

Sailing into the wind

ON 28 JANUARY THIS YEAR, KERLING PLC SUCCESSFULLY LAUNCHED A €785M SEVEN YEAR HIGH YIELD BOND TO REFINANCE INEOS'S CHLORVINYL BUSINESS. THIS WAS THE CULMINATION OF A SERIES OF CHANGES, EXPLAINS CHLORVINYL TRESURER **PAUL NICHOLS**.

In 1997, ICI's Chlor-Chemicals business publicly celebrated 100 years of chlorine manufacture at its Runcorn site at the head of the Mersey estuary in Cheshire. After unveiling a sculpture on the site, the then ICI chief executive told the Chlor-Chemicals board that ICI intended to find a buyer for the business and that they should prepare to be sold.

ICI had started its divestment programme in the late 1980s as part of a strategic decision to transform itself from a bulk commodity chemicals group into a performance chemicals group – reducing its vulnerability to the business cycle by focusing on lower volume and higher value added products and favouring investments in Asia Pacific rather than traditional markets in the UK, US and Western Europe. This divestment programme was accelerated after the demerger of ICI's bioscience business as Zeneca, which left the remaining group in a more exposed position, and by ICI's acquisition in 1995 of a group of businesses from Unilever for \$8bn.

INEOS, at the time a much smaller group than today, bought the loss making Chlor-Chemicals in January 2001 together with two smaller but profitable ICI businesses. Within a few months it had also acquired a majority share of EVC – European Vinyls Corporation. This had been set up in 1986 as a joint venture combining the PVC assets of ICI in the UK and Germany, and Enichem in Italy. It had floated on

the Amsterdam Euronext at the peak of the cycle in the early 1990s but had now breached its debt covenants and was effectively in the hands of its (unwilling) bankers.

If the Chlor-Chemicals business was loss making and EVC was in financial difficulties, why did INEOS decide to acquire it?

Why did it think it could succeed where the previous management hadn't? INEOS wasn't afraid to take on a commodity chemical business. The focus is on minimising the cost

per tonne of product – which means maximising the output from production assets and squeezing 'fixed' costs. The objective is to be cash positive at the bottom of the business cycle while maximising profit and cash at the top. In general, INEOS has bought from well respected companies that have attracted good quality employees who understand the business – but often companies which for various reasons were unable to squeeze costs in the way that INEOS could.

EVC was Chlor-Chemicals' largest customer – 40% or so of chlorine goes into the PVC chain. The bulk of the Italian PVC business was subsequently divested and the result was, in effect, that we had reintegrated ICI's chlorine and PVC assets in the UK and Germany into one business.

To fast forward six years, in 2007 INEOS agreed a deal with the Norwegian group, Norsk Hydro, to buy its Chlorine and PVC business headquartered in Norway and with substantial operations in Sweden and the UK. The deal was held up by eight months of discussions with the Competition Commission before it could be implemented and by that time the banking crisis had started in earnest. We had an initial facility in place to finance the acquisition but the intention had always been to syndicate within six months of the transaction. This proved impossible to achieve.

As a result, we found ourselves in 2008 with the original ex-ICI ChlorVinyls business integrated in the main INEOS legal entity structure and banking arrangements and with the newly acquired Kerling business sitting in a separate legal entity structure with a standalone and increasingly expensive bank facility.

■ **Where did the name 'Kerling' come from?** Norsk Hydro had packaged the business ready for a flotation on the Norwegian stock market under a holding company with the name 'Kerling'. The name comes from the wooden structure developed by the Vikings to give extra strength to the masts of their ships – enabling them to use larger sails and to sail farther and faster. There's a particularly good example of this in the Viking ship museum in Oslo.

■ **So how did the refinancing eventually happen?** In the second half of 2009 we had discussions with various advisors and came to the conclusion that a bond issue was now a realistic possibility. The project launch meeting took place in mid October with various bankers and lawyers plus a team of about six of us from the ChlorVinyls business. A few overlapping workstreams then kicked off in parallel – planning and then implementing the series of legal entity changes that would be needed between then and financial close to put the whole ChlorVinyls business in one place, setting up the



dataroom for the due diligence process, preparing the offering memorandum, defining the covenants to be included in the bond indenture and in the bank facility which would be in place alongside it, negotiating the security package, etc.

■ **How were the lead managers chosen?** INEOS had a long standing relationship with Barclays and Merrill Lynch. They had been in from the start of the Kerling acquisition. They knew the business very well and had a good understanding of what could or couldn't be achieved in the capital markets. We had confidence in their ability to help us to a successful launch.

■ **Why was a high yield bond chosen?** Chlorine/PVC is a cyclical business and capital intensive. For both reasons it's preferable to have a funding package in place beyond the three years that banks might typically be prepared to offer. The advice we had was that the bond market was open again for a business like ours. The bond provided our core funding. We also put a €100m revolving credit facility on top for any fluctuations in working capital. We already had a separate debtor securitisation programme in place for extra liquidity.

■ **What messages would you highlight for anyone else faced with a similar process?** I'd say there were several things to bear in mind;

- Whoever's responsible for preparing the dataroom needs to understand your business well enough to know what information is relevant and should be included and where to find it – or at least to know who to ask to find this out.
- Preparing the financial data to go into the offering memorandum and getting it signed off by the auditors can be a complicated and time consuming process – especially if the data isn't readily comparable from year to year because of acquisitions and/or divestments.
- To meet the planned timetable you have to be prepared to respond quickly to questions arising from the due diligence process.
- You need to make sure that your bankers and lawyers have an in depth knowledge of your business – and you need good working relationships with them at various levels to ensure good communications and understanding especially when unexpected difficulties arise
- Getting the right credit rating is vital – you need to put the effort in to make your case well
- Negotiating the security package can be frustrating at times – it helps to get a good commercial understanding with the lenders first and to be prepared to take up points directly with them when necessary, rather than expecting the respective sets of lawyers to come to a resolution

You also need to pace yourself. The process lasted several months in our case. In the final two weeks it was hectic as we went through the process of pricing the bond and then closing the transaction. The sheer volume of documents at the very end can be physically exhausting to work through.

Looking back to the original INEOS acquisitions in 2001, could anyone have anticipated such a successful refinancing on this scale?

If so, I haven't met them yet! It's been a continually evolving business. We've faced a lot of challenges and taken those opportunities that have come our way. It's a tribute to a lot of hard work and clever thinking from people across the business that we've come so far.

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