

Early Warning System

Who Will Be First To Hit The Wall?

By David Toll

A widely anticipated rush of defaults – should it materialize – promises plenty of business for everyone in the bankruptcy and restructuring market. Still, it can't hurt to get an early jump on opportunities.

Every two weeks since the summer of 2005, Peter J. Solomon Co., a New York-based M&A and restructuring advisory shop, has been sending clients a proprietary list of publicly-traded companies that it believes are potentially heading for trouble.

The list is based largely on movements in stock price. Companies that experience a stock price decline of more than 10% in the last week, more than 15% in the last month, more than 20% in the last six months, or more than 30% in the last year, are all potential candidates – provided they also meet a variety of financial benchmarks, such as having a ratio of total funded debt-to-Ebitda greater than five to one, or negative Ebitda over the last 12 months (except for financial services companies). A significant change in stock volatility over the past 10 days can also land a company on the list.

A typical watch list includes some 200 “decliner” companies that qualified because of drops in their stock price, or changes in stock volatility. (The watch list also includes a list of “gainer” companies whose stocks have jumped higher of late.) Perhaps 20 to 50 companies get added to the list of decliners every week, while some five drop off, according to Anders Maxwell, a Peter J. Solomon managing director.

Why put such faith in equity prices to forecast trouble ahead? According to Maxwell, who has conducted research on the high-yield market for more than 30 years, large drops in stock price often reflect significant changes in market sentiment toward a company. Specifically, he says, large number of investors have suddenly been “disabused” of their original thesis for holding on to the security – presumably for a good reason. By contrast, price movements in bonds and bank loans say less about the company's prospects, because trading tends to be thinner, Maxwell says. A drop in bond prices could easily reflect, say, a single large investor's decision to cash out.

Over time, the watch lists have interesting things

to say not just about individual companies, but also about the prospects for whole industries. Consistent with research presented elsewhere in this report, industries with heavy exposure to the real estate market and to consumer spending have been well-represented on the list of decliners in recent months. The table below presents an analysis of companies that made the decliners portion of the watch list the four times it was published in July and August. • *dbri*

Top Industries Represented In The PJSC Leveraged Company Watchlists, July And August*

Broadcasting & Cable TV	45
Regional Banks	36
Airlines	28
Auto Supplies & Equipment	23
Thrifts & Mortgage Finance	20
Homebuilding	18
Reits	18
Paper Products	17
Aerospace & Defense	16
Casinos & Gaming	16
Publishing Cos.	15
Ind. Machinery	14
	13 Diversified Commercial & Prof. Svcs.
	12 Wireless Telecom Svcs.
	12 Packaged Foods & Meats
	9 Commodity Chemicals
	9 Real Estate Management & Development
	9 Property & Casualty Insurance
	9 Marine Ports And Services
	8 Office Supplies And Services
	8 Movies And Entertainment
	8 Household Appliances
	8 Forest Products
	8 Food Retail Or Distributors

*Companies appearing on more than one list were counted each time they appeared. Source: The PJSC Leveraged Company Watchlist, July 6, July 20, August 3, August 20. To be considered for the list, companies must be U.S., Canadian and West European public companies, and meet a variety of financial benchmarks. For example, they must have an enterprise value greater than \$100 million, and a ratio of total funded debt-to-Ebitda greater than five to one, or negative Ebitda over the last 12 months (financial services companies are evaluated differently).