BARGAIN-HUNTERS ARE BUYING UP COMPANY DEBT...SOMEONE, AT LEAST, IS STILL SPENDING

Dealers in DISTRESS

By **HELIA EBRAHIMI** and **DAN ATKINSON**

ALL shoppers love a discount and traders in the Square Mile are no exception, which is why they are embarking on a huge spending spree, snapping up company debt at what they hope are bargain prices.

With few buyers of company shares and the credit crunch putting the bite on private equity takeovers and management buyouts, the 'for sale' signs have been hoisted over company debt and those debt portfolios owned by the big banks.

In the markets, banking activity has stalled until the banks clear the decks of the debt already on their books. And the traditional shoppers for debt, the hedge funds, are standing back fearing falls in the prices of anything they buy.

With anxiety spreading as to whether over-borrowed companies can repay what they owe, the price of their IOUs has dropped, adding to the pressure on banks to sell this 'distressed debt'.

But as they try to do so, in a market short of buyers, the prices are depressed even more.

This sounds like a vicious downward spiral, destroying economic value. But as prices sink to the lower depths, the bargain-hunters are ready to step in – and in doing so they are kick-starting the long process of restoring liquidity and confidence to the market and pointing the way out of the current financial turmoil.

And the price of debt – ranked as senior, mezzanine and junior debt – has certainly

DEBT SALE Who has most to clear?

Company type	Equity	Debt
FTSE 100	85-90%	10-15%
Foreign quoted	80%	20%
Housebuilders	10%	90%
FTSE 350 average	70%	30%
Private equity owned	30%	70%

breaking down in the fourth quarter of this year and the first quarter of next year.'

Keith Goodman of insolvency practitioner Leonard Curtis said: 'The autumn is going to be hugely busy.' He identified retail as a key area of stress.

Neville Kahn, restructuring partner at accountant Deloitte and a spokesman for the insolvency professionals' body R3, said: 'Late 2008 and early 2009 is when the increase in the trading of banks' distressed debt will be seen, along with the associated restructuring.'

Some private equity owners, such as Bridgepoint, have been buying up part of the debt issued by their portfolio companies because it is trading at a discount.

been sinking.

Earlier in the year, Citigroup sold a £6 billion leveraged loans and bonds package for 80p in the £1 to a private equity consortium. And Deutsche Bank put the 'for sale' sign over £4 billion of its loan portfolio.

Meanwhile, the banks that had financed the £9 billion of debt for the KKR-Boots deal, sold off the last tranche for 91p in the £1.

Now institutions such as Royal Bank of Scotland and HBoS are expected to come under pressure to clean up their balance sheets by selling off their own leveraged loan portfolios.

Helping them in this task has been the emergence of players such as Intermediate Capital group, which is planning a £1 billion recovery fund to buy leveraged loans selling at a discount.

Elsewhere, a number of major funds, including Jon Moulton's Alchemy, have raised an estimated £12 billion in the first half of this year to buy discounted debt. American-based funds with offshoots in the UK include RCapita, HillCo and Endless.

These buyers hope that the pound of debt they are buying at a discount may actually be worth a pound again at some point.

And by controlling the debt, they in effect control the companies because if a business defaults they can take ownership.

But Martin Gudgeon, head of the newly beefed-up restructuring arm of private equity group Blackstone Advisory, said: 'The rain clouds are here, but it's not raining yet.'

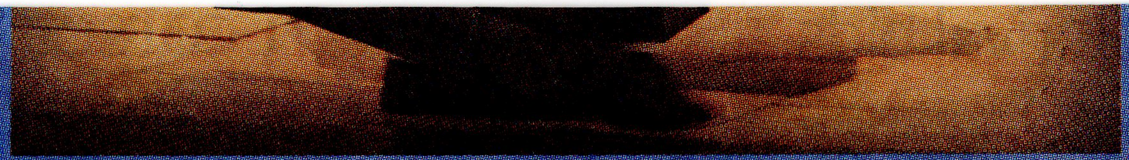
Until now, distressed debt funds have kept their powder dry because default rates have not yet caught up with market fears.

'At the moment, why would a fund buy distressed debt at 60p in the pound when you can buy healthy debt at 80p in the pound?' said Gudgeon. 'Though the distressed debt market is not quite here, it is coming.'

Over the next two years, companies are expected to need £50 billion of refinancing. That sort of money is not easy to find in a credit crunch, particularly when those same firms are facing a tough business environment as costs increase and consumer spending slows.

One top City banker said: 'More companies are going to go back to their banks to say their business plan is not working as expected.

'Life is going to get crunchier, hitting consumer spending, thus company cash flow. Banking arrangements are going to start



SHOPPING SPREE: Traders are banking on picking up some debt bargains during the crunch

HOWEVER, concerns have been raised as to whether equity owners should be allowed to take tranches of debt in addition to the stakes they already hold.

In some cases it could be seen as a defensive move. If a business goes bust and the equity backer of the business has bought enough debt to ensure it is also the largest creditor, it keeps control of the assets.

This happened in the case of the insolvent women's clothing retailer Ethel Austin and its equity backers Credit Suisse and ABN Amro.

Peter Sargent, R3 vice-president and partner with insolvency practitioner Begbies Traynor, said: 'As the year goes on, businesses in trouble will have less wool on their backs.

'Is debt being bought up? Yes, you can see that. The hedge funds have come in.'

Cook to break the mould at Shell

GROUND-BREAKER: American Linda Cook

By **FRANCO CAPALDO**

COMPETITION between BP and Shell is set to intensify next year if Linda Cook, an American mother of three, is appointed to the top job at the Anglo-Dutch energy group.

Cook, who earns nearly £2 million a year and last week emerged as frontrunner to take over from Jeroen van der Veer who retires next June, has been crucial to positioning Shell as the world's second-biggest gas producer after ExxonMobil.

About 45 per cent of Shell's production is gas, including liquefied natural gas, compared with BP's 39 per cent.

Cook, a no-nonsense University of Kansas-educated Roman Catholic, has been described as a 'gas industry evangelist'.

It's here, it's relatively cheap and its the most environmentally friendly hydrocarbon energy source, she says.

Cook joined the Shell board in 2004 in the aftermath of the embarrassing reserves scandal that cost chairman Sir Phil Watts and finance director Judy Boynton their jobs.

She was devastated by the shake-up, having liked and respected Watts, but she refused to be deflected by the upheaval, choosing instead to get on with the job.

Her no-nonsense approach was exemplified when she introduced bleepers to keep meetings on time when she was head of Shell Canada. That attitude has helped her rise through the ranks as the oil giant took its agonising path to modernising governance and internal culture to restore confidence with investors. It also helped her survive the company's bruising experience in Russia where it lost control of its huge Sakhalin-2 project.

RETIRING: Jeroen van der Veer

Cook's succession chances improved last week when Peter Voser, chief financial officer, dropped out of the succession race. That left only Malcolm Brinded, head of exploration and production, as an internal challenger – and he is five years older than Cook and more closely linked with the previous regime.

If Cook is appointed, it will make Shell, worth £121 billion, the largest company in Britain with a female leader.

Cook joined Shell in 1980. Her husband, Steve, looks after their three children at their home in the Netherlands.