

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

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

**Profs. Edward Altman/Stuart Kovensky
Fall 2017 (1st Half)
Tue/Thurs 10:30-11:50 a.m.
Location: KMEC ____**

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. Over the last 20 years the market for non-investment grade debt has grown considerably and with that, the field of Corporate Bankruptcy has become increasingly prominent. This had led to the development of a number of interesting and potentially lucrative career paths within the fields of investment management and investment banking as well as restructuring and turnaround consulting.

In fact, the issue of insolvency has become relevant outside of just the corporate arena with the bankruptcy reorganization of Detroit in 2013, as well as the current Puerto Rico debt restructuring.

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. 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 below investment grade issuers, distressed or bankrupt 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. The bankruptcies of corporations like Enron and Worldcom, the credit crisis in 2008/2009 and the recent cycle of extreme distress in the energy industry 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.

In addition to the classroom discussion, all students are given the opportunity to join the NY Chapter of the *Turnaround Management Association* at a highly discounted price. Membership in the TMA provides access to TMA's networking, educational resources, and certification opportunities available to its members in the field of corporate bankruptcy.

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: altman@stern.nyu.edu, skovensky@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 history and current state of the US Bankruptcy Code, 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 municipal restructurings and cases as well as to empirical and theoretical scholarly and professional studies.

II. Course Requirements & Instructions

During the term of the class there will be a few minor individual or group assignments as well as reading requirements of the required text as well as individual handouts to support certain lectures. 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 three or 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.

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. M. Whitman and F. Diz, **Distressed Investing: Principles and Technique**, Wiley Finance, 2009
 - d. H. Rosenberg, **The Vulture Investors**, 1st or 2nd edition, John Wiley & Sons

IV. Detailed Course

Outline Session

Dates Subject and Readings

- 9/5,7 **The Corporate Bankruptcy Phenomenon (E. Altman, S. Kovensky)**
- Overview of the Course, Assignments, the Kodak Bankruptcy, Final 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 1971-2016
 - 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 – **Officer, Turnaround Management Association**

The Bankruptcy Process, Introduction to Kodak Bankruptcy (S. Kovensky)

- Basics of the Bankruptcy Code
- Focus on **chapters 7 and 11**
- Steps in the restructuring process
- Key Terms and Milestones
- Changes to Bankruptcy Code and Implications

Introduction to Group Assignments

9/12, 14 **The High Yield Bond Market – Chapters 8,9 and 2017 Salomon Center Mid-Year Report (E. Altman)**

- Evolution and current status of the market (review introductory materials)
- Risk and return analysis
- The raw material for the distressed securities market
- Distressed Debt Market – Market Dynamics
- Traditional default and mortality rate methods
- Estimating the probability of default
- Are historically based models still relevant?
- Comparing 2007 with Today
- Major risks going forward – Market Outlook

The Sovereign Debt Market - Predicting Sovereign and Municipal Debt Defaults

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

9/19 **The Bankruptcy Process (continuation)(S. Kovensky)**

9/21 **NO CLASS**

9/26 **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 Case Assignment

- 9/28 **Credit Scoring Models: Predicting Financial Distress – Chapters 11, 12 (E. Altman)**
- Z-Score Family of Models – **Chapter 11**
 - KMV, Neural Networks, etc. – **Chapter 11**
 - For emerging markets-expanded version of Z'-Score – **Chapter 12**
 - Enron/WorldCom and GM/Ford discussion

- 10/3 **Implications & 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

- 10/5 **Analyzing Distressed Securities and 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 re-organize?
 - 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?

Introduction to Dynegy Assignment and American Airlines Case

- 10/10 **Guest Speaker and Z-Score in Practice (Case Study)**
- 10/12 **Guest Speaker – Andrew Yearley, Partner, Lazard & Co. (American Airlines Case)**
- 10/19 **Example of Inter-creditor Issues - Case Study – Dynegy**
- 10/19 **Dynegy Case – Cont.**
- 10/26 **Final Project Summary/Update Presentation**
- This is not a regularly scheduled class. Instead, each group will meet with us during the day for 15-20 minutes and have 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.

FINAL PROJECT WILL BE DUE ON DECEMBER 12th

Office Hours/Location:

**Thursday: 2:00 - 4:00 p.m.
& by appointment, KMC bldg, Rm. 9-61**

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