Atlantic crossing

FUNDING OPPORTUNITIES EXIST IN THE US PRIVATE PLACEMENT MARKET, AS **PETER WILLIAMS** DISCOVERED AT A RECENT ACT BREAKFAST BRIEFING IN LONDON.

Back when bank lending was plentiful and easy, the US private placement (USPP) market slipped out of view for many European treasurers. But now the halcyon years of bank credit have gone, many are revisiting the market, as evidenced by a well-attended ACT breakfast meeting sponsored by insurance company and USPP investor MetLife, and hosted by law firm Allen & Overy.

Van Thorne, managing director of MetLife, outlined the key characteristics of the market, which traces its origins back to the early 1900s. These days that market is worth between $30bn and $40bn a year. The cross-border market developed in the late 1980s/early 1990s, and around 40% to 50% of those currently accessing the market are non-US issuers.

The investors are predominantly US insurance companies. Around 30 are consistently in the market and these top investors can drive demand. One of the stark differences with other types of funding is that these investors don't ask for nor expect any ancillary business – a characteristic that must seem quite a change, and indeed a welcome relief, for treasurers.

Transaction sizes vary enormously; they can go as low as $25m and as high as $1bn, and the deals are mainly fixed rate. The USPP market offers long-term deals, funding diversity and access to the world's largest capital market.

Thorne emphasised the flexibility of private placements. Tailored structures allow for funding in major currencies, multiple funding dates, and bullet maturities or amortising. The last few years have also seen the introduction of standardised documents, which cuts down borrowers' legal fees and late-night negotiations.

However, treasurers do need to be aware of callability issues – the par or make whole provision, which requires the borrower to make good any loss of interest on early repayment.

USPPs have relatively light compliance requirements: no rating is required as the National Association of Insurance Commissioners (NAIC), the organisation of US state insurance regulators, assigns a designation. Nor does the issuer have to be SEC-registered. In terms of track record, five years of historical financials are required.

Treasurers thinking about a USPP should think about the drivers of the investor base. Because they are insurance companies, investors have a steady inflow of cash from premiums that they want to invest. The market has a desire to buy and hold to maturity. The investors have in-house credit resources and they look to model downside risk, which leads to an examination of credit, structure and pricing (see Box 1). As Thorne put it: "We are conservative folk; we are looking for a safe haven for our investors."

Conservative or not, Thorne suggested that, with global underlying yields low and spreads tightening over the past 24 months, this is an unparalleled time for issuers to lock into medium to long-term rates. Last year saw the highest volumes in the USPP market for three years and Thorne said there was a feeling of greater certainty. While demand is high for well-structured transactions with solid credit, the challenge for investors is to achieve higher yields.

ROLE OF THE ADVISER Francis Burkitt, managing director of debt advisory at NM Rothschild & Sons, provides independent advice to corporates on funding issues and has long experience of USPP. He told the meeting about the role of advisers, what they were currently telling clients and how they saw the market developing. He drew a distinction between the roles of adviser and arranger, with the latter

doing the job the bookrunner does in the public bond market. Burkitt said: "As an adviser, we see our role differently. We sit firmly on the borrower's side of the table, sometimes visible, but often acting on a private or undisclosed basis." He described the adviser's job as "helping the treasurer complete the deal just that little bit better than he or she might have done if they hadn't retained us".

Burkitt noted that views on PPs had altered over time. In the early 1990s they were popular with UK companies but fell out of favour in the late 1990s and early 2000s. "A few companies had covenant problems and at that time some of them found their noteholders to be inflexible and unforgiving," he explained, but added that PPs were now back in vogue, with treasurers encouraged to look to USPPs by treasury committees and non-execs.

One interesting recent development was the relationship between the PP community and the banks, he said. "We advised quite a lot of UK companies on covenant resets in their PPs and bank facilities during the credit crunch," he explained, "and although these processes were pretty painful at the time, it seems to me that it has reinforced the mindset that – at least in covenant terms – the PPs reflect, mirror and follow the banks. The PPs want the same terms and conditions as the banks; the PPs want to be treated in the same way as the banks.

"In fact, that was a learning process for the banks as much as anyone else last year, as they quickly learnt that the PPs were not prepared to be pushed around by the banks, or put in a relatively weaker position – for upstream guarantees, security, covenants or other terms."

THE CAPITA EXPERIENCE Gordon Hurst, the group finance director of business process outsourcer Capita, explained why the company decided to cross the Atlantic to tap the USPP market. Up to 2002 Capita, which has a market capitalisation of £4.1bn, had been financed from bank debt, leasing and free cashflow, and, compared to other entities, was underleveraged. In 2002 it diversified its funding with its first USPP. Since then it has tapped the market seven times.

According to Hurst the USPP provides core long-term funding with bank debt via a revolving credit facility (RCF) used primarily as a backup (see Box 2 for his reasons for using the USPP market). Capita kept going back to the market, said Hurst, because it offered easy access for repeat issuers. The process is quick and simple, with often no roadshow required. And, as Thorne had pointed out, standard documentation is a good incentive. Capita has regularly termed out bank debt in the PP market in small amounts, because it was cheaper than bank debt and margins were competitive with other sources of finance. One other element of its flexibility is that companies can issue at any time; there are no closed periods.

Investor relations are important and these should be built up over time. Communication with investors starts at deal launch with, ideally, a roadshow to generate enthusiasm, an investor presentation, an information memorandum and a conference call with a question and answer session. Issuers can then expect to receive a due diligence site visit, which happens after investors have committed but before the funding is in place. The site visit lets investors see the company's facilities and meet the management so they can explain in greater detail the drivers of the business.

It is important to keep contact up on an ongoing basis, and that means ensuring financial information – including annual and interim financial figures and annual and semi-annual covenant certificates – are distributed promptly. Those contacts can clearly be scheduled but investors should be appraised promptly via conference calls of any significant problems or issues as they arise. That way a supportive investor base can be built and repeat issuance take place.

THE FIRST-TIME ISSUER In contrast to Capita's long-term experience in the market, appliance manufacturer Dyson gave the breakfast the perspective of a first-time issuer. Director of tax and treasury Martyn Smith explained the thinking behind last autumn's foray into the market in which Dyson raised £76m.

For the company it represented a logical development; it diversified the lender base, secured longer maturity and particularly suited the company to have borrowings in US dollars. And, as Smith emphasised, as Dyson is a privately held company, it was attracted by a private placement. From an investor perspective the company is an attractive proposition with its low net debt to EBITDA and its strong free cashflow.

Among the key questions that Smith and his team had to answer were whether to employ an agent, how many lenders to go for and over what term to take the money. The journey took Dyson from January – when the broad strategy was agreed with the board – to August when the deal was complete. As Smith told the meeting: so far so good. It's a sentiment that many who have gone to the USPP market would appear to agree with.

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Box 1: How investors evaluate transactions

Credit
- financial characteristics of the industry and company;
- company track record;
- performance (margins, debt/EBITDA, interest coverage); and
- market share and business segment analysis.

Structure
- covenants offered and level;
- existing levels of subsidiary and/or secured debt; and
- operating versus holding company.

Pricing
- other private placements;
- public bonds of comparable quality in the same industry; and
- market conditions.

Box 2: Why Capita uses the USPP market

- Diversification of funding sources away from bank debt
- Longer-term finance than bank debt
- Smaller deal size than the public bond market
- No requirement for an expensive public rating
- Small investment of time in marketing/roadshow
- Comfortable in giving financial covenants due to stable business model
- No US business presence required
- Low ongoing investor relations required.