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Edcon's landmark debt restructuring explained

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The complex restructuring of well-known South African retail group Edcon completed on February 1 2017. The transaction involved 11 months of extensive negotiations with various creditor groups across Edcon's capital structure to restructure its ZAR 29 billion ($2.2 billion) debt burden.

Background

The Edcon group owns a stable of iconic South African brands and is the largest non-food retailer in southern Africa, having been in operation for more than 85 years. Its footprint includes 1,500 stores, the majority of which are in South Africa, and the group is a key employer in the region, with approximately 44,500 employees. The group's capital structure was complex with three tiers of debt comprising super senior debt, senior secured debt and holding company debt. The liabilities were incurred in the form of issuances of public notes and private bank debt, with complex hedging arrangements. Edcon was highly levered compared with its peers and, notwithstanding a 2015 debt restructuring, its debt servicing obligations were causing operational challenges. The sponsor sought to avoid a restructuring through a strategic sale of the business but that sale failed to be implemented.

Edcon then announced in March 2016 that it would not be paying the April coupon and interest on its senior secured bank and bond debt. Following this announcement, an informal ad hoc committee of the senior secured bondholders holding more than 50% of the senior secured notes was formed, advised by Weil. Interest deferrals were agreed in May 2016 for a period of approximately five months with both the senior secured bondholders (via a consent solicitation) and bank lenders, which provided a stable platform for restructuring negotiations and time to diligence the group's liquidity need. The consent solicitation also provided for the appointment of a chief restructuring officer (from Alvarez & Marsal).

Negotiations progressed, but in July, Edcon required ZAR 1.5 billion of emergency funding to continue trading. This bridge funding was provided on a super senior basis by certain members of the ad hoc committee and certain first-ranking bank creditors. Restructuring negotiations were thus able to continue.

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In October, 80% of the secured creditors reached a binding lock-up agreement, which envisaged a South African compromise proceeding (similar to a UK scheme of arrangement) being used to render the restructuring binding across the entire senior secured and super senior creditor classes. The South African compromise proceeding received court sanction in Johannesburg in early January and, following the satisfaction of various conditions precedent (including US chapter 15 recognition and competition approval in a number of southern African jurisdictions), the restructuring closed on February 1.

The restructuring

The restructuring was implemented via an enforcement of a share pledge over an intermediate Edcon Group holding company. All debt, other than the super senior bank debt, was then hived up to a new double holdco structure interposed above the intermediate Edcon Group holding company. The reinstated holdco debt was structured as publicly-traded debt, due to the noteholders' preference for a tradeable instrument. Senior secured term lenders and senior secured noteholders reduced their debt claims by 50% and received up to 85% of equity (pre-dilution) in New Holdco 2, the ultimate parent. Fifteen percent of the equity (pre-dilution) was allocated to the new money subscribers (see below). Provision was also made for a management incentive plan and the Edcon Group's staff empowerment trust.

The restructuring used a leveraged buyout-style holdco payment-in-kind (PIK) structure with stapled equity, to ensure uncoupled economics and governance remain aligned. However, given the public nature of the debt, it was not legally possible to staple the equity to the debt in the usual fashion (requiring the transfer of equity as a condition of the transfer of debt), because this would impinge upon the free transferability of the debt security. The solution was a one-way staple. Debt was freely transferable but any transfer of the equity had to be accompanied by a pro rata transfer of debt.

Edcon's liquidity position has significantly improved through the provision of ZAR 2.25 billion in new money, in the form of a tradeable instrument. The ad hoc committee's portion of the bridge funding had a preferential roll into the new money. The new money was injected into a new holding company (New Holdco 1), and consisted of USD-denominated notes paying 25% PIK. The new money providers also received up to 15% of the equity in New Holdco 1's parent (New Holdco 2), while the committed creditors received a commitment fee equal to a three percent original issue discount.

The outcome

In conclusion, the restructuring resulted in Edcon's equity being transferred to the senior creditors. Four different New York law notes were issued, the existing facilities were converted and a new revolving credit facility was put in place. The transaction de-levered Edcon's operating company group net leverage from x18.9 to x4.1 (excluding subordinated debt), right-sized Edcon's balance sheet to a sustainable level and reduced its cash interest burden. The transaction prevented a potentially value-destructive insolvency process and preserved the jobs of 44,500 employees across southern Africa.

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