinated lenders, legal and financial advisors, DIP lenders, bankruptcy courts, vulture investors, distressed debt traders/brokers) to better understand the roles, agendas, and objectives of each of the participants and how they affect investment results.

Course Prerequisites

- Basic accounting and financial statement analysis
- Basic knowledge of fixed-income and equity securities and related mathematics
- Basic corporate finance (discount cash flow analysis)
- Basic common sense

Recommended textbooks and materials

- Altman, Corporate Financial Distress and Bankruptcy (Wiley)
- Bankruptcy Code, Rules, and Official Forms (West)
- Other materials and case studies will be distributed in class

Other texts and sources of information

Texts

- Altman, Distressed Securities (Probus)
- Branch and Ray, Bankruptcy Investing (Dearborn)
- Rosenberg, The Vulture Investors (Harper Business)

Periodicals

- *Mergers & Restructurings*
- *Turnarounds & Workouts*
- *Daily Bankruptcy Review*

Miscellaneous

- Analyzing Investment Opportunities in Distressed and Bankrupt Companies (AIMR)
- Numerous websites (of various usefulness)

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Structure: The course will use a combination of lectures, case discussions, and guest lectures.

Lectures: 6

Lectures will focus primarily on the bankruptcy/reorganization process, valuation methods, and special issues including, for example, issues related to claim seniority/subordination and stepdowns, estimating rejected executory contract claims, indenture analysis, and industry specific considerations. Recent academic research relevant to the area will also be discussed.

Case Analyses: 4

Case studies will be distributed in class. Cases will be based on recently concluded or pending distressed situations and utilize a combination of consolidated facts and actual financial and bankruptcy court documents. Each case will stress a key evaluation aspect. Write-ups can be a maximum of 2 pages of text (single space with generous font and margins) plus exhibits and will address specific questions. Group write-ups are perfectly acceptable (maximum of 3 persons in a group, please); keep in mind that a group of x people submitting a write-up should demonstrate a proportional increase in effort. Group papers can be a maximum of 3 pages in length. As a final point, please realize that quality and quantity are mutually exclusive (i.e. don't feel the need to fill up the page with fluff).

Guest Lectures: 4

Prominent professionals in the industry will discuss opportunities in non-U.S. distressed investments, investing in distressed bank debt, trading strategies, and other topics. Attendance is mandatory and will be recorded.

Final Case: Analysis and investment recommendation related to a current distressed situation chosen from a list to be distributed. Case materials should consist of actual financial statements and SEC filings (available on the SEC's EDGAR site), bankruptcy court documents (if necessary), public disclosures, and market information. The paper should be a maximum length of 10 single-spaced pages plus exhibits. Graded on the depth of analysis (quantitative and qualitative) and the strength with which the recommendation is supported.

Grading:	Case summaries	30%
	Final case	40%
	Class participation*	<u>30%</u>
		100%

* Very heavily weighted with respect to attendance at guest lectures ...

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Lecture and Case Study Schedule (guest lectures will be interspersed)

1	Introduction to investing in distressed securities Discussion of why firms go into distress / bankruptcy Distressed vs. Defaulted Securities Example of a distressed investment from start to finish
2	Analytical tools EBITDA vs. GAAP accounting Evaluating the corporate and capital structure of the firm Market value of the enterprise Interest coverage ratios; cash vs. non-cash interest expense Liquidity measures and availability Estimating normalized operating numbers of the going-concern Estimating debt capacity Estimating the liquidation value of a firm Using DCF and cash-flow multiples to value the enterprise <i>Case 1 distributed: Evaluating a distressed bond</i>
3	The basics of the bankruptcy reorganization process (Chapter 11) Brief history of bankruptcy Filing Operating as a Debtor in Possession The automatic stay Bankruptcy professionals and their costs DIP financing Estimating indirect costs Exclusivity Adequate protection and post-petition interest Other claims that arise in Chapter 11 Creditors' committee(s) Absolute priority vs. negotiated stepdowns Cramdown Best interests test Plan of reorganization Disclosure statement Emerging from Chapter 11 Chapter 7 liquidation
4	Case 1 discussion <i>Case 2 distributed: Evaluating a distressed bond #2</i>
5	Indenture analysis: What to look for as an investor and implications for security valuation History of the Trust Indenture Evolution and purpose of covenants Typical affirmative and negative covenants Modifications, supplements, and waivers Events of default <i>Case 3 distributed (analysis of an indenture)</i>

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(continued)

6	Case 2 discussion
7	Case study 3 discussion The Bankruptcy Code in more detail; implications for investors Executory contracts and leases Equitable subordination Substantive consolidation Partial liquidation (Section 363 sale) New Value Exception Trustees, Examiners Creditors' Committees Responsibilities Negotiations with the debtor, other committees, inter-committee
8	Discussion of the distressed securities industry (players, returns, investors) Applications to portfolio management Correlation to various benchmark indices Investment strategies Trade claims Inter-capital structure arbitrage Hedging strategies Leverage Blocking positions Acquiring control of the firm through distressed debt Exit strategies Current market environment The high yield market: issuance, trading, yield curves Distressed market: default rates, future outlook Job prospects <i>Case 4 distributed: Evaluation of a Plan of Reorganization and Disclosure Statement</i>
9	Special topics in bankruptcy and how they affect investors Fraudulent conveyance Preference Jurisdiction Tax issues Pension plans and other post-retirement promises Issues related to current employees: retention and emergence bonuses Trustees in Chapter 11
10	Case 4 discussion
11	Academic research on distressed investing Recovery rates Performance of equities of firms emerging from Chapter 11 Not so great ideas: what we can learn from bad investments

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TENTATIVE SCHEDULE

1a. 1b.	Tuesday 10/31/00	Introduction to Investing in Distressed Securities; Analytical tools Analyzing the Distressed Investment – Case 1 distributed
2a. 2b.	Tuesday 11/7/00	The reorganization process Case 1 discussion – Case 2 distributed
3a. 3b.	Tuesday 11/14/00	Indenture Analysis – Case 3 distributed Case 2 discussion
4a. 4b.	Tuesday 11/21/00	Case 3 discussion Special Topics in Bankruptcy Managing a Distressed Portfolio; Hedging Strategies The Distressed Securities Industry Case 4 distributed
5a. 5b.	Tuesday 11/28/00	GUEST LECTURE: Jeff Bersh, DLJ: Trading Case 4 discussion
6a. 6b.	Tuesday 12/5/00	GUEST LECTURE: Christine Daley, Lehman Brothers GUEST LECTURE: Doug Teitelbaum, Bay Harbour Investors
7a. 7b.	Tuesday 12/12/00	GUEST LECTURE: David Storpor, Rothschild: Asian Distress Academic research What went wrong: Learning from bad experiences Final papers due