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Richard,

Here is some info. on

Zapata Oil.

Jeff

Att copy

Banks and bankruptcy

So long, old buddy

NEW YORK

BANKERS expect applause for the rise from the ashes of Federated Department Stores, which emerged from bankruptcy in America on February 5th. They claim it is the agreement by most banks to take shares in exchange for 24% of their loans that is enabling the owner of Jordan Marsh, Bloomingdale's, Abraham & Straus, Burdines and other famous department-store chains to emerge from the bankruptcy courts as a publicly traded company. Others may reasonably ask why it was necessary for the banks to push the retailer into the courts in the first place, and so enrich the lawyers of all the parties involved.

Federated Department Stores and Allied Stores, the two retailing groups that fused to form Federated Department Stores, had always made healthy operating profits. Their financial troubles started when Robert Campeau, a Canadian property developer, bought them in the late 1980s for $9.9 billion, and sold high-yield junk bonds to finance his overpriced purchase. When the economy softened, the operating profits of Allied and Federated were too small to service the massive debt.

In theory, this presented banks with a classic opportunity to play a leading role in resolving a debtor's financial distress. As the textbooks tell it, one of the benefits of borrowing from a bank is that a relationship forms which enables the bank to help the firm if it gets into trouble. In practice, this hardly ever happens—at least not in America, where commercial banks (unlike their German or Spanish counterparts) lend to public companies but do not own them.

A recent study* of companies in financial distress finds that outside formal bankruptcy proceedings, banks almost never forgive principal on their loans and rarely provide new financing in such circumstances. Its authors—Paul Asquith and David Scharfstein of the Sloan School of Management at MIT, and Robert Gertner of the Graduate School of Business at the University of Chicago—look at 102 public issuers of junk bonds in the 1970s and 1980s whose operating income later fell short of interest payments for two years in a row.

In only one case did the banks agree to take a package of cash, debt and equity in exchange for principal without insisting that the company first file for reorganisation under Chapter 11 of America's bankruptcy laws. And the exception was truly exceptional: Zapata, a Houston-based oil company founded by George Bush in 1953.

Bail-outs mainly benefit subordinated public creditors, the study suggests. Because banks are usually senior lenders, and in many cases secured, they stand to do quite well in a bankruptcy. "Therefore their incentive to take unilateral steps to help the company is quite limited," the authors logically conclude. But they are puzzled to find that banks will sometimes forgive debt in a Chapter 11 reorganisation, yet are loth to do it as part of a comprehensive restructuring outside the courts.

For Chapter 11 is a relatively costly and inefficient way out of trouble. It provides wobbly firms with a shield against their creditors as they seek to regain their balance through asset sales, closures, lay-offs, debt renegotiation and so on. Its disadvantages include administrative costs (consulting and accounting as well as legal), the potential loss of valued customers and employees, the distraction of management, and the court's influence on operating decisions.

Nonetheless, when comprehensive restructuring is needed, banks plainly prefer the formality of Chapter 11 to more informal alternatives. Wall Street bankruptcy lawyers think America's financial history helps explain this preference.

After the 1929 crash, laws were passed limiting how many shares a commercial bank could acquire in a public company, how long it could hold them and in what circumstances. The Federal Reserve is prepared to interpret these restrictions liberally when banks swap debt for the equity of corporate customers in trouble, but banks still hesitate to become shareholders.

Even in Chapter 11 proceedings, banks regard debt-for-equity swaps as a last resort. In negotiations over the $1.9 billion they were owed when Federated and Allied filed in January 1990, all banks initially refused to accept equity in part-payment. They were afraid that it would establish an awful precedent for all those other stores in financial distress. Including Macy's, which has just entered Chapter 11?

*"Anatomy of Financial Distress". Working paper number 3942, National Bureau of Economic Research.

Thai property

Docklands East

BANGKOK

THE larger stockbrokers in Bangkok have private trading rooms for their punters, with rows of comfortable chairs facing a bank of screens. Girls in neat uniforms serve coffee and pass around order slips, while an excited market commentator burbles over the tannoy. It is just like an upmarket betting shop.

Bangkok's stock exchange is losing its patina of respectability. The launch of Bangkok Land's shares on February 5th seemed to symbolise the change. It is one of two speculative property companies controlled by the Kanjanapas family, which together now account for almost 12% of the stockmarket's total value.

