Lenders Squeeze Corporate Borrowers Amid $112 Billion of Losses

By Pierre Paulden

Oct. 7 (Bloomberg) -- McClatchy Co., Building Materials Holding Corp. and almost 100 other companies across the U.S. are suffering payback from lenders stung by at least $112 billion of losses in the loan market.

Banks and investors who are losing money on the record $1.7 trillion of high-yield, high-risk loans made in 2006 and 2007 are charging borrowers an average of 1.64 percentage points more in interest to amend borrowing agreements and avoid default, according to Standard & Poor's. That's the highest since 1997 and almost eight times more than the first half of last year.

Lenders, reeling from an almost 20 percent decline in loan prices, are punishing borrowers in jeopardy of breaking their loan agreements as the economy teeters on recession. As many as 135 companies are in danger of breaching targets set by their banks, S&P says. Sam Zell's Tribune Corp. and Leon Black's Realogy Corp. may soon trip their covenants, according to Moody's Investors Service, which like S&P is based in New York.

``We would use an opportunity of a company violating a covenant as an opportunity to strengthen our hand, particularly in a deal where the spread is too thin or original terms were too generous,'' said Scott Page, head of the bank loan group at Eaton Vance Corp. The Boston-based firm oversees about $156 billion.

`More Painful'

Banks for McClatchy, owner of the Miami Herald, demanded as much as 2.25 percentage points more in annual interest to relax the publisher's lending agreements, the Sacramento-based company said in a Sept. 30 regulatory filing. McClatchy was paying an interest margin of 1.25 percentage points at the start of the year. San Francisco-based construction-supplier Building Materials agreed last week to pay an extra 3.5 percentage points on $340 million of loans after its earnings fell below targets, according to a Sept. 30 filing.

``We're in a credit crunch and getting those covenants amended will be lot more painful,'' said Andrew Feltus, who oversees $8 billion in high-yield debt at Pioneer Investment Management Co. Inc. in Boston.

Debt rated below Baa3 by Moody's and less than BBB- at S&P is considered junk, or in the case of loans, leveraged. Loans are typically made by banks such as Citigroup Inc. and JPMorgan Chase & Co., which then sell pieces to mutual funds, hedge funds and other institutional investors.

The market for leveraged loans ballooned as banks arranged $956 billion of the debt in the first half of 2007, compared with $549 billion in 2005 as banks raced to finance the record amount of buyouts. The market ground to a halt a year ago as the subprime mortgage contagion spread, making investors wary of buying all but the safest of government debt.

Rising Rates

Rates on loans soared to 11.6 percentage points more than the three-month London interbank offered rate, or 15.9 percent, compared with a spread of 1.8 percentage points over Libor, or 7.2 percent, in February 2007.

The Standard & Poor's/LSTA index of $590 billion of corporate loans fell to a record low 81 cents on the dollar last week from about 100 cents before the credit crunch began in August 2007, causing losses of more than $100 billion for investors.

``We want a commercially reasonable compensation for the risks we're taking and the risks are clearly higher now,'' said Mark Okada, chief investment officer at Dallas-based Highland Capital Management, which manages $30 billion of loans.

Lenders are also exacting higher one-time fees to loosen loan terms. Such charges increased to 63 basis points for 89 companies this year, according to S&P, from 32 basis points in 2007 for 39 issuers and 19 basis points in 2006 for 36 companies. A basis point is 0.01 percentage point.

Little Choice

Borrowers who breached their debt agreements have little choice but to pay higher fees and rates. Options for finding money are narrowing after financial institutions worldwide took $585 billion in writedowns and losses since the start of 2007.

Plus, the number of big lenders is dwindling after Lehman Brothers Holdings Inc.'s bankruptcy, Bank of America Corp.'s acquisition of Merrill Lynch & Co. and the purchase of Wachovia Corp. by either Wells Fargo & Co. or Citigroup.

Building Materials, a 21-year-old company that supplies lumber, roofing and construction services to contractors, broke covenants earlier this year as the housing market collapsed. The company had a net loss of $65 million in the first half of 2008, versus a profit of $14.4 million in the same period of 2007.

Lenders led by JPMorgan and Wells Fargo increased rates on $340 million of the company's term loans by 3.5 percentage points to 8 percentage points over Libor. Building Materials also gave lenders $1.3 million of warrants to buy an 8.75 percent stake in the company at 47 cents a share.

`Live or Die'

Building Materials closed at 68 cents in New York Stock Exchange composite trading yesterday, down from $11.60 a year ago. Bill Smartt, the company's chief financial officer, didn't return calls for comment.

``Once you breach covenants the lenders determine whether you live or die,'' said Steven Chercover, an analyst at D.A. Davidson & Co. in Portland, Oregon. ``Given the state of the banking industry it's remarkable they got this done.''

Banks for McClatchy also eased terms on a $1.18 billion loan to allow debt to rise to 7 times cash flow next year from 5 times. The company agreed to pay as much as 4.25 percentage points more than benchmark lending rates on its debt, up from 2 percentage points, according to its regulatory filing.

McClatchy was paying a margin of 1.25 percentage points at the start of the year before a record drop in advertising sales forced it to cut quarterly dividends by 50 percent and eliminate 10 percent of the staff. The amendment offers the company room to work through the economic slowdown, CFO Pat Talamantes said in a Sept. 26 statement.

Striking a Balance

Lenders are seeking to strike a balance between recouping some of their losses and driving a company into bankruptcy.

``If you go too far, you cause problems,'' Eaton Vance's Page said. ``We try to be reasonable, protective of our shareholders and not abusive of the company. This is a long game and we're in it for the long haul.''

Orthofix International NV, a maker of medical equipment, persuaded Wachovia and Citigroup to renegotiate covenants on a $375 million loan last month after the company forecast lower profits.

The banks increased the amount of debt Huntersville, North Carolina-based Orthofix can have compared with earnings, said Dan Yarbrough, vice president for investor relations. In return, lenders increased the rate on $292 million of loans to 4.5 percentage points over Libor, from 1.75 percentage points, and charged a fee of $1.5 million.

``Market conditions are difficult,'' Yarbrough said.

Tribune, Realogy

Tribune, the Chicago-based media company bought by billionaire investor Zell last year, needs to sell the Chicago Cubs baseball team and improve revenue to avoid breaching its covenants, said Mike Simonton, an analyst at Fitch Ratings in Chicago. Tribune has $12.5 billion of debt and its loans were quoted as low as 37.5 cents on the dollar yesterday, according to S&P. Gary Weitman, a Tribune spokesman, declined to comment.

``We're cautious of how the negotiations would go with lenders if they needed to get an amendment or waiver from the banks,'' Simonton said.

Realogy, bought by Black's Apollo Management LP for $6.6 billion in April 2007, may have difficulty meeting loan terms if the housing slump continues into next year, Moody's analyst Lenny Ajzenman said. The company's senior debt exceeds earnings before interest, tax, depreciation and amortization by 4.9 times. The loan agreement stipulates that the ratio can't exceed 5.6 times, and will tighten to 5 by September.

Realogy spokesman Mark Panus referred questions to an Aug. 14 conference call where executives said they anticipate the company will remain in compliance with its covenants.

``It's going to be very tight,'' Ajzenman said. ``If they do violate it will be a struggle to get an amendment and it will be on pretty onerous terms,'' he said.

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