Dealreporter
An Acuris company

13-Mar-09 20:07

Expected rights issues could be delayed as 'rights issue fatigue' causes squeeze on sub-underwriting capacity, stronger stories could still be fine - analysis

Story

* Next wave of deals could be five or six weeks away whilst market digests cash calls

* Institutional investors could be getting more choosy

* Companies could get more creative in structuring deals

Companies planning cash calls could decide to delay launching them for five to six weeks as the market digests the latest wave of large, heavily discounted rights issues, according to industry sources. Companies could also find securing sub-underwriting more difficult as "rights issue fatigue" hits the market, according to bankers, lawyers and fund managers surveyed by this news service. They said that companies with strong stories should be able to secure support for their rights issues but rescue deals could face difficulty.

The bankers, lawyers and fund managers also suggested that those who were planning to come to market soon could wait until the market digests large deals like HSBC's GBP 12.5bn cash call which was announced earlier this month. "I think the market is going through a period of indigestion," one banker said. "There are a vast amount of cash calls out there." An ECM lawyer added "HSBC has taken a huge chunk of cash out."

Other rights issues to hit the market over the past couple of weeks include Wolseley's call for GBP 780m as well as CRH's EUR 1.2bn rights issue and Premier Foods GBP 378m equity raising. "There have been a lot of rights issues, and many have been dilutive," said Martin Cholwill, senior fund manager at Royal London Asset Management. "It has been a big call on institutional investors."

At the presentation where Wolesley unveiled its long-anticipated cash call Chairman John Whybrow said that the company had decided on a placement alongside the rights issue due to "firm issues" concerning the capacity of those institutions being called on to back a huge wave of equity issuances by UK companies, particularly with regards to sub-underwriting. It is understood that arranging the underwriting for Segro's recent cash call was "tricky" to attract sub-underwriting.

But the flood of rights issues is not likely to stop as sources predicted that there are still many companies who to need to come to market. According to dealreporter analytics, the number of rights issues over EUR100m rocketed to 13 in February and 9 so far in March, compared to two and three in December and January. The average discount to TERP on announcement in February was around 35%.

In addition, there are a number of UK companies reportedly considering rights issues. Those rumoured in the press, or who have said they could consider a cash call, include property companies Liberty and Brixton, retailers Debenhams, Inchcape and DSG, media company ITV and construction company Travis Perkins. Brixton, for example, is understood to be delaying a possible rights issue to avoid going to the market while Wolseley and HSBC are holding their hats out to investors. Brixton will report full year results on Monday 16 March but, despite a press report on Friday suggesting it may use the occasion to announce a cash call, the company was said to be still undecided on whether to pull the trigger. In any case, the company's share price has nosedived in recent weeks, so much so that based on Friday's closing price of GBP 0.1475 it now

has a market capitalisation of only GBP 38m.

And the stress is already starting to show, as evidenced by the heavily-discounted 5 for 1 rights issue undertaken by property company Workspace. On 9 March, Workspace announced that it received just 49% acceptances and sub-underwriters were obligated to pick up the rest.

Underwriting capacity

A restructuring specialist said that the squeeze on underwriting capacity makes now an especially difficult time to launch a rights issue. A second banker agreed and said he heard some banks were having issues with underwriting because of the high volume of deals. He added that some are limiting themselves to underwriting only those where they are acting as a bookrunner.

A second lawyer also pointed out that underwriting fees are rising. He explained that fees used to be 2% for the first 30 day of risk; 1.25% for sub-underwriter; 0.5% for lead manager; 0.25% for others; an extra cent or so per additional day of risk. He said that now the lowest is now 2.5% and can be as high as 5% - but is typically 3-3.5 to 4%. The first banker added that sub-underwriting fees were around 1.75% at the beginning of this wave, but are following the same upward trend.

As for sub-underwriting, there were differing views on exactly how much capacity is left, particularly as there has been a movement towards existing shareholders sub-underwriting. "A lot of the clearing banks have been involved on the sub-underwriting side and you can see there's not that much capacity left there either," said the first banker. But the second banker thought that they would continue to see shareholders sub-underwriting, especially since fees were around 1.75%. "There have certainly been a lot of rights issues and I think there will be some tension, the market isn't saturated yet," he said.

Cholwill agreed: "If it is priced to go then institutions will find money," adding that "you are seeing such large discounts". Sub-underwriting capacity can depend on which investment banks are involved in the underwriting, the second lawyer said. He also pointed out that recent clauses in sub-underwriting agreements preventing banks from shorting the stock - as in the case of Xstrata and Hammerson - are now becoming commonplace and could be deterring sub-underwriters. "Shortselling," he said, "is the only risk-management tool available to sub-underwriters." It was also suggested that private equity funds could pay a larger role in sub-underwriting.

