

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

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

**Profs. Edward Altman/Stuart Kovensky
Fall 2019 (1st Half)
Tue/Thurs 10:30-11:50 a.m.
Location: KMEC 3-130**

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 Distressed Debt investing, including valuation and analysis of distressed firms
- Examples of historical bankruptcies
- 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, bank loans and the equities of companies that are distressed and trade either before or during bankruptcy reorganization or have emerged from Chapter 11. The market for these 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, operational and financial restructurings and "vulture" investing. Grading will be determined by a combination of your in-class participation, assignments (individual and group), a mid term quiz and a group take home project will be due at the end of the full semester. Students may 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, 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 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 or theme related to the topics covered in the course. Students are required to work in small groups of three 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, Edith Hotchkiss, Wei Wang, **Corporate Financial Distress, Restructuring & Bankruptcy**, 4th edition., John Wiley & Sons, 2019.
- 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**, 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 Techniques**, 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

9/3

The Corporate Bankruptcy Phenomenon (Read Chapters 1,2 and 4)

- Overview of the Course, Assignments, Mid-Term Exam, Final Projects and Grading
- Introduction to corporate financial distress and factors that cause firms to enter bankruptcy
- Business failures, corporate distress and bankruptcies - **Chapter 1**
- Major players in the reorganization process
- The chapter 11 process - **Chapters 2-4**
- Trends in bankruptcy reorganization

Introduction to Group Assignments

9/5, 9/10

The High Yield Bond Market – Chapters 2,8 and 2019 Salomon Center Mid-Year Report

- Evolution and current status of the market
- 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

9/12

The Bankruptcy Process – Part 1

- Basics of the Bankruptcy Code, **Chapters 3,4 of Text**
- Focus on **chapters 7 and 11 of The Bankruptcy Code (not text)**

9/17

The Bankruptcy Process - Part 2

- Steps in the restructuring process

9/19

The Bankruptcy Process Part 3 and Quiz

- Key Terms and Milestones

9/24

Review Case Study

9/26

Investing in Distressed Securities, Chapters 14-15

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

10/3 **Analyzing Distressed Securities and Investment Strategies – Ch. 14,15**

- Financial and operational analysis required
- What caused the company to be 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 **Credit Scoring Models: Predicting Financial Distress – Chapters 10**

- Z-Score Family of Models – **Chapter 11**
- KMV, Neural Networks, etc. – **Chapter 11**
- For emerging markets-expanded version of Z"-Score
Enron/WorldCom and GM/Ford discussion

10/10 **Implications & Applications of Financial Distress Prediction
Models – Chapters 11, 12**

- For investors – **Chapter 11**
- For bankers – **Chapter 11**
- For managers – the corporate renewal process
- The GTI corporate turnaround – **Chapter 12**
- How to Avoid Chapter 22

10/17 **NO CLASS (Make Up will be on 10/24)**

10/22 **Guest Speaker - TBD**

10/24 **Make Up Class – Review of Final Projects**

FINAL PROJECT WILL BE DUE AT THE END OF THE SEMESTER

Office Hours/Location: **Tuesday and Thursday: 2-3:30pm & by appointment**
KMC bldg, Rm. 9-61

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