A survey in 1978 listed Mongkol Kanjanapas, the family's patriarch, as the seventh-richest man in Thailand. He has grown richer since then, mainly through his family's interests in Hong Kong, where they use the name Wong. In Thailand, Mr Mongkol is chairman of Tanayong and of Bangkok Land. The first, managed by his second son, Keree Kanjanapas, was the most heavily traded stock in Bangkok last year, and is now worth 39 billion baht ($1.6 billion). Tanayong is building a satellite city on 243 hectares (620 acres) to the east of Bangkok.

Tanayong's ambitions are as nothing compared with those of Bangkok Land, which is run by Mr Mongkol's eldest son, Anant Kanjanapas. It intends to build a self-contained city on 640 hectares of land near Bangkok's airport. The company claims that 15 or 20 years from now, Muang Thong Thani (Golden City) will provide workplaces and homes for 1m people. It aims to have completed 49,500 units in high-rise buildings by 1995 and to have sold property with a total value of 362 billion baht in the first ten years of the project's life.

Last October Mr Anant issued 60m new shares—10% of Bangkok Land's total—at 90 baht apiece. Several months of uncertainty followed, because the stock exchange feared that so large a listing might undermine an already weak market. A brisk rally in January, helped by banks that had already bought 17m of Bangkok Land's shares and were keen to sell them at a profit, persuaded the exchange to list the shares on February 5th. They opened at 151 baht, which placed a value of 91 billion baht on the whole company, now the exchange's largest.

Bangkok's punters are evidently bothered neither by the Kanjanapas's abrasive style of doing business nor by the sort of things that keep foreign analysts awake. The latter are worried that there may be less to the grandiose housing project than meets

BY JEFFREY M. LADERMAN

CAREERCOM COULD TEACH THE STREET A LESSON IN PATIENCE

There's no greater pariah on Wall Street than the stock of a company whose takeover has fallen through. So it's not surprising that when the $11.50-a-share leveraged buyout of CareerCom collapsed in November, the shares plunged (chart) and have remained under enormous selling pressure since. "Nobody has a profit in this stock," says Kermit Rath, an analyst at Louis Nicoud. "Everybody wants to get rid of it by yearend."

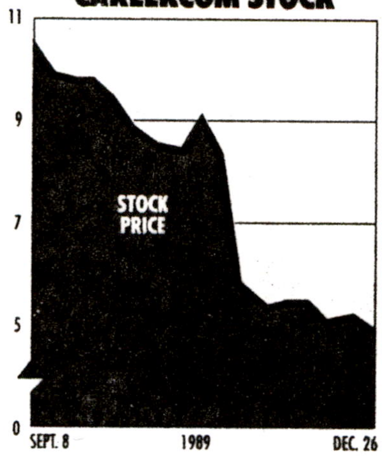
But some analysts think the rush to dump this Big Board-listed owner and operator of proprietary vocational schools affords savvy investors an opportunity to double their money over the next year. They argue that CareerCom, which lost 75¢ a share in fiscal 1989, can earn $1 a share in 1990. If so, CareerCom, at 5, is screamingly cheap.

Wall Street isn't going to change its mind about CareerCom quickly. First, some view vocational-education companies warily. A new federal law requires that vocational schools take steps to lower the default rates on their students' government-backed loans. Even more central to CareerCom's image is that the last failed takeover was the third in less than a year. Plus, 1989's write-downs and buyouts of the company's founders left an uncomfortably leveraged balance sheet. "This is a 'show me' stock," says Ken Abrams, a vice-president at Wellington Management, a major institutional shareholder. "CareerCom has to produce the numbers."

NEW SKILLS. The company's boosters are betting that the new management team, headed by President Robert Smith, will do just that. The company operates 74 vocationally and geographically diverse schools that teach such skills as truck driving, auto mechanics, computer programming, and nursing. Smith says that first-quarter earnings will weigh in at 26¢ to 28¢ a share. And Jeffrey Kessler, an analyst at Shearson Lehman Hutton, notes that CareerCom has shown strength vs. its competitors by maintaining enrollments in a low-unemployment economy while others have lost students. If the economy slows further, CareerCom's business should pick up as the jobless look to learn new skills.

Three times burned on the takeover front, CareerCom recently instituted a poison pill. Smith wants to expand and says tougher regulation and lending standards will lead smaller operators to sell out to larger companies such as CareerCom.

