Prudence visits US PPs

Following a boom year in the US debt private placement (PP) market in 2003, activity has slowed but remains buoyant. European-originated transactions – the key driver for 2003 – have slowed noticeably in 2005. Total US PP volumes to end-August were $21.3bn, a 2% increase on the same period in 2004, but the non-US share of volumes fell heavily (*see Chart 1*). Likewise in the public eurobond market, volumes have fallen by nearly a fifth to €111.7bn in the first three quarters of 2005.

Investor interest in PPs remains strong in the US. In Europe, investors have yet to catch on. The arranger landscape, where European banks have ramped up their US PP marketing as a good way of leveraging off large lending portfolios, is more balanced.

INVESTORS AIM FOR BETTER CREDITS US investors have raised the credit profile of their PP portfolios in 2005. While the 2003 boom was underpinned by a keen search for yield, the second quarter of this year saw more prudent behaviour. The move coincides with a turning of the credit cycle in the same quarter, with downgrades outnumbering upgrades for the first time in seven quarters.

In January 2004, the National Association of Insurance Commissioners (NAIC) introduced its filing exempt process under which the public or private rating of a nationally recognised statistical rating organisation is fully recognised by the NAIC, whose Securities Valuation Office credit unit will no longer perform its own analysis. The procedure assigns a rating ahead of investor placement, removing NAIC rating risk. As the credit cycle turns, Fitch believes that investors will increase their focus on credit transparency.

COVENANTS, HEDGE FUNDS AND PRIVATE EQUITY Unlike the public bond market, a standard feature of US PPs is the inclusion of financial covenants in documentation. While covenants do not give creditors preferred status, they bring them to the table in case of financial difficulties for the issuer. In some cases, a Most Favoured Nations (MFN) clause extends to investors any subsequent grant of financial covenants to a creditor.

However, as hedge funds have become active buyers of troubled PPs, so an issuer may find that a limited number of buy-and-hold investors has changed into a more short-termist and unwieldy group. Troubled French chemicals group Rhodia is one example of traditional PP investors finding themselves mired in a complex workout alongside hedge funds less willing to negotiate covenant waivers and eager to trigger make-whole payments.

Further, the increasing capacity and activity of private equity funds on the mergers and acquisitions scene has caused concern among fixed-income investors. In the public bond market the new private equity owners of investment grade-rated Danish service company ISS took a hard line with incumbent bondholders, declining to repay notes on grounds of a lack of such covenants in the documentation.

European borrowers may need US-style Chapter 11 legal protection from opportunistic investors if covenants in bond documentation are to be negotiated in good faith.

INCREASED DIVERSITY OF EUROPEAN ISSUERS In the first nine months of 2005, 22 European corporates issued US PPs totalling $6.6bn. The single largest transaction, and possibly the largest US PP ever, was UK building materials wholesaler Wolseley's $1.2bn deal (*see opposite*). The building materials sector has remained popular with investors, accounting for nearly a third of all European issuance with four big deals (Grafton, Kingspan, Cemex Espana and Wolseley).

The geographic diversification of European issuance was high, with the UK accounting for only just over a quarter of volume and a total of 10 other countries represented. In fact, lower UK volume was a major reason for the overall decline in European issuance. France remains absent from this market, with issuers unwilling to risk Rhodia-style developments.

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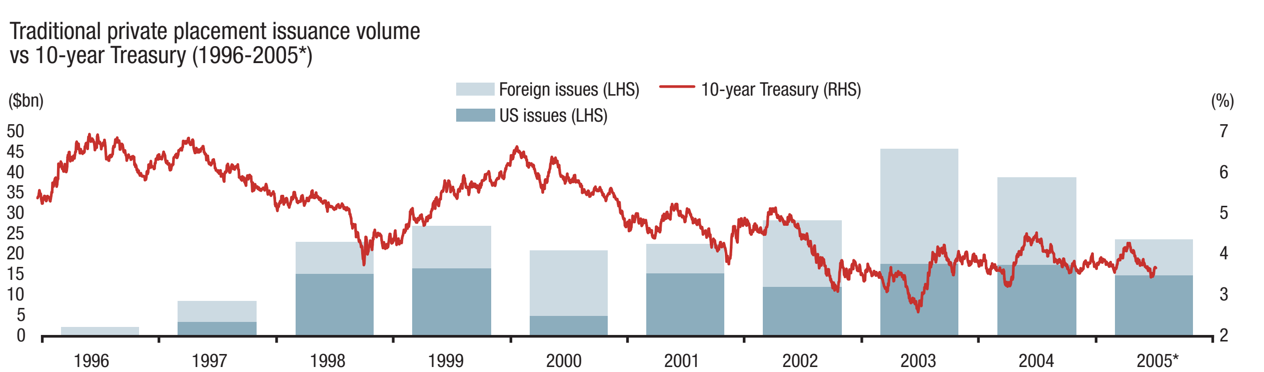
Chart 1. Market Volume



* 2005 data as of 1 Aug 2005
Source: HSBC, Private Placement Monitor

Bonds, Loans and Equities

Wolseley plc, the world's largest distributor of heating and plumbing products to professional contractor markets and a leading supplier of building materials, raised $1.2bn through a private placement of fixed and floating senior unsecured notes. The transaction will refinance existing facilities due to mature within the next two years.

