

In Tonon, Gramercy sees opportunity and hope for exchange offer

The Deal

By Jamie Mason

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Emerging markets investment manager Gramercy Funds Management LLC, among Tonon Bioenergia SA most significant noteholders, is confident that an exchange offer that will improve the Brazilian sugar, ethanol and energy producer's liquidity by saving it money on interest payments will be completed successfully.

"We are quite confident that the transaction should move forward, as we think most noteholders will agree that this is in their best interests, rather than holding out and blowing up the transaction," said Robert Rauch, a senior partner at Gramercy and its emerging markets distressed portfolio manager, in a phone interview.

Bocaina, Brazil-based Tonon announced on June 13 that it's looking to exchange all of its \$300 million in 9.25% senior unsecured notes due Jan. 24, 2020, that were issued on Jan. 16, 2013, for new step-up pay-in-kind senior unsecured notes due in 2020. Every \$1,000 of the existing notes would be exchanged for \$1,000 of the new notes. The company is also getting a new \$70 million, 12% secured loan that will come due on May 14, 2019, which is primarily being provided by Gramercy.

While the exact amount hasn't been disclosed, Greenwich, Conn.-based Gramercy holds a significant share of both Tonon's secured and unsecured notes. Gramercy has had positions in the bonds of the company for well over a year, but with the pressures Tonon is facing this year, it became an attractive investing opportunity for the Gramercy funds able to get involved in distressed situations, Rauch said.

He noted that basic business is solid and that Gramercy is fairly selective when it comes to investments in Brazil, since it's a difficult place to invest in stressed and distressed companies because of how poorly the courts there treat international bondholders in restructurings.

Rauch said Tonon had more than 80% of its noteholders committed to participate in the exchange offer prior to launch, but with the company's cash flow situation and sugar prices continuing to be weak, getting an even higher degree of participation is important, so the minimum threshold was set at 95%.

The new step-up senior notes will mature on Jan. 24, 2020, and will bear interest at 7.25% per annum through Jan. 23, 2017. After that, the interest rate will increase to 9.25% until the notes mature, if Tonon doesn't pay the interest in cash. The new notes allow Tonon to PIK the interest, rather than paying it in cash. The notes are known as step-ups because of the increase in interest.

The exchange offer has a June 26 early expiration deadline and will expire on July 13.

"The overall transaction preserves most of the economics, but gives the company the ability to PIK interest for two years and then PIK/toggle the interest, depending on if their cash position recovers," Rauch said.

Those options, he noted, provide a relatively "creditor-friendly concession."

Rauch asserted that the deal allows Tonon to PIK \$55 million in interest over the next two years, giving it the flexibility to pay down debt, marshal resources and preserve liquidity. There is also a capital expenditure restriction that would be put into place to give the noteholders some greater certainty that the company will be rebuilding its cash.

"The company will be in a position to make it through an extended period of low sugar prices, which have been down below 12 cents per pound for the last couple of days," Rauch said. "Our outlook is that the global supply and demand imbalance that has been putting pressure on the company, should work its way through by year end or early next year, and we will see the fundamentals improve significantly as we head into 2016."

There have been other Brazilian sugar and ethanol producers that have run into trouble recently.

Aralco SA, a Santo Antônio do Aracanguá, Brazil-based sugar and ethanol producer, filed for Chapter 15 in the U.S. Bankruptcy Court for the Southern District of New York in Manhattan on Feb. 25 in an effort to seek recognition of its Brazilian bankruptcy as its foreign main proceeding. The company filed for bankruptcy protection in the 2nd Civil Court of Araçatuba, Brazil, on Feb. 28, 2014.

In addition, São Paulo-based sugar and ethanol producer Grupo Virgolino de Oliveira has been working on a debt restructuring after missing an interest payment on its \$135 million in 10.875% first-lien senior secured notes due Jan. 13, 2020, on Jan. 13. GVO also missed an interest payment on its \$300 million in 10.5% senior unsecured notes due Jan. 28, 2018, on Jan. 28 and an interest payment on its \$300 million in 11.75% senior unsecured notes due Feb. 9, 2022, on Feb. 9. The company hasn't been able to raise the financing that it needs and could be facing a Brazilian bankruptcy proceeding.

According to Rauch, "there are a couple of things that differentiate Tonon from other Brazilian sugar producers," such as the fact that Tonon is a low-cost sugar producer that breaks even on operating expenses at about 5 cents or 5.5 cents per pound of sugar. If you include capital expenditures and interest on its debt, Tonon breaks even at around 10 cents per pound of sugar, he added.

"This puts them in a different situation than some of the higher cost producers, like GVO and Aralco," he said.

Another thing that makes Tonon different is that it had a significant amount of unencumbered assets, such as two mills that were pledged as collateral to the rescue financing, which facilitated keeping the company out of trouble, Rauch said.

Rauch also like that Tonon has a professional management, rather than mainly family members in control. Nor is Tonon part of the sugar cooperative in Brazil, Copersucar, which has seized sugar collateral from companies in other cases, he noted.

The company also produces ethanol, allowing it to take advantage of the high ethanol use in gasoline in Brazil, Rauch pointed out.

He said that in late April or early May, Gramercy approached the company to discuss its liquidity situation. Then, in mid-May, Tonon and its advisers met with both unsecured and secured noteholders and made a presentation to them about the difficulties the company was having and proposed a much more comprehensive restructuring, which involved a significant amount of debt-for-equity conversion.

It was a deal, Rauch said, that wasn't going to be acceptable to creditors.

So as the day went on at the mid-May meeting, it became more obvious that Tonon was mainly having liquidity issues, Rauch said, adding, "The company's capital structure is not horribly overleveraged vis-a-vis the cash flow generating capability that they have."

On May 14, Tonon missed a \$12 million interest payment on its \$230 million in 10.5% senior secured notes due May 14, 2024. The company had a 30-day grace period to make up the missed payment, which expired on June 13. The company has since made up the missed payment.

Tonon's \$230 million in 10.5% first-lien notes due on May 14, 2024, were issued on May 9, 2014. The first-lien notes were issued by the company's subsidiary Tonon Luxembourg SA.

Rauch, noting that Aralco has gone into bankruptcy and hasn't come out yet, said that "consideration of the legal risks of a judicial reorganization, and the risks involved with the likely business disruption that would be suffered while in a judicial reorganization, led to the decision to accept a proposal for new capital and PIK interest through an exchange offer."

Tonon plants sugar cane and manufactures and sells sugar, ethanol and other products derived from sugar cane. The company also co-generates electricity and does agricultural exploitation of products and raw materials

Tonon is getting financial advice of the deal from Blackstone Advisory Partners LP. Davis Polk & Wardwell LLP and Felsberg Advogados are providing legal counsel. The Deal has learned that Thomas Felsberg at Felsberg Advogados is advising Tonon.

The unsecured noteholders are getting legal counsel from Cleary Gottlieb Steen & Hamilton LLP and Stocche Forbes Advogados.

Richard Cooper and Francisco Cestero from Cleary Gottlieb and Marcos Leite de Castro at Stocche Forbes are advising the noteholders.