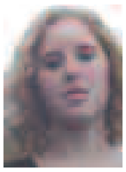
Tesco checks out bond with 2057 sell-by date



JULIA BERRIS TALKS TO TESCO TREASURER NICK MOURANT ON WHY THE COMPANY HAS ISSUED A BOND THAT MAY OUTLAST MOST OF ITS INVESTORS.

Tesco's latest move in the sterling corporate bond market delighted investors and commentators with its ultra-long-dated maturity bond, the largest of its kind. The £500m, 50-year fixed-rate bond received orders rising to £2bn from various investors including pension funds.

Group Treasurer at Tesco, Nick Mourant, said: "Demand primarily came from UK institutions and pension funds which are seeking out ultra-long bonds to match their pension liability."

The supermarket's excellent reputation and strong credit rating of A+/A1 generated strong demand for the bond. Tesco has become the UK's top grocery retailer with success extending from its convenience Express stores through to its hypermarkets Tesco Extra.

The bond was priced at 117 basis points (bps) over 55 gilts, which is 8bps inside the initial guidance between 120bps and 125bps.

Mourant said: "We tightened the spread over the gilts. The reason we were able to do this was that there was significant demand for the bond overall. We launched at 7.30am on February 26 and closed the books just two hours later."

Long-dated sterling bonds are a real rarity, with only a handful of bonds preceding Tesco's latest contribution. French rail network operator Réseau Ferré de France issued a 50-year sterling bond in 2002, as did British Gas in 1994.

Mourant explained that the latest move by Tesco was part of a wider strategy that involves other issuances in recent years.

Mourant said: "The latest bond constitutes a big chunk of our longer-term maturity. In March 2006 we issued a £350m bond due in 2023 at 5% and a £300m bond, due in 2042 at 4.875%. So we regard the latest activity to be more of the same from Tesco."

Embarking on a transaction of this kind is not something to be undertaken lightly. Ultra-long bonds are not always suited to a corporate and making this move should be done only after proper consideration for how the bond will be received.

Mourant said: "It is not complicated to issue a long-dated bond but you do have to be sure that the demand is covered by 20 or so of the biggest institutions.

"We were definitely confident beforehand that we would have their support. You have to be sure you have this level of confidence in the market you are accessing."

The supermarket industry has been under the spotlight lately, with Sainsbury's the subject of bids from a private equity consortium in recent months.

Market commentators argued that some investors would be anxious of buying into Tesco's extremely long bond given the risk of private equity firms snapping up the retailer in the future.

Although Tesco did include a change of control clause in the bond, it was criticised as too weak, which could have deterred investors.

Mourant said: "Some have commented that the change of control clause was weak in that it requires a takeover and a downgrade to below investment grade for the bondholders to be able to put the bonds back to us at par. I don't see this as being true necessarily. We included a change of control clause because we don't think it is fair to ask investors to take a 50-year commitment without a covenant. This would be unreasonable."

But with such a positive response from the market, it seems that the criticism of weak change of control protection did not influence investors overall.

With Tesco's phenomenal success over recent years it is easy to see why this bond proved a hit with investors and hit the headlines in the national press.

Lead managers were Deutsche Bank, JPMorgan Cazenove and Barclays. Co-leads were HSBC, RBS, BNP Paribas and Citigroup.

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