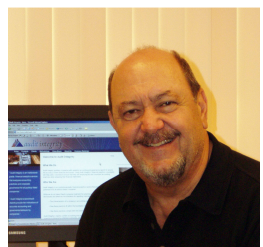


## CHAIRMAN'S CORNER

by James A. Kaplan



### “Going Concern” –The Road to Hell

April 16, 2009

It appears that General Motors (NYSE: GM) will file for bankruptcy in the coming weeks. I, personally, am not alarmed at this development, since our bankruptcy system has been well tested and is designed to treat all stakeholders in a judicious way. In fact, bankruptcy, and the subsequent reorganization, might very well create a sustainable General Motors – which I think is not very likely to occur as a result of government intervention.

General Motors' continuing operation as a “going concern” has been evident for some time, while a number of other publicly-held companies have already filed for bankruptcy this year, as reported by BankruptcyData.com.

#### Largest Public Company Bankruptcy Filings – 2009 to date\*

Company	Bankruptcy Date	Description	Assets
Lyondell Chemical Company	01/06/09	Global Manufacturer of Chemicals	\$27,392
Charter Communications, Inc.	03/27/09	Operates Broadband Communications	13,882
Nortel Networks, Inc.	01/14/09	Supplies Networking Products & Solutions	9,000
Smurfit-Stone Container Corporation	01/26/09	Mfgs. Paperboard & Paper-Based Packaging	7,387
Aleris International, Inc.	02/12/09	Produces Aluminum Products	5,120
Spansion Inc.	03/01/09	Semiconductor Device Company	3,815
Chemtura Corporation	03/18/09	Specialty Chemical Company	3,064
Masonite Corporation	03/16/09	Door Manufacturer	2,660
Spectrum Brands, Inc.	02/03/09	Consumer Products Co.	2,247
Trump Entertainment Resorts, Inc.	02/17/09	Gaming Company	2,231
BearingPoint, Inc.	02/18/09	Provides Mgmt. & Technology Consulting Svcs.	1,981
Idearc Inc.	03/31/09	Provides Yellow & White Pages Directories	1,815
Silver State Bancorp	01/06/09	Bank Holding Company	1,764
Tronox Incorporated	01/12/09	Produces & Markets Chemicals	1,732
Apex Silver Mines Limited	01/12/09	Mines, Explores & Develops Silver	1,324
Magna Entertainment Corp.	03/05/09	Operates Horse Racetracks	1,242
Tarragon Corporation	01/12/09	Real Estate Developer	1,134
Herbst Gaming, Inc.	03/22/09	Diversified Gaming Company	1,080
Journal Register Company	02/21/09	Publishes Newspapers & Prints Publications	932
Sun-Times Media Group, Inc.	03/31/09	Publishes, Prints & Distributes Newspapers	791

\*Source: [www.BankruptcyData.com](http://www.BankruptcyData.com)

The incidence of bankruptcy has been historically low, but the current adverse macro-economic conditions will have a heavy impact on future filings. In order to assess the potential

damage to stakeholders, Audit Integrity is developing a model to predict the likelihood of bankruptcy over a moving one-year time horizon of all companies we follow.

Auditors have been the traditional source of going-concern information, but their interpretation is (and should be) far more strict than an estimation of possible bankruptcy. Where a company has been determined not to be a going concern, auditors are required to focus on the balance sheet on a break-up basis.

Auditors are understandably reluctant to attach the “going concern” label, for the legitimate fear that it may prove to be a self-fulfilling prophecy – a “Road to Hell.” The Accounting profession, in order to avoid triggering an avalanche of negative consequences, has created an interim step: the “modified opinion.”

We at Audit Integrity, do not suffer with the same limitations as auditors do. Our intent is to supply research to our clients that is a precursor to a “modified” or “going concern” opinion.

