

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

**Corporate Bankruptcy & Reorganization  
FINC-GB.3198.20**

**Professor Stuart Kovensky  
Spring 2016 (2<sup>nd</sup> Half)  
Tues/Thurs 10:30-10:50  
Location: TBD**

The subject of corporate bankruptcy and reorganization is both an exciting and important area in the study of corporate finance, capital markets, corporate law and investor behavior. During the course of your graduate studies, you have focused on studying capital markets, valuation and corporate finance from both an investor and issuer perspective. But what happens when these best laid plans do not play out as expected; when capital markets become more volatile and/or the corporate issuer becomes distressed or declares bankruptcy?

Bankruptcy in the corporate context is often misconstrued as purely a liquidation of the issuer involving the fire sale of assets and the loss of jobs. In fact, this is more of a rarity than the norm. More often the company begins a complex process of operational and financial restructuring that can also include a formal bankruptcy. During this period the prices of the company's securities (loans, high yield bonds and preferred/common stock) can be extremely volatile. Gaining an understanding of this process will introduce you to a fascinating dynamic in the corporate life cycle as well as an incredibly rewarding area of investing. Over time, distressed investing has offered very strong absolute and risk adjusted returns and the amount of capital dedicated to this form of investing has grown considerably.

The purpose of this class is to expose you to this lesser known but fascinating area. I am a graduate of the Stern School (1996) and teach this course from a practitioner's perspective as I bring almost 20 years of experience investing in distressed securities. My time studying under Professor Edward Altman and Professor Max Holmes was instrumental in my decision to pursue a career in this area of finance and I hope to convey why I feel it is so interesting in this course. Incidentally, I am not alone in my progression from student to practitioner in this area. Stern has "hatched" at least five- dozen vulture investors and traders of distressed securities over the years.

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, General Motors, Kodak and others
- Municipal and Sovereign Bankruptcies

While the financial distress prediction aspect is an important part of the course, it is also important to understand 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.*”

The pedagogy of the course includes traditional lectures, case studies, guest speakers on various topics, such as, corporate restructuring and “vulture” investing and a term paper related to the theme of the course. The 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 final session at the end of the term.

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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. 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 or a paper related to the theme of the course. 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-three students).

### Required Materials:

- A. Edward I. Altman and Edith Hotchkiss, **Corporate Financial Distress & Bankruptcy**, 3<sup>rd</sup> ed., John Wiley & Sons, 2006.
- B. Packet of PowerPoint Handouts and Exhibits.
- 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**, 2<sup>nd</sup> 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**, 1<sup>st</sup> or 2<sup>nd</sup> edition, John Wiley & Sons

## IV. Detailed Course Outline

### Session

#### Dates Subject and Readings

#### 3/24 **The Corporate Bankruptcy Phenomenon**

- Introduction to corporate financial distress as well as the growth and evolution of restructurings
- Defaults and bankruptcies in 1971-2014

- The credit crisis of 2007-9 (corporate); 2010-2012 (euro-sovereign)
- Major players in the reorganization process
- Review term project process and options

- 3/26 **Corporate Restructurings - Leveraged and Deleveraged**
- 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
- 3/31 **The Bankruptcy Code and the Real World Implications of Bankruptcy**
- History and evolution of the Bankruptcy Code
  - Important terms and principles
  - Parties involved and key milestones in a reorganization
  - Who wins and loses in a reorganization
- 4/5, **The Non-Investment Grade Debt Market – Senior Loans and High Yield**  
4/7 **Bonds**
- Evolution and current status of the market
  - Risk and return analysis
  - Trends in issuance, defaults and recoveries
- 4/12 **Investing in Distressed Securities/Distressed Debt Market Size, Scope and Outlook**
- Historical returns
  - The bankruptcy process and investing
  - Techniques/opportunities to invest
  - Debt vs equity, or both
  - Growth in number and size of restructurings

**4/14 Analyzing Distressed Securities/Credit Investment Strategies**

- 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?

**4/19 Case Studies in Reorganization with a focus on their impact on the company, its creditors and owners**

- How to create value in bankruptcy - Chemtura case study
- A case study in creditor conflict - Dynegy

**4/21 The Duplan Case will be discussed and collected**

**4/26 Credit Scoring Models: Predicting Financial Distress**

- 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**

**4/28 Implication & Applications of Financial Distress Prediction Models – Z-Score in Practice – GTI and Kodak**

**5/3 Final Project Due/In-Class Presentations**

**Grading:** The final project is the most important factor in your class grade (50%). The remainder is based on class participation (25%) and other assignments during the term (25%)

**Office Hours/Location:** By appointment - before or after class  
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