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Back in business

One way or other, the global financial crisis has brought distress to the lives of people, be it in the form of lost jobs, lower wages or losses on investments.

There are a lucky few, however, for whom their business gets a boost when the economy goes down. These include the distressed asset buyers who stand to profit from the crisis, motivated by the same reason that drives bargain hunters to pick up cheap offers at fire sales. And the big question facing them now is: buy now or later?

One would be well advised to wait until later, according to **Edward Altman**, Max L. Heine Professor of Finance at New York University, and an expert on corporate bankruptcy, high-yield bonds, distressed debt and credit risk analysis. "Bankruptcy liabilities are the raw material for distressed investors. In 2008, there were over US$700 billion (worth of bankruptcy liabilities) in one year alone, but over US$600 billion was attributed to Lehman Brothers," Altman said during a keynote presentation here at the Distressed & Troubled Asset Investing Summit organised by FinanceAsia and AsianInvestor.

"This year is going to break the record for liabilities and this of course is a potential for investors. But the question is, if you buy distressed debt at 25 cents on the dollar on a bond, or 40 cents on the dollar on a loan, is (the price) likely to go up in the next 12 months? It's pretty clear that the assets will not go up in value if the default rate is escalating at a high rate. Supply and demand will probably mean prices will be lower, rather than higher, for six to nine months, and that's why it's still too early for the distressed industry to pile into defaulted assets," he says.

Altman also notes a "creeping amount" of distressed assets in Asia. "We expect the (US) unemployment rate to rise to well above 10 per cent. That's another six million jobs lost in the US alone, and it's absolutely clear that the decoupling theory that was promoted for many years prior to this recession has been proven wrong. So that's why I do expect Asia to have more distressed opportunities and I think in places like Hong Kong and others, it's only just beginning," he says.

Drawing on the examples of Malaysia and Indonesia, he notes: "In Kuala Lumpur, it's virtually impossible for anything other than double-A or triple-A credit to get credit. Anything below double-A can no longer issue a bond in the market."

"In Jakarta, while there is more credit available

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because of the state-owned bank lending to state-owned enterprises and (others) …. they are just gearing up for an increase in distress and workout situations although the growth rate in Indonesia is expected to be four per cent a year but that (estimate) is down from seven per cent before and could be lower by the end of this year as they revise the estimates."

US default rates based on scenario analysis are expected to rise to 15-18 per cent in 2009 from 4.6 per cent in 2008. "A tremendous amount of new debt will come on to the market," Altman says.

"Supply and demand for distressed assets in the United States is so out of line today. We estimate there are two trillion US dollars in market value of distressed debt out there - both distressed and defaulted - and about 250 billion US dollars of assets under management chasing that and this is a tremendous change from just two years ago when the supply and demand was quite different," he notes.

In the US, there is currently US$2.7 trillion worth of risky debt outstanding, comprising US$1.6 trillion of leveraged loans and US$1.1 trillion of high-yield bonds.

"It used to be the case that only two to three per cent of risky debt was the triple-C tranche, or the most risky tranche. Today, 27 per cent of risky debt is of the lowest quality. And usually, the default rate on that tranche in a recession will be 35-40 per cent over the next 12 months."

Touching on the subject of US automakers, Altman adds, "I think we can look forward to either a deal or a bankruptcy petition on Chrysler in the next week and the same thing with respect to General Motors in the next month."

The spike in distressed situations has also resulted in a need for better forecasting techniques for default rates. Developed by Altman in 1968, the Z-score model is widely used to predict the likelihood of a company going into bankruptcy.

"The Z-score model has been around for 42 years, so we are developing a new Z-score model. Our work in this area is to build models that are not only score models, but are rating-equivalent models from which, for individual companies on a global basis, we end up with a probability of default estimate which could be used like the way you might use credit default swap spreads or yield spreads in the credit market as indicators of default rates and default probabilities."

The Distressed & Troubled Asset Investing Summit was held in Hong Kong on 28/29 April 2009.

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