



## CHAPTER 1

## Emerging from the Egg

*I have no wish to beautify the vulture, but, on the other hand, I cannot acquiesce in the poets' terrible indictment. They make it ominous and gloomy, hungry and thirsty for blood. . . . This is all undeniable poetry, but it is all injustice, because out of sympathy with Nature. And Nature is far more poetical than even the poets.*

—Philip Robinson, “The Poets’ Birds,”  
*Atlantic Monthly*, June 1882

I have always had something of a knack for business. The youngest of eight children, I spent much of my youth in suburban New Jersey looking for ways to make a buck. Whether it was mowing lawns, shoveling driveways, or delivering newspapers by bike on a paper route, I was usually working to earn some cash during my spare time instead of watching TV or playing video games.

Since money was tight at home after my parents separated, I needed to find for myself the means to keep up with my peers in affluent Upper Saddle River. By the time I was a teenager, I had rotated through all sorts of jobs, learning a good deal about business in the process.

One formative experience was a job I took at a local men’s clothing store when I was in high school. Irv Lerner’s, set in a highway strip mall near the New Jersey/New York State border, paid me minimum wage, then \$3.25 per hour, which even at the time was very little. The work was tiresome and boring, but it gave me a firsthand look at how difficult and competitive retailing could be.

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One weekend, my manager asked me to bring out clothing from the back room to a big table at the front of the store for Irv Lerner's annual sidewalk sale. The project took me hours—folding and organizing stacks and stacks of men's shirts and pants—but when I was done, I was proud of my beautiful display.

Unfortunately, when I returned to work on Monday after the sidewalk sale, I found that although hundreds of shoppers had rifled through my neat stacks, leaving a huge mess for me to clean up, they had bought hardly anything. I quickly decided that retail wasn't for me (and, I guess it really wasn't for the owner either, since he barely came to work one day a week). Like most strip-mall retailers of its type, I believe Irv Lerner's eventually went bankrupt, killed off by the rise of big-box retailing, which transformed the industry with its high-tech inventory management and enormous purchasing power.

My next job was at the headquarters building of Magnavox, the electronics company, in Mahwah, New Jersey. I worked evenings as a maintenance engineer—that is, as a janitor—cleaning the executive offices. I found this much more pleasant, and considerably better paid, at \$9.15 per hour.

The lesson for me was that dirty work, although stigmatized, could be much more profitable than a seemingly more-desirable job. Like a vulture investor's work, a janitor's work entails handling things someone else has discarded. Nonetheless, as a sensitive teenager, I was afraid of what people would think, so I didn't tell any of my high school friends or girlfriends where I was working.

Another lesson I learned from cleaning the Magnavox offices was how much you can tell about people from their trash. At the end of the day, it was obvious which employees worked harder—and equally obvious that entire departments just sat there all day, filling up their trash cans with cigarette butts and coffee cups on the shareholder's dime. For some reason, young as I was, this lack of productivity frustrated me to no end. I yearned to bring the problem to someone's attention, but of course it was hardly my place to take it up with senior management. I would get my chance later in life.

My next job, walking dogs and hosing out their cages at a boarding kennel, was not nearly as well paid, but it did teach me a few things. One was the value of a monopoly. Since Dr. Totorra's Dog Kennel was the only real choice in Upper Saddle River for pet owners to board their darlings when

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they were away, he could charge top dollar for rather bad accommodations. The monotony of the job—which I really hated—also gave me plenty of time to think about the future.



At that point, I decided I needed to find a way to work smarter, not harder. I became more creative, dreaming up all sorts of moneymaking ideas and researching them as best as I could. I would go to the local library in Upper Saddle River and take out every business book I could get my hands on. I ordered a raft of kits from late-night infomercials: “How To Buy Real Estate with No Money Down,” “How To Get Rich Collecting Judgments,” and other money-making titles about buying tax liens and conducting multilevel marketing. I studied them all but concluded that there really was no free lunch and that short cuts mostly don’t work. To be successful, you need to put in the time, so you really have to love what you do.

Although my older siblings took an indulgent attitude toward their baby brother’s wacky ideas, it wasn’t long before they started calling them Wak Get Rich Schemes (my nickname, Wak, was a phonetic play on my middle name, Joachim). However, I ended up getting the last laugh.

