KIM: Trump's bankruptcies hold important investor lessons

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When asked about his history of bankruptcies, Donald Trump's standard response has been 1) none of the bankruptcies was personal and 2) the bankruptcy laws are simply a financial tool which every major financier has used to his/her own advantage.

In other words, declaring bankruptcy can be "just good business."

When a company files for protection from its creditors (including banks, bondholders, landlords and suppliers), it's generally under Chapter 11 of the U.S. Bankruptcy Code. Chapter 11 enables the debtor company to stay in business while it attempts to reorganize/restructure its business and finances.

In a typical Chapter 11 bankruptcy reorganization, all parties suffer (except the lawyers). Creditors take a significant "haircut" on the amount owed and the owners' investment is effectively wiped-out.

Back in 1976, New Jersey's politicians and voters heeded the siren call of casino gambling bringing an unending bounty of cash to fund all of the state's needs. With Las Vegas 2500 miles away, Atlantic City would have the densely-populated Northeast all to itself. Unfortunately for those who invested in Atlantic City, neighboring states also heard the call and the region became *hotly* competitive.

A corporate bond is a ***contract*** between the issuer and buyer, specifying when periodic interest payments will be made and the principal repaid (the "maturity"). Standard & Poor's and Moody's rate bonds along a spectrum from most- to least-creditworthy. Bonds are classified as "investment grade" (BBB- or better by S&P/Baa3 or better by Moody's) or "speculative" (also known as "high-yield" or "junk").

Unlike with a stock, a bondholder has ***no upside*** beyond receiving the periodic interest payments and return of principal. Thus, bondholders need to be adequately compensated for the risk the issuer becomes unable to make the contractual payments. The higher the risk, the higher the interest rate or yield required.

With U.S. corporate bonds, this risk premium is expressed as the yield differential or "spread" versus the comparable maturity, "riskless" U.S. Treasury bond.

The Trump Taj Mahal opened in April 1990 to great fanfare (including an appearance by Michael Jackson), but missed its very ***first*** interest payment that October. The Taj filed for bankruptcy protection in 1991. Trump had ***personally guaranteed*** $900 million of the Taj's debt.

Trump reportedly avoided personal bankruptcy by convincing his lenders their best option for recovery was to work with him to restructure his debt, rather than have his assets tied-up in bankruptcy court for years. Still, he forfeited his Trump Shuttle airline, Trump Princess yacht and agreed to a personal spending limit.

Trump's other bankruptcies were: the Plaza Hotel (New York City--1982); Trump Hotels and Casino Resorts (Trump Taj Mahal, Trump Plaza and Trump Marina in Atlantic City, Trump 29 in California and Trump Casino & Hotel in Gary, Indiana--2004) and Trump Entertainment Resorts (Trump Taj Mahal and Trump Plaza—2009).

John Pierpont ("J.P.") Morgan was the world's most powerful financier a century ago. During Congressional testimony, Morgan was asked if commercial credit was based primarily on money or property. Morgan's famous reply was, "No sir, the first thing is character. Before money or property or anything else. Money cannot buy it…because a man I do not trust could not get money from me for all the bonds in Christendom."

This is sage and timeless advice for investors.

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