Rebuilding Barratt

In summer 2008 Barratt Developments renegotiated its bank covenants to support the business through the difficult economic climate the business was experiencing at the time. The credit crunch had affected all housebuilders. With the number of mortgage providers and the number of mortgages available both declining sharply, house purchasers were finding it a challenge to finance their new homes.

By summer 2009 Barratt had seen some price stability for the calendar year as well as stability in demand. Group treasurer Bob Williams says the group realised that it was an appropriate time to consider raising equity to pay down debt and to provide a platform for growth by investing in land and work in progress, thereby positioning the group for market recovery.

Executive summary

- No one could deny that housebuilders have endured a terrible time, with the credit crunch and the economic downturn both taking a heavy toll. But Barratt Developments is reacting by refinancing and strengthening its balance sheet. It announced a successful equity placing and rights issue, and amended its banking facilities, including a renegotiation of covenants. The result? A re-engineered balance sheet with substantially reduced gearing and a group ready to take advantage of the long-term market opportunities in new homes.

CORE RELATIONSHIP BANKS So during the summer of 2009, the group started to talk to its core relationship banks to discuss a covenant and facility amendment package to support the business, including making a debt paydown. The aim was to ensure that the business had operational flexibility. In particular given the current economic climate, Barratt wanted to make sure that it could successfully bridge the period of time between investing in land and work currently in progress and converting that investment into sales and cash at some point in the future.

Williams says the first task was to reach an agreement in principle with Barratt's core relationship banks on an amended debt finance package. The core element of the deal was a reduction in the existing committed finance facilities from £2.3bn to £1.6bn supported by an amended covenant package. Once the group had reached an agreement in principle with its core banks, it moved to reach an agreement with its private placement note holders and its general banking group. The target was to be close to formal lender approval, conditional on the equity issue.

This timeline was critical to allow the group to embark on the pre-marketing exercise for the equity raising ahead of the announcement of its full-year results. It was essential for a successful equity raising exercise that the group could tell the market about the refinancing package, in the same way that the refinancing itself depended on the equity fundraising proceeding. In the end Barratt received a 100% support from the relationship banks and note holders across all its facilities and note holder agreements. Williams describes this achievement as "a great success".

WORKING CAPITAL MOVEMENTS The net result of the debt package negotiations was that Barratt effectively paid down 40% of its term financing facilities and notes and at the same time reduced

Box 1: Putting the financing in context

At the announcement on 23 September of the company's results for the year ended 30 June 2009, Mark Clare, group chief executive of Barratt Developments, said: "This has been an intensely difficult year for the group following the sharp decline in the UK housing market. In the first half, as prices fell, we drove sales and reduced stock and debt levels. In the second half we have been able to maintain price levels and increase our reservation rates, with these encouraging trends continuing through the summer into the autumn.

"The board has therefore decided it is now an appropriate time to substantially strengthen the company's balance sheet and reduce its debt levels via a placing and a rights issue. This will also enable the group to develop a number of its existing sites and to take advantage of land purchasing opportunities as they arise."

PETER WILLIAMS HEARD FROM BOB WILLIAMS, GROUP TREASURER OF BARRATT DEVELOPMENTS, ABOUT THE GROUP'S £545M RIGHTS ISSUE.

BARRATT NOW HAS A MARKEDLY STRENGTHENED BALANCE SHEET WITH SUBSTANTIALLY REDUCED GEARING. ON A PROFORMA BASIS THE BALANCE SHEET HAS MOVED FROM GEARING AT JUNE 2009 OF 89% (DEBT TO NET TANGIBLE ASSETS) TO A PROFORMA OF AROUND 34%.

its headroom by £100m on its revolving credit facilities (RCFs). Williams explains the rationale for skewing the reduction more toward the term loan rather than cancelling the RCFs as the desire of the group to rebalance towards the RCF so that it would have sufficient flexible funds to support working capital movement throughout the year. In common with other housebuilders, Barratt has a large peak to trough of working capital. The group, in line with the rest of the sector, invests in work in progress during its half years in order to support legal completions of house purchases towards the end of those periods.

EQUITY RAISING The bank financing discussions were well advanced by early September but were subject to the successful equity raising exercise and it was time for the company to embark on an equity roadshow.

The structure of its share register meant that it lacked a strong enough shareholder base to support an equity raising of the size required through just a rights issue. To deal with this the group realised that it would have to include a firm placing element as well as a rights issue with the right for placees to participate in the rights issue, similar to some other equity raisings in the market this calendar year. Barratt sought to restrict the size and discount of the firm placing element to minimise the dilution impact on existing shareholders. The equity capital raising resulted in gross proceeds of £720.5m. Of this £175m was raised through the firm placing at a discount of broadly 10% to the prevailing market price. The balance of the funds – £545.5m was satisfied by a rights issue of 1.3 shares for every one share held, at a price of £1 per share.

Barratt considers that the pricing and the discounts were broadly in line with or slightly better than the market comparatives at the time. To ensure the success of the equity issue, and the inter-conditional refinancing, both the placing and the rights issue were fully underwritten.

As with any equity issue there were multiple legal and compliance hurdles to negotiate. The equity raising had to be approved at a general meeting of shareholders. The approval was forthcoming. The group received the go-ahead it was after and in the end it had a 92.3% take-up of the rights issue, leaving a 7.7% "rump" to be placed in the market by the joint bookrunners, which was successfully achieved at a significant premium to the rights issue price of £1 per share the morning after the rights issue closed.

SUBSTANTIALLY REDUCED GEARING Barratt now has a markedly strengthened balance sheet with substantially reduced gearing. On a proforma basis the balance sheet has moved from gearing at June 2009 of 89% (debt to net tangible assets) to a proforma of around 34%. Williams describes it as a "a step change".

Looking back on a hectic few months, he is pleased with the progress Barratt has made. The paying down of debt and cancellation of facilities leaves the company well positioned financially for the market recovery and to take advantage of the UK's long-term demand/supply imbalance in the market for new homes.

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BARRATT RIGHTS ISSUE

PRICING DATE	VALUE	ISSUER NAME	BOOKRUNNER PARENT	DISCOUNT TO THEORETICAL EX-RIGHTS PRICE (TERP)	RIGHTS RATIO	TERP
04/11/2009	£545m	Barratt Developments plc	Credit Suisse, UBS	–42.3% calculated by reference to the closing price of 268.5p per existing ordinary share on 22 September 2009, being the last practicable date prior to announcement of the placing and the rights Issue	1.3 for 1	1.73