Good or bad credits?

Most sources, however, believed that there is a difference between companies that announce rights issues from a position of strength and those that seem to have no other option. "Companies that need the cash can't raise it while those that don't can," said a third banker. "Troubled companies are finding it difficult - you need a bloody good story," said the first banker. The second ECM lawyer also said it was difficult to tell whether investors are running out of cash or just becoming more selective. "It looks like it's specific to individual companies," he said. A third lawyer thought that "there is still appetite for some companies", but warned that if you were the third or fourth to the market in a sector –then the appetite among investors may well have waned. One example is the property sector, where there has been a spate of rights issuers including British Land, Land Securities and Segro.

"The appetite is related to the strength of the company," said Cholwill. He added that as an investor the worst case scenario is that of a company announcing a highly dilutive cash call that doesn't cover its entire debt. "As an investor you have to make a judgment as to whether they are raising enough or whether they will still end up with a lot of debt. It is imperative that companies raise as much as they could need." Cholwill gave Johnston Press as an example. Less than a year after its GBP 212.3bn cash call in in May 2008 at 53p per share, Johnston was trading at around 5.5p at time of writing. The restructuring specialist noted however that liquidity is available

and that institutions are keen to participate if a story is good and they are sure they're not following bad money with good.

An auditor noted that there is reduced appetite for UK credit as there is a lot of equity flowing into the UK market but said that companies that are seen to be shoring up their balance sheets, cost cutting and making non-core disposals will appear more attractive when they do pursue a cash call.

An example of this is in the UK house-building sector, where the trend has been for covenant re-sets and cost cutting instead of announcing rights issues. For example, Barratt and Persimmon both cut costs and trimmed their operations back instead of turning to the market. Sector bankers previously told this news service that housebuilders were likely to cost cut first in the hopes that it would drive up their share prices making conditions more conductive to a rights issues later in the year.

"The bottom line is that debt markets are closed unless you're investment grade and even then you will pay high fees. This leaves companies looking to shareholders. If you want to survive, you need to raise equity," said the third lawyer. "At the same time, covenant renegotiation will continue."

All about timing

CRH, HSBC and Wolseley have all just announced rights issues, leading some bankers to suggest that there could be a pause in the equity rush while companies wait for capacity to return. "I think you are looking for a timetable of between five and six weeks," said the first banker. "The sub-underwriting will improve, once that timetable's run its course." A third banker added that it is not an issue of available cash but of available sub-underwriting . He said he expected it will pick up after current deals are done.

But despite the current flood of deals, not everyone was in agreement that companies should wait to launch their rights issues. "I still think it is best to get in early," Cholwill said. For example, if Wolseley had done one earlier its share price would have been higher, making it less dilutive." The second banker agreed. "I don't think that the underwriting capacity is such an issue that it is worth waiting for. The risk that your share price will fall is far worse." He said that there are some companies that could have launched rights issues in January that will find it too dilutive to do so now. "It is far worse to be in denial because when a company is forced into a rights issue it makes it more difficult to execute," he added.

Getting creative

The sources also predicted more rights issues alongside placements as companies devise new ways of executing cash calls. "Structures are getting more complicated – you'll see more creative solutions like the Wolseley one," said the third lawyer. He thought that converts, preference shares and firm placings with no clawback or pre-emption rights could all be options.

Bankers also thought that there would be more deals like Premier Foods, in which its GBP 379m capital raising involved a firm placement involving private equity house Warburg Pincus alongside the rights issue.The second banker added that he expected converts to come back, especially as two were announced in the US recently which he said will give companies in the UK confidence to tap the convert market as well. The French convert market is also said to be on the verge of coming to life again, with a Paris-based DCM banker saying at least one CAC 40 company was planning an issue. The second banker pointed out that with dividends being cut across the UK convertibles and other instruments that yield coupons could also interest long-only fundamental equity investors.

by Alexandra Cain

26-Feb-09 14:44 **Tomtom debt reduction positive, but market sources see a need for further covenant talks, equity issuance and focus on balance sheet this year**

Story

* Shareholder says equity issue should be a last resort, but founder underwriting would signal market confidence
* Sector banker suggests private investor could be alternative to rights issue

---

Tomtom's reduction of its net debt through cash flow in the fourth quarter was viewed by the market as a positive sign, but industry sources said the company should focus on doing more to improve its balance sheet in the coming year. A rights issue, paying down debt through cash flow and cost cutting, further covenant renegotiation and bringing in a private investor were all flagged as options for the listed Dutch navigation systems maker.

