# THE MAIDEN VOYAGE OF FIRST BOND

AS THE THEN ACTING GROUP TREASURER AT FIRSTGROUP, **DAVID PATTERSON** PLAYED AN IMPORTANT ROLE IN HELPING THE GROUP TO MAKE ITS BOND DEBUT A FINANCIAL SUCCESS. HE TAKES US THROUGH THE PROCESS.

FirstGroup plc typically has £700m of net debt mostly made up of bank facilities. The banking relationships have been, and continue to be, very strong but there was an over-reliance on this relatively short-term funding. First now has three strong and complimentary business operations. When the US school bus division of Ryder was acquired in 1999 a step increase in bank funding was arranged. We knew it would need to be refinanced at some stage and longer term financing was the preferred route.

**TIMETABLING.** In the autumn of 2001, the launching of a bond had already been in the pipeline for two years so lead managers had been selected and a rating obtained. This enabled us to get off to a flying start but both of these areas needed further work.

We had planned to launch before the end of 2001, as investor demand was high. When Railtrack went into special administration we felt that, although we knew it was still business as usual, the investors had lost a certain degree of confidence in the transport sector. We had the luxury of time on our side as we were acting before any refinancing deadlines, so we rescheduled to the new year when demand would be stronger leading up to the fiscal year end.

The timetabling in the new year was very tight. We wanted to use new numbers from the budget round, meet Standard & Poor's (S&P) to confirm the rating, announce the bond, hold the roadshows and then launch all within five weeks. S&P were very accommodating and found a new slot for us with a subsequent rating committee meeting within a week. However, because of the compressed timetabling there was less time for us to answer S&P's questions.

The tight schedule also meant that the joint lead managers (JLMs) had less time than they had hoped for to invite the investors to the roadshow. The result was that 24 hours before the JLMs could issue a press release for the bond on the key Reuters page IIIA, there was a leaked one liner on a Telerate 'rumour screen'. But because the bond was going ahead anyway, and the screen was rather obscure, it wasn't a problem.

**RATING.** S&P had given us a private rating of BBB (stable) for the previous two years. With this in place FirstGroup was ready to launch when the timing was right, and a positive relationship was allowed to build with S&P. We were very open with the rating agency, presenting prudent figures and being clear about the few existing business risks.

The BBB rating was confirmed and made public for the roadshows. FirstGroup's Corporate Communications team, which liaises with equity investors, was able to prepare presentations for S&P illustrating the ability of FirstGroup to: generate cash; switch on and off the capital expenditure; and rely on stable UK bus revenues and five-year contracts in the US. These aspects helped to compensate for the relatively high gearing in the group and our BBB rating was confirmed.

**AVOIDING SUBORDINATION.** Once the Offering Circular was in an advanced state, S&P were able to give their separate rating for the bond itself. The key issue here was whether the bond holders could be structurally subordinated to other creditors in the group including the banks. Our bank facilities contain subsidiary guarantees, so we

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First transforming travel

FirstGroup is one of Britain's largest passenger transport companies with an annual turnover of some £2bn and employing 50,000 employees across the UK and the US. The Group is the UK's largest bus operator with about 23% of the market and is also one of the UK's largest rail operators. It is also one of the major transport operators in North America.

First Student is the second largest operator of yellow school buses with operation in the US and Canada. First Transit is a leading provider of public transit contracting and management and First Vehicle Services is the largest provider of fleet maintenance services in the US.

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gave similar ones on the bond. This ensured that the bond holders could not be regarded as subordinated to other lenders (to Top Co) or creditors (in subsidiaries). But we are currently negotiating with our banks to remove the subsidiary guarantees (replacing them with limitations on subsidiary indebtedness), and the guarantees on the bond will automatically fall away once the banks agree to let go themselves.

**THE BOND MANAGERS.** The JLMs were selected at a beauty parade. The financial rewards and status at stake are so big that some institutions will keep pushing for a bigger role as long as they perceive any opportunity. Starting out with a clear set of criteria and decision paths to keep as a hard back drop is very useful. We sought to: attract experienced players in the bond market to ensure success; reward prominent lenders; and use our valued corporate brokers which could help us through this debut issue.

