INVESTING

Rewards come to those who wait for companies to run into trouble

'Distressed' debt specialists feast on scraps, but please don't call them vultures

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NEW YORK -- The recent credit crunch and ensuing economic clouds have depressed a lot of people on Wall Street.

But not Wendy Landon.

An investor in "distressed" debt for a Boston investment firm, Landon makes money when companies fall into trouble.

Since the credit crisis struck this summer, Landon has been scooping up bargain-priced bonds of faltering companies. Her firm, GB Merchant Partners, profits if the borrowers' plight improves and they get back on track to pay off their debts in full.

Landon isn't alone in her enthusiasm for the financial markets' downturn.

She is part of a larger community of restructuring specialists, bankruptcy lawyers and others who profit in the wake of others' misfortune, but who themselves have suffered in recent years as a strong economy and free-flowing credit propped up companies that might otherwise have fallen on hard times.

"We are entering what should be a good time for distressed investing," Landon said. "I've been waiting a really long time."

The so-called vulture community prospered after the collapse of the Internet and telecom booms around 2002. But the last few years were relatively fallow -- a fact that buyers of beaten-down debt blame on the easy-money era that appears to have ended this summer.

While the good times rolled, troubled companies could easily refinance their debt or raise new cash, forestalling at least temporarily any real financial pain.

"Over the last several years, there have been companies that have been able to stay out of bankruptcy that I've been amazed that they could do that," said Brad Erens, a bankruptcy partner in the Chicago office of law firm Jones Day. "In more normal times, they would have filed [for bankruptcy protection] a couple of years ago."

That made it tough for distressed-debt firms such as Denver-based Summit Investment Management, which had to branch into other investment areas three years ago as companies in financial trouble became hard to find.

"The big home runs you get when you buy distressed debt and play it right just weren't as frequent," said Frank Grimaldi, head of Summit's New York office. "It was frustrating."

Now, however, the implosion of the sub-prime mortgage market and the resulting credit crunch is changing all that.

Bonds of companies with heavy debt loads have fallen in value. More than in the past, many companies are seen as at risk of failure not because of fundamental problems with their business operations but because they've simply taken on too much debt, some experts say.

Companies fell prey to the blandishments of investment bankers who encouraged aggressive borrowing, said Patrick Blott, head of Blott Asset Management in New York.

"Someone shows up on your door and says, 'Here is a rate and a debt level you can't refuse,' " Blott said. "It's partly [the company's] fault and partly Wall Street's fault."

Now such a company may find its bonds being bought up by investors who are prepared, if the borrower defaults, to take control of the business by converting the debt into equity -- either in the bankruptcy process or as part of an agreement that keeps the company out of Chapter 11.

If that happens, the "loan to own" investors are likely to pressure management to turn things around. If it can't, the investors may liquidate the companies and sell the assets.

Distressed-debt investors reject the notion that they're feasting on the pain of others. Instead, they see themselves as cleaning up messes that others have created. The investment firms say their restructuring advice and cash infusions can help companies pick themselves up.

"Nobody in the industry likes the phrase 'vulture' ," said Michael Imber of Lakeside Advisory Group, a corporate-restructuring advisory firm in Weston, Conn. "There's no question we have a counter-cyclical industry. I'd liken it to an emergency-room physician. You get called in because the patient is bleeding profusely, and you need someone to stop the bleeding."

It's still early in the distressed-investing cycle, and the payday for investors may be pushed off again if the economy stays strong -- a prospect helped by last month's Federal Reserve interest-rate cut.

Nevertheless, distressed-debt players believe their prospects are brightening.

"There is a lot more buzz going on now -- where people are saying, 'We're going to get a lot busier' -- than I've seen in five or six years," Imber said. "As long as there are bad businessmen and bad bankers there will always be work for people in my industry."