

New York University
Leonard N. Stern School of Business

**Advanced Corporate Bankruptcy & Reorganization
B40.3398**

**Edward I. Altman
Spring 2005
Thursday 6:00-9:00 p.m.
Room:**

This is an expanded and more in-depth offering compared to our Stern “classic” bankruptcy course which itself 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 this 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 combined with a companion mini-course on “Investing in Distressed Securities.” 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.” The materials in this course are no longer “niche” subject areas as bankruptcy plays an increasingly “popular” role in our economy. **Indeed, approximately 100 U.S. companies filed for bankruptcy and have reorganized under Chapter 11 with at least \$1 billion in liabilities in the three-year period 2001-2003.**

The pedagogy of the course includes traditional lectures, case studies, guest speakers in bankruptcy law, “vulture” investing, and operational and financial restructuring. A choice of either a take-home project (usually a complex case study), or a term paper related to the theme of the course is the major grade requirement. 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 at the end of the term. Incidentally, Stern has “hatched” at least four-dozen vulture investors, analysts and traders of distressed securities over the years and this course is oftentimes the “breeding ground” for these successful “birds.”

This 3-credit course should not be taken by students who have already had Professor Altman’s 1 ½ credit Bankruptcy Course B40.3198. It is fine if you have taken Professor Holmes’ Bankruptcy course or Professor Brown’s Distressed Securities course. Permission to take this course will be given, however, if the mini-bankruptcy course was taught from a different instructor. Call me at (212) 998-0709 or visit my web site at www.stern.nyu.edu/~ealtman or email: ealtman@stern.nyu.edu

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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 and other techniques for corporate renewal. 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. On some themes, students can work in small groups of two or three members. See partial list of bankrupt firms and paper themes attached. Each student is responsible for only one bankruptcy or one theme and therefore this report should reflect a major effort. It is possible to work on term projects with a partner. 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)**.

Required Materials:

- A. Edward I. Altman, **Corporate Financial Distress & Bankruptcy**, 2nd ed., John Wiley & Sons, 1993
- 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

2/10 **The Corporate Bankruptcy Phenomenon**

- Introduction to corporate financial distress
- Current trends in business failures and bankruptcies [Power Point (PP) File #1]
- Business failures and bankruptcies – chapter 1, 2
- Macroeconomic influences on business failures
- Major players in the reorganization process
- Valuation theory in a distressed reorganization – review basic concepts

- **Discussion of term projects**

The Bankruptcy-Reorganization Process – Legal & Economic Issues

- The turnaround management industry – **guest speaker (representative of the TMA) best paper award competitions**
- The chapter 11 process – chapter 3
- Emerging (emerged) trends – chapter 4

2/17 **The Bankruptcy Legal Process: Guest Speaker – Judge Robert Martin, U.S. Bankruptcy System; Milwaukee, Wisconsin**

- 2/17 **Managing Credit Risk: A Global Challenge** – power point (PP) File #2, article on
2/24 Credit Risk and/or 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 – changes are imminent
- 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 March 10. You must work in teams of two or three students.

3/3 (1/2) **Credit Scoring Models: Predicting Financial Distress**

- Chapter 8 – Z-Score and Z^{''}-Score analysis (available on *Bloomberg*)
- Chapter 9 – ZETA, KMV, Neural Networks, etc. (PP file #3)
- For emerging and non-U.S. markets-expanded version of Z^{''}-Score (PP file #4)

Implications & Applications of Financial Distress Prediction Models

- For investors – chapter 7
- For bankers – chapter 10
- Enron/WorldCom discussion using Distress Prediction Models as a Turnaround Technique

3/10(1/2) **Discussion of the Duplan Case**

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

Risk and Return Analysis of the Corporate High Yield Bond Market (PP file #5)

