CROSS CHANNEL SHOPPING

KINGFISHER

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Kingfisher £2bn fully underwritten rights issue, 8 July 2002

■ CORPORATE PROFILE

Kingfisher is Europe's leading home improvement retailer, ranked number three in the world. It employs more than 90,000 people in nearly 1,400 stores across 17 countries and has some of the best known retail brands in Europe, including B&Q, Castorama, Comet, Darty and BUT among others. Kingfisher is listed in London and Paris and has ADRs listed in New York.

www.kingfisher.com

On 8 July 2002, Kingfisher launched a £2bn rights issue, the largest ever underwritten rights issue in UK history, to fund the £3.3bn acquisition of the minority stake in Castorama. The acquisition process required an offer for the French DIY group that guaranteed funding imposing an exceptionally long underwriting period. A 'standby' underwriting facility was put in place at £1 per share. It provided Kingfisher with certainty of funds to overcome numerous barriers and acquire 100% control of the company in line with its strategic ambitions to create an integrated pan-European home improvement business that combines global scale with local marketing skills.

A MATTER OF CONTROL. Kingfisher obtained a 55% economic stake in Castorama in return for merging its B&Q business into the Castorama Group in 1988.

Helen Weir, Finance Director of Kingfisher, said: "We had to accept co-control as the price of doing the deal in the first place but we always intended to move to full ownership, although not quite so quickly. We were not achieving the progress we felt was necessary in terms of building the business as originally envisaged and so we were prompted to move to full control sooner than later."

Sharing control proved sub-optimal for Kingfisher as it could not implement the initiatives that had made B&Q so successful. Synergies to the magnitude of £40m in the first year and £80m a year thereafter have been bandied about.

The French controlling members of Castorama, the Commandités, were not keen to exit so quickly and following negotiations over a period of six months Kingfisher concluded that it would have to make a cash offer for the 45% minority stake, although Weir said: "We would have preferred a less protracted solution." It also had to be cash to comply with terms of the 1998 agreement. The acquisition was complicated by the Commandités opposing the bid on legal and strategic grounds, and it was this that forced Kingfisher to closely follow the letter of the original shareholder agreement.

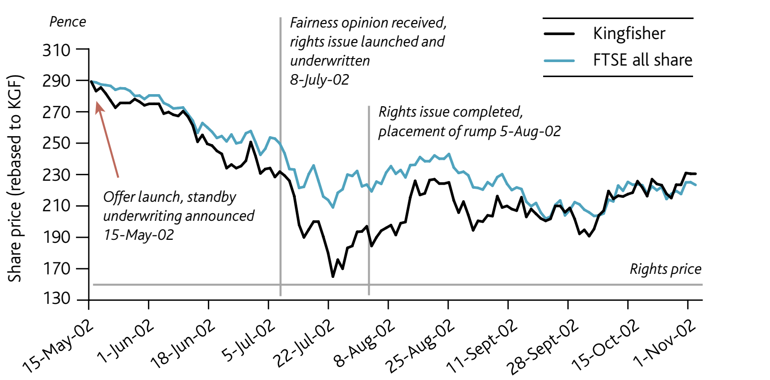
FULL AND FAIR. On 15 May 2002, Kingfisher announced the proposed offer to acquire the 45% minority stake in Castorama that it did not already own. The bid was pitched at €67 per share valuing the offer at €5.7bn (£3.3m). Weir emphasised: "We wanted to make a full and fair offer to the minority shareholders", and €67 represented a 20% premium to the pre-speculation price of Castorama.

The acquisition process determined by the Castorama articles contained a clause that an independent investment bank must give an opinion on the fairness of the offer. Furthermore, to start the process, Kingfisher had to submit an offer that was only conditional on competition approval. Guaranteed funding therefore needed to be in place – more so, as the Commandités doubted Kingfisher had the cash to back the offer.

On the face of it, it might have seemed a darn sight easier if Kingfisher has just bridged the £3.3bn acquisition cost with short-term debt and refinanced shortly thereafter, but with 20:20 hindsight, delaying the equity

FIGURE 1

SHARE PRICE CHART.



Source: UBS Warburg

issue might not have been such a good idea after all (see *Figure 1*).

Sheena Boyce, Director of Treasury at Kingfisher, said: "This was just not considered feasible, given Kingfisher was committed to maintaining its investment grade status and wanted to demonstrate equitable support from shareholders and debt investors for the transaction."

After much deliberation a M&A loan of £1.3bn from the banking market was signed in June (see below), leaving £2bn to be raised from shareholders

Jim Renwick, Head of European Equity Capital Markets at UBSW, said: "We had to come up with enough equity to keep the credit rating, but from an underwriting and overall risk point of view we were pushing the envelope. A one-for-one issue is quite an important psychological hurdle and this is territory where bankers start to get nervous. You may see a heavier issue for a rescue, but this was not a rescue – it was a strategic move by the company and it had to be supported by underwriters for up to 14 weeks."

