

Equity Strategy

USPP Debt – Viral Loading

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The US Private Placement (USPP) market has been a happy hunting ground for NZ corporates over the past 10 years as a means of sourcing cheap debt; however its inflexibility when the chips are down can create problems for issuers. Fletcher Building (FBU) found this out when it experienced two consecutive half years of significant construction losses. We understand that there is little flexibility in the covenants and the penalties for breach can be material. Penalties could include an immediate principal payment penalty and an interest rate loading. USPP covenants are backward looking, which provides scope for balance sheet measures to enhance gearing ahead of key balance dates, but in an environment where profitability is likely to be materially depressed for some companies, covenants may be breached.

Corporates with USPPs

A number of NZX companies have undertaken USPPs as outlined in the table below. While many of these companies have low risk of covenant breach given the limited earnings impact from COVID-19 related demand challenges, AIA, SKC and Wellington Airport (IFT) are facing a period of depressed earnings, which will create covenant pressure. The most important credit metric for these companies in the near term are their respective, A-, BBB-, and BBB+ credit ratings. A rating downgrade may trigger immediate increases in funding costs and more stricter covenants/oversight from lenders.

Options for impending breaches

USPP holders provide very limited to zero flexibility to covenants in place. They typically rank as senior debt (it takes priority over other unsecured debt) owed by the issuer. A breach is a breach, with contractual penalties at stake for the issuer. Corporates will undertake measures to avoid a breach where possible, and may raise additional equity capital. Typical covenants include net debt/EBITDA and EBITDA interest cover on a 12-month historical rolling basis, therefore the impact of potential covenant breaches may only become apparent after December 2020 balance dates.

Local lending provides more flexibility

All USPP issuers have a mixture of debt instruments. Local lenders are likely to be more flexible in their approach to covenant breaches and assisting cooperates through periods of earnings or balance sheet stress.

Figure 1. USPP exposure across NZX

| Company | Code | USPP amount | Other foreign sourced non-bank debt |
|-------------------------------|------|-------------|---|
| Auckland Airport | AIA | NZ\$632m | NZ\$312m of Australian medium term notes (AMTN) |
| Contact Energy | CEN | US\$340m | |
| Fletcher Building | FBU | US\$451m | Other private placements amounting to ~NZ\$190m |
| Genesis | GNE | US\$150m | |
| Goodman Property | GMT | NZ\$192m | |
| Mercury | MCY | US\$200m | |
| Meridian | MEL | ~NZ\$600m | |
| Precinct Properties | PCT | NZ\$261m | |
| SKYCITY | SKC | NZ\$349m | |
| Vector | VCT | US\$612m | |
| Wellington Airport (Infratil) | IFT | US\$72m | |
| Z Energy | ZEL | NZ\$393m | |

Source: Forsyth Barr analysis. Note: based on reported numbers, which for NZD amounts will have changed given currency movements

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