While an undergraduate at Rutgers College, I won the *Wall Street Journal* Award for Excellence in Economics, and in the 1991 AT&T Annual Stock Picking Contest, I placed twenty-third nationwide (from over 14,000 participants) and first at Rutgers. So, by the time I was in graduate school, my father and some of my siblings trusted my business sense enough to give me some of their money to manage—an account they dubbed the Wak Get Rich Fund (WGRF). That fund turned out to be my launch pad into the world of vulture investing. In fact, even after I started Schultze Asset Management LLC in 1998, I kept the WGRF name as a headline file for most of my business documents.

When I graduated from Rutgers in 1992 with a BA in economics and political science, I was 1 of only 10 students accepted that year into Columbia University’s four-year joint JD/MBA program. I knew I wanted to get into business, but I was also convinced that becoming an attorney as well would give me a powerful edge.

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As a teenager, I saw firsthand how much influence attorneys can have over the outcome (and duration) of a dispute when my parents went through a very difficult and protracted divorce—which I felt went on much longer than it should have because the lawyers wanted to maximize their hourly fees. On a more positive note, my father often spoke of how important attorneys were as advisers in his business career.

My father was a director in the U.S. office of Agfa-Gevaert, a German photofinishing company that had the second-largest market share behind Kodak. His job was researching acquisition opportunities, since Agfa was constantly looking to increase its U.S. business. My career has taken a totally different direction, but in some respects, the fundamental company analysis I do to research my investments is similar, and I have benefited from my dad's business insights over the years.

Although I was already doing a fair amount of investing for my own and my family's account, getting the Columbia dual degree turned out to be a great choice, giving me just the right training for a career in vulture investing. On the business side, Columbia's highly respected curriculum included value-investing courses, featuring guest speakers such as Warren Buffett, Jimmy Rogers, Seth Klarman, and Mario Gabelli. I was also lucky to have stimulating fellow students and friends, many of whom went on to have successful careers in investment as well.

The legal side of my education was perhaps even more important, since in the United States nearly every distressed company, if not bought out or otherwise rescued, eventually ends up restructured in a federal bankruptcy court. A successful vulture investor, whether in distressed companies, real estate, or securities, therefore has to be able to deal with attorneys, judges, financial advisers, and the court system. A law degree is pretty much an essential.

Of course, earning a dual degree in law and business from an Ivy League school isn't enough to guarantee success in this business. A true vulture must love sniffing out potential prey. Like most investors, vultures make their money by finding inefficiencies in the market and arbitraging out those inefficiencies.

But the complexity of the structural and legal issues inherent in the distressed-securities market can make those inefficiencies much greater than in many other investment fields, creating a much larger potential for profit. Many holders of distressed securities are legally, or contractually, obliged to sell their positions, regardless of the fundamentals. Rational investors,

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however, will be happy to buy those same securities after the company's problems are resolved.

To find those opportunities, you need a laser focus on understanding each investment before taking any action. You must really love doing fundamental company analysis—fortunately, I do. For me, the drudgework to find opportunities is easy, even though it may be time-consuming. Hours, days, and weeks literally fly by when I'm immersed in company investment research.

I find myself going home in the evenings anxious to explain the fun things I've discovered that day to my wife and kids. In fact, I believe that the best way to know when you understand a company or security well enough to make an investment decision is when you can explain your ideas to a child. If you can't distill your ideas to that level of simplicity, you probably don't know enough to make the right choices.

You also need confidence in your abilities, a willingness to pit yourself against the market, flexibility—and a soupçon of humility. The best investors make most of their money in a very small percentage of their trades, so you must be willing to admit you are wrong and sell out of losing positions before they eat up too much of your profits and investment capital.

When I enrolled at Columbia I didn't know exactly where my career would take me, but during the third summer of my four-year program, I started to focus on distressed and special-situations investing. That summer, I was splitting my time between an internship at Mayer, Brown & Platt, a large, established law firm, and one at Fiduciary Partners, a small hedge fund that invested in a variety of vulture funds. The stark contrast between those two working environments helped push me toward the hedge fund world.

While at Fiduciary Partners, I had the opportunity to learn about different styles of vulture investing. I was particularly impressed by the operations of one of Fiduciary's investments, David Tepper's Appaloosa Management. (Tepper, in fact, became something of a role model for me, so I was pleased in later years to become involved in several deals alongside him.)



