

## DISTRESSED DEBT

# A Wealth of Opportunity

ADM Capital, a Hong Kong-based hedge fund, makes its money picking off and devouring chances missed, ignored and even discarded by others

PHOTOS OF SLEEK GREY sharks appear first on ADM Capital's Web site, followed by pictures of bright-eyed—and oblivious—tropical fish. "Are you the hunter . . . or are you lunch?" the caption asks.

The deep-water Darwinian theme suits the team at ADM Capital, a Hong Kong-based hedge fund that makes its money picking off and devouring opportunities missed, ignored and even discarded by others. The company thrives on being both predator and scavenger.

It certainly has been successful. Set up during the Asian financial crisis in 1998 with Chief Investment Officer Robert Appleby at the helm, ADM Capital's five funds have raised nearly \$1 billion and won numerous performance awards. Its flagship Galleus Fund, named after the aggressive tiger shark, returned 20.72% in 2002 and is on track to reach about 22% this year. Its investor base has been growing bigger and richer and curious private bankers, funds of funds and pension-fund managers and high net-worth individuals recently trooped through ADM's modest offices, decorated with edgy modern Chinese ink paintings and a Jimi Hendrix portrait, to get a first-hand look.

The strategy Appleby and his team employ for Galleus is the same for all of the funds, each named after predatory fish or sharks. ADM buys distressed bonds—typically those that trade at 30% or less of their original value—in small amounts, sometimes as little as \$50,000. "That little bit of ownership opens up a whole new world to the investor," says Appleby, who studied zoology at Oxford.

His team of four researchers then gets to work on a "forensic" analysis of the indebted company's balance sheet, relying as much on their investigative skills as on the bond documents and accounts provided by the borrower to search out off-balance-sheet assets and revenues. "It's a lot like being a private investigator," says Appleby. "There's a lot of gumshoeing."

In the course of the research, Appleby and his team try to meet other creditors, win seats on creditor committees and talk to the management, finding out everything they can about the borrower's business and finances. If ADM identifies ways the borrower could repay part of the loans within a set time, through restructuring cash flows, asset sales or equity swaps, for example, then it will take a bigger position in the bonds and present the borrower with restructuring options.

The analysis could take years. In the case of Asia Pulp & Paper, emerging markets' biggest corporate default, ADM Capital made its first substantial portfolio investment in 2002, four years after it first took a small position on the Indonesian company's defaulted bonds.

While time-consuming, the research also pays off. Last year, ADM made an internal rate of return of 105% on its ▶▶

**RISK APPETITE:** Appleby describes his work as similar to that of a private investigator

By Karen Richardson/HONG KONG



investment in Zhuhai Highways debt, in part by bringing its research findings to the management and, eventually, ratings agencies. After buying some of the bonds ADM discovered the Chinese toll-road company had failed to honour some bond covenants, or rules, that govern the repayment of bonds in a legal contract.

After learning of the problem, Standard & Poor's downgraded the bonds. That spooked institutional investors into selling, since many are prohibited from holding bonds below a certain investment-grade rating. The bond prices fell—senior notes to 50 cents on the dollar and junior notes to 10 cents—and ADM, along with a couple of other investors, bought up 50% of the senior notes. Within about 14 months of their purchase, Zhuhai bought back the senior loans at par with accrued and penalty interest, and the junior bonds for 64 cents.

As Asia moves into its sixth year after the Asian financial crisis, distressed-debt investors like ADM have already taken much of the "low-hanging fruit" in the region. Many of the distressed bonds of big Asian holdings companies are no longer yielding double-digit returns since the borrowers have started restructuring their balance sheets, thus lowering their risk.

Worse, for quiet bottom-feeders like ADM who thrive on digging up obscure opportunities, brokerage research on these companies has increased as more investment banks move into the lucrative debt-restructuring game.

To maintain their edge and the promise of high returns, Appleby and his team are launching a new fund that invests in riskier businesses. Named Maculus, after a deep-water shark that waits quietly for its prey to float by before striking out to devour it whole, the new fund buys the loans and even seeks equity stakes in the cash-making subsidiaries of indebted holding companies. "We're moving down the credit curve but up the capital structure," Appleby says.

One of its first purchases was United Tractor, a subsidiary of Indonesian car-maker PT Astra. While the bonds of the holding company are yielding single-digit returns after a couple of restructurings, its operating company, United Tractor, a small heavy-equipment concern, is earning steady revenues. By taking an equity stake, Maculus gains directly from the operating company's growing revenues, which are no longer being "upstreamed" to pay for Astra's debts. About 10% of ADM's entire Galleus portfolio is in equities, mostly of operating companies like United Tractor.

Appleby is excited about Maculus, and already the fund is attracting attention from institutional investors. While Asian economies and companies are moving back to an even keel

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after the crisis, such distressed-debt opportunities are ample for investors committed to the region. Appleby, Chief Executive Officer Chris Botsford and Chief Operating Officer Denys Firth make regular monthly trips to visit companies all over Asia, and now are even turning their attention to the new distressed-debt market in India.

With more money and opportunities, it's tempting for ADM—with just 17 staff—to expand. It would be an unlikely fit, though, for the collegial gang, who attend rock concerts together and regularly compare notes about their lunch-time workout regimens. "The moment this becomes a large institution is when we lose interest," says Appleby. "We want to keep it small, robust and keep the returns high." ■

## Shark Attack!

ADM Capital, based in Hong Kong, is open to investment only by institutional investors. It currently manages five funds and is launching a sixth one soon.

**Mytilus Fund**—Established in 1998, this fund is named for the common mussel. Investors were given units of the fund in exchange for their distressed bonds, which ADM would manage.

**Galleus Fund**—Established in 1999 and named for the tiger shark, ADM's flagship fund invests in undervalued

and under-researched distressed assets in Asia. As at September 30, the fund had \$164.5 million invested.

**Koromas Fund**—Established in 2001, this fund is named for a bright red, aggressive fish found in Korea. A collateralized bond-obligation-style fund that packaged the bonds of 59 small and medium Korean companies, it was sponsored by the Korean Small and Medium-size Business Administration, a Korean government entity.

**Global Perspectives Fund**—Established in 2002, this global

macro-style fund invests in different securities around the world using a longer time horizon.

**Coro Voltin Fund**—Established in 2002, this \$360 million fund is named after another Korean fish and is similar in structure to the Koromas Fund.

**Maculus Fund**—Soon to be launched, this fund is named after another shark and will invest in the loans or equity of obscure operating companies or subsidiaries of indebted holding companies.

Karen Richardson