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ADELPHIA COMMUNICATIONS CORP'S BANKRUPTCY CASE STUDY

FM 2

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Problems identified :

1. **Why did Adelphia Communications Corporations get into trouble ? What acted as the precipitating factors for the scandal ? (Suprabhat)**
2. **Prior to bankruptcy filing, how was Adelphia business performance that signalled its demise? (Srijan)**
3. **Prior to bankruptcy filing, how was Adelphia business performance that signalled its demise? (Shelly)**
4. **Is going for Bankruptcy the right choice for the firm? Could its various entities continue its operations by conducting their own bankruptcy reorganisation plan? (Avisek)**
5. **How can Adelphia resolve the issue between the investors of unsecured funds i.e Holding Company Debtor group and Arahova Creditors ? (Sarvesh)**

1. **Why did Adelphia Communications Corporations get into trouble ? What acted as the precipitating factors for the scandal ?**

Adelphia Communication Corporation grew from $300 company to a company which filed for Chapter 11 bankruptcy with $19 billion debts. Though numerous reasons can be attributed for this great fall, following are some of the major reasons.

a. Lack of transparency in the Board of Directors : The Board of Directors was filled up with Rigas' family members and his close friends. Though the bibliography of the board boasts of elite B schools like Harvard, Wharton and former judge and CEOs, still there was a lack of independent neutral members. As a result, there were never any dissents and a tacit collusion formed within the board to approve and aggravate the frauds. One of the most notable examples can be the signing off the 'co-borrowing' arrangement inspite of all the leverage that Adelphia carried. A neutral, independent director would have put off brakes on that.
b. Complete Control of Stakes : As John Rigas put it, "...I was always inclined to keep control (over Adelphia)". This was characteristic of the entire time of Adelphia. Since the time Adelphia got public, the Rigas family voting was 95% which till the disclosure came out stood at 84%. Even with issuance of new shares mainly in the form of class B shares, they held only 26% of share though they didn't dilute the voting rights. This heavy control over Adelphia gave Rigas a complete autonomy on the functioning of Adelphia. This probably gave him the leeway to go ahead with all his personal spending via Adelphia's account.
c. Unplanned Acquisitions: Adelphia went on through a rampant acquisition phase. It acquisitioned 3 large companies in a month and later 2 more Florida based companies in a very short time. Unplanned acquisitions led to liquidity crunch and Adelphia relied heavily on leveraging to finance the deals.
d. No long term planning : As per John Rigas, he didn't have much finance exposure. This seems obvious in the way they have planned and grew the organisation. With arbitrary subscription rates of cable, personal spending funded by Adelphia, no capital structure decisions, no WACC estimation, the company did what seemed convenient to steer out of immediate problems or to gain immediate headwind. This was later acutely felt when the company arranged for coborrowing and tapping in Adelphia's account through its holding companies.

e. Wall Street Pressure : Rigas didn't loot the company for his own personal benefit. But, later as the interest and tax payments increased, it tried to manipulate the balance sheet to meet investor's expectations and grow steadily on its share price. To correct the situation, Rigas maintained a high share price that enabled Adelphia to get debts. And it made situations worse. Inflationary accounts, false reporting of profits were all ways to get the show rolling till John Rigas could get out of the mess which ofcourse didn't happen.

Conclusion : In light of the above reasons, it is pretty obvious Adelphia was headed to bankruptcy. With no financial planning or audits in place, money laundering reached newer lows. And how hard, John Rigas tried to get rid of existing debts, he did so by acquiring more debts. Moreover, the personal luxuries of John Rigas of buying a hockey team, cars for personal use did nothing but abet the situation. So, it was only a matter of time before the false reporting went overboard and Adelphia stumbled and fell.

2. Prior to bankruptcy filing, how was Adelphia business performance that signalled its demise?

Negative shareholder equity: Prior to bankruptcy, Adelphia took aggressive business steps that triggered it rise and ultimately its fall. High leverage it took to boost its subscriber base stressed the business. Referring to exhibit 10 (a), total equity of shareholders were negative from 2001-2004. This shows shareholders lost the ownership of the firm. The ownership reside with lendors. In this situation, the survival of the firm was almost impossible.

Interest coverage negative: company reported negative EBIT or operating income from the years 2001-2004. This shows company was not in a position to service its debt either.

Liquidity position:

Liquidity position of the firm is very weak if we analyse the balance sheet figure from 2001-2004 suggesting the stress on the operations. Working capital requirement is not met by the current capital the firm has. The severe liquidity crunch will not allow the firm to function on going basis.

Items	**2001**	**2002**	**2003**	**2004**
cash and cash equivalents	121474	223630	252661	338909
restricted cash	0	9244	14327	6300
accounts receivable	200126	136567	139007	116613
other current assets	121304	118059	126042	82710
Total Current Assets	442904	487500	532037	544532
Total Current Liabilities	18997914	737650	1015592	1904034
Current Ratio	**0.02**	**0.66**	**0.52**	**0.29**
Quick ratio	**0.02**	**0.50**	**0.40**	**0.24**
Cash ratio	**0.006**	**0.303**	**0.249**	**0.178**

Cable Systems, the saving grace: considering such a weak coverage ratio, high leverages and extremely weak liquidity position, the firm offers a dismal business prospect. But the major positive for the firm is its cable systems valued at 13.193 bn USD which propels the total liquidation value of the firm to be equal to 12.414 bn USD. The high subscriber value of Adelphia is the major positive for the business and makes it a lucrative choice for acquisition. The 12 bn USD valuation of the firm owes to its revenue generating capacity and subscriber base.

