LOANS: SIX CONTINENTS

On the edge

THE THREE JUMBO FACILITIES – WHICHALLOWED Six Continents to transform into the InterContinental Hotels Group and Mitchells & Butlers pubs – were anything but straightforward. The boards of the two businesses decided to split in August of last year to form two separate companies – InterContinental Hotels and Mitchells & Butlers. The board wanted to see the entire demerger completed by April 2003. It was decided that the deal would go public in October, and there would be a board meeting in March to confirm shareholder approval of the action, after which the demerger would go ahead.

Anthony Stern, until recently Head of Treasury at InterContinental Hotels (and then Director of Treasury at Six Continents), explains: "It was my job to raise the finance for the two new companies, which had to be in place >>

Corporate profile

InterContinental Hotels Group and the Mitchells & Butlers pub business demerged in April 2003 from the former Six Continents leisure group. The company looked to split to allow the two business streams to best manage their disparate businesses. Facing a hostile takeover bid in early 2003, while the demerger plans were in the works, the shareholders voted overwhelmingly not to accept the offer from restaurant entrepreneur Hugh Osmond.

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Principal terms of the £6bn, three-tranche, loan facilities

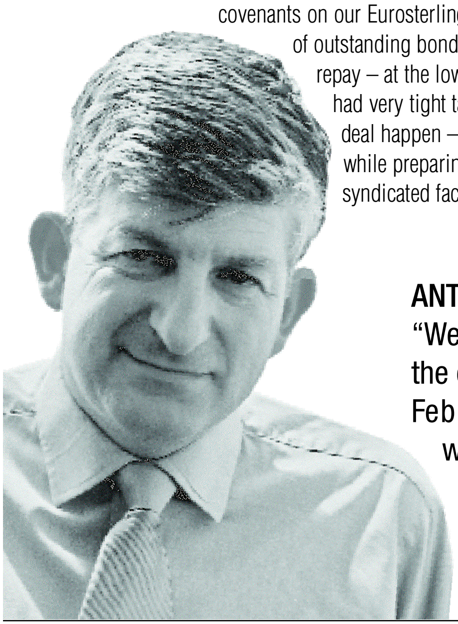
Amount £3bn. £1.5bn multi-tranche. $2.35bn multi-tranche
Date Feb 2003. Apr 2003. Jun 2003
Company Six Continents. Mitchells & Butlers. InterContinental Hotels Group

Margin 125bp over Libor. 70bp-160bp over Libor
Maturity 2004-2008. 2004-2008
Bookrunners Barclays, Citigroup, HSBC, JP Morgan, The Royal Bank of Scotland

<< before the shareholder meeting in March." Having available financing was critical, as the group could not proceed to the board meeting stage without it being in place, so there was a very fixed deadline for when it had to be set up.

"It was part of the deal to return a significant amount of cash to shareholders, so we spent some time in September discussing with the rating agencies what that amount could be and still allow us to retain our current rating coming out of the demerger." Both Moody's and Standard & Poor's agreed a tentative rating near the end of the month.

"By the end of September I was feeling quite confident. It was all proceeding quite smoothly. But then two days before we were set to announce the demerger we discovered that the two companies could not separate without breaking covenants on our Eurosterling issue. We had £530m of outstanding bonds that we might have to repay – at the lowest price possible as we had very tight targets for making this deal happen – and we had to do this while preparing to launch our syndicated facilities." Ultimately the group repaid the bonds, and at a reasonable price, thanks to some good advice from Citigroup.



ANTHONY STERN
"We had to get all the debt tied up by February 13, the war was imminent, and some banks were nervous."

But that was just the beginning of the hurdles that were thrown in the way of Stern and his team at Six Continents.

It was decided that in order to enact the demerger two facilities would be needed: $2.65bn for the hotel group and £1.5bn for the retail group, which would both need to take effect in April. The group also had an existing facility that would mature in early February. Which left a £3bn gap in funding for the period between February 13 (when the existing five year syndicated facility matured) and the beginning of April when the new facilities would take effect (or longer if the separation did not take place for some unforeseen reason). A bridge facility would also be needed.

"Just before Christmas we invited our key relationship banks to quote for the three facilities. But as Christmas approached, the market started getting nervous. We could tell a war in Iraq was in the offing, but had no idea when or how that would play out," says Stern.

Come January, the first bad news hit: two of the group's relationship banks were re-examining their credit relationships and had decided to pull out of the UK corporate lending market altogether for the time being. In addition, the risk of war was increasing and sales figures were down – and the rating agencies were expressing some concerns. It was of course crucial not to lose the credit rating.