HOSTILE MARKETS. On 8 July, Kingfisher received confirmation from NM Rothschild, the independent referee that its €67 per share bid was indeed fair and launched a one-for-one rights issue for a staggering £2bn. It was the largest ever underwritten rights issue in the UK, the largest for an acquisition and second only in size to the huge £5.9bn issued by BT (Winner of *The Treasurer* Deals of the Year 2001). It was fully underwritten by house brokers UBS Warburg and Credit Suisse First Boston, with Goldman Sachs, which acted as M&A adviser on the bid.

A total of 1,293.6m new shares were issued at 155p a share to raise £2bn, doubling the number of shares in issue. This was struck at a 50% discount to the previous closing price of 310p and 33% discount to the theoretical ex-rights price. The ex-rights discount is comparable with the few other large-scale equity issues in the market this year. Some 95.65% of the rights were taken up in the most hostile markets seen since 1987 and at one point before closing, the deal was nearly underwater, with the share price just 5p away from the offer price on extraneous factors. The £95m rump was placed in the market on the following Monday (5 August) at 181p, letting the sub-underwriters off the hook.

Nick Bowers, Director of UK Corporate Broking at CSFB, said: "The judgment to go ahead with the largest ever underwritten rights offer in the UK proved to be correct and came to be seen as total commonsense. But it was not so obvious at the outset because Kingfisher was coming out of a troubled patch and equity markets were very tough – witness the number of deals that have had to be pulled through no fault of their own."

THE STANDBY. Underwriting fees would normally be 1% for a conventional rights issue over a typical period of six weeks, but this deal had a potential exposure of 14 weeks (see *Table 1*). Underwriting commitment had to be obtained before the bid was tabled, but the need for a fairness opinion could stretch the standard 6.5-week period by another eight weeks. As if that wasn't enough, markets were volatile and a colossal £2bn had to be assured. Underwriting fees would have been more than 3%, or £60m-plus, were it not for the innovative two-stage underwriting facility.

The first stage was a 'standby' facility, providing Kingfisher with a £2bn underwriting to a rights issue at the highly discounted price of £1 per share from the date the Castorama bid was tabled on 5 May 2002. It was announced that, following the receipt of the fairness opinion, all three underwriters would underwrite a rights issue on more conventional terms, which they did. This interim solution provided the necessary funding commitment and greatly reduced the costs for Kingfisher. The rights

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TABLE 1

MAKE-UP OF THE EXTENDED UNDERWRITING PERIOD.

Date (2002)	Actual duration (days from D-day)	Event
15 May	D-Day	Table offer for Castorama
22 May	D+7	EGM notice given
27 May	D+12	Agree identity of independent bank to provide fairness opinion
7 June	D+23	EGM approves the acquisition and rights Issue
10 June	D+26	Appoint NM Rothschild to provide fairness opinion
7 July	D+53	Fairness confirmed at €67 per share
8 July	D+54	Rights issue launched
2 August	D+79	95.65% rights taken up
5 August	D+82	Successful placing of rump on Monday morning
	2.3 weeks	Actual underwriting exposure
	11.7 weeks	Buffer for procedural delays
	14.0 weeks	Maximum duration per underwriting agreement

issue fees, estimated at £40m, or 2.025%, contained more than a third of the potential damage.

The fees were progressive during the standby period and varied according to the underwriting risk, for example, they started at 0.2% from announcement to the time of the EGM approval, as Kingfisher was not assured of getting the deal done and the underwriting risk was therefore low. If the deal had fallen over before the EGM, Kingfisher would have been a little out of pocket. Thereafter, the costs rolled up with the likelihood that the deal was going to happen to the final level of 2.025% all in for broking and underwriting.

Renwick said: "£40m in fees may seem high, but the reality was the alternative of not doing the deal at all. The funds had to be guaranteed and, if Kingfisher had delayed the deal or not underwritten it at all, I believe then it would have failed. The mountain we had to climb to do a one-for-one and £2bn was absolutely enormous."

Significantly, the standby nominal price of £1 also served to deter speculators and hedge funds from driving Kingfisher's price down as it was made clear the issue price would be revisited at a later date making that uncertainty too risky a play.

M&A LOAN. The £1.3bn funding was raised via an €2.4bn syndicated facility led by mandated lead arrangers – BNP Paribas, Deutsche Bank and UBS Warburg. The facility was divided into a €1.6bn three-year term loan and a €800m 364 day revolving credit facility with extension options to a maximum of three years. The margin for both tranches pays between 55bp and 75bp over Euribor. The facility was structured to fit the timing of the acquisition with a commitment fee on the three year tranche during the availability period of 20bp to October 2002 and 40% of the margin thereafter. The terms were kept relatively short to reflect the Board's stated intention to separate the electricals businesses by May 2003.

By 24 October, Kingfisher had acquired 98.9% of the fully diluted share capital of Castorama and re-opened the offer for a further ten days in an attempt to mop up the stragglers. With B&Q firmly back in the stable and with full management control of Castorama, Kingfisher can crack on and reap those synergies. Any good DIY enthusiast would do so.

■ HELEN WEIR AND SHEENA BOYCE'S TRANSACTION HIGHLIGHTS

- Gaining full control of assets which firmly position Kingfisher as the number one Home Improvement retailer in Europe.
- Successful completion of a challenging and complex transaction.
- Securing £2bn acceptances for the rights issue in a difficult market against initial estimates which capped expectation at £750m.