FRENCH CONVERT

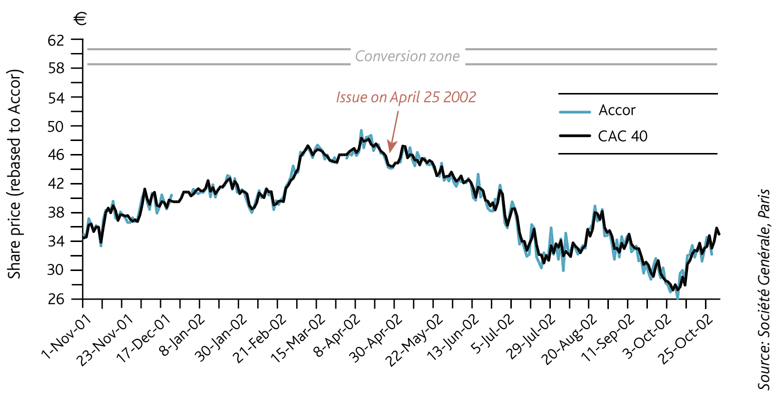
ACCOR
€570m convertible bond,
25 April 2002

CORPORATE PROFILE
Accor has more than 3,700 hotels in 90 countries operating under brands such as Sofitel, Novotel, Mercure, Ibis, Motel 6 and ETAP, with complementary travel agency, restaurant and casino activities. The second core business, Accor Services, serves 13 million people in 32 countries with food vouchers, personal assistance, expense management, public sector services, loyalty and incentive programmes. Accor is listed in Paris with ADRs in New York.
www.accor.com

On 25 April 2002, Accor, the French hotel and services group, launched a €570m bond convertible into ordinary shares of the company at a coupon of 1% – with a premium of 24% that is redeemable in three tranches, with the ultimate redemption due in 4.7 years. The novel issue structure used in Europe for the first time successfully spread the potential dilution and refinancing risk over the last three years of the bond.

COMFORT IN NUMBERS. Accor is not shy of tailor-made capital markets solutions. Its €202m equivalent bond, was fully converted into ordinary shares in 2001. The last of a €434m bond exchangeable into shares of Compass plc was redeemed in March 2002. The new convertible also sits comfortably alongside €3.1bn of net indebtedness on the balance sheet, including €183m *Titrés Subordonnés a Durée Indéterminée*, which somehow sounds less complex than Repackaged Perpetual Subordinated Floating Rate Notes. On €3.6bn turnover for the half-year to 30 June 2002, Accor's activities generated €306m of free cashflow that together with interest cover of 5.3x support the level of gearing last disclosed at 80%.

FIGURE 1
ACCOR SHARE PRICE VS CAC40



The gearing reflects tight management of reported earnings per share.

Christian Gary, Group Treasury and Financing Director of Accor, said: "We wanted to diversify our source of funds and a convertible seemed right for the moment. We did use it to partly refinance existing short-term debt and to strengthen our balance sheet with equity issued at a premium."

Accor selected three of its relationship banks to jointly lead the transaction – in no particular order, Deutsche Bank, Société Générale and HSBC CCF. These banks and a few others presented numerous convertible issue permutations to Accor prior to the issue and enabled a full evaluation of the parameters involved. The complexity of the ultimate structure inevitably had an incremental cost that Accor balanced with its corporate objectives after market sensitivities to premium, coupon, yield, dilution, puts and calls and the like, were run *ad nauseam*.

THE STRUCTURE. The issue was structured as one global bond incorporating three separate tranches with specified redemption dates, so the market could not segregate the three elements and trade them separately. Indeed, if the magnitude of each tranche had been of sufficient size to ensure liquidity in the after market, Accor would not necessarily have employed this customised solution. A redemption premium was incorporated into the bond to yield 3.125% that facilitated a lower running coupon of 1%, leaving the conversion premium subject to the vagaries of the market. The ultimate issue price was €166.89 (representing three shares at €55.63) reflecting the conversion premium that settled within the range at 24% after a day of book-building.

The bond is convertible into three shares at various points during its five-year life. On the first action date of 1 January 2005, investors can either redeem a third of their holding at €58.86 per bond or convert this third into one share. Again, on 1 January 2006, the second third is redeemable at

€60.14 per bond or convertible into one share per bond. Then on the final maturity on 1 January 2007, the final tranche is redeemable at €61.47 or convertible into one share per bond (see *Table 1)*.

As is so often the case, getting the structure right, combined with sensible timing, is more important than quibbling over the last basis point – or, in this case, the conversion premium.