My first real-life opportunity in the vulture world was the Trans World Airlines (TWA) bankruptcy in 1995, which ultimately launched my career

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in this investing niche. At that point, I was working as an intern at Merrill Lynch's private client office on Sixth Avenue in New York, which mostly entailed cold-calling investors out of the phone book. Since I found this much less compelling than my earlier work at Fiduciary Partners, I began studying distressed-company disclosure statements at night.

TWA was a messy case, complicated by the involvement of the legendary Carl Icahn. As I studied the bulky disclosure statement,<sup>1</sup> I realized that the difficulty and complexity of the situation had generated significant "deal fatigue" among investors and participants, which served to further depress the value of TWA securities. TWA bonds had traded on the public markets down from par to below 20 cents on the dollar, even though (as the disclosure statement explained) their holders were likely to get a much higher recovery coming out of reorganization. So I decided to take the plunge and purchase some of these bonds for my own account.

As a fledgling vulture, I wasn't in a position to participate directly in the furious wrangling that went on for months among the airline unions, Carl Icahn, several creditor committees, and even the Pension Benefit Guarantee Corporation (PBGC). After endless rounds of difficult negotiations, a very complex settlement emerged. Under the plan, investors holding TWA's bonds would receive a package of securities that included new stock, new preferred stock, and, in an unprecedented twist, coupons giving the holder the right to purchase standby tickets on future TWA flights at a heavily discounted price.

Usually, former lenders are very reluctant to take back anything other than cash, principal, or interest in a restructuring—much less airline tickets. TWA's lenders couldn't believe that anyone would have the temerity to offer such payment in kind, and they rushed to the exits in a panic. Well, one person's garbage is another's opportunity. One savvy and enterprising vulture firm, M.D. Sass, bought these unsecured bonds at a steep discount to face value and then emerged as the chief purchaser of the TWA standby ticket coupons—at a further discount, of course.

My own investment turned out to be a phenomenal success. The TWA bonds I purchased for about 20 cents on the dollar (\$200 for each \$1,000

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<sup>1</sup>Nearly every company in the United States that restructures under Chapter 11 of the U.S. Bankruptcy Code is required to produce a disclosure statement, a plain-English document that helps creditors and other parties in interest make an informed decision about how to vote on the restructuring or plan of reorganization.

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face amount of bonds) skyrocketed to over 60 cents on the dollar after the deal was completed, and I had converted the new securities and ticket coupons that I received into cash. I did, however, hold onto the new publicly traded TWA stock I received in the reorganization. I continued my analysis of this new post-reorganization stock and absorbed as much information as I could about the company's financial condition and future prospects.



The turning point came for me one day while taking the elevator down from the Merrill Lynch office. The doors opened on a floor labeled M.D. Sass—I had just been reading about Sass's investment in the TWA ticket coupons and was thrilled to realize that the firm was in the same building. I decided at that moment that I would get a job with M.D. Sass so that I could learn more about its involvement in this deal, and perhaps compare notes on the value of the TWA common stock.

I managed to get an interview, and it went very well, largely due to our shared interest in the outcome of the TWA deal. Of course, it also helped that I actually offered to work for free, despite my stellar qualifications. Since I had largely put myself through college and graduate school with a combination of big student loans and funds I earned from working and investing, taking a job with no pay was quite painful. But for me, getting this valuable experience with a distressed-securities shop was well worth it.

I stayed with Sass after I finished graduate school for almost two more years (by then, of course, as a paid employee). In hindsight, I probably would have paid M.D. Sass for the privilege of working there, just to get the experience.

Perhaps the most important thing I learned while working at Sass was how cutthroat Wall Street can be. As an analyst researching prospective distressed-security investments, I would do a ton of work on a potential acquisition and then recommend it to my portfolio-manager boss, Jim Rubin. He would then ask a few of the larger sell-side brokers whether any debt in this company was for sale.

The usual answer was that nothing was for sale—at least not at the lower prices we were looking for, such as 20 cents on the dollar. This

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puzzled me because several of the daily “axe sheets”<sup>2</sup> we got from smaller regional brokerage houses quoted the same debt at around that 20-cent level. Eventually a larger shop, like Donaldson, Lufkin & Jenrette (DLJ), by a strange coincidence, would begin researching the same company in an effort to connect a seller and buyer for a possible trade-based commission. Unfortunately, when DLJ completed its work it would also broadcast the results widely, scaring anxious owners into selling the distressed debt position and generating substantial buying interest from vulture funds.

