DON'T LOSE SIGHT OF YOUR AIMS

PILKINGTON'S DEBUT IN THE EUROBOND MARKET CAME AT A TIME WHEN MOST FIRMS CHOSE TO STAY AWAY. BUT, AS **ADRIAN MARSH** EXPLAINS, THE RISK WAS WORTH IT.

"The future is not what it was", as we discovered, in a fairly dramatic fashion, a few hours after having announced our debut Eurobond at 10am on Tuesday, 11 September 2001. Anyone who has ever issued a public bond for the first time will appreciate that the amount of work and effort required to get to the stage of announcing a transaction is enormous. For Pilkington, the decision was taken by the Board in May 2001 that the time was right for the company to obtain a credit rating from Standard and Poor's and Moody's and then to seek to raise at least €350m for a minimum of seven years. This would increase the average maturity of committed facilities from some four-and-a-half years to six-and-half-years and, by accessing the Eurobond market, provide an additional source of credit to the group.

Founded in 1826, Pilkington is one of the world's largest manufacturers of glass and glazing products for the building and automotive markets, with annual revenues of £2.8bn and manufacturing operations in 25 countries on six continents. Over the past four years Pilkington has transformed itself as an organisation, completely restructuring all of its businesses in pursuit of its target to be the most competitive, most profitable and fastest growing global glass company in the world.

READY FOR A RATING. In 1997, at the time of Paolo Scaroni's appointment as Chief Executive, the prospect of Pilkington obtaining an investment grade credit rating with a stable outlook would have been unthinkable. By May 2001, however, the Pilkington Board recognised that, in the light of the considerable progress made over the intervening four years, such a rating was achievable.

The timetable set in May envisaged securing the credit ratings by the first week in September and launching a transaction by the second week of October. With the full co-operation and support of the two main business line executives and a fair degree of work both within Group Treasury and the Ratings Advisory Group of Schroders Salomon Smith Barney (SSSB), Pilkington was awarded Baa1 from Moody's and BBB from S&P, both with stable outlook. The 'stable outlook' rider proved to be particularly valuable in an environment of extreme economic uncertainty both prior to and following, the events of 11 September.

Deutsche Bank and SSSB were engaged to lead this debut transaction and much effort then went into preparing the presentation of the credit story. Both houses believed that market access for investment grade credits had rarely been so good, in terms of depth and sophistication, and that Pilkington would be better advised to try to issue a benchmark €500m size. It was felt that any attempt to raise the €50m originally identified would not attract as wide an investor base, and that Pilkington would be unable to price the transaction as economically as it would with a benchmark.

ON THE ROAD. Roadshow dates in London, Frankfurt, The Hague, Amsterdam, Helsinki, Copenhagen, Milan and Paris were filled immediately, as investors expressed considerable interest in a non-telecom or high tech issue. Target pricing was agreed and a preliminary offering circular approved. With the ink still drying, we headed for lunch on 11 September safe in the knowledge that the deal was all but done!

On the morning of 12 September it became fairly clear that the deal was far from being in the bag. It was agreed that no immediate action would be taken until some sort of stability had returned into the market, and that a final decision on whether or not to proceed should be left until the latest possible moment. This was Tuesday 18 September – the day before the first roadshow meetings. During discussions between the Chairman, Chief Executive and Finance Director it became clear that, far from dampening our desire to execute a transaction, the World Trade Centre attacks had actually hardened our resolve.

Even before the events of 11 September, we were already sensitive to a possible increased funding cost and credit squeeze. We recognised that companies other than Pilkington that had not restructured when the going was good would face considerable liquidity issues as the widely forecast economic downturn set in. This would inevitably reduce investor demand and ratchet up pricing. We believed that this assessment would now be accelerated and that the market for investment grade issues would be changed fundamentally. We considered it strategically sound to seek to access the market before any such distressed re-financings started to appear, recognising that the slight premium we would have to pay would now appear to be extremely attractive in six to nine months time. Our advisers, who

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felt that the Pilkington credit story was second to none and that investors who could buy new paper would react positively, encouraged us. So, the decision was taken to proceed with the marketing of the bond.

INSPIRING CONFIDENCE. The roadshow opened in London on a wet and miserable morning. The horrible weather, as it transpired, was to follow us around Europe – accompanied by more news of doom and gloom than we could ever have been imagined possible. The roadshow was extremely successful and very well attended, although Andrew Robb, Pilkington's Finance Director and myself felt at one point like the main exhibits in a freak show! In one country in particular it seemed that the entire audience had only attended to see for themselves these mad Englishmen who were trying to launch a bond in a company with exposure to both the building materials sector and the automotive sectors so soon after the uncertainty created post-11 September.