Following strong investor demand, the transaction was more than double the company's initial target, having expanded from $500m to $1,200m, making it the largest traditional private placement financing in recent history.

There are eight tranches, six at fixed rates, ranging from three to 15 years and two floating rates notes, for three and seven years. All the tranches have bullet repayments.

Steve Webster, Group Finance Director, said: "We are delighted that our placement has been so well received by this new investor base. Our strategy to grow the business in fragmented markets, both organically and through acquisition, has delivered strong returns over several years. The placement allows us to diversify our debt funding away from bank finance. We view this market as an attractive source of long-term debt capital. Investors in this market take a long-term view of the growth prospects of the company and we are delighted with their positive response to our initial offering."

In less than a year, Wolseley's market capitalisation has risen nearly 30% and analysts have raised their consensus forecasts for 2006 by more than 10%. Earlier this year, Dresdner Kleinwort Wasserstein said Wolseley had "the second-best track record of adding value by acquisition in the sector".

Wolseley's private placement was jointly arranged by Banc of America Securities and RBS Greenwich Capital.

ITV, the UK commercial broadcaster, has issued a £325m eurosterling issue with a 2015 maturity. Bookrunners were Barclays Capital, The Royal Bank of Scotland and UBS Investment Bank. The bonds were issued under ITV's £1bn Euro Medium Term Note programme, which is rated BBB, BBB and Baa2 by Fitch, Standard & Poor's and Moody's respectively.

The bonds will carry an annual coupon of 5.375%. The issue was priced to give a spread of 113 basis points over the 4.75% 2015 gilt, representing a re-offer yield to investors of 5.39% semi-annual. The bonds were sold to a broad range of investors within the UK, Europe and Asia.

Henry Staunton, Finance Director of ITV, said: "ITV's financial position has continued to strengthen very significantly since the merger, enabling us to reposition our debt profile more efficiently. We have been extremely pleased with the very strong demand from investors for this sterling bond and have increased the issue to £325m.

"This will provide ITV with long-term core financing, extending our debt maturity profile and pre-financing some forthcoming debt maturities at an attractive price reflecting our improved financial position."

Satellite TV company **BSkyB** followed ITV's example in raising £1bn by selling a three-part bond: a £400m 12-year bond, a $750m 10-year bond and a $350m 30-year bond. Lead managers were Barclays Capital, Citigroup and JPMorgan. BSkyB is the UK's biggest pay-TV operator and is 37.2% owned by media conglomerate News Corp.

The company said the funds would be used for "general corporate purposes". A spokesman said: "We plan to continue to set the pace of change in media and distribution, including initiatives such as our broadband content portal, and our mobile and high-definition TV offerings."

Commenting on BSkyB's results for the three months ended 30 September, James Murdoch, Chief Executive, said: "The group's intended use of capital continues to be to invest in the significant growth opportunity for pay-TV in the UK and Ireland, to consider potential acquisitions such as Easynet, and to continue the policy of returning capital that has seen almost £700m returned to shareholders over the last year."

See p13 for report on RBS Roundtable.

INTERNATIONAL EQUITIES

ISSUER	AMOUNT	TYPE	NO OF SHARES	OFFER PRICE	PRICING DATE	EXCHANGE	FEES (%)	BOOKRUNNER
KAZAKHMYS PLC	$1,352m	IPO	122,477,716	$9.60	6 October	London	–	Credit Suisse First Boston, JPMorgan Cazenove
Kazakhmys is the 10th largest copper producer in the world with a low cost base and ambitious growth plans. While Kazakhstan is known to the bond market, it is much less familiar to the equity market.								
LOGICACMG PLC	$739m	FO	375,495,147	$1.97	14 October	London	–	Merrill Lynch, ABN AMRO Rothschild
IT services group LogicaCMG announced a one-for-two rights issue in order to finance the acquisition of a 32.3% stake in French IT service provider Unilog.								
IPO=Initial Public Offering, FO=Follow-on (secondary) Issue								

All data provided by Dealogic. www.dealogic.com