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Boom market for distressed debt looming, U.S. experts say

By Dane Hamilton

NEW YORK, April 5 (Reuters) - Tighter bank credit and a slowing economy are creating a boom for private equity funds looking to loan money to distressed companies, lenders say.

The field is now dominated by such names as General Electric Co.'s (NYSE:GE - news) **GE Capital, CIT Group Inc.** (NYSE:CIT - news), and smaller funds like **Cerberus Capital, Foothill and Congress Financial.** But experts say more distressed debt or ``vulture'' funds are being formed to offer advice and higher-priced money to faltering companies.

"The opportunities will be enormous over the next few years," said **Hugh Larratt-Smith**, a national director of **Turnaround Management Association**, a 5,000 member trade group of advisers and lenders to distressed and bankrupt companies. ``This is really now the flavor of the month type of buyout fund and I suspect there are many in the wings.''

Larratt-Smith, a principal with **Trimingham Americas Inc.**, a Manhattan-based firm, said tightening U.S. banking regulations in the last year have all but closed bank doors for riskier companies, despite lower interest rates. And a national business slowdown is causing a growing number of companies to violate loan covenants or use riskier accounting techniques, he said.

"A number of companies are entering unknown territory as to their viability,'' said Larratt-Smith. ``Good examples are the telecom companies that people were throwing money at in the last few years.''

New York-based **Cerberus Capital**, for instance, is one of this small but growing number of funds willing to be ``lenders of last resort'' to distressed companies, at a price of anywhere from 12 percent to 15 percent interest rates, significantly higher than the prime rate.

William Richter, Cerberus senior managing director, said the firm, which has $6 billion under management, is looking for a 20 percent return on its money. It has loaned to distressed companies including steelmaker **LTV Corp., Chiquita Brands International** and software maker **Lernout & Hauspie**.

"We're seeing a surge in business because of the difficulties in obtaining loan from banks,'' said Richter, speaking Thursday at the New York Capital Roundtable, a trade organization for bankers.

Richter said one big challenge the firm faces is the speed at which rivals like GE Capital can pull together loan packages. He said GE, for instance, jumped quickly in offering $60 million to Lernout & Hauspie, the troubled Belgian software maker which is under investigation by U.S. and European regulators. But he said Cerberus trumped GE by offering a rival $60 million loan with more cash up front for the company.

Richter, whose firm is named after the mythical Greek three-headed dog that guards the entrance to Hades, claims his fund is more flexible in offering loans at more attractive rates than funds that are owned by banks, which may be restricted by U.S. bank rules. Foothill, for instance, is owned by Wells Fargo, while Congress is held by First Union.