

Companies face \$100bn debt bill

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Australian companies are facing an uphill battle to refinance more than \$100 billion of debt over the next 18 months as jitters in global credit markets force banks to cut funding lines to industries such as retailing and manufacturing.

Two years on from the end of the global financial crisis, heavily indebted companies in real estate, media, utilities and infrastructure industries such as Reliance Rail, BlueScope Steel, Nufarm, Infigen Energy and Nine Entertainment Co are still operating under a degree of stress as they look to pay off debt. Several are even engaging in what debt specialists call "pre-insolvency" discussions with creditors.

"There is a combination of publicly listed companies, large LBOs [leveraged buyouts] that were done in 2006 and 2007, and infrastructure and property developments that have hefty debts that need to be refinanced, and there is simply a lack of liquidity to do that in the market," Deutsche Bank head of strategic investment group George Wang said.

The so-called "debt wall" of more than \$100 billion mirrors the amount of equity raised by Australian companies in 2009 in a rash of "rescue raisings" to pay off debt and get companies on a more secure footing.

But with difficult conditions in some industries and debt worries in the northern hemisphere, banks are being more cautious. Business credit growth fell by 1.9 per cent over the year to July, while system credit growth stalled at 2.7 per cent.

Equity capital markets have not been able to take up all the slack. At \$US17.8 billion (\$16.8 billion) this year, it is running ahead of last year's total. But a number of vendors such as cinema chain Hoyts, Nine and mining services firm Barmarco have had to shelve initial public offerings while others, such as A J Lucas, have been forced to consider asset sales to pay off debt.

"Investors are pretty apprehensive about what the future might bring," JPMorgan head of equity capital markets David Gray told The Australian Financial Review. "Obviously, that makes it a challenging environment in which to raise money." BT Investment Management's head of fixed interest, Vimal Gor, who oversees about \$13 billion in assets, told clients on Monday that despite the recent economic instability, credit markets had not frozen to the extent witnessed in 2008.

"But this could yet happen if the building pressure in the European banking system continues," he said.

If debt markets were to deteriorate to that extent, both the volume of the debt due over the next couple of years, and a significantly higher price for that debt, could compound the problems of companies already struggling with difficult economic and trading conditions.

Credit-worthy companies can still get five-year bank loans at margins of about 2.5 percentage points above benchmark rates.

But less credit-worthy companies that need funds must look for more "creative solutions", such as mezzanine debt and private capital from special situation funds and hedge funds, debt market specialists say.

Lazard director David Wills said the "visible dislocation" in debt markets meant company boards needed to consider the full gambit of options available to them, including convertible debt, or mezzanine debt.

Many of these instruments were abused at the height of the last economic cycle, but their flexibility and autonomy make them ideal tools for viable companies seeking to fix and de-lever their capital structure.

Mezzanine financing for leveraged acquisitions has recently been offered to companies at rates of more than 12 per cent per cent.

But the offers are even less generous for companies that are under financial stress. Their options are usually more akin to equity-like vehicles that, while flexible, are often dismissed as too expensive.

Gresham Private Equity-owned specialist contractor Barminco secured a \$50 million preference-share-like facility from Goldman Sachs to bridge its funding gap before a float that was later pulled. Restructuring specialists gathered at the Turnaround Management Association conference in Melbourne last week said the refinancing task has been made more difficult by the lack of a market for high-yield corporate debt issues.

In other developed countries, these markets allow companies to find alternative funding when banks pull back lending lines and reduce the amounts they are prepared to lend. Losses incurred by private equity firms that relied on cheap debt have been felt across the market.

Gresham Partners was forced to cede equity upside from its investment in trans-Tasman printing business GEON Group to its lender in exchange for a cut to its debt load.

CVC Asia Pacific has already lost radiology provider I-MED to hedge funds and is fighting to keep some equity value in media giant Nine Entertainment Group. Affinity Equity Partners appointed administrators to the Colorado Group, while Ironbridge Capital is trying to engage with lenders to MediaWorks.

Sales of distressed debt by banks to hedge funds and private equity investors have also led to changes of control at companies, with TPG leading a \$2 billion debt-for-equity swap for the listed utility Alinta Energy.

“So over the past five years, you have seen a huge amount of distressed debt opportunities, and as that tails off in Australia . . . I guess we are going to see more primary restructuring sort of opportunities,” said Mr Wang, who manages Deutsche’s illiquid investments, focusing on distressed debt and special situation investments in Australasia.

After two decades of uninterrupted economic growth, many Australian boards and executives facing this wall of debt lack experience and expertise in corporate restructuring.

Pacific Equity Partners saw its investments in book retailer REDgroup collapse into bankruptcy, while watching a bunch of hedge funds and investment banks take control of its vacuum-cleaner business Godfreys.

CHAMP Private Equity also recently injected capital to refinance printing business Blue Star, while Crescent Capital Partners and Catalyst Investment Managers have also lost control of New Zealand’s Metroglass to hedge funds.

Unitas Capital and Ontario Teachers Pension Plan also lost New Zealand Yellow Pages, and the situation could face a second restructuring in the medium term. “One of the things that I think is still evolving in Australia is the dialogue between advisers, companies, funds, and banks in these situations,” Goldman Sachs’s head of restructuring, Asia-Pacific, Lachlan Edwards, told the TMA conference. “People are still learning how to live with each other.” He said companies were forced to consider a wider range of refinancing options. “The reality is that a company entering a turnaround phase is in transition where cash flow and timing are uncertain,” he said.

“So this is where those instruments – which were effectively used as a proxy for equity in the last boom, like payment in kind, and pay-if-you-can structures – have a proper place.

“It is at that point where those types of instruments, which offer an equity-type return to investors, are appropriate.

Because, as the company gets back on its feet and its cash flow and profitability regenerate, it becomes more able to pay cash on its interest. Then the debt can be refinanced with interest at lower margins.

But, Mr Wang said, the universe of companies seeking capital is expanding rapidly while there was a limited capacity in the market.

“I think part of the advice should be that the right approach is not always the cheapest approach,” he said.

“Companies need to be more strategic about how to face these things, and they cannot always wait until the last minute to see if they can find the optimum, best-of-breed restructuring or refinancing options, or equity capital raisings. Perhaps, they now need to move faster.”

CVC Asia Pacific-owned Nine Entertainment Group is currently undergoing tough negotiations with a subsidiary fund of Goldman Sachs, which owns most of the \$950 million of Nine’s mezzanine debts, and its numerous other senior lenders.

The company has about \$2.7 billion of senior loans that are heavily traded in the secondary market, as hedge funds seek to position themselves to take ownership of Nine through a “loan-to-own” deal that would wipe out the company’s equity and mezzanine holders.

These lenders – already occupying about 40 per cent of Nine’s senior lending register – are unlikely to agree to any refinancing proposal which, for it to be consensual, would need unanimous consent.