EQUITY-LINKED: EMI

Blasting into the market

A BLOCKBUSTER EQUITY-LINKED ISSUANCE from EMI Group in September demonstrated all of the characteristics looked for in an award-winning deal. It was the cornerstone in a financing package that would revitalise the troubled music house; it had good execution given a rather complex overall package that had to be managed throughout the launch; it launched in slightly uncertain market conditions but received an outstanding response; and it gave the company cheap funding and extended maturities through a new source – the equity-linked market. >>

Corporate profile

EMI is the world's largest music publisher in terms of copyrights owned, controlled or administered, with rights to more than one million musical compositions and offices in 30 countries. The group is undergoing restructuring after a couple of tough years of declining music sales and dealing with music piracy. EMI experienced a downgrade below investment-grade in March and has been reworking the financial profile of the company since then. The group is now well on the road to recovery.

Principal terms of the $243.34m convertible bond

Amount $243.34m
Maturity Oct 2010
Coupon 5.25%
Issue price 100
Conversion premium 40%
Pricing date 11 Sep 2003
Bookrunners BNP Paribas, HSBC, JPMorgan

<< With the equity capital markets suffering for the first half of the year, many corporates turned to equity-linked transactions to take advantage of share price volatility for cheap financing. Such was the case for EMI, which put together and launched its $243.34m convertible in September.

The deal was part of a larger financial restructuring, as the group was looking to lengthen maturities and diversify types of funding. Just a week later, following on from the convertible, EMI launched a strong €300m 144a high-yield issue and a syndicated loan facility came later to round out the financing package.

"All in all, it should meet EMI's financing needs well into the future," explains Roger Faxon, CFO of EMI Group. "And gives the group a much more solid debt profile, coming in from various sources and types of structure."

The story of EMI Group is that of a fallen angel – facing a waning market, the group underwent a downgrade to below investment grade in March 2003. The general environment was complicated by music piracy and declining music sales, says Simon Piney, Head of Equity Capital Markets at BNP Paribas. "There had been a lot of news about a potential US fee-dumping campaign, which was not helpful either," he says. "But the equity-linked market was extremely strong, so we decided to go with that one first. It was a record year for converts, with an increasing amount of money now in the hands of investors involved in the equity-linked market. There were a number of substantial deals in the market this year."

But the roots of the refinancing package begin in the spring of 2002, when EMI issued a sterling bond and entered into revolving credit agreement. The intention was to roll the revolver into longer-term debt when possible, says Duncan Bratchell, Senior Vice-President Tax & Treasury at EMI: "We didn't feel we could do it all in one go, with just one instrument, so we planned on a package of deals."

Refinancing options

After the downgrade, the group re-evaluated their financing options and market conditions to determine how best to proceed with the refi. "We wanted to refinance the revolver but the question was when? We took the view that it was timely to do it in the summer or early autumn, because the credit markets were healthy." In addition, there was a growing sense that EMI's business was doing better, and the underlying market characteristics were clarifying for music businesses. With that in mind, it was decided that early autumn would be the ideal time.

The next question was what type of instruments to use. "We thought it was appropriate given health of the convertible market to do an equity-linked deal," he says. "The EMI share price had exhibited considerable volatility, which is of course an attractive prerequisite for a convertible."

Faxon adds: "In light of downgrade below investment-grade, liquidity was of course an important issue, and we wanted to make sure we were adequately financed for the foreseeable future. We did not plan on doing a pure equity issue but felt it would be appropriate to look at a convertible, as the market was strong."

Plans were in the works as well for the high-yield bond and loan placement. But one of the big challenges was sorting out the logistics of the three deals. Peter Harrison, Managing Director at HSBC, says what really made the deal a success, and what was the hardest part for the company and arrangers, was the complexity of the refinancing and the interactions of the various constituent parts. He says: "First, it is quite a large refinancing of the company. Second, all three issues were undertaken at the same time."

Complex multi-deal structure

Managing that process, bringing all thee deals together in the same time period and ensuring that all three deals were a

BRATCHELL
'We planned on a package of deals'

success was difficult. Says Harrison: "For example, there were potentially additional guarantees in the high-yield bond that had to be reflected in the convertible. It had to be ranked *pari passu* with the high-yield debt, but we could not write documentation to reflect that directly, as the final decision to launch the high-yield was not taken until after the successful completion of the convertible. And it was key that all three deals got done and got done well. Any one or two would not have been enough to fully meet the needs of the company, it had to be all three."