Cazenove, RBS, UBS and HSBC (a co-manager) all have a high profile in the market and long-term relationships with First. They were able to use their complimentary skills to give key advice, court investors and launch the bond smoothly. Unusually, one JLM was not a bookrunner but the investors it selected from the split list were rewarded equally to the other JLMs' selections. The lead management team we set up was very successful, even if a little crowded for a small vanilla deal.

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**GETTING IT ALL DOWN IN WRITING.** The company lawyer took care of most aspects of the documentation. I was most involved with the Offering Circular, a draft of which was put into the roadshow packs. Key issues included:

- Ensuring consistency with the bank facilities: although bonds are generally less restrictive in each point, there were areas of wording that could have potentially impacted upon us because of the different approach in the documents.
- Ensuring tight wording: our advisers explained how some issuers had been forced to repay principal amounts due to wording that unexpectedly caught planned events.
- Ensuring covenants would not restrict the business. We started with a 1.5% interest step-up in the event of a 30% disposal or change in control resulting in a downgrade to non-investment grade. We much preferred the step-up to the conventional 'investor put', so as to ensure continuity of funding. After the roadshow we added a 30% acquisition clause to this condition.

**ON THE ROAD.** The JLMs encouraged us to hold as many one-on-one meetings with investors as possible, as the take-up by those who are seen personally tends to be much higher. The response by the Chief Executive and Finance Director was very positive and five clear days were identified, one in Scotland and four in London, over two weeks (because English and Scottish half-terms straddled the weekend!). We offered six sessions a day plus a group lunch for the other interested investors – quite a tough schedule.

Corporate Communications (again) worked with the JLMs to prepare the roadshow presentation. Among other things, they had long discussions about the corporate gifts. These ended up being (some say 'naff', others say 'fun') squashy foam yellow school buses and a chrome clock bearing our logo.

The material prepared and the presentations given were a big success, reflected in the investor demand and the positive feedback from investors. It is one thing to get the bond lined up ready to go. But it needed the full enthusiasm of these other players to make the launch as successful as it turned out.

**FROM ROADSHOW TO DEAL LAUNCH.** To rearrange our balance sheet by the March year end we needed to launch by around 22 February.

The book-building had got off to a good start on 13 February, the first day of the roadshow. But some of the key investors were seen at the end of the round, so the strength of our position was not clear at the half-way stage. Some investors were calling for a second rating or new covenants. Unlike bank negotiations, where each side creeps forward to a compromise, there is a single chance to compromise enough or to lose the deal when launching a bond.

If we gave away our granny, we definitely had a full book at Gilts + 195bps. This was with 48 hours to the point of finally deciding the price, size, term and covenants. The JLMs needed to give unambiguous messages to the investors and we had to consider our position. By examining each covenant we decided to reject all requests apart from a tighter (that is, bank equivalent) negative pledge and the addition of the acquisition clause referred to above.

Who knows what the order book would have been had we pushed for anything less. But two nights later we had all the orders in and were able to launch at the target 195bps margin, with an order book of £400m for a £200m bond. We had been able to say "no" to some demanding big names and still get the bond away. We decided to increase the size to £300m and I am sure I heard champagne corks pop in the background at the JLMs when we said this, as their fees instantly increased by 50%.

Fortunately for us the investors had appetite for 11-year money rather than 10-year. It was easy for us to agree to this attractive increase in maturity at the last moment, for no increase in spread and using the same reference gilt. The final size of the book was £600m.

**COUNTING UP THE COSTS.** With the rating fees, lawyers fees and the like amortised over the long life of the issue, the accounting charges are attractive compared with arranging a bank loan. And the all-in cost of the bond increased only by 0.012% by adding in the costs.

**A BOND SUCCESS STORY.** There was a lot to do to get our maiden bond issued. There were many hurdles that could have prevented success. But because each key individual was able to give everything needed, the result was a success.

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