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Steel – an innovative restructuring in the steel sector

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Where are we now?

Stemcor is a leading global steel trading business, with trading operations throughout the steel value chain. In recent years, Stemcor had grown and rapidly diversified through access to finance under a series of revolving credit facilities (RCFs). These short-term facilities had been used to support overseas investments, to purchase businesses and, in some cases, to support losses.

In November 2012, Stemcor reported to its lenders that its performance, in common with other participants in the global steel sector, had suffered over the previous 12 months. Persistently weak end-user demand had led to excess market capacity of more than 20%, in turn depressing margins for those involved in the supply chain.

Further internal setbacks in the first quarter of 2013, together with the market shock of the administration of Balli, the family-owned steel trading group, meant that Stemcor's lender group was collectively unwilling to refinance an $850m maturity of the RCFs in May 2013. This triggered cross-defaults in Stemcor's other financing arrangements and started the financial restructuring process.

The critical issue

Stemcor is reliant on access to trade finance facilities, which are normally made available by banks on an uncommitted bilateral basis, with banks reserving the right to finance (or refuse) any individual trade. By their very nature, the trades are 'self-liquidating' when end customers pay for delivered product, often directly to the financing bank.

However, this poses an obvious problem in a restructuring scenario. The trading company needs access to ongoing finance to place further trades, but lenders, naturally, are reticent to increase their exposure to a business in restructuring. Indeed, as trades 'self-liquidate' lenders may see value in protecting their own position, by running off their own trade finance position.

Nonetheless, not all lenders were in this position; Stemcor had RCFs of around $1.3 billion and those (defaulted) RCF lenders were faced with the prospect of a significant write off in an insolvency. They therefore had a vested interest in seeing the Group survive. Standstill arrangements required lenders to maintain their exposure to Stemcor at the level it was at on 1 May 2013, allowing time for a restructuring solution to be developed.

The solution

For Stemcor to deliver a sustainable restructuring solution, it needed confidence that it would have access to trade finance while implementing its operational restructuring plan. This finance needed to be committed. By mid-summer, those lenders that had no RCF exposure had largely liquidated their positions and it was clear that committed finance was only going to come from RCF lenders seeking to maximise the recovery on their existing lending.

However, many of the lenders in the RCFs had never provided trade finance and did not have the capability to do so. Those who did have the capability were, understandably, not willing to finance Stemcor alone and give a 'free ride' to other RCF lenders, without a commensurate return. However, as more than $1 billion of trade finance was required, any significantly increased interest margin would have destroyed Stemcor's profits and guaranteed that it could not compete in the marketplace.

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A facility needed to be designed that allowed every RCF lender to contribute to the trade finance requirement. This was achieved through a radical departure from the traditional uncommitted bilateral trade finance lines, by forming a syndicate behind a collection of 'Fronting Banks', which have the capacity and the capability to place all of Stemcor's trades.

Funding this facility was the next challenge. It was not possible to compel RCF lenders to provide additional finance to Stemcor. A tranching mechanism was devised for the RCFs whereby commitments to the new facility 'elevated' the repayment priority of the existing debt in the RCFs. Lenders were asked to provide a multiple of their existing RCF exposure as a commitment to the new facility, with the maximum elevation guaranteed for any lender committing twice the value of their exposure in the RCFs (i.e. potentially tripling their exposure to Stemcor). Mechanisms were introduced to scale back commitments in the event that the new facility was oversubscribed.

The deal was now capable of being supported by any lender, whether they wished to commit new money or not. At the vote on the Scheme of Arrangement, no lender voted against the restructuring proposal (with only about 5% abstaining), demonstrating the level of lender buy-in to the solution. Also of note was the relative stability of the RCF lender group, with less than 25% of the debt traded on the secondary market during the restructuring process.

This syndicated committed facility marks a radical departure for lenders familiar with the trade finance market, but gives Stemcor the platform to complete its restructuring.

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