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Dividend recaps make return in Europe

By Anne-Sylvaine Chassany, Private Equity Correspondent

Private equity groups are taking dividends from their European companies by adding more debt at the fastest pace since the credit boom, using a contentious technique known as dividend recapitalisations to return cash to investors.

Buyout fund managers have returned €2.3bn through refinancings in the first quarter, 20 per cent more than the dividends they took for the whole of last year, according to S&P Capital IQ.

If the pace keeps up, the amount for this year could get close to the €10bn in dividends received in 2007, at the height of the credit bubble. In the US, the companies have taken $7.6bn in the first quarter, down from $11bn in the same period in 2012, a record year.

The trend highlights the buoyancy of credit markets in Europe, with investors rushing into non-investment grade debt in search for yields amid low interest rates. Private equity groups are taking advantage of liquidity in the market to return money to investors while other more traditional ways – IPOs and disposals – remain tough.

“If you can’t sell or can’t do an initial public offering, what other option do you have to return cash?” said a senior banker at a British lending group. “Dividend recaps are all we do now.”

In February, KKR funded a dividend from British retailer Pets at Home, which it bought in 2010 for £955m, by adding £135m in new debt. It raised total debt to about five times the company’s earnings before interest, tax, depreciation and amortisation, according to S&P.

Blackstone took a dividend from Spanish packaging company Mivisa and Advent did a dividend recapitalisation of card payment processing company WorldPay.

There are more to come, bankers say. JPMorgan and Goldman Sachs are working on more than 10 refinancings in Europe, according to an industry insider. London-based Bridgepoint is planning a recapitalisation of British sandwich chain Pret A Manger. British group Charterhouse may opt for a

refinancing of German metering company Ista if it cannot get the price it wants in a sale.

Bond investors and banks typically do not like dividend recapitalisations because they allow the owners of the companies to secure a profit before an actual sale while leaving those companies more levered and more vulnerable to economic hiccups.

“Some credit committees at banks such as Royal Bank of Scotland or Barclays did not like the idea of a private equity owner getting a dividend,” William Allen, partner at debt adviser Marlborough, said. “But they are doing it now.”

In 2005, Carlyle added debt to German car part maker Edscha and paid itself a €60m dividend. The 139-year-old company filed for bankruptcy in 2009, despite Carlyle reinjecting €25m in the company and amid wider difficulties for the German car industry following the financial crisis.

“If companies are left very levered for protracted periods, most will suffer from the effects of low investments and sporadic crises so that the business does not prosper,” Jon Moulton, founder of private equity firm Better Capital, said. “Failures of companies post-dividend recaps will definitely bring the private equity industry back into the political focus.”

However, levels of debt were not yet reaching the highs seen during the boom years, Mr Allen said.

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