ANALYSIS-Hedge funds target distressed companies for control

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By Gerard Wynn

LONDON, Dec 18 (Reuters) - Hedge funds investing in distressed debt are increasingly aiming for control of company boards, seeking more from their holdings than just yield and capital gain.

Fund managers said some hedge funds were now targeting equity holdings in contrast with their more traditional debt trading activities.

Distressed debt funds can obtain equity by negotiating debt-for-equity swaps in company restructurings.

"In the United States we have recently launched a new, long only fund to buy bank debt and bonds of distressed middle market companies with the aim of actively participating in restructuring and taking equity at conclusion," said the managing director of one U.S.-based hedge fund with European operations.

In mainland Europe, equitising debt through restructurings is a newer concept than in the United States, and hedge funds with equitisation strategies are becoming involved for the first time, for example buying up debt in struggling Italian food company Parmalat.

"It's a new game in Europe," said one distressed debt player. "There is money moving into Germany and Italy in the hope of opportunities."

BARGAIN HUNTING

The equitisation approach to obtaining control of a company can bring real bargains, costing as little as two-to-four times EBITDA core earnings.

These lower valuations are bought at a risk, however, as there is typically little information, setting equitisation apart from investment alternatives such as private equity.

Longroad Asset Management is a U.S. distressed debt fund which aims to buy a minimum of one third of a troubled company's debt at between 40 to 60 percent face value, with the aim of taking board control.

Paul Coughlin, fund manager, said the lack of information was a price for getting control of companies at discount prices.

"The business I'm in, once you have 70 percent of the jigsaw pieces, you buy. Private equity will wait until they have 95 percent, but for us that's too costly -- they'll pay twice as much for the extra certainty."

Jon Moulton, director at UK private equity firm Alchemy, agreed that bondholders faced information access difficulties, setting them apart from the private equity approach.

"The drawback for equitisation is that bondholders very rarely have access to information, especially at the small end where we operate, because it is difficult to access information at an affordable price."

But not every hedge fund is after control.

The fund manager of another U.S.-based distressed debt hedge fund, P. Schoenfeld Asset Management LLC, acknowledged that there was a new equitisation trend in Europe, but pointed out that not all hedge funds wished to take control post-restructuring.

"We get involved in restructurings, to accelerate the process and maximise our returns, but we're not control investors," said Peter Faulkner, portfolio manager of PSAM's new Rebound Fund.