The company is carrying acquisition debt of around EUR 1,585m from the acquisition of Tele Atlas last year due in December 2012. This leaves it with a total net debt of EUR 1,109m, compared to its EUR 395m market capitalisation. The company also has a EUR 200m revolver that was undrawn as at 31 December 2008.

In Tomtom's results on Tuesday the company maintained its 2009 plan envisages that it should remain within the covenants on its loan facility that it renegotiated in October last year. Although the company remained tight lipped on the details of these covenants, CFO Marina Wyatt did say in a conference call that Tomtom has "not walked away from" its Q2 target to reduce net debt to EBITDA to 3x by the end of 2009. The company also admitted that "scenarios can be envisaged where the loan covenants could be breached." Tomtom said that it therefore continues to "evaluate options aimed at remaining within its loan covenants under a variety of possible scenarios, which could include renegotiating the terms of the facility in isolation or in combination with other actions."

A Tomtom shareholder and a sector banker both viewed Tomtom's drop in net debt during the fourth quarter from EUR 1,322m to EUR 1,109m as a positive. "This was more than expected, in terms of working capital reduction, and this was positive," the banker said.

Christian Vondenbusch, a fund manager at Robeco in Amsterdam who holds a position in Tomtom said: "I like the company and I like its growth." But, he said, Tomtom needs to get further away from its covenants and should focus on the balance sheet. "Only when they have sorted out their balance sheet will people buy them for their fundamentals," he said. Tomtom's share price was trading at EUR 3.21 this afternoon, a long way from its October 2007 high where was trading well over EUR 60 per share.

Tomtom's reported revenue of EUR 528m for the quarter, down from EUR 634m in Q4 2007, but its net result was EUR -989m after it was forced to record a goodwill impairment charge of EUR 1,048m related to the Tele Atlas acquisition. Tomtom also announced a cost-cutting programme, from which it forecasts to achieve EUR 60m, or around 10% of operating costs, in savings through a reduction in headcount, alignment of marketing expenses, discretionary expenditure and sharing functions and facilities between Tomtom and Tele Atlas.

"Obviously the cost cutting programme is positive because it protects the EBITDA," Vondenbusch said. There are two options for the company, he said, to re-negotiate the covenants again and focus on paying down debt through cash flow; or to take a more "aggressive approach" and look at a rights issue or preference shares. He said renegotiating covenants would be his preferred route, but acknowledged that this would make the debt more expensive for the company. "As a equity holder I am not a big fan of the rights issue, it should be the last option. However if the founders would underwrite it would be a positive sign to the market that they were behind the company," Vondenbusch said.

A Tomtom spokesperson said that the company could not be specific about what measures they were taking to avoid covenant breaches, but they expect to comply with the covenants. “We realise there is a lot of uncertainty in this market, but we are being proactive and looking over the scenarios.” He said that the company “of course has options” without giving specifics on what these were. He declined to comment on whether they had appointed outside advisors, such as a bank or consultancy, to look at options.

Tomtom’s four founders are also its main shareholders, each owning a 13.2% stake. The sector banker agreed that any rights issue would require support from the founders, either by coughing up cash themselves or finding another investor.

The banker thought that a good option for Tomtom would be to consider a PIPE (a private investment in public equity) a structure more commonly used in the US. He said there have been a few done in Europe and in the Netherlands, and in particular Tele Atlas used this method to raise cash in 2004. He suggested Tomtom could attract interest from US based specialist technology investors, who could have the cash to do a transaction like this. He did not want to comment on whether he thought the company could avoid a rights issue through negotiating its covenants again.

A market participant was less enthusiastic about the company’s prospects. “I can’t see what else the company can do than some type of equity raising,” he said. “And at their current share price that would be very dilutive.” He suggested that one option would be to find an outside investor. The only other option than a rights issue could be a merger with someone else, he speculated. CEO Harold Goddijn denied that they were considering taking the company private in a conference call yesterday, when asked.

The market participant said that it was not only the debt, but the fact that the company was operating in a difficult market that relies on consumer spending. He said one positive was there was some possibility for cost cutting through input costs coming down from the factories that manufacture the products. “But it is the operational issues which is making everyone concerned about the refinancing,” he said.

Executives in a results conference call declined to comment when specifically asked whether issuing equity was an option, saying they have “many options”. The executives also declined, when asked, to give details of the company’s covenants.

by Alexandra Cain

Keywords: Convertibles/Preferred shares/Rights Issue, Covenant Breach/Amendment

Source dealReporter