The vulture funds, in turn, would drive up prices, so that the debt that I had originally sourced in the 20s would now be available for 30 cents on the dollar. Although not completely certain, I suspected DLJ was involved in front-running these higher-priced sales, since, as the primary dealer in the name, the firm saw all the flows from buyers and sellers.

This chain of events would repeat itself time and again, as I struggled to beat the market and find attractive acquisition candidates for the portfolio manager to whom I reported. I came to realize that despite the seemingly collegial counterparty relationships among Wall Street firms, all market participants are out for their own profit—short term or long term. They will do whatever it takes to eat your lunch before you have the chance to unwrap it.

One of the first deals I researched at Sass was Foamex International (FMXI) Inc. This company, a maker of polyurethane foam and foam products used in automotive and home furnishings applications, was completely uninteresting, apart from its incredibly complex capital structure. Sass management figured that it was better to give Foamex to the new guy, since I’d be more able to spend time on it than my busier colleagues could.

So I delved into Foamex’s ownership maze, which took some doing. Foamex LP, the actual operating company, was in essence a subsidiary of FMXI Inc. But it wasn’t really that straightforward, since the company’s corporate partners were the owners of record.

These “partners” included FMXI Inc., which held a 1 percent managing general partnership interest in Foamex LP; Trace Foam Company Inc., which held a 1 percent nonmanaging general partnership interest; and Foamex-JPS Automotive LP (FJPS), which held a 98 percent limited partnership

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<sup>2</sup>At that time (with no e-mail, Internet, or Bloomberg), brokerage firms sent daily faxes advertising their bid and offer quotes for fixed-income securities to their institutional clients. Sass received at least 100 pages of these “axe sheets” each day.



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interest. However, FMXI and FJPS, in turn, were both wholly owned subsidiaries of FMXI Inc. Meanwhile, Foamex LP itself had several wholly owned subsidiaries.

At the top of the heap was Trace International—a holding company that owned shares in both Foamex and in another publicly traded company. This corporate and partnership structure was designed to help the company's colorful chairman, Marshall Cogan, avoid taxes and shield himself from potential liability at each corporate level. Unfortunately, the more complex a structure like this becomes, the more difficult and expensive it is to manage—that, along with an ample helping of debt, helped seal its downfall.

Cogan had started out by purchasing Foamex from Firestone Tire & Rubber in the 1980s. He went on to acquire other businesses, until Foamex became one of the largest manufacturers and marketers of flexible polyurethane foam and foam products in North America. However, Cogan used so much debt to finance each acquisition that the company's leverage had reached ridiculous levels.

Moreover, the company was a defendant in multiple lawsuits filed on behalf of approximately 5,000 recipients of breast implants in various U.S. federal and state courts—as well as one Canadian provincial court. Although Foamex did not itself make breast implants or approve the use of its products in making them, other companies had produced gel implants using its polyurethane foam as a covering.

In addition, the U.S. Environmental Protection Agency had designated Foamex as a potentially responsible party in the contamination of 13 sites around the country. Meanwhile, environmental regulations had raised its cost of operations in comparison to those of international competitors in what was essentially a commodity product.

All these factors contributed to my conclusion that Foamex was not a good buy for Sass. I was proved correct in July 1999, when Trace International Holdings filed for bankruptcy protection, eventually taking Foamex down with it.



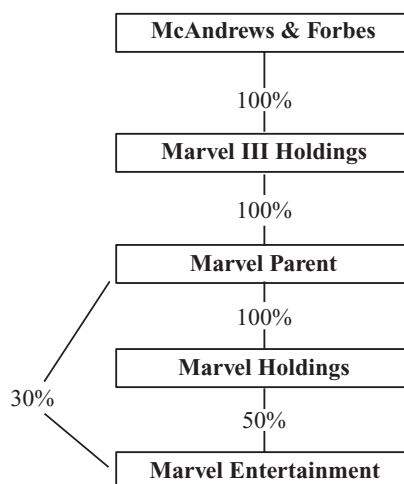
Other projects I researched while at Sass included paging companies (Arch Wireless, Metrocall, MobileMedia, PageNet), apparel makers (undergarment maker Maidenform), waste-to-energy incinerators (Okeelanta

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Cogeneration Facility in Florida, Ford Heights Waste Tire to Energy Facility in Illinois), real estate (59 Maiden Lane Associates), Mexican toll-road operators, several pulp and paper facilities, and numerous other corporate restructurings. But the highlight of my tenure at Sass was my work on the Marvel Entertainment Group bankruptcy.