INVESTORS FLUNK CAREERCOM STOCK



DATA: BRIDGE INFORMATION SYSTEMS INC.

IS THERE MAGIC IN PRESTO?

By many measures, National Presto Industries, which makes small appliances such as pressure cookers and electric frying pans, is sizzling. For the first nine months of 1989, sales were up 32%, and profits gained nearly as much. It recently declared an 85¢-a-share extra dividend on top of the $1.40 annual payout. Yet Wall Street treats the stock like a day-old fish. This New York Stock Exchange issue hit a high of 40⅝ last summer but now trades at 36⅛, up less than 10% from year-ago levels.

Some who know the company say it's a steal. Presto is a well-recognized consumer brand name and a leader in product innovation. "To be a winner in this business, you need new products all the time," says Jerome Ballan, an analyst at Fahnestock & Co. Presto's latest offerings include a cordless version of the Salad Shooter, a hand-held electric slicer and shredder, and the HeatDish, an energy-efficient space heater. Older products provide steady, reliable revenues. The Eau Claire (Wis.) company is conservatively managed, with only $6 million in debt—about 3% of total capital. Plus, the company has $173 million in cash and securities, worth $23.50 a share.

Why the cash? "We'd like to make an acquisition," says Maryjo Cohen, Presto's president and the daughter of Chairman and CEO Melvin Cohen. "But we're not going to overpay." The company's unleveraged, highly liquid balance sheet might normally make it a takeover target, but that's unlikely, since directors and insiders hold more than 20% of the stock and, says the president, "we have plenty of shark repellent."

Even so, some pros, such as Stephen Leeb of *Indicator Digest*, think National Presto is a smart play. The cash and the 3.8% yield cushion the downside, while the stock has an upside target of 50. John Stone, president of Markston Investment Management, which holds a 3.2% stake, says Presto is selling for only 70% of its true value.

ZAPATA MAY BE A DRY HOLE

President Bush would not be proud of the recent tidings at Zapata, the Houston offshore oil-drilling company that he co-founded in 1953. True, Zapata's Big Board-traded shares have climbed from 2 a year ago to 3¼ recently, sharing the surge in oil-related issues. But Zapata, burdened with debt left over from oil's heyday, has suspended interest payments on its subordinated debentures and plans to restructure. James Rubin, who runs M. D. Sass Re/Enterprise Partners, thinks any debt overhaul will render Zapata stock worthless.

Rubin, who specializes in distressed securities, is shorting Zapata stock. He points out that the company's balance sheet is overwhelmed with bank debt—more than $500 million of the $690 million in total capital—which is, says the company, "secured by liens on all material assets of Zapata and its subsidiaries." The remainder of Zapata's capital consists of other types of debt and shareholders' equity of negative $57 million as of June 30. By Rubin's reckoning, Zapata's total assets are worth $350 million—about half of what it owes.

To satisfy creditors, Rubin thinks Zapata will have to issue so much equity that it will severely dilute the ownership of current stockholders—who could wind up with shares worth no more than a nickel each. Rubin believes that the stock, which sold for a high of $25 a share in 1984, "is dead." Zapata officials did not respond to BUSINESS WEEK's calls.

By Gary Weiss in New York

PAUL GRANGE/BW

Follow-Through

Edited by Kerry Hannon

Rocky Thies

Walkman food

June 29, 1987

Gil Friesen

More bad news for vinyl lovers. FORBES reported more than two years ago on the advent of the cassette single, a new recording format featuring just two songs that was introduced by A&M Records. Its mission: to replace the dying 7-inch, 45rpm vinyl disk. The concept took off after sales of vinyl singles hit a ten-year low in 1986. Only 94 million singles were sold that year, compared with the nearly 200 million discs a year that had been sold in earlier years.

Cassette singles, by contrast, are selling briskly. In their first full year on the market, 23 million cassette singles were sold, representing nearly 25% of the overall singles market and providing lots of food to feed all those Walkmen.

The cassette single's quick success could mean doom for the struggling 45rpm. David Steffan, A&M Records' senior vice president of sales, says that so far this year cassette singles have done about 80% of A&M's singles business. Other diskeries report similar inroads. Delicious Vinyl, whose single record "Wild Thing," by rap musician Tone Loc, became the second-bestselling single in history, sold 3 million units of the hit, 66% of which were sold on cassette.

