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Firms Move to Scoop Up Own Debt

By SERENA NG

A number of corporations are quietly buying back bonds on the cheap in the open market as the financial system works its way out of crisis mode.

They are taking advantage of depressed prices to save millions of dollars in interest and debt-repayment costs.

In the recent round of second-quarter financial filings, companies including Beazer Homes USA Inc., Hexion Specialty Chemicals Inc., Harrah's Entertainment Inc. and Tenet Healthcare Corp. disclosed they had bought slugs of their bonds from the market at discounts to the debt's face, or par, value. Until the disclosures, investors were mostly in the dark about the purchases.

Bond Buybacks

Some companies are buying their own debt in the open market at discounted prices.

	Bonds purchased (in millions)		Cents on the dollar
	Face value	Amount paid	
Hexion Specialty Chemicals	\$288	\$63	22
Hovnanian Enterprises	578	223	39
Harrah's Entertainment	788	378	48
Beazer Homes USA	116	58	50
Tenet Healthcare	68	60	88

Source: Standard & Poor's Leveraged Commentary & Data, Company filings

Bankers said the trend could signal that corporate executives think the worst of the credit crisis is over and are feeling better about the economic outlook, because they are using cash to buy back debt instead of hoarding it.

But the moves also reflect how companies and private-equity firms are coming to grips with the new reality. Companies with below-investment-grade credit ratings have roughly \$1.4 trillion in debt coming due through 2014, according to Standard & Poor's data. With markets unlikely to allow them to easily refinance most of that debt, companies are doing whatever they can now to pay some of it down or buy extra time to repay.

"The real issue for companies now is how they delever, and every little bit counts," says Judith Fishlow Minter, a managing partner at North Sea Partners LLC, a private investment bank in New York.

While many companies are purchasing bonds through publicly announced tender offers, those that conduct buybacks without formal notification can often do so without driving prices higher.

"No one wants to announce a bond or loan buyback until they have to, as that will move prices," said Tom Newberry, head of leveraged finance at Credit Suisse in New York. "Those firms that can do this quietly and under the radar screen can buy more cheaply and chip away at their maturities."

Chemicals producer Hexion, which is controlled by Apollo Management LP, spent \$26 million in the first quarter buying back notes with a face value of \$196 million, paying an average of 13 cents on the dollar.



Between April and August, Hexion spent another \$37 million purchasing \$92 million in debt at an average of 40 cents on the dollar. While the buyback enabled Hexion to book a gain of \$182 million, the company still has \$3.5 billion in outstanding debt. An Apollo spokesman declined to comment.

In addition to open-market bond buybacks, others are getting lenders' consent to push out the maturity dates of loans. Many also are selling secured junk bonds to replace bank loans that impose strict financial-performance standards known as covenants.

But while buybacks and bond tenders are helping companies shrink debt loads at the margin, the challenges ahead are immense.

Buying back debt cheaply also is advantageous because a company can record accounting gains, reflecting the difference between what it paid and the value of the bond on its books, boosting bottom lines.

"You can rearrange the deck chairs all you want, but these are mostly short-term fixes," said Daniel Toscano, a former Wall Street banker. "At some point, something's got to give and someone in the food chain will lose money."

Most of the debt buybacks took place between March and August, a period in which average high-yield-bond prices rose from 59 cents to 85 cents for every dollar of debt. Leveraged loans issued by companies with speculative-grade ratings traded between 66 cents and 86 cents, according to Standard & Poor's Leveraged Commentary & Data.

The run-up in prices will make it more expensive for companies to repurchase debt, but with many bonds still trading well below par value, firms still may find it a worthwhile move.

In July, hospital operator Tenet Healthcare bought back \$68 million in debt from the open market, spending \$60 million in cash, the company disclosed this month.

Biggs Porter, Tenet's chief financial officer, said the company ended the second quarter with a "strong cash balance" and undertook the buybacks to reduce total debt and annual interest expenses.

The move was "opportunistic as it wasn't part of a broader plan, and relative to what we would earn on our cash in the bank, it made economic sense," Mr. Porter said.

In the second quarter, Beazer spent \$58 million buying back \$115.5 million in bonds, paying an average of 50 cents for each dollar in debt. The bonds represented 8% of Beazer's debt.

Effectively, the Atlanta company paid half of what it would have had to pay had it allowed the debt to mature on time. In its earnings conference call this month, Beazer Chief Financial Officer Allan Merrill said the purchases were "part of efforts to address our capital structure," and the company expects to take more steps to reduce debt. Beazer declined to elaborate.

"I'd characterize this as the credit-repair phase," said Matt Eagan, high-yield portfolio manager at Loomis Sayles in Boston.

Meanwhile, Hovnanian Enterprises Inc. paid \$223 million to buy back \$578 million in debt, mostly during February and April. The home builder in June tendered for some of its bonds.

Units of casino operator Harrah's, which was taken private in 2008, paid an average of 48 cents on the dollar to purchase \$788 million in debt during the second quarter, according to Harrah's filings. The company has taken other steps to reduce debt in recent months through tenders and bond-exchange offers. A Harrah's spokesman declined to comment.

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Questions:

1. How must companies account for and disclose early extinguishments of debt as discussed in this article? Under what circumstances are gains recorded in these transactions?
2. Access the Harrah's Entertainment, Inc. Form 10-Q filing for the quarter ended June 30, 2009 available at <http://www.sec.gov/Archives/edgar/data/858339/000119312509174432/d10q.htm> (Note that the live link in the online article to the Harrah's Entertainment company information on the WSJ site does not work.) How much of a gain on extinguishments of debt did Harrah's recognize in this quarter? Where is this information found?
3. Compare the gain on extinguishments of debt to Harrah's overall operations in this quarter; describe your assessment of this comparison, clearly stating your references to other financial statement items.
4. In the article, the author refers to Harrah's having paid "an average of 48 cents on the dollar to purchase \$788 million in debt, during the second quarter, according to Harrah's filings." Access the discussion on Debt and Liquidity, Open Market Repurchases and Other Retirements, page 41 of the 10-Q filing obtained above. How is this information reported in the WSJ article obtained from this note? Clearly explain your calculations.
5. How does the summarization of Harrah's debt extinguishment from their footnote discussed above allow comparison to other companies cited in the WSJ article?
6. What other debt transaction by Harrah's contributed to the gain on extinguishment reported in the quarter ended June 30, 2009, and discussed in answer to question two, above?
7. Return to your analysis of the note discussed in answer to question four above. How do the extinguishment results differ between two Harrah's subsidiaries' debt repurchases? What factors do you think contribute to that difference?
8. What are debt covenants? According to the article, what actions are companies taking to distance themselves from the impact of debt covenants? Why do you think that step is necessary particularly during these economic times?