Controlled by the well-known financier Ronald Perelman, Marvel was then the largest comic book publisher in the world, and it also owned subsidiaries that made candy, trading cards, and toys. These subsidiaries included comic book and trading card publisher Fleer/Skybox, of which Marvel owned 100 percent; toy maker Toy Biz Inc., in which Marvel owned a 27 percent economic interest and 79 percent voting control; and Panini, an Italian sticker producer that Marvel wholly owned.

At the top sat Ron Perelman's investment vehicle, MacAndrews & Forbes, which owned 100 percent of Marvel III Holdings, which in turn owned 100 percent of Marvel Parent, which owned 100 percent of Marvel Holdings, which in turn owned 50 percent of Marvel Entertainment (which had about 102 million shares of public stock outstanding), plus several operating subsidiaries below it as well. Exhibit 1.1 shows the company's corporate structure after it went public.



**EXHIBIT 1.1** Marvel's Corporate Structure  
*Source:* Company reports and Schultze Asset Management estimates

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Like most large companies that end up in bankruptcy court, Marvel had a complex capital structure that included numerous holding companies, loan facilities, and bonds. Both Marvel and its Toy Biz subsidiary had issued publicly traded stock. With Perelman at the helm, it was perhaps no surprise that the company was a marvel of creative financing. As I dug deeper into Marvel's figures, the story that emerged from them became more and more interesting—and disturbing.

I started my work on Marvel the same way I still do to this day when I look at a distressed company. I read through the company's public filings, including its 10-K (annual), 10-Q (quarterly), and 8-K (shareholder information) reports on file with the Securities and Exchange Commission (SEC). As I did this, I created a valuation model spreadsheet detailing the company's capital structure, cash position, and market values of securities that traded. Once I had a net enterprise value for Marvel, I compared it with the company's annual and quarterly cash flow trends.

Often with companies that get into trouble, revenues stay constant or even increase, while cash flow—generally measured by earnings before interest, taxes, depreciation, and amortization (EBITDA)—actually decreases. Marvel was no exception to this phenomenon. Its revenues climbed steadily, from \$415 million in the fiscal year ending December 31, 1993 to \$553 million in the fiscal year ending December 31, 1997.

Meantime, its EBITDA cash flow dropped into negative numbers over the same period, from +\$117 million in 1993 to −\$78 million by 1997. Obviously, no business can thrive in the long term with negative cash flow, particularly an overleveraged company, like Marvel, with regular debt-servicing obligations. I continued to look at the company's financial history going back to 1989, when Perelman bought it. This was no easy task, since at the time, company financial reports were not available on the Internet, so I had to order copies of historic 10-Ks from a printing company that would ship or fax them and charge by the page.

I learned that Perelman acquired Marvel for \$82.5 million, then took it public three years later for a \$40 million profit. Shortly thereafter, Marvel bought Fleer, and in 1993, it acquired nearly 50 percent of Toy Biz in exchange for the rights to produce Marvel toys. Marvel continued making acquisitions, including Panini in 1994 and SkyBox International in 1995.

In 1993 and 1994, a hot bond market allowed Marvel's three primary holding companies to issue what eventually became \$894 million in bonds secured only by Marvel stock—effectively a margin loan, which

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kept appreciating as the company grew. The bond issues included \$125 million of 9.125 percent senior secured notes due February 15, 1998 at Marvel III Holdings, \$252 million of 11.875 percent senior discount notes due April 15, 1998 outstanding at Marvel Parent, and \$517 million of 11.25 percent senior secured discount notes due April 15, 1998 at Marvel Holdings.

The so-called discount notes paid interest in kind (by tacking on additional principal each period) instead of in cash, until a certain number of years after the original issuance date. By the time the company ultimately filed for bankruptcy, these discount notes had grown to an accrued principal claim value of \$755.4 million.

In addition, the operating companies carried numerous additional loans secured by all the underlying assets, including accounts receivable, inventory, and trademarks. The loans included an 8.5 percent amended and restated credit agreement revolver, with a face amount of about \$15 million outstanding, a combined Panini term loan and revolver facilities of about \$186 million outstanding, a \$350 million U.S. term loan, and a \$120 million amended and restated credit agreement. Marvel's total indebtedness came to over \$1.5 billion.

