

# Ploughing the depths at Elders



By Brad Newcombe

**PORTFOLIO POINT:** The rural services company has many problems, but brave investors might find the rewards could well outweigh the risk on its listed hybrid.

Elders recently reported a \$217.6 million loss for 2009-10, bringing total losses for the past two years to \$432.7 million. The company is confident that the worst is behind it but it is still in the process of selling assets to reduce debt, as evidenced by the recent sale of its remaining stake in Rural Bank for \$176.0 million.

The result was well flagged and most of the losses related to \$220.6 million in writedowns incurred during the year. While hardly a point to brag about, underlying net profit was \$3 million, compared with a loss of \$24.4 million last year.

## More writedowns to come

We would expect the underlying performance of the company to improve from here but we are also prepared for further writedowns.

The market capitalisation of the company is currently approximately \$282.6 million, yet the book value of Elders (less \$150 million of hybrid capital) is \$856.1 million. This implies that Elders shares are either a fantastic bargain at current prices or, if the market is correctly pricing the equity, then there is about \$573.5 million in writedowns still to come.

One division most likely to incur further write-downs is the automotive business. The company will soon be forced to pay \$27.1 million for the remaining 50% of the Plexicor business it doesn't already own. In light of the upcoming purchase, the company has already consolidated the debt of this business on to the accounts.

Automotive is one division that improved performance during the year, however we don't think the \$15 million in earnings before interest and tax the business earned during 2009-10 justifies the book value of \$173.3 million.

Then again, all of the remaining divisions would be hard pressed to justify their current book values based on the results over the past two years. Importantly for investors in the Elders hybrid (ELDPA), there is leeway for substantial writedowns to occur (the market is pricing this in) so there is no need to panic as/if future one-off losses are reported.

## Bank sales to reduce debt

The good news for hybrid investors is that while the company's businesses might be overvalued on the books, their value should still be substantially more than the debt of the company. The following table outlines the net debt of the company adjusted for a number of items including the outstanding payment on the Plexicor put option, the sale of the stake in Rural Bank and a deduction of the trade debtor finance debt.

The stated net debt of the company is \$435.1 million, which is derived from taking gross borrowings of \$497.6 million then adding a restructuring

provision of \$17.5 million and deducting cash of \$80 million. However, there are a number of changes that have occurred, or are likely to occur, post balance date which need to be included.

First, there is the \$27.1 million outstanding for the Plexicor put option, which is almost certain to be exercised in the next few months. Elders has already bought on all the debt relating to this joint venture on to the balance sheet but the \$27.1 million payable to the vendors still needs to be paid out as cash (currently a liability), which will increase the effective net debt of the company to \$462.2 million.

Offsetting this are the proceeds of the remaining stake in Rural Bank. The \$176 million proceeds should reduce pro forma net debt to just \$286.2 million, a figure we are far more comfortable with than the current level.

Finally, there is also an argument for deducting the trade debtor finance from this figure. Currently, Elders has \$111.2 million outstanding on this facility and total trade debtors of over \$400 million. Effectively, this debt is ring-fenced against these assets and means that the net corporate debt of the company is just \$175 million.

Elders Net Debt Reconciliation	\$m
Gross Borrowings	497.6
Debt Restructuring Provision	17.5
Less Cash	(80.0)
Reported Net Debt	435.1
Plexicor Put Option	27.1
Total Net Debt	462.2
Less Rural Bank	176.0
Proforma Net Debt	286.2
Less Trade Debtor Finance	111.2
Net Corporate Debt	175.0

## Substantial assets

This relatively low level of net debt is the main reason we believe the company will survive despite its current operational difficulties. Even if the core rural services business continues to struggle, the company can sell either of its other divisions to reduce debt further.

Forestry has a net book value of \$483 million and Automotive \$173.3 million. While we don't think these values would be realised in a forced sale, they can still be sold at significant discounts and repay the corporate debt of Elders.

Alternatively, since the company still has substantial value in its remaining businesses, we still think Elders has access to capital markets. Typically, a listed company will only be unable to raise equity if there is no prospect of the additional capital generating a solid return on the new funds. With such a low level of net corporate debt we believe investors would still be willing to support a further equity raising if required.

## High risk, high return

As mentioned in previous articles, an investment in the Elders hybrid is still high risk (it is after all currently not paying distributions) and should be regarded as closer to an equity investment rather than fixed income.

We continue to believe the value of the remaining businesses is more than sufficient to discharge the company's financiers and pay out the \$150 million outstanding on the hybrids. The biggest risk remains that the company will delay the recommencement of distributions on the hybrids until after the currently stated September 2011. However, considering the price of this security is still about \$50, the potential rewards significantly outweigh the risks. For high risk investors, the ELDPA remain a buy. ♦