Reader's Digest turns to Chapter 11

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Reader's Digest Association , the venerable staple of doctors' waiting rooms and middle-class bedside tables, on Monday announced plans for voluntary bankruptcy as it became the latest victim of the advertising recession.

Equity investors led by Ripplewood Holdings, who announced the $2.4bn acquisition in November 2006, will lose their entire $600m investment.

The pre-packaged Chapter 11 filing, agreed with senior lenders but contingent on agreement with other lenders, marks the latest media industry deal struck at the peak of the credit-fuelled buy-out market to head towards the bankruptcy courts.

Reader's Digest, launched by a husband and wife in a backroom in New York in 1921, began as a mail-order collection of condensed articles from other magazines and evolved into a direct-mail pioneer and one of the world's largest publishers.

Nine of its 94 magazines have a circulation of more than 1m in the US alone, and its titles claim a combined global readership of 130m people in 78 countries.

But advertising revenue from the flagship magazine fell 18.4 per cent last year, and is down another 7.2 per cent in the first six months of this year, according to the Publishers Information Bureau.

"The deal was done at the height of the frothy investment banking model, and the company was saddled with $2.2bn worth of debt," said Tom Williams, chief financial officer.

Group revenues are down just 2 per cent this year, said Mary Berner, chief executive. However, as cash flows came in below the Ripplewood-led buyout group's expectations, it found itself struggling to make a $27m interest payment, due yesterday.

Working with Kirkland & Ellis, a restructuring firm it hired in early March, Readers Digest struck an agreement with senior lenders led by JP Morgan and including Bank of America and GE Capital that will cut the debt load to $550m.

The agreement, which includes $150m of new debtor-in-possession financing, will lower annual interest payments from $140m to $80m despite a higher "mid teens" percentage interest rate on the new debt.

International operations, which have seen revenue growth in the past year, are ring-fenced from the bankruptcy process, as most of the debt was secured only on the minority of revenues that come from the US.

Readers Digest expects to be able to secure agreement with holders of its senior subordinated notes within a 30-day grace period on the $27m interest payment, and is hoping for an "expedited" exit from the bankruptcy process.

Ms Berner said the restructuring would not affect its operations or suppliers.

"This is a balance sheet issue and not an operational issue," she said.

Financial Times, London, Aug. 17th 2009, Companies, online.