As I looked through the old filings, it became apparent to me that Perelman had passed up most of the proceeds from the holding company bond issues as dividends to his own MacAndrews & Forbes. In effect, over the years Perelman had paid himself more than half a billion dollars in bondholder cash, borrowed through a company in which he no longer had any of his original investment at risk.

While I came to respect Perelman's business acumen, I could hardly believe the audacity of these moves—and the blindness of the bondholders who let it all happen. The problem was that demand so exceeded supply in the high-yield bond market that pretty much anything went. In exchange for a high-yield IOU, bondholders were willing to buy into "covenant-lite" loan deals with little protection for lenders, including bonds secured only by holding company stock and deals that permitted borrowers to pay cash dividends to holding companies for no legitimate corporate purpose.

In fact, as the Wall Street bond-underwriting machine kicked into high gear during the tech bubble, all kinds of crazy bond offerings went through. Eager buyers would oversubscribe for billions in unsecured bond issues from

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companies like Global Crossing, Iridium, and Globalstar with hardly any revenues and totally unproven business models, even though they had no legitimate means of repaying their borrowings when they came due.

Sometimes, as a concession to the ridiculous level of risk that bond buyers were assuming, investment banks would structure a bond offering with a cash reserve for four semiannual interest payments in an escrow account. That way, the thinking went, the bond buyers could be sure the issuers wouldn't default at least for two years, and by that time, the bonds would likely be refinanced—presumably, by sales to even less-savvy investors.

By November 1996, Marvel's party would come to an end, as the cash drain from Perelman's dividends, its acquisition spree, and its excess debt finally caught up with it. Moreover, demand for Marvel's iconic sports trading cards had tailed off substantially after a 1994 major league baseball strike decreased fan enthusiasm. At the same time, an unsustainable speculative bubble in demand for comic books, which had previously juiced Marvel's revenues, now began to deflate. Marvel's revenues dropped precipitously—from a peak of \$829 million in 1995 to just \$746 million by 1996 (see Exhibit 1.2).

Unfortunately, the company's high fixed-cost structure—which comprised royalties it owed sports teams for trading cards and stickers, plus

**EXHIBIT 1.2** Marvel Cash Flow Analysis

Fiscal year	1993	1994	1995	1996
		(\$ millions)		
Revenues	\$415.2	\$514.8	\$828.9	\$745.5
EBITDA	\$116.8	\$123.8	\$69.1	(\$35.4)
EBITDA margin	28.1%	24.0%	8.3%	−4.7%
Interest expense (Int)	\$38.4	\$81.7	\$43.2	\$58.9
EBITDA/Int	3.04	1.52	1.60	−0.60
Capital expenditure (Cap ex)	\$3.3	\$4.2	\$42.5	\$43.2
EBITDA - Cap ex	\$113.5	\$119.6	\$26.6	(\$78.6)
EBITDA - Cap ex/Int	2.96	1.46	0.62	−1.33
Net income	\$56.0	\$61.8	(\$48.4)	(\$464.4)

Source: Company reports

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ballooning interest payments on its bonds—allowed no flexibility to adapt to this new economic reality.

Marvel's cash flow as measured by EBITDA fell from almost \$124 million in 1994 to just \$69 million in 1995, and finally into negative territory by 1996. In November 1996, rather than let Marvel enter uncontrolled Chapter 11 bankruptcy proceedings, Perelman offered to buy the company. His plan, dubbed the Andrews Plan by bond traders, offered \$350 million for the company through a rights-offering mechanism that would substantially dilute Marvel shareholders and nearly wipe out all holding company bondholders as well.

I was one of more than 100 bond traders and analysts sitting in a Manhattan hotel ballroom when Howard Gittis, a former Wolf, Block, Schorr & Solis-Cohen lawyer who had become Perelman's representative, presented the Andrews Plan. Frustrated analysts couldn't raise their hands quickly enough when Gittis put up a simple slide that showed how bondholders would lose almost all of their principal in exchange for the privilege of investing new money into Perelman's plan. My teammate from Sass asked Gittis why any investor would ever trust a management team that had done this to current bondholders—some of whom had bought into the most recent issues only a few months before at 100 cents on the dollar.