Jean-Paul Castex, Director Capital Markets at Société Générale in Paris, said: "Accor went to market at a time when it was still possible to issue an instrument that was very much tailored to its objectives and probably one of the last successful issues with such tight terms.

"It secured an issue price incorporating the conversion premium very near the highest level that it could have achieved this year, which in turn gave them the optimal impact on EPS dilution." (See *Figure 1*.) Since the issue, Accor's share price has moved in line with the CAC40 and makes this issue look well timed.

Much has been said of Accor structuring the issue to deter conversion. Jan Zarzycki, Director of Equity Capital Markets at Deutsche Bank in London, said: "When you launch an issue there is a probability that it will get converted. Accor is not saying that it does not want it to be converted but it wants to manage the potential creation of new shares in a progressive manner – and that is the key to this transaction."

Control over potential conversion is tight and there are no put features. Also, by excluding call options many 'what-if' scenarios were eliminated for the issuer at the expense of a few basis points on the yield.

MARKET SUPPORT OPERATIONS. Market conditions were tough and not helped by being the fifth European equity-linked deal that week. Key to the success of the transaction was the support the lead managers gave the underlying share price during book-building. With the convertible being marketed on a range to the underlying reference share, these activities can be more important than the headline conversion premium.

On Thursday, 25 April 2002, the CAC40 was down 2.7% and Accor's price dipped just 2.1% despite the waves of negative liquidity that can damage the stock during such an exercise.

The market support activities had to endure a longer than normal book-build because investors were confronted with something they had not seen before and had more parameters to evaluate than their desktop software would expect.

Many investors are reputed to have worked on the 2006 redemption details to work out the valuation at the mid-point. Others separated the tranches and calculated the value of each at the top and bottom end of the marketing range. Although the issue was unrated, Accor has a BBB rating and the underlying bond was priced at 85bp, 90bp and 95bp over mid swaps for the three maturities. The market needed to value the convertible by stripping down to the bond and embedded option components. Talk of volatility and embedded options can put hairs on your chest and it is no surprise the market took some time to digest Accor's structure.

The issue came in 1.3x oversubscribed, giving the issuer comfort that the terms were just right for the market on the day, as opposed to the gutting feeling when a deal comes in grossly oversubscribed. A greenshoe option had been provided for, but Dominique Expert, Deputy Director, Group Financings and Market Transactions at Accor, said: "We expected to get €500m away but we were comfortably oversubscribed at €570m and there was no reason to issue the greenshoe as we determined beforehand it was contrary to our EPS management priorities."

LE RÉSISTANCE. The issue was based on a fairly standard OCEANE's, a French acronym for a much-used bond structure convertible into new or existing shares. Tim Lloyd-Hughes, Managing Director of the Lodging, Gaming and Hospitality Sectors at Deutsche Bank in London, said: "The convertible market in the UK is somewhat immature, certainly in comparison to the US, primarily because of pre-emption rights.

"Historically, UK finance directors and treasurers have had a sceptical view of the convertible product. That is changing and recently we have seen Legal & General, itself an institutional investor, issuing a convertible, and some of the resistance equity investors have had in the past is beginning to disappear."

This view was perhaps borne out in Accor's case, where 31% of orders were generated in the UK.

UK treasurers will not be rushing to adopt French convention regarding redemption dates that bunch convertible maturity dates on the first day of the fiscal year, usually January, leading to the obscure 4.7-year maturity of this deal. Prudent refinancing risk management and the avoidance of peak demand surges for inter-bank rates would deter such unsociable behaviour. Jean-Francois Mazaud, Head of Equity-Linked Origination at Société Générale in Paris, said: "What strikes me the most is that the company was able to achieve aggressive conditions, particularly on the coupon and on the yield to maturity for a triple B, at a time when market conditions were poor and congested with new issues meeting mixed success."

TABLE 1

THREE TRANCHES TO A CONVERT.

	Maturity dates	Redemption price		Conversion ratio	Credit spread
		Absolute amount	*Third of issue price*	*Shares per OCEANE*	*Over Euribor*
1st tranche	1 Jan 2005	€58.86	105.81%	1	80bp
2nd tranche	1 Jan 2006	€60.14	108.12%	1	85bp
3rd tranche	1 Jan 2007	€61.47	110.50%	1	90bp

Issue price €166.89 (representing three shares at €55.63)

CHRISTIAN GARY'S RECOLLECTIONS

- A convertible seemed right for the moment.
- We selected the banks on the basis of our relationship with them and their market expertise.