

Insurance: Asset rich

In the current environment the words “asset” and “rich” sit uncomfortably in the same sentence. Insurers are discovering this in a variety of ways. The life insurers have just been through a major scare from the mark downs and defaults in their bond portfolios. The commercial real estate and CMBS issue still has to play out for life insurers. The P&C industry has not escaped either. Default rates in “political risk” books are escalating fast. However, it seems to be actual assets themselves that are making the headlines this week. Fitch has just downgraded AIG subsidiary, ILFC, on the basis that it will not be able to fund itself beyond the stated support by parent AIG

ILFC today

It seems that the true state of ILFC today escapes many. The company has been for sale for eighteen months without a successful conclusion. It has recently lost its CEO and founder. It is not effectively supported by the Federal Government. Although this support is not direct, ILFC has only been able to refinance its maturing debt by borrowing from its parent, AIG. AIG has only been able to provide this finance by drawing on the loans that it has itself from the Federal Government.

None of the news on ILFC is a surprise to the BRAVE partners. The partners were outlining the issues to a major commercial lender over a year ago. At the time the BRAVE partners suggested that ILFC could only be sold if a consortium of banks put together a bold package to refinance the \$30bn of debt at AIG into a long term financing structure, secured on the aircraft. At that time there was some potential to structure a deal. Today, there just is not a market for general asset risk. Everyone is a seller and the few buyers are abandoning the market

None of the news on ILFC is a surprise to the BRAVE partners. The partners were outlining the issues to a major commercial lender over a year ago. At the time the BRAVE partners suggested that ILFC could only be sold if a consortium of banks put together a bold package to refinance the \$30bn of debt at AIG into a long term financing structure, secured on the aircraft. At that time there was some potential to structure a deal. Today, there just is not a market for general asset risk. Everyone is a seller and the few buyers are abandoning the market in droves.

Initially the sale of ILFC was estimate to provide between \$5bn and \$10bn towards repaying the Federal Government loans to AIG. Today, a realistic view has to be that the equity value is wiped out and the Federal Government is left with a choice of ploughing in more money to support the debt, or cutting ILFC loose.

The ratings agency Fitch is predicting the latter. Fitch downgraded ILFC debt to below investment grade (commonly known as “junk”) on

the grounds that the Federal Government will not allow AIG to continue to support ILFC. Currently, AIG has publically announced that it will stand behind ILFC to November 2010. However, politicians have been known to change their minds before and BRAVE Partners believes that they could easily do so again.

Asset risk

The world today spurns asset risk. Bank balance sheets are brimming over with the risk. The few other providers are all in financial difficulty, such as Textron Finance and the other financial businesses of manufacturers. The small niche of the insurance markets is losing participants by the day. Brit withdrew. QBE has just withdrawn and the other, more marginal, players were out a long time ago. Berkshire Hathaway continues to be present, but it does not have infinite capacity and they only participate for the right price.

Asset rich

BRAVE Partners is observing a growing interest from the cash rich in acquiring distressed assets. The asset market is much like the stock market in the depths of a sell off. Pundit Jim Cramer, star of the excellent Mad Money on CNBC, implores investors to pick stocks that he calls the “accidental high yielders”. These are stocks that have strength and value, but have been sold off with a general market drop. For those who have not seen Jim Cramer in action, the BRAVE Partners do recommend a quick glimpse at: http://www.youtube.com/watch?v=OhZzhZAWd_0

The equivalent is now happening directly in asset markets. Mention shipping to an expert and they often turn pale. The headline is that there is enough shipping capacity currently available and being built to provide supply equivalent to 1.75 times the supply at the peak of the Baltic Index. This would appear catastrophic for shipping day rates and therefore ship values.

BRAVE Partners has seen a few deals which involve purchasing ships out of Chapter 11, which means purchasing them cheap because the equity is wiped out. Furthermore, in contrast to the general market, these ships are in demand and command significant day rates – maybe ten times the standard rates for the equivalent standard ship.

Steven Udvar-Hazy, the founder and former CEO of ILFC, built the company from the ground up. He knows how to start asset businesses and he has succeeded in building them before. BRAVE Partners has observed his departure with great interest.

Cherry picking

No one will know the ILFC portfolio better than Udvar-Hazy. As the debt maturities of the business bite and without the support of the Federal Government (er – AIG), ILFC will be faced with two alternatives:

“Steven Udvar-Hazy, the founder and former CEO of ILFC, built the company from the ground up. He knows how to start asset businesses and he has succeeded in building them before. His departure from ILFC is of great interest.”

Christopher Cloke-Browne
Managing Partner
BRAVE Partners LLP

- try to liquidate the entire company, which would involve the fire sale of a \$40bn+ fleet of commercial aircraft.
- look for the quick, private sale of a few assets to meet debt maturities as they arise.

Under either scenario, the BRAVE Partners believes that Udvar-Hazy will be in a position to purchase the best assets cheaply and from this core rebuild his business.

Follow the smart money

The smart money is investing in asset risk. Finding the right assets requires a lot of knowledge and work. However, BRAVE Partners is increasingly finding opportunity to participate in transaction originated and vetted by the smart money. Udvar-Hazy will be looking for financing for sure, although this is probably already in place given the extensive rumours of potential purchasers of ILFC itself. However, other opportunities exist and continue to come up.

For those that did watch the clip of Jim Cramer, he was extolling the virtues of physical assets. In Jim's words:

"See this jet engine: eh - not that you could miss it. This is something real, something that is not a CDO; not a credit default swap; not a structured investment vehicle. It is something that companies buy and use – and you know what; they are still buying them and using them."

At BRAVE Partners, we believe that distressed physical assets is the investment for 2010. Selecting the right assets and the right partners is crucial to success.

BRAVE Partners services

BRAVE Partners is in touch with a range of opportunities for taking asset value risk. These opportunities range from financing niche assets, often bought out of a Chapter 11 to providing residual value insurance on an asset. Each opportunity arises from a unique set of circumstances that is well documented and well researched.

Interaction

If you enjoyed this commentary and would like to receive a weekly update by E-Mail, then please contact BRAVE Partners on commentary@bravepartners.com

If you would like to comment on the content of this piece, then please send an E-Mail to discussions@bravepartners.com

- BRAVE Partners LLP is seeing a myriad of opportunities to invest in cheap physical assets.
- Selecting the right assets, the right investment and the right partners can produce superior returns.
- BRAVE Partners can advise on the asset financing markets.
- BRAVE Partners can identify partners and structures to invest in asset risk.

enquiries@bravepartners.com

www.bravepartners.com