Don't bother dusting off that turntable.—**Peter Newcomb**

Ouch!

Sept. 19, 1988

We blew it. Last fall Streetwalker advised buying Zapata Corp.'s New York Stock Exchange-listed debentures at about 85 cents on the dollar. Today they are trading at about 35 cents, and the Houston-based oil services company has suspended interest payments on the debentures.

FORBES wrote that Zapata was in the midst of a $600 million restructuring that included asset sales as well as massive writedowns of oil and gas properties. Despite losses, cash flow from operations was running at a rate of over $40 million a year.

Some of the biggest gains at Zapata were coming from its 57-vessel fishing fleet, which still accounts for nearly 50% of the company's revenues. FORBES reasoned that the fishing operations, plus a leaner oil service division, would surely allow Zapata to cover interest payments, making for annual yields of 25% for 1989 and 1990, and 15% to maturity in about ten years' time.

Here is how we missed the boat. Though Zapata's operating income from fishing more than doubled in 1988, we expected the company to do better. The problem: The drought increased the Gulf of Mexico's saline content, depressing Zapata's fish catch to 725,000 tons. About 950,000 tons would have been more typical. Also, its offshore drilling didn't recover, and major losses continued at Zapata's oil service operations.

But now may be the time *not* to sell. Richard Lehmann of the *Defaulted Bonds Newsletter* in Miami Lakes, Fla. advises holding the defaulted notes at 35 cents. To avoid Chapter 11, he thinks Zapata's management, which owns 5% of the stock, will propose a plan to convert the notes to stock. He estimates that should get debenture holders more than 70 cents on each dollar of face amount. We hope he's right.—**Matthew Schifrin**

$500 million, extremely negotiable

Nov. 3, 1986

As any matador will tell you, bulls don't normally negotiate. But the bulls at Merrill Lynch, it seems, will. With competition in residential real estate brokerage intensifying three years ago, Merrill announced plans to exit the business, offering to sell its brokerage, corporate relocation and mortgage servicing units. However, FORBES doubted that Merrill Lynch would be able to get its $500 million asking price.

And Merrill didn't. It took until last August to find a buyer, Prudential Insurance Co. of America. Prudential paid Merrill about $300 million for businesses that Merrill had accumulated over the past 12 years for roughly $120 million. On Merrill's real estate brokerage business, pretax profit margins were a modest 1.4% of sales in 1987 and 1988.

One bright light: As a result of the Prudential purchase, investors in Merrill Lynch's public limited partnership, Fine Homes International, L.P., got to cash out. A minority stake in Fine Homes, the vehicle for Merrill's real estate operations, was offered to the public in June 1987. Though partnership units had consistently traded well below the $18 offering price, the terms of the Prudential transaction allowed Fine Homes International holders to recoup their original investment, plus a 12.5% annual return. —**Ralph King Jr.**

Ian Bradshaw/Katz/Woodfin Camp

It's coming, it's coming

Oct. 30, 1989

Glen Renfrew

The good news is that Reuters Holdings Plc.'s ambitious plan to automate foreign exchange trading is moving ahead. The bad news is that the new system won't be operational in December, contrary to what FORBES reported two months ago. In fact, the company's powerful computer in Hauppauge, N.Y., which will coordinate the new system, probably won't be up and running for at least six months.

The British company lost its nerve, postponing the service's debut until sometime in the third quarter of next year. Reason for the delay: Reuters says it wants to do additional development work and testing. Reuters Managing Director Glen Renfrew says that the delay will have only a negligible effect on the company's financial results.—**John Marcom Jr.**

Streetwalker

Edited by Thomas Jaffe

A Mexican play

Drexel Burnham's Michael Milken is only one of the savvy investors who have been looking at opportunities in Mexico. Though its problems are many, Mexico has shown a surprising ability to cope with them. How does the smaller investor take a stake in this emerging economy? A handful of large Mexican companies have U.S.-traded ADRs—Teléfonos de México *(see next page)* and Tubos de Acero, for example. There is the New York Stock Exchange-listed Mexico Fund, which recently sold at a 30% discount to its net asset value. The venturesome investor, however, might want to look at an open-end investment fund trading on the Mexican stock exchange called Fondo Accivalmex, or Accival. As of June, Accival had around $130 million in assets and is roughly the same size as the Mexico Fund. But Accival has been a far better performer than its New York-listed competitor. Since the beginning of 1983 the total return of Accival is more than 1,800% (in U.S. dollars), compared with 42% for the Mexico Fund, making it the best-performing of Mexico's 36 mutual funds. Like the Mexico Fund, Accival typically invests in blue-chip Mexican stocks. But it trades as well as invests, according to Eugenia Pichardo, the managing director at Acciones y Valores, the brokerage house that runs Accival. That way it not only represents a long-term stake in the economy but a way to try profiting from the wild swings that are endemic to the Mexican market.

