# SOMETHING FOR THE WEEKEND?

**ANGLO AMERICAN**

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$1.1bn convertible bond maturing in 2007, 8 April 2002
- **CORPORATE PROFILE**
Anglo American is the global leader in the mining and natural resources sectors, with interests in gold, platinum, diamonds, coal, base and ferrous metals, industrial minerals and forest products. Its shares are listed in London and Zurich and it remains the largest company listed in Johannesburg, Botswana and Namibia.
**www.angloamerican.co.uk**

On Monday, 8 April 2002, SSSB launched a $1.1bn five-year convertible bond for Anglo American at a 3.375% coupon and 35% conversion premium. Anglo, under the guiding hand of Cazenove, secured the terms under a bought deal the previous Friday. This optimised the strike price and made its debut in the capital markets at a discounted coupon without a rating or well-understood credit. The timing was perfect.

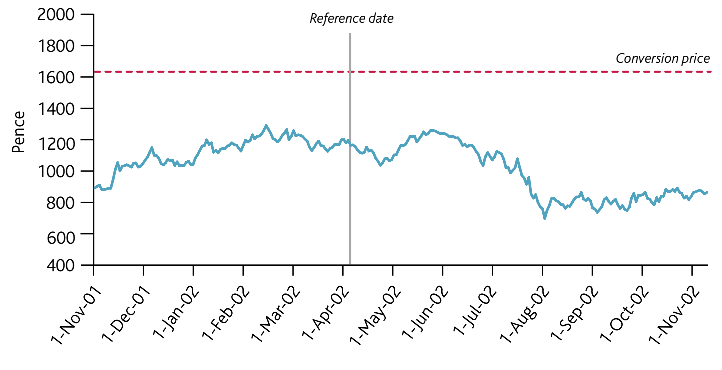
**ANTISOCIAL BEHAVIOUR.** One might wonder how a team of bankers can pitch up on a Friday at 5pm, learn the identity of the credit and submit an aggressive bid to underwrite $1bn, risking their bank's capital and their own heads within three antisocial hours.

Prior knowledge of the issuer, together with an understanding of the bank's risk profile, certainly helped. Three-SB had approached Anglo American a few months earlier convinced it was an ideal candidate to tap the convertible bond market on an opportunistic basis and therefore had a sound understanding of the credit, a detailed view of the credit spread and knowledge of the underlying stock.

Others had also been mooting the idea of a convertible bond and when it came to the four o'clock call, a handful of banks were invited to participate in the auction process based on their relationship with Anglo, ability to underwrite $1bn and track record in convertible issuance.

Susan Lewis, Managing Director, Head of Convertibles at SSSB, said: "My pulse quickened when I learned the identity of the issuer as we had spent a lot of time with Anglo and it was a company I really wanted to do a trade for."

**FIGURE 1**
SHARE PRICE VS CONVERSION PRICE.




**LACK OF AMBIGUITY.** There was no time to play rabbits caught in the headlights because the banks had three hours to prepare bid sheets specifying precise terms in a transparent auction process that was to eliminate ambiguity between bids. With a clear understanding of maturity, structure, pricing and risk management, the outliers were soon discounted and after a process of discussion three final bidders came in close. Doug Smailes, Group Treasurer at Anglo, said he was "impressed with the response of all of the financial institutions, given the size and unrated nature of the credit – without exception we got firm and unqualified bids from all the institutions that were invited."

SSSB took the day bidding a 3.375% coupon over five years, a premium of 35% to the Friday, 5 April 2002 reference price of £11.95, with a fairly standard call option after three years and 21 days at 130% and fees of 1.5%. These were aggressive terms on the night, but a quick look at the market data (see *Figure 1)* demonstrates what good timing this was for Anglo American. Assuming no conversion, funding was sub-Libor while the conversion price at £16.13 ($23.12 @ 1.433) looking good in light of the current share price. The convertible market is prepared to accept un-rated paper, providing the underlying equity story is positive with liquid and volatile stock but not too high a dividend yield. These characteristics generate efficient pricing of the embedded option, while at the same time supporting demand for this type of product. Anglo's stock met these criteria and fulfilled investor demand for the strong credit profile and defensive nature of the stock.

Despite being the largest European convertible bond this year, the largest ever to come out of the mining sector and the second highest premium ever achieved by a UK issuer, the bond has been well liked and well traded from the outset. This bodes well for future issuance.

