

Private equity playing with distress

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Paulina Duran

Private equity investors are known for their ability to find good companies with lazy balance sheets and improve profitability by loading it with debt. But some such investors do the exact opposite: acquiring the discounted debt of companies, to then turn them around, usually by swapping that debt in return for equity in the business.

A panel of three leading Australian distressed investors and turnaround experts have highlighted the potential opportunities available in the distressed investment space in Australia, as banks deal with mounting debt in their books set to mature in 2012 and 2013.

Allegro managing director Chester Moynihan said at the AVCJ Private Equity & Venture forum that pressure from the banks would bring opportunities for private equity firms with undrawn capital to invest in companies with sound underlying businesses but with debt-laden balance sheets.

"We are not investing in distressed business, we like to use the distressed situation to give us the price advantage and really targeting growing business in stable segments of the market," Mr Moynihan said.

Allegro recently benefited from private equity firms such as Next Capital agreeing to refinance mounting debts of one of the firm's portfolio companies, caravan park group Discovery Holiday Parks.

"In that situation where the portfolio that we took over from ABN AMRO, we were constantly battling a very high debt overhang that came up to maturity, and we were under a lot of pressure to introduce equity to pay the banks out," said Mr Moynihan.

"We might see quite a bit more of that going forward," he said.

But playing with distress is a risky game, as Allens Arthur Robinson Ian Wallace, who is advising the senior lenders of stricken utility Alinta Energy – including global firms TPG, Oaktree and Anchorage – explained.

"[Alinta] is really a classic example of the buying of debt for control type of transaction. [There are] very high risks, obviously the private equity funds have put out an awful lot of money into it," he said.

In Alinta's case, a risk involved in executing a debt for equity swap proposed by the lending group owed \$2.8 billion entails dealing with factions from activists shareholders who have to vote in favour of the creditor schemes proposed, for any deal to go ahead.

These activists investors have increased their positions in the failed company to try to use their bargaining powers to ask for more than the 10¢ per share they have been offered as part of the deal.

"I guess time will tell whether the returns they generate over time justify the risks or the money they have invested," Mr Wallace added.

Looking ahead, the Chairman of the Turnaround Management Association of Australia, and managing director at Helmsman Funds Management, Ian Johnson said the Australian economy was a multi-speed economy where some sectors were struggling more than others, increasing the likelihood of continuing opportunities for private equity investors.

Mr Johnson also pointed out the Australian market remains a difficult market to access due to its dominance by the banks, which hold the vast majority of corporate debt in Australia.

"That's great, and the harder it is the better it is for us, because it make it more difficult for the fly-in fly-out guys to play in our space," Mr Johnson said.

"If you look at our team, and probably Chester's team, there's probably guys that have spent 20 years of their lives with workout bankers. And that's 20 years we'll never get back, but these guys drive a lot of the sources of our deals and it's a great benefit for us to have."

As part of the forum, offshore distressed investor Clearwater Capital managing director Robert Petty will give a plenary address on Friday.

pduran@afr.com.au

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