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Finance Leasing Company bondholders dissecting command structure as majority shareholder and issuer disavow USD 150m bond

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Finance Leasing Company bondholders are beginning to scrutinize the chain of command at FLC and majority shareholder United Aircraft Corporation (UAC), as both companies continue to distance themselves from USD 250m of defaulted bonds. FLC's general director, Nail Malyutin, told lenders at a recent meeting that the company was a victim of fraud – fraud he expects Russian prosecutors to investigate – but investors' patience is running thin and creditors are seeking legal advice, two bondholders and a source close to bondholders told Debtwire.

FLC defaulted on two US dollar-denominated bonds in December, as reported, but lenders currently have their spotlight trained on the second deal, a USD 150m issue marketed by the US firm BCP Securities last June. With UAC and FLC executives disavowing the transaction, holders of the debt are trying to establish who knew about the issue in advance and who authorized it.

Sources close to the situation say the corporation was unaware of the deal until the final stages of the placement. FLC's current directors, including Nail Malyutin, have also distanced themselves from the deal, referring during meetings and conference calls to the company's new management, said the source close to bondholders.

This has caused some puzzlement among creditors, said the same source and one of the bondholders. Nail Malyutin was the deputy general director of FLC from 2002 until 2007 and has been general director since 2007, both noted. And according to FLC's FY07 financial report published in May 2008, Alexey Fedorov, president of UAC, was and still is chairman of FLC's board of directors.

But according to a source close to the situation, neither UAC nor FLC's board of directors was aware of the bond until the placement was in its final stages. "UAC [tried to] establish the size and other details of the deal. [UAC] sent out requests [for information] but did not get a response," said the source. "[The] FLC board of directors did not approve the issue and was not aware of it."

UAC placed a bond of its own in mid-2008, pricing a USD 200m two-year bond on 27 June last year with a 10.25% yield at issue. The source close to the situation said the corporation was asked about an FLC deal while it was marketing the USD 200m bond and was told by its subsidiary that a deal was not in the offing.

FLC's USD 150m bond settled on 30 June but UAC was not informed about the placement until early July, said the second source close to the situation. UAC did not approve the deal and the letters of comfort it gave to FLC were addressed to rating agency Moody's and various export credit agencies, the source said. The letters were not intended to support FLC's USD 150m bond, he added.

The two comfort letters are attached as appendices to the USD 150m bond's information memorandum, as reported, and bondholders have argued previously that leaves UAC responsible for the USD 250m owed to investors. As reported, UAC officials have maintained ever since the event of default in December that the company is not responsible for the FLC bonds, with or without the comfort letters.

One of the letters was sent to Moody's in February 2008 and the other was addressed to export credit agencies and financial institutions in September 2008, as reported. In the second letter, UAC confirmed its intention "to provide the company [FLC] with support and assistance, which can be required for guaranteeing the sufficiency of capital and liquidity for the purposes of the timely fulfilment of financial obligations."

Both communications were signed by UAC's chairman, Alexei Fedorov. Fedorov still holds that position and last week wrote to the Russian business daily Vedomosti to assert again that UAC was not obliged to step in.

"The first comfort letter was ... prepared for Moody's; the letter was addressed only to the rating agency, not investors," said the first source close to the situation. "It was at the time when the [Russian] government was joining its shares in FLC to those held by UAC." The second letter was provided to help FLC get loans for leasing equipment deliveries via export-credit agencies, the source continued, noting that it was issued two months after the USD

150m FLC bond was completed.

UAC purchased a 51.8% stake in FLC in 2007. UAC is itself 90%-owned by the Russian government, which also owns a 28.69% stake in FLC through a federal agency, as reported.

On the road again

When FLC began marketing its USD 150m bond in June last year its name was not new to foreign investors. The leasing company completed a debut USD 100m deal a year earlier via IG Kapital, MDM Bank and VTB. Dresdner Bank acted as credit agent.

The roadshow arranged by BCP Securities for FLC's second deal ran from 9 to 19 June 2008 and visited Geneva, Zurich, London, Singapore and Hong Kong. Listed as participants in correspondence sent to potential investors were Konstantin Koledenko, head of FLC's corporate financing department; Kirill Sychev, an analyst in the same department; and Dmitry Nikitin, a managing director at BCP Securities.

Documents in bondholders' possession show that before the placement, on 15 May 2008, general director Nail Malyutin signed a document giving "first signatory power" over FLC's bank accounts, financial liabilities and tax filings to Viktor Drachev, FLC's executive director, and Nikita Egorov, first deputy executive director. Drachev had already been given general unlimited power of attorney on 28 April, according to another letter signed by Malyutin.

This is standard practice, conceded the source close to bondholders, but creditors are re-examining the chain of command at FLC because the bond documentation was signed by Drachev and Yelena Zaigraeva, FLC's chief accountant. UAC's website still lists Drachev as executive director of FLC; Zaigraeva is still listed on FLC's website as the company's senior accountant.

Nail Malyutin could not be reached for comment.

The information sent to potential investors in support of FLC's second bond included a BCP report from June 2008, a Moody's report from April 2008, unaudited IFRS financial statements as of 31 December 2007 (in Russian), a presentation on UAC and a presentation on Sukhoi, Russia's flagship aircraft to be leased by FLC.

Moody's assigned FLC an initial 'Ba2' rating in April 2008 that it has since cut to 'Caa3'. The rating agency attributed FLC's two defaults last December to "inadequate" liability management and a significant deterioration in asset quality.

The source close to bondholders dismissed claims that UAC was unaware of the deal until after it was completed. BCP Securities had telephone conversations about the deal with UAC's vice president of corporate finance, Andrey Slivchenko, and set up meetings in Moscow in June 2008, the source said.

UAC did correspond with BCP Securities at around that time but remained unaware of the FLC bond until it was completed, both sources close to the situation maintained.

FLC last met creditors on 30 June. Instead of unveiling the debt restructuring plan some bondholders were hoping for it introduced two new advisers – law firm Cleary Gottlieb and financial consultant Newstate Partners – to work alongside PricewaterhouseCoopers.

FLC also suggested that holders of its two bonds should form a single investor committee to engage with the company's advisors, as previously reported. Bondholders formed a committee earlier this year, even writing to Prime Minister Vladimir Putin for help, but FLC said it was receiving mixed messages and asked for the committee to be reformed.

With talks now heading into a seventh month, some creditors have already taken legal action against FLC. Investment manager Thames River Capital has filed a claim against FLC in the London Court of International Arbitration (LCIA), and other legal proceedings are underway in other jurisdictions, as reported.

The deadline for FLC to appoint a nominee for the LCIA proceedings ran out earlier this week but during the 30 June meeting, Malyutin said FLC was unconcerned because the company is in a “permanent state” of litigation. He also said he expects the Investigations Committee of Russia's Prosecutor General's Office to examine the circumstances surrounding the USD 150m bond and the use of proceeds.

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