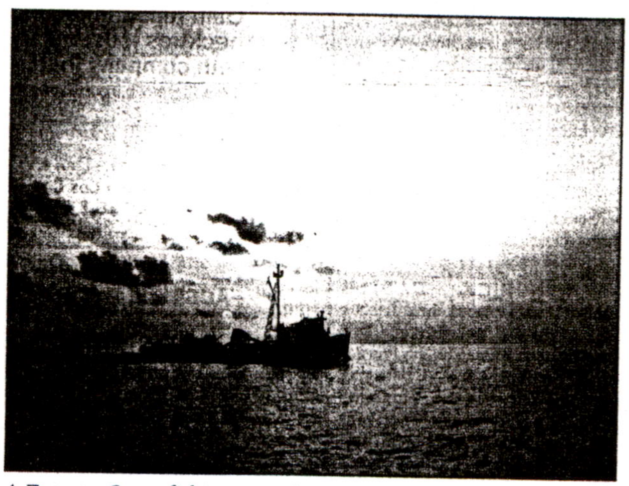
Last fall the Mexican market crashed and gave up most of the 700% gain it scored during 1986 and 1987, but Accival shares finished 1987 up 60% in U.S. dollar terms. Mexico Fund ended 1987 up 3%. The main difference was that Mexico Fund went into the market crash near fully invested, while Accival had 40% of assets in cash.

Accival's Pichardo believes that many stocks on the Mexican market are cheap despite a 28% runup in real terms so far in 1988. The average Mexican company is priced at four times cash flow and 77% of book value—adjusted for inflation.

You or your broker can buy shares in Accival by calling Acciones y Valores in Mexico City, asking for the International Department and opening an account. Commission: a little under 2%. Stock trades around $1.25 a share. Certificates can be held at either Acciones y Valores or Citibank, or at any other custodian in Mexico City.—**Matthew Schifrin**

No fish story

New York Stock Exchange-listed Zapata Corp. was founded in 1953 by George Bush and Pennzoil Chairman J. Hugh Liedtke, both of whom have long since sold their interests. But that's not what this item is about.



A Zapata Corp. fishing vessel
Zapata's new cash machine.

A $600 million debt restructuring saved the offshore drilling concern from bankruptcy a year ago, but some of its debt issues still aren't paying interest.

However, Zapata Chairman R.C. Lassiter reduced overhead by 50% and wrote down over $200 million in oil and gas properties. The company lost $156 million in 1987 on $146 million in revenues, but cash flow remained positive to the tune of $10 million.

This year things are looking better. The company pocketed a quick $65 million profit through the cannily timed buying of two financial services companies from United Technologies and then reselling them. Moreover, Zapata's cash flow from operations will be at an annual rate of $43 million by year's end.

The company's Houston-based drilling business is improving, but Zapata's biggest gains are coming in commercial fishing. Zapata produces around 200,000 tons of fish meal a year; the fish are caught in the Gulf of Mexico and Chesapeake Bay by its 57-vessel fleet. This summer's drought has savaged the soybean crop and pushed up the price of fishmeal, which is used as poultry feed.

Bear, Stearns broker Roger Smith recommends two of Zapata's defaulted junior debentures. These 10%-plus coupon notes come due in 1997 and 2001. They trade at around 85 cents on the dollar and have accumulated two years' unpaid interest.

Come autumn, the notes are scheduled to start paying half of their coupon interest, and beginning next spring they will pay double their coupon rate for two years. According to Smith, that should provide 25% current annual yields during 1989 and 1990. After that the bonds will yield around 15% to maturity based on the recent price.—**M.S.**

Where's the buyer?