Conclusion: From exhibit 15, we can observe that among the major cable business players, Adelphia still ranks among the top 5 players in terms of revenue generation and EBITDA (Revenues 4.3 bn USD and EBITDA 1.18 bn USD). So business is still viable in case of Adelphia and is a popular choice for big players to overtake its operations.

3. **Is going for Bankruptcy the right choice for the firm? Could its various entities continue its operations by conducting their own bankruptcy reorganisation plan?**

   Reorganisation: The major advantage of reorganisation attempts by Adelphia would be to keep hold of most of the assets and subscriber base to themselves. They would be hoping for some massive restructuring to save the business and hope for revenue stream in future to pay off the huge debts. However, considering the current liquidity and coverage positions, the options are dim to say the least. The massive amount of debt would not generate enough optimism in the eyes of the lenders to allow restructuring. Also, the confidence of shareholders has fallen to abysmal low and it's highly unlikely that board would approve such reorganisation or grant more time. Currently the firm has good liquidation value which might diminish further in case of further deterioration of books.

Separate entity bankruptcy reorganisation plan: Here the blanket deal would not be required and each of the separate entity would have done negotiations with respective creditors and negotiated a deal depending on the amount of stress it carries. But the major drawback is the amount of time it would take to negotiate the deals and also the massive costs that would be involved in carrying out such deals on individual entity level. Also the lenders would not be willing to allow more time for the deals to close off.

Conclusion: Auctioning route seems like the best solution in current scenario- the major positive for the firm is its current cables system which is still valued at 13 bn USD by the market. Adelphia needs to try to sell off itself as long the market is ready to pay for it handsomely. Other big advantage is that during bidding process, bidders may bid in excess of the real worth of the firm which would boost the prospects of the firm. This route is what is demanded by lenders as well and will face fewer hurdles compared to other routes. However, the firm will stand to lose its ownership and will pass it to new buyers.

4. **Should Adelphia go with Time- Warner's offer or Cablevision's offer?**

After Adelphia's new management tried to reorganize Adelphia as a stand alone entity, it was rebuffed by creditors. So, it aggressively pursued the sale option which creditors endorsed. After many dozen expression of interest from acquirers, they finally decided on two highest offer – a $17.5 billion cash and stock offer from Time Warner and Comcast Corp which consisted of $12 billion cash option and $5 billion stock option and $16.5 billion cash only offer from Cablevision which was later upgraded to $17.1 billion.

Time Warner- Comcast : They were the second and largest cable television company in USA. They were interested in the bid from the starting itself. With a capital structure that could afford more leverage, they clearly had thought the deal through. Their combined financial leverage was low. Comcast would sell off 21% equity shares of TWC in lieu of the cable properties. Thus, though complex, they had a detailed plan on how they would use Adelphia. Also, with an increase of 31 million subscriber base, they had the expertise of handling Adelphia and revive the morals of the employees. But, creditors of TWC were wary on the effect of the shares of TWC once the shares trading again. As a hedging risk instrument, they had also sought a $440 million break up fee if the deal fell through.

Cablevision : It was the fifth largest cable operator in USA. Their last minute all-cash offer, though lucrative to creditors lacked the credit worthiness. One, they entered the bidding at the last moment and they didn't disclose plans on handling Adelphia's assets. Secondly, Cablevision was also a family dominated company with the family's voting rights upto 75%. After the crisis at Adelphia with the recklessness of Rigas family, being acquired by another family driven firm seems an unlikely option. Analysts were also unsure about the leverage coverage of the firm for this transaction.

Conclusion : Considering the two offers, it will be better to opt for Time Warner's offer since they can afford more debt for financing the deal. Their commitment to stocks makes Time Warner-Comcast's deal more believable and it seems they will be able to turn the company around. Also, the interest they have shown from the beginning of the bid makes believe that they had done their due diligence.

5. **How can Adelphia resolve the issue between the investors of unsecured funds i.e Holding Company Debtor group and Arahova Creditors ?**

A number of hedge funds had invested significant amounts in the different classes of Adelphia's debts. Now, with the acquisition of Adelphia, they were contesting their hierarchy and the amounts due to them. Adelphia had a very complex structure and they opened 100s of entities for funding purposes. And each entity had its own debt structure. To complicate the issue, they lent to each other and often transfer of funds and assets happened between entities. This made consolidation and pooling of assets of Adelphia tougher. Also, the various transfers once discovered led to accusations over the true nature and scale of investments of the various hedge funds. The issue should be solved for the smooth acquisition process.

Conclusion : Adelphia should consolidate the assets and funds fast. And, in that process make their stand very clear. They should deal with the debts on a seniority basis, wherein the debts against riskier prospects should be given less priority over debts made against higher rating of Adelphia. Also, the debt transactions as well as inter-entity transfer should be standardised except for cases that involve considerable sum of money. Case by case dealing would make the process cumbersome. Instead, new management of Adelphia should come out with a process that is uniform without hurting any investor seriously. And, an agreement on the subject is must for the takeover to take place sooner.