Not surprisingly, the news scared the daylights out of those bondholders, who rushed to sell out their holdings the next day. Since Sass was a buy-side vulture fund, its phones literally wouldn't stop ringing as Marvel's high-yield investors tried to dump their holdings through every broker on the planet. It was amazing how many crafty sell-side brokers called me during the next few weeks to tell me about the new Marvel story. Some wrote long reports estimating valuations for all the component parts of the Marvel empire. However, they had their work cut out for them to sell anything, as Marvel bond prices continued to fall.

Original-issue lenders who simply couldn't bring themselves to believe that Perelman had taken all their cash in dividends, or that he would now try to undercut bondholders, panicked like never before. Previously they had rationalized hanging onto the bonds in the hope that the comic book slump would reverse and that Perelman would put in more money to make them whole. Now, reality hit them like a baseball bat. Marvel bond prices in the secondary market plummeted from about 80 cents on the dollar to under 20 cents—creating more than \$500 million in bondholder losses within a few hours.

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At that point, I recommended to Sass that we should take a position in these bonds. I was not alone in my interest. Carl Icahn bought the bonds at around 20 cents on the dollar as well and moved to block Perelman's buyout plan in court. Despite Icahn's quick maneuver, Perelman was quicker—he filed Marvel for bankruptcy protection in late December 1996.

Icahn responded with further legal action to take control of the company away from Perelman, arguing that since Marvel's bonds were secured with its stock, the bondholders now owned a majority of the equity and could replace Marvel's board to oust Perelman. This move set off a barrage of lawsuits and countersuits among the bondholders, the company, the banks, Perelman, and the owners of Toy Biz.

As the litigation nightmare began to threaten the position of Marvel's bank lenders, even the senior secured loans began to trade down to distressed levels. Icahn (and I) saw an opportunity, concluding that the senior secured loans would most likely be the new "fulcrum" security that would put holders in the best position during a bankruptcy.

Icahn offered a new plan that would cash out the senior secured lenders, but at a healthy discount to the loans' full face value, known in the market as par. Those choosing to remain invested would get post-reorganization stock, as well as some preferred stock. With this news, the senior loans traded down to about 60 cents on the dollar, at which point I recommended that Sass buy these loans as well. Sass ultimately bought about \$50 million worth of Marvel's bank debt, in tandem with Icahn, who had also begun to accumulate a large stake in it.

When Marvel finally emerged from reorganization in June 1998, the senior bank lenders received most of the company's newly issued equity. This result was a huge home run for Sass—although I wasn't around to see the full benefit, since I left in December 1997 to set up my own company, Schultze Asset Management, LLC (SAM).

One reason that I was in a position to go it alone was that Sass had allowed me to continue my personal investing. To do so, I only needed to get preapproval from compliance for each trade I executed. From 1994, when I started it, through 1997, when I left Sass, my primary trading account showed a seamlessly strong track record.



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I started SAM on a shoestring with less than \$1 million of my own and my family's money. After nearly 15 years, we now have approximately \$200 million under management from a mix of high net worth private investors, pension funds, foundations, states, and other institutions from around the world. At its peak, our firm managed over \$725 million in assets; lately we've gotten much smaller but much more nimble. And I continue to manage money for my parents and older siblings, who still call me Wak—but not wack.

In retrospect, it's clear that vulture investing was the right career for me. Distressed-securities investing has not only made good use of my legal and business training, but has also given me both intellectual and financial rewards, while allowing me enough flexibility to balance my career with a family life.

Moreover, unlike legal or management consulting work, vulture investing gives me a daily "scorecard," since the market tells me how well I am doing. I have always found this kind of instant feedback particularly stimulating.

While I've mostly done quite well in vulture investing, no one avoids the occasional setback. Along the way, I've learned a lot, so I'm in a position to give you a bird's-eye view.

**VULTURE'S VANTAGE**

The structural and legal complexities of the distressed-securities market create greater inefficiencies than in many other investment fields. To find those opportunities, you need a laser-like focus to understand each investment. If you can't distill your ideas enough to explain them to a child, you probably don't know them well enough to make the right choices.

You need confidence in your abilities, a willingness to pit yourself against the market, flexibility—and a soupçon of humility. The best investors make most of their money in a very small percentage of their trades, so you must be willing to admit you are wrong and sell out of losing positions.