Over the last year or so the shares of Cincinnati-based Kroger Co. have been moving up on takeover rumors, and now trade at around 36 a share, up almost 60% from the October crash low. The old story: With $17.7 billion in sales, 1,300 supermarkets and 900 convenience stores, Kroger is said to be worth more broken up than whole. Rotan Mosle's Gary M. Giblen has a report out arguing that the stock is really worth over $50 a share. Giblen claims to have found, buried in the financials, $3.50 to $4.50 a share in undervalued real estate. Giblen believes a buyout will happen within the next six months—to beat the deadline of a new Administration in Washington.

All very convincing except for one thing: Who would buy it? Any buyer would need over $4 billion, and virtually all the big supermarket chains are already digesting major mergers. Kroger's management is not interested in

A VULTURE IN EVERY POT

As banks dump bad debt, vultures looking for asset-based takeovers will feast.

BY DAVID CAREY

EVERYONE KNOWS THAT LEVERAGED buyouts are dead, right?

Well, guess again. LBOs are flourishing today, just as they did in the Eighties. The chief differences are that the debt is now old debt, not new, and the takeover struggle occurs in bankruptcy court, not the boardroom.

This year, raiders walked off with Wheeling-Pittsburgh, the nation's eighth-largest steelmaker (FW, Nov. 14, 1989), snatching assets from the jaws of bankruptcy after buying the company's bank debt. Soon after, both Zapata and Reading & Bates, large offshore oil drillers, fell to raiders in swift, out-of-court restructurings.

In each case, the raiders won control by buying soured senior loans from the original lending banks at steep discounts to face value. This debt was then turned into controlling equity stakes through the alchemy of financial reorganizations that the raiders forced other creditors to accept. What gave raiders the power to do this was that they had bought the senior debt. In financial overhauls of bankrupt companies, says William Golub, a bankruptcy lawyer at the New York City firm Rosenman & Colin, "it's very often the most senior creditors who have the real clout." That clout can be insuperable, as the seizures of Zapata and Reading & Bates show. Junior creditors knew that to force either company into bankruptcy to fight the raiders in court would be fruitless. In court or out, the raiders couldn't lose.

"There will be lots and lots and lots" of these takeovers during the 1990s, contends Richard Rainwater, the masterful Fort Worth, Tex., investor, former chief adviser to the Bass family and well-known takeover artist. Rainwater's own new-style conquests include Wolverine Exploration, Blocker Energy (now named Energy Service) and Penrod Drilling, although he snared the last two after the companies' banks already had control of the equity. Ronald LaBow teamed with Australian industrialist David Hains to capture Wheeling-Pitt, while with fellow New York City turnaround expert Basil Vasiliou, LaBow grabbed a hefty piece of UNR Industries, a steel-products manufacturer.

Having already executed debt/equity swap takeovers of Anglo Energy (now Nabors Industries) and Mission Insurance (now Danielson Holding), the New York City investment firm of Whitman Heffernan Rhein joined with Paul Loyd, a Houston vulture, to take Reading & Bates.

With the backing of Wall Street money managers Michael Steinhardt and Michael Price, Japonica Partners acquired Allegheny International largely through bank claims. The raider Robert Bass and a Los Angeles vulture firm, Trust Co. of the West, jointly pried away 20% of Lone Star Steel from its corporate parent, Lone Star Technologies. Trust Co. and Cargill Financial, of Minneapolis, were the chief recipients of the Zapata stock. Foothill Group, another Los Angeles partnership, recently engineered a debt/equity swap takeover of American Healthcare.

And now comes word that the Pritzker family and the Tisch brothers may be contemplating raids of this ilk.

Even a handful of top-tier commercial banks are getting into these New Wave takeovers. Arthur Schoen, head of Bankers Trust's restructuring group, says the bank has become an avid vulture—or speculator in distressed assets—having acquired roughly $100 million worth of other banks' loans since 1988. Bankers Trust bought into Penrod with Rainwater, putting up a bridge loan for the Texan and a clutch of minority investors led by junk bond maven Randal Smith, and came away with a slice of Penrod's equity. In a similarly venturous move,

Morgan Guaranty, Bankers and Chemical in effect gave LaBow and Hains a margin loan, staking the pair half their $130 million investment in the busted bank loans of Wheeling-Pitt.

Lending of this sort goes well beyond the banks' routine practice of capitalizing companies once they have come out of bankruptcy with their balance sheets safely purged of debt, or the practice of supplying Chapter 11 cases with temporary working capital. These bridge loans are every bit as risky as those done in the freewheeling Eighties.