Tapping the convertible market was an opportunistic way of lengthening the maturity profile of Anglo's borrowing portfolio at an attractive all-in cost.

Smailes said: "Having carried out considerable in-house research and evaluation over a variety of financial instruments, convertibles became more interesting. As a hybrid equity and debt instrument we thought an independent party would add value in guiding us through the complexities of the debt characteristics, and, more particularly, some of the equity considerations that come hand in hand with convertibles."

**BONUS TIME.** Cazenove, one of Anglo's joint brokers, was mandated with the explicit role of providing independent advice over the full range of issues and was precluded from participating in the transaction in any other way. Cazenove was remunerated with an undisclosed fixed fee and a bonus element that was entirely at Anglo's discretion based on its perception as to the satisfactory outcome of the deal. Smailes confirms: "The bonus was most certainly paid and, in the context of the $1bn transaction, the advisory fees were worthwhile and de minimus."

One of the key players at Cazenove said "The process was front-ended and the time fully utilised crafting documents, obtaining listing approval, appointing lawyers, conducting due diligence and wading through a lengthy check-list."

Surprisingly, the terms and conditions in CB documentation are still bespoke as the techy aspects require provisions for conversion price adjustments specific to each issuer to accommodate pre-emption rights, special dividends, mergers, takeovers and so forth.

Bringing this expertise on board enabled Anglo to take the unusual route of soliciting a bought deal to remove the risk of the share price going south during the book-building process, as might happen with the traditional one-day book-build.

The subscription agreement and all other necessary documentation were fully prepared in advance after negotiation, with lawyers appointed on behalf of the successful bidder, whoever that was going to be. The written offer received from SSSB on Friday night was therefore only subject to due diligence to be completed on Saturday morning, with intensive transatlantic discussions taking place over several hours.

Had SSSB failed to satisfy itself that morning, Anglo had the second bidder standing in the wings waiting to sign on the dotted line.

**CIRCLING ORDERS.** The winning team that night placed its bid knowing the strategy it was going to employ to sell down the $1bn issue with a significant level of subscription and healthy demand in the aftermarket.

SSSB knew from the outset that selling $1bn of bonds at 100% would be challenging and so it set out to sell them at 99%, offering the market an enhanced yield of 3.6%. The underwriter then managed its risk by 'circling' orders – in this case, immediately accepting significant proportions of the quality orders coming in to achieve broad but fair allocations and ensuring the stock was not flipped straight into the aftermarket.

There was a certain amount of griping in the financial press over the competitive auction process and the ramifications it might have on future issues, but there was no shortage of bidders. Sour grapes spawned stories that SSSB had to discount the deal to get it away, but Lewis respects the importance of getting the pricing right from the start.

She said: "Convertibles are about marketing and when the deal hits the tape the market gives a binary response – positive or negative. If the initial reaction is negative, it is nigh on impossible to turn it around. The market must think this is a great deal and want to take a look."

**TABLE 1**
TIMELINE TO A BOUGHT DEAL.

| | | | |
|---|---|---|---|
| Fri | 5 April 2002 | 4.30pm | Receive invitation to bid from Cazenove |
| | | 5.00pm | Pitch up and learn identity of Anglo American |
| | | 8.30pm | Submit bid sheet under specified headings |
| | | 9.30pm | Final stage interview |
| | | 10.45pm | Successful underwriter announced and morally on the hook |
| Sat | 6 April 2002 | 8.00am | Risk taker reviews documents and starts due diligence with management |
| | | 2.00pm | Subscription agreement signed, SSSB now legally on the hook |
| | | | Sales strategy developed |
| Mon | 8 April 2002 | 7.00am | Launch transaction |
| | | 7.30am | Realise deal is a huge success |
| | | 8.00am | Quickly establish deal can be upsized |
| | | 10.15am | Increase deal to $1.1bn |
| | | 11.30am | Final allocation to investors |

**DOUG SMAILES' RECOLLECTIONS**

- The cloak-and-dagger of Friday afternoon and evening certainly was an intriguing and interesting process.
- By 2pm Saturday, the legal agreements were signed, and we were able to place our bets and watch the Grand National, confident in the knowledge that the process had been well managed and the deal execution was now in safe hands."