

IRONGATE RECEIVERSHIP REMINDER FOR INVESTORS TO KEEP EYE ON CORPORATE BONDS

MAY 2011

The announcement that Irongate Property Limited had gone into receivership, taking their bondholders with it, sounds an important warning bell for DIY investors of corporate bonds. Mark Brooks, Principal and Head of Income at NZ Funds Management explains.

When it comes to investing in bonds, investors who don't keep track of their investment or pay for professional investment managers to do it for them are toying with a penny wise, pound foolish strategy.

Many New Zealanders are only beginning to appreciate this now given the substantial declines in value faced by holders of bonds issued by the Blue Star Group (where a restructure and maturity extension is likely), Allied Farmers and NZF, via maturity extensions and coupon changes or just troubled business.

The receivership of Irongate Property came as a shock to many of the 1545 investors who purchased the formerly named St Laurence Property & Finance bonds years earlier and expected them to mature on 15 May 2011.

Irongate is yet more evidence that corporate bonds can experience declines in value of similar magnitude to individual shares. As such they require full-time professional investment oversight.

Unfortunately, retail investors often see corporate bonds as a simple and safe investment that does not need to be actively managed and is suitable for a DIY investment approach.

Retail investors continue to treat corporate bonds as long dated term deposits which require little or no diversification and little or no ongoing monitoring. Once purchased retail investors appear to place them in the bottom draw and wait for maturity. Default, or serious impairment of their savings, comes as a total surprise.

Many investors are unable or uninterested to track the flow of financial information which would give them prior indication that a bonds credit quality is deteriorating. But ironically these same investors are unwilling to pay an

investment management fee to have someone else do it on their behalf.

So when things do go wrong, instead of being diversified across a portfolio of thirty or forty names, the lucky ones find themselves owning only five or ten bonds. The unlucky ones have between 20% and 100% of their savings exposed to one issue.

What is clear is that the repayment of the Irongate May 2011 bonds has been far from certain and the financial writing of Irongate has been on the wall, in plain view for anyone who cared to look, for some time.

For those who cared to look, back in July 2010 the company was saved temporarily from receivership by Australian property company Bluestone which acted as a 'white knight' and refinanced existing debt holders to enable the repayment of \$30 million of bonds maturing in July 2010.

Subsequent to this positive event, the May 2011 bonds traded to a high of 82 cents on the NZDX. Indeed there has been active trading in the bonds over the last year. In total, bonds with a face value of \$5 million have changed hands over the last year at prices ranging from a high of 82 cents to a low of 43 cents. For investors actively monitoring their hard earned savings, there were several opportunities to exit, albeit with a small loss, if they wished.

The fact that the company is in receivership does not in itself immediately mean that investors have lost 100% of their investment. But once a corporate bond has defaulted, retail investors rarely know how to assess the likelihood of recovery or have the resources to go about maximising the recovery of their capital through either the bankruptcy or restructuring process.

The key is how much the receivers can recover by selling the company's assets to first repay prior ranking creditors (BNZ and Bluestone as the senior lenders and Westpac and Allied Nationwide Finance as lenders with specific mortgages over assets) before beginning to pay the remaining secured bondholders.

Irongate's Property portfolio has some good properties and some not so good properties and they have been trying to sell them for the last two years – with some degree of success. The sales to date, as noted by Kevin Podmore in his media release, have significantly reduced the amount of the senior ranking debt outstanding. This means that on paper (the valuations in the company's annual accounts) the value of the properties is sufficient for the bonds to be repaid. However, these valuations may bear little resemblance to the actual price that the receivers can ultimately sell the properties for.

This is especially the case for the larger properties in the portfolio, given that sales of higher value properties in excess of \$20 million have been a rare event since the onset of the Global Financial Crisis in 2008. The challenge for the receiver is to balance the speed at which they can sell properties and return capital to investors against the additional value that can be captured through a more measured but time consuming sales process.

Of course the problem for investors, especially those that are relying on the income from their investments to cover living costs or had anticipated using the 'expected' bond repayment for other purposes, is that any payment from the receivers could take potentially an extended period of time. For many investors relying on that income, a long time will be far too late.

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