Returns from these takeovers can be spectacular. Of course, to a large extent, the fate of the raider's investment turns on the price movements of the stock he gets in place of his debt holdings. But many New Wave takeovers also are hedged with cash or debt, which is perhaps a measure of how risky these investments are. In a typical deal, the raider arranges to swap his loans for cash or newly minted bonds in addition to his majority share of the stock. If he gets cash, the raider's net investment shrinks commensurately and the magnitude of his return rises. If he gets bonds, if worst comes to worst, he can force the company to buy back the bonds, a move that likewise slashes his effective cost.

Thanks to such maneuvers, Rainwater has whittled his investment in Energy Service from $12 million down to nothing. Yet on paper, four years after the takeover, his holding in the company is worth $70 million. As for LaBow and Hains in the Wheeling-Pitt deal, the payoff looks rich already. By May, five months after the company escaped bankruptcy, the pair expects to have recouped roughly $25 million of the $65 million they plowed into Wheeling and to have snapped up more shares on credit. If the steelmaker's stock and bond prices hold steady, LaBow and Hains will be sitting atop a $100 million paper profit.

Junk bond holders prescient enough to have bought in at bedrock prices can also score big. That's why junk collectors such as Carl Icahn and George Soros love bankruptcy plays. Buying a third or more of an entire bond class, as Icahn did with Southland's 13.5% PIKs, gives a vulture the legal wherewithal to stymie a Chapter 11 reorganization plan that's not to his liking. That's because a two-thirds approval of each class of creditors is needed to ratify the reorganization plan. In the idiom of vultures, this "blocking position" endows the junk holder, at the very least, with "gadfly power."

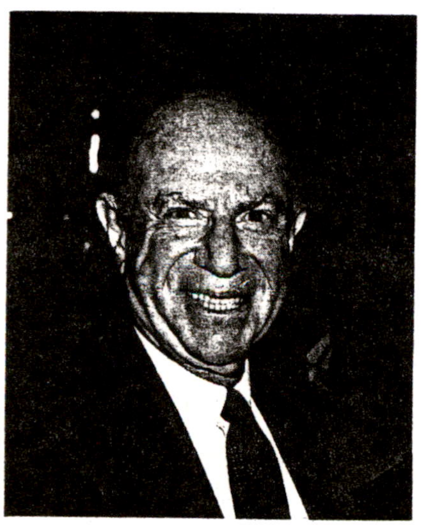
History shows that junk holders with that amount of muscle usually wind up with anywhere from 25% to 70% of the face value of their claims. Icahn is believed to have acquired his Southland holdings at less than 40% of face value, then cashed them out at 60% and walked away at least $40 million richer.

But while bankruptcies can enrich a junk holder, his chances of capturing a company from that base are slim. In only seven of the 22 debt/equity swap takeovers that FW examined—Campanelli Industries, Care Enterprises, Citizens Mortgage Investment Trust, Coleco, Commonwealth Oil & Refining, Maxicare Health Plans and Republic Health—were junior creditors the victors.

No one has a weaker voice in bankruptcy proceedings than common shareholders, however. Consider Goldman, Sachs's woeful fate in the Wheeling-Pitt deal. The elite Wall Street firm acquired 34% of Wheeling's common in 1989 for $14 million, four years into Wheeling's tortuous bankruptcy saga. Goldman got sandbagged. After LaBow and Hains were through with Goldman, its stake in Wheeling had been diluted to 3% and its loss stood at $8 million.

This isn't to say that New Wave debt/equity swap takeovers from a base of senior debt are easy. They can be nasty, protracted tussles pitting senior creditors against managers, fearing for their jobs, and fractious bondholders. The war can rage on for years. Remarks James Rubin of the New York City-based vulture partnership Sass Lamley Rubin: "These deals aren't like the Rales brothers backed by Milken doing a three-month greenmail effort. They require a two-to-four-year investment perspective. But the good thing about them is that if they are executed properly, no matter how hard others fight you, you're ul-