- Evolution and current status of the high yield market

3/24 **The High Yield Bond and Leveraged Loan Markets**

- Risk and return analysis
- Traditional default and mortality rate methods
- Analyzing fallen angels
- HY bonds as raw material for the distressed debt market
- Growth and importance of leveraged loan market
- The collateralized debt markets
- **Introducing the distressed debt market (PP file #6)**

3/31 **Guest Speakers on Distressed Investing: Allan Brown, Portfolio Manager, Concordia Capital – Marti Murray, President, Murray Capital**

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

Geoffrey Gold, Partner, Strategic Value Partners

- Distressed investing outside the U.S.
- Comparing domestic with European opportunities

4/7 **Corporate Highly Leveraged Restructurings (PP file #7)**

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

4/7 **Adding or losing value through leveraged restructurings**

- Debt for equity swaps (Leveraged Recapitalizations)
- Leveraged buyouts
- Post restructuring asset sales

4/14 **Financial Restructuring Techniques – Guest Speaker: Steve Zelin, The Blackstone Group or Barry Ridings, Lazard Freres**

- Distressed financial restructurings
- Investment banker approach
- Current issues and career opportunities
- Enron/Xerox

4/14 **Interco Case #1 – Leveraged Restructuring**

- Hostile takeover defense – Poison Pill?
- Role playing by student groups

4/21 **Guest Speaker: Turnaround Management, Representative from the TMA**

4/21 **Continued Discussion of Interco Cases: Interco #2 (Bankruptcy)**

4/28 **Take-home Final due (for those not doing the term paper) and Student Presentation of Term Reports: All Reports due**

- Maximum 10-minute presentation of research

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: Tuesday/Thursday: 2:00-4:00 p.m.
& by appointment, KMC bldg, Rm. 9-61
Phone: 212 998-0709
Fax: 212 995-4220
Email: ealtman@stern.nyu.edu
Web: www.stern.nyu.edu/~ealtman

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)
Bankruptcy in e-commerce land
Bankruptcy in the telecommunication industry
Bankruptcy as a business strategy
Bankruptcy and pension plans
Bankruptcy and reorganization in the airline industry
Bankruptcy expert system
Bankruptcy in Central and Eastern Europe
Busted convertibles
China's experiment in bankruptcy
Claims purchases as a takeover technique
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
Emerging market debt models
 -Corporates
 -Sovereign
Energy industry prediction model
Equity performance after bankruptcy
Fallen angels
FASB 107 Disclosures
Financial reporting consolidation (captives) & Z-Scores
Foreign bankruptcy law
Fraudulent conveyance
Highly leveraged transactions (HLT)
Investing in bankrupt equities
Japanese bank problem loans
Macro-default models
Macro-influences model
Municipal defaults
Option pricing default models
Power companies and public utilities (2003)
Pre-packaged bankruptcies
Rating downgrade triggers
Retail industry prediction model
S&L debacle
Telecommunications industry defaults
The new BIS regulation on credit assets
The 1999-2002 default explosion
Z-Scores for Japanese firms
Z-Scores and investing

Sample Companies

Allegheny International/Sunbeam
Allied & Federated Department Stores
Ames Department Store
Arch Wireless
Armstrong World
Bethlehem Steel
Boston Chicken
Braniff International (Chapter 33)
Caldor
Canary Wharf
Columbia Gas System
Continental Airlines (Chapter 22)
Dow Corning
Eastern Airlines
Enron
Euro Tunnel
Federated Department Stores
Gillette Holdings
Global Crossing
Globalstar
Grand Union (Chapter 33)
Greyhound
Hills Department Stores
Hillsborough (Jim Walter)
Iridium
ICO Global Communications
Kaiser Aluminum
Kmart
Loewen
Manville Corporate
Montgomery Ward
National Gypsum
Olympic & York
Pacific G&E
Polaroid
PanAm
Prime Motor Inns
R. H. Macy & Company
Resorts International
Revco Corporation
Spectrasite
Southland
Storage Technology
Swissair
Trump Plaza
USAirways
Wang Laboratories
WorldCom
Xerox Corporation
Zale