NEW YORK UNIVERSITY - LEONARD N. STERN SCHOOL OF BUSINESS

B40.3176.32
Topics in Investments: Investing in Distressed Securities

Spring 2009
Wednesdays 6:00 – 9:00 pm  (February 11 – March 25; no class on March 18)
KMC 2-90  (44 West 4th Street)

Allan Brown       Brad Eric Scheler
Concordia Advisors LLC      Fried, Frank, Harris, Shriver & Jacobson
E-mail: aabrown@concordiafunds.com  (No phone calls please)
Office hours by appointment
Mailbox on 9th Floor (Finance)

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
• Extraordinary enthusiasm and effort

Optional textbooks and reference materials
• Corporate Financial Distress and Bankruptcy, 3rd Edition
  Edward I. Altman and Edith Hotchkiss (Wiley, 2005)
• Distressed Securities
  Edward I. Altman (Beard Books, 1999)
• Distressed Debt Analysis; Strategies for Speculative Investors,
• The Vulture Investors (revised edition)
  Hilary Rosenberg (Wiley, 2000)
• Bankruptcy Investing – How to Profit from Distressed Companies
  Ben Branch and Hugh Ray (Beard Books, 2007)
• Creating Value Through Corporate Restructuring: Case Studies in Bankruptcies, Buyouts, and Breakups
  Stuart C. Gilson (Wiley, 2001)
• Bankruptcy Code, Rules, and Official Forms: 2007 Law School Edition
  (Thompson West, 2007)
• A good online site to reference the code is: law.cornell.edu/topics/bankruptcy.html
• Other materials and case studies will be distributed in class

Other texts and sources of information
Periodicals
• Bond Investors Association: Troubled Company Reports (various)
• Daily Bankruptcy Review
• The Daily Deal(www.thedeal.com)
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Structure: The course will use a combination of lectures, case discussions, reading assignments, and guest lectures.

Lectures:
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: 3
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 unlimited 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).

Tips for good case studies (in my opinion, if that matters)
- Try to deliver a professional-looking work product
  - It’s a reflection of the effort you put into the project
  - It indicates that your serious
  - It’s usually easier to read
- Make sure your conclusions and statement make common sense
  - Don’t rely on quantitative output of a model if results seem out of line; take a step back and ask yourself if everything makes sense
  - Double-check for simple calculation errors and modeling mistakes; here it’s only your grade; out there, it could be your job that’s at risk
- If the case asks specific questions, make sure you give specific answers
- In exhibits, use arrows, circles, bold font, and comment boxes to point out relevant information that supports your case or that you’d like to emphasize
  - The less effort it takes me to find it, the happier I will be
- General Format (for investment recommendation)
  - Recommendation (One short sentence telling me what the conclusion is); puts the entire paper in context as I go through it
  - Text of recommendation
    - Rationale supported by data, evidence, exhibits
    - Risks
    - Expected IRRs, risks, other potential ways to structure trades

Reading Assignments: Current topics and primers. Students are expected to be able to discuss..

Guest Lectures:
Prominent professionals in the industry will discuss a variety of topics related to distressed investing. **ATTENDANCE IS MANDATORY AND WILL BE RECORDED.**

Grading: Case summaries 100%
Class participation* \( \frac{\text{+/-}}{100\% \ (\text{+/-})} \)
| 1 | Introduction to investing in distressed securities  
Distressed vs. Defaulted Securities  
Example of a distressed investment from start to finish  
*Case I distributed: Evaluating a distressed bond; enterprise valuation; distribution to creditors* |
| 2 | Historical Perspective  
The high yield and leveraged loan markets  
Distressed Investing – Overview  
Life cycle of Corporate Distress and Reorganization  
Investment Strategies – Choices and Drivers  
Distressed Credit Analysis  
Trading Conventions  
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  
*Case I discussion*  
*Case 2 distributed: Indenture and Credit Agreement Analysis* |
| 3 | Indenture and Credit Agreement 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  
Defaulted Credit Analysis  
Valuation  
Debt Capacity  
Capital Structure Analysis  
Capital Structure Arbitrage  
Contractual vs. Structural Subordination  
Guarantees  
Examples  
Balance sheet restructuring |
| 4 | **BRAD SCHELER – TOPIC TBD**  
|   | Bankruptcy and Insolvency Law  
|   | Brief history of bankruptcy  
|   | Cost of Bankruptcy  
|   | Chapter 11 Process  
|   | Bankruptcy and Consumer Protection Act of 2005  
|   | Operating as a Debtor in Possession; DIP Financing  
|   | The automatic stay  
|   | Executory contracts and unexpired leases  
|   | Exclusivity  
|   | Adequate protection and post-petition interest  
|   | Creditors’ committee(s)  
|   | Cramdown  
|   | Best interests test  
|   | Plan of Reorganization and Disclosure Statement  
|   | Emerging from Chapter 11; Exit Financing; Credit Bidding, Rights offerings and other capital infusions  
|   | Chapter 7 liquidation  
| **Case 2 discussion**  
| **Case 3 distributed: Evaluation of a Plan of Reorganization and Disclosure Statement** |
| 5 | **BRAD SCHELER – TOPIC TBD**  
|   | The Bankruptcy Code in more detail; implications for investors  
|   | Equitable subordination  
|   | Substantive consolidation  
|   | Recharaterization  
|   | Fraudulent conveyance and Preferences  
|   | Jurisdiction  
|   | Tax issues  
|   | Pension plans and other post-retirement promises  
|   | Issues related to current employees: retention and emergence bonuses  
|   | Trustees and Examiners in Chapter 11  
|   | International Insolvency Laws  
| **GUEST LECTURER – to be announced** |
| 6 | **BRAD SCHELER – TOPIC TBD**  
|   | Discussion of the distressed securities industry (players, returns, investors)  
|   | Applications to portfolio management  
|   | Correlation to various benchmark indices  
|   | Investment and trading strategies  
|   | Bank Debt and Trade claims  
|   | Credit Derivatives  
|   | Hedging strategies and shorting securities  
|   | Leverage; The Role of a Primer Broker  
|   | Blocking positions  
|   | Acquiring control of the firm through distressed debt  
|   | Exit strategies  
|   | 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  
| **Case 3 discussion** |