Piney at BNP explains that the whole refinancing package rested on the success of the convertible: "This was key. This would determine investor response to EMI and if it was successful would give a boost to everything that followed. We put this deal first for that very reason. If successful it would give a boost to the group's share price and the general market view on EMI. The high-yield and syndicated facility were very well received partly as a result of the incredible response to this deal."

Adds Harrison: "Market response was incredibly encouraging. For a company on the mend and in a relatively difficult industry, market response was very strong." The deal was 10 times oversubscribed and share price on launch day rose from 138p to close at 147p. In addition, credit default swap spreads for EMI tightened 50bp on the day, showing the equity and credit markets both felt it was a good deal for the company. "It de-risked EMI completely because it solved the groups financing situation for a long time to come."

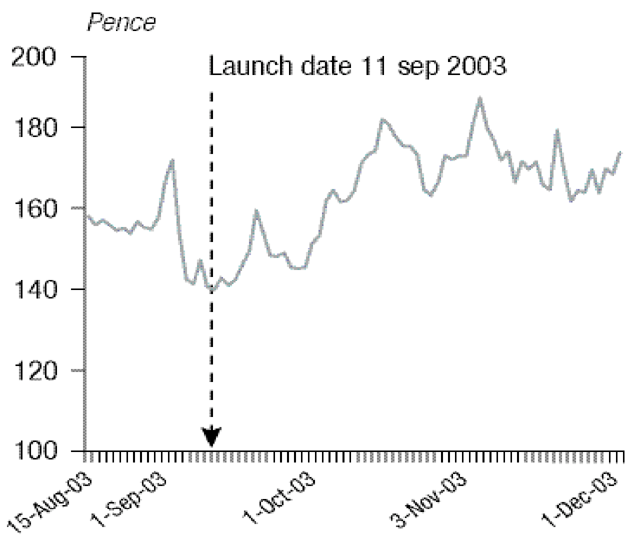
The deal was also aggressively priced, as the coupon came in at the tight end of pricing guidance – at 5.25% from a guidance of 5.25%-5.75% – and the deal had a conversion premium of 40%. Faxon adds: "Being able to put out a bond with a 40% conversion premium on a share price that had already risen since the spring, and at a relatively low cost, with a coupon which is below our dividend yield, showed the confidence that the investor community has in the business. It was an affirmation of what we believe, which is that EMI has a strong future."

Harrison at HSBC adds that there was a potential opportunity with that much demand to tighten the pricing terms, but the company was opposed. "The company did not want to risk any one part of the refinancing, as they were returning shortly with the high yield and were happy to have the convertible viewed as a great success. They wanted to leave a little bit for investors."

"On the day we were very surprised and pleased by the demand and the international base of investors interested," adds Faxon. "From our point of view it was a win-win situation, and it worked very well within our overall refinancing package."

After a few tough years, EMI is revamped and all set to move forward with its new strategy. This is thanks in great part to the refinancing package that has extended maturities, diversified funding sources and strengthened the credit profile of the once-suffering music publishing house.

Historical Prices EMI Group plc.
15 Aug – 3 Dec 03



RUNNER-UP. SCOTTISH POWER

ScottishPower

June 2003
US$700mn perpetual hybrid convertible bond
8 year, 4.0% coupon for first 8 years then unconditionally callable with a step-up to 3-month US$ Libor plus 400bp, 25.2% conversion premium
UBS

International energy group ScottishPower took advantage of good market conditions to launch a benchmark convertible with a unique deal structure. The US$700m deal is the first-ever European corporate issue to use a hybrid perpetual convertible – and one of few corporate perpetual deals – and looks set to lead the way for other corporates to take advantage of the hybrid deal. The structure, which gives the group between 25% and 50% equity credit from rating agencies S&P and Moody's, is usually associated with banks or insurers. But the equity credit offers a strong argument for corporate use, as well. The deal is deeply subordinated in order to get the equity credit.

It launched to strong demand, allowing arrangers to price it at the tight end of guidance, coming in at 4% on talk of between 4.125% to 4.625%. In addition, a conversion premium of 25.2% was achieved. It is non-callable for six years, and after eight years a step-up sets the floating coupon at 3-month US$ Libor plus 400bp. As such, it was effectively viewed as an eight-year maturity by investors.

The group will use the money to fund new projects, in particular wind farm projects in Scotland. With half of group operations in the US, the dollar denomination was attractive. It was a groundbreaking transaction that worked well for ScottishPower, offering cheap financing and a structure that worked well with their needs. It also opened the door for other corporates to follow.