Nevertheless, in every case by the end of the meeting even the most pessimistic of observers could understand why we were so confident about the prospects for the company. The weather also proved useful in one sense in that it helped us illustrate the benefits of Pilkington Activ™, the world's first self-cleaning glass, another factor that helped convince hard-nosed credit analysts why the company looked forward to further progress. By the time the roadshow had concluded in Paris we already were receiving feedback that investors would definitely buy and that our price talk, while being quite aggressive in the current market, was not unachievable.

The last phase of the exercise was to finalise deal size, maturity and pricing. We needed also to address insidious covenants of the kind Keith Phair referred to in last month's *Treasurer*. Pilkington has been extremely successful in the past couple of years in respect of financing through, as much as anything, a rigorously pursued policy of relationship management and openness. To this extent, whilst we were prepared to be sensitive to the genuine concerns of potential investors, we were not prepared to be bullied into a disadvantaged position.

What was clear, however, was that a couple of recent transactions had 'polluted the well' somewhat for other issuers, and that investors were mainly concerned with event – driven downgrades, ie management actions which could not be pre-assessed by the credit analysis process. To this extent, we agreed to a covenant which would increase our funding cost by 100bp if Pilkington were downgraded to sub-investment grade following a Reorganisation Event (broadly, a change of control or a major disposal). This coupon step up would reverse when investment grade status returned. We were comfortable that this would have no effect on commercial decisions for the Group, nor would the company be penalised if the global economic situation ever changed the credit rating. It was agreed that such a position was fair to both parties and recognised investor concerns, and was the only covenant included in the deal apart from the normal cross default and negative pledge standards of the Eurobond market.

In terms of size and maturity again investor sentiment was taken into account. Investors demonstrated a strong desire to buy a smaller and shorter deal. We agreed that, since our original requirement was for €350m, this should be the amount raised. The pricing advantage of a benchmark size no longer applied in the post-11 September environment. However, the maturity was key to us since this was one of the principal reasons for issuing. If our lead managers could not successfully sell a seven-year deal at our target pricing then there would be no point in proceeding. This was the moment of truth, where both houses were required to stand behind the credibility they had used to win the mandate. Clearly, both would have preferred some flexibility on pricing, since the absence of any other similar transaction in the market held them a hostage to fortune. I was also very pleased at this time that we had decided to split the mandate between two banks, as I suspect that neither one was prepared to admit anything other than complete confidence in their respective distribution capabilities! Consequently, we finalised pricing at 180 bp over mid swaps for a seven year €350m Eurobond.

We agreed the terms, including the pricing to be offered, late on 1 October. The day after we went firm on the pricing another deal was announced for a much larger size, from a better credit rated company, for a shorter maturity and, worst still, at a pricing only 10bp cheaper than ours. However, the orderbook for our bonds was complete at this point, and it only remained to confirm the orders, launch and price the bonds. This was done later on the morning of 2 October. The coupon was fixed at 6.5%, which equated to 180bp over mid swaps, or 212bp over the Bund rate.

Referring again to Keith's article last month in which the post launch secondary trading was analysed. Our bond traded about 1bp above the issue price for the first couple of days and has now moved further out in line with the market to be trading, as I write, at 225bp over the Bund rate. It goes without saying that we were extremely pleased with the result achieved by Deutsche Bank and SSSB, and, while the pricing was clearly more than would have been paid 10 weeks ago, we believe it still represents potentially very good value for liquidity in such uncertain times. Most importantly, we have been able to relieve some of the funding burden from our relationship banks and are still able to turn to them as a source of finance in the future.

KEEPING A CLEAR HEAD. What lessons did we learn during this roller-coaster ride on the Eurobond market? The most important was to be completely clear at all times on what the objectives had been when the decision was first to access the market, and not to be swayed. For us, the objective was always to improve liquidity and to widen our debt base. What we were not prepared to do was to achieve this at any price. There is always a temptation when events are transpiring against you to chase the market and conclude a deal because you have invested so much time and effort in it. At all times, Pilkington executive directors were kept informed of progress and would have supported withdrawal from the market, even at the price of a small amount of negative publicity.

In conclusion, at the time of writing we are still the only UK BBB investment grade issuer to have accessed the Eurobond market, and we have achieved an issue which has met all our objectives. While the market is undoubtedly volatile and considerably different compared to that of three months ago, we believe it still offers considerable opportunity to a company with a good credit story and a management team that can effectively communicate this to investors.

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