Our approach will combine both the power of static (accounting-based) and hazard (market-based) models. This approach allows for dynamic adjusting for potential bankruptcy between financial reporting periods. Our predictive bankruptcy measures will not be a substitute for Going Concern disclosures, but should be a leading indicator of these events. Variables taken into account include:

<b>Hazard Measures</b>		
<i>AGR@ Score</i>	<i>Stock Price Volatility</i>	<i>Market Value / Debt</i>
<b>Accounting Measures</b>		
<u><i>Liquidity:</i></u>	<u><i>Leverage:</i></u>	<u><i>Maturity:</i></u>
<i>Current Ratio</i>	<i>Debt / Equity</i>	<i>Retained Earnings / Total Assets</i>
<i>Quick Ratio</i>	<i>Interest Coverage</i>	<i>Tangible Book Value / Total Liabilities</i>
<i>Cash Ratio</i>	<i>EBIT / Interest Expense</i>	
<i>EBIT / Assets</i>		

We are still finalizing and testing this new model, but I thought you would be interested in a preliminary list of companies at risk. The list below is representative of companies that fall within the lowest decile of all companies modeled by Audit Integrity for bankruptcy.

All Accounting and AGR ratios have been industry-adjusted to remove industry bias. This list excludes financial stocks, REITs, and Limited Partnerships, which will be included as we expand the model’s capability.

It is important to remember that any predictions are dependent on a number of variables, including changes in:

- Macro-economic conditions
- Industry conditions
- Company actions

Company actions remain the most critical of all the variables. Company management will make, and does make decisions in order to stave off bankruptcy. Actions such as

downsizing; renegotiating debt; reducing expenditures; etc., all are methods to forestall insolvency over both the short and the long term. Management's actions, coupled with business flexibility, can dramatically influence outcomes. However, the stress of potential bankruptcy increases the likelihood of opacity – the deliberate masking of problems – as well as outright fraud.

With these caveats in mind, it is important to recognize that any statistical model will contain a margin of error. Our intent is to provide our clients with a highly predictive bankruptcy estimate based solely on quantitative measures. This estimate should be regarded as yet another useful tool in managing risk.

Stay tuned for updates on this critically important issue.

<b>Companies with Highest Probability of Bankruptcy (90th percentile or higher)</b> <b>(preliminary results of Audit Integrity Bankruptcy Model)</b>				
<b><u>Company</u></b>	<b><u>Ticker</u></b>	<b><u>Industry</u></b>	<b><u>Current Price*</u></b>	<b><u>Auditor's Opinion</u></b>
Ameristar Casinos, Inc.	ASCA	Casinos & Gambling	\$13.20	Unqualified
AMR Corp.	AMR	Airline	\$4.22	Unqualified
Asbury Automotive Group, Inc.	ABG	Retail (Specialty)	\$5.89	GCO
Boyd Gaming Corp.	BYD	Casinos & Gambling	\$6.28	Unqualified
Constellation Energy Group, Inc.	CEG	Electric Utilities	\$22.11	Unqualified
Ford Motor Co.	F	Auto & Truck Manufacturers	\$4.30	Unqualified
General Motors Corp.	GM	Auto & Truck Manufacturers	\$1.78	GCO
Jardin Corp.	JAH	Appliance & Tool	\$15.55	Unqualified
Lennar Corp.	LEN	Construction Services	\$7.78	Unqualified
M & F Worldwide Corp.	MFW	Business Services	\$12.75	Unqualified
MGM Mirage	MGM	Casinos & Gambling	\$6.60	GCO
Orbitz Worldwide, Inc.	OWW	Recreational Activities	\$1.45	Unqualified
Quicksilver, Inc.	ZQK	Apparel/Accessories	\$1.31	Unqualified
Qwest Communications International, Inc.	Q	Communications Services	\$3.78	Unqualified
Revlon, Inc.	REV	Personal & Household Products	\$2.79	Unqualified
Rite Aid Corp.	RAD	Retail (Drugs)	\$0.41	Unqualified
Standard Pacific Corp.	SPF	Construction Services	\$1.20	Unqualified
Tenet Healthcare Corp.	THC	Healthcare Facilities	\$1.36	Unqualified
US Airways Group, Inc.	LCC	Airline	\$3.37	Unqualified
X-Rite, Incorporated	XRIT	Office Equipment	\$1.19	Unqualified
YRC Worldwide, Inc.	YRCW	Trucking	\$4.22	Unqualified

\*at close 4/14/09

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