Laurence Tisch

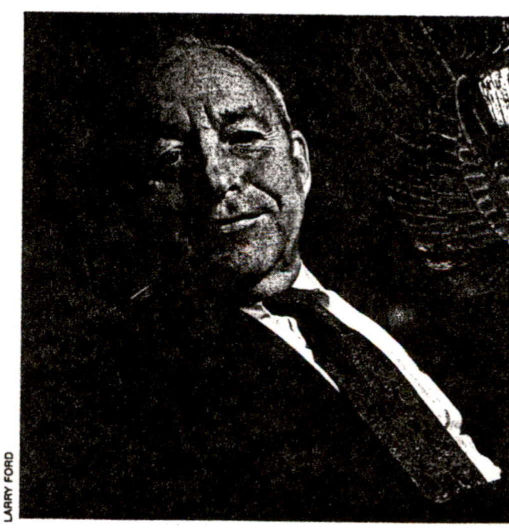


ALLEN/GAMMA-LIAISON

Preston Tisch

WAGNER/ONYX

Martin Whitman



LARRY FORD

timately going to own the company."

The whole arduous affair ultimately culminates in a game of chicken between junior and senior creditors—a contest hinging on how the asset values of the deleveraged, reorganized company will be divvied up. The challenge for the raider is to hash out a reorganization plan that "impairs" his claims in some small way, because he's legally barred from voting on any plan that restores his claims in full.

If junk holders decide not to play along, the raider can threaten them with a "cram down"—the only option the court has when creditors fail to agree on a plan. A cram down works like this: "Let's say the assets are worth $500 million and there's $600 million of senior debt and $400 million of junior debt," explains Dan Harmatz, manager of Fidelity's Belmont vulture fund. "In that case, the senior class is in a position to cram down the juniors." That's because the "absolute priority rule" dictates the outcome of cram downs, giving senior claimants first crack at the assets. When the seniors' claims surpass the assets, as in Harmatz's example, they gather in whatever value the company has, and the junior creditors get zilch.

Notes attorney William Golub: "It's not at all unusual in a cram down for shareholders and even junior creditors to get totally wiped out and lose everything."

Why raiders usually get their way can be discerned in the Wheeling-Pittsburgh takeover. Before the reorganization took effect, Wheeling owed $585 million to senior claimants and $647 million to junior unsecured claimants. It had $650 million in its till. Under a cram down, the senior claimants would have gotten as much as $585 million cash, leaving virtually no cash to spare the mass of junior claimants. As it was, junior creditors fared far better under the LaBow and Hains takeover plan, taking in $447 million in cash.

Junk bond holders aren't defenseless in these contests. They can thwart takeover ambitions by concocting a reorganization plan that pays the raider's claims in full. Because his claims aren't being impaired, he is cut out of the voting. The inherent risk in this stratagem is that junk holders, in effect, cram themselves down, something that makes sense only if the company is so flush with value that junk holders have little to lose. Even so, the self-inflicted cram down has been used effectively on occasion.

As the ranks of failed LBOs grow, predict bankruptcy experts, so, too, will successful bankruptcy takeovers staged by junk bond holders rather than bank claimants. Why so? Because a good many busted LBOs are likely to arise from mere overindebtedness, not collapsing business prospects. And the asset values in these cases, suggests Harmatz, "could greatly exceed the bank claims and extend down into the junior claims."

Just how meaningful a role these debt/equity swap takeovers will play in the ongoing deleveraging of American industry is unclear. Banks such as Bankers Trust and Morgan Guaranty seem eager to funnel more funds into these takeovers. But persuading most banks to dump their troubled loans can be a tough sell because of the immense write-offs that loan sales can trigger.

Still, there may be such a large supply of heavily discounted bad loans on the market that greater sums of capital will be drawn into the New Wave takeover game. The temptation is rapidly mounting for banks to cut their losses and put more of their troubled loans on the block. Only recently, banks auctioned off some or all of Leaseway's $220 million of claims to a host of vultures believed to include Robert Bass, Carl Icahn and Cargill Financial.

Says Christopher Snyder of Loan Pricing Corp., a New York City firm that tracks the bank loan market: "A big hang-up to loan sales is the Japanese banks, which are very big players in commercial lending in the U.S. Right now, they're unwilling to discount their U.S. loans. But if and when their attitude changes, the bank loan market could go through a real blowout."

Indeed, Snyder calculates that there is $52 billion in syndicated bank debt now outstanding. As much as a third of it may be distressed. For vultures hungry for takeover opportunities, that's a feast in waiting. ■

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BEN WEAVER

Richard Rainwater

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