"We had to demonstrate that although income was falling, we had cut costs significantly, which counteracted the effects of the slow sales from a lenders' perspective," says Stern. "We had to get all the debt tied up by February 13, the war was imminent, and some banks were nervous."

Finding common ground

Six Continents took the best bids from their remaining banks and tried to find some common ground. "By mid-January we were negotiating hard – and then SARS hit," he says. "Occupancy in our far-east hotels dived out of sight, and the uncertainty grew."

"By the end of January, I was not sure whether we were going to make it," he says. The lead banks were concerned that they would have to syndicate the deal while there was a war on. Stern adds: "The banks came back to us and said we would have to change the terms and pricing if they were to syndicate it." At that point a report came out confirming the group's credit rating, and the company and banks met in the middle on terms and pricing.

Barclays Bank, Citigroup, HSBC, JPMorgan and The Royal Bank of Scotland led the syndicate on the three transactions. Six Continents was advised by KPMG. Stern says that the banks gave the company strong support at a time when their credit committees were nervous. He welcomes the practical and commercial approach of the syndicated loan teams and the relationship managers.

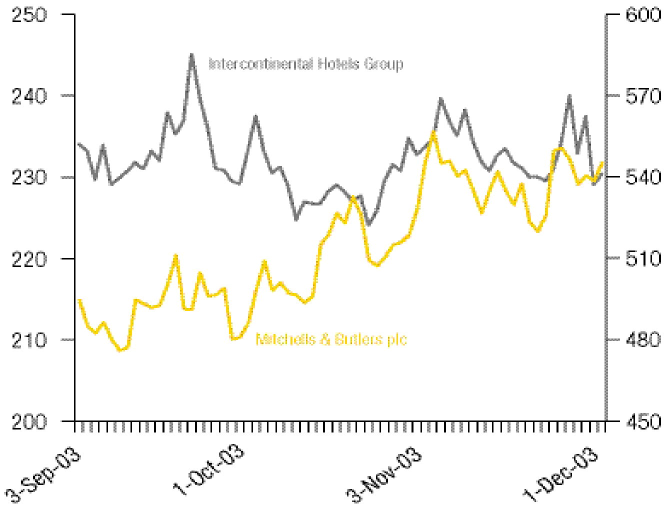
The £3bn bridge facility for Six Continents was signed on February 3, and the facilities for InterContinental Hotels and Mitchells & Butlers were signed ten days later. "Trying to syndicate during a war is not a good idea," notes Stern. "We went to syndication at the worst possible time, and then came a hostile takeover bid." Hugh Osmond, through his company Capital Management & Investment, had launched a hostile bid for the company.

By this point, banks were happy to lend to the pub business but were less keen to lend to the hotels business. Thanks to the impact of cost-cutting, the syndication of the hotel facility was cut to $2.35bn. Both the facilities went ahead, and at the shareholder meeting in March, the demerger was overwhelmingly supported by shareholders.

Since then, InterContinental's share price has risen by some 30% and the company launched a successful debut euro-denominated bond issue. "We went from a difficult credit to a attractive investment in nine months, but nothing fundamental, such as the credit rating, had changed. It was certainly an experience for us."

Neill Thomas, a Partner at KPMG who advised the company, says: "It was undoubtedly a challenging transaction but it succeeded through a combination of a borrower who we helped to develop a clear understanding of the terms it could obtain from the market and the strong support of a number of key relationship banks."

Intercontinental Hotels Group & mitchells & Butlers plc.
Share price



Stern says the most difficult thing is it was all so unpredictable: "We kept reviewing the situation and changing the plan of action" he says.

Thomas at KPMG says: "Companies which have undertaken a demerger and a return of capital have rarely faced such uncertainty in their core businesses. World conflict and SARS combined to provide a particularly challenging backdrop to the transaction, complicated further by an unsolicited offer for the company."

"Many people think of the syndicated loan as the simple, straightforward transaction," says Stern. "But there are times when arranging a syndicated facility can be much more difficult than any other type of transaction. It worked for us, but it was never an easy process."

RUNNER-UP. E.ON

December 2002
€10bn revolving credit facility
Mature 364 day with one-year termout option, 20bp over Euribor
€5bn revolving credit facility
Mature 2007, 25bp over Euribor
Barclays, Citigroup, Deutsche Bank, Dresdner Kleinwort Wasserstein, HSBC, JPMorgan

For a debut bank facility, German utility E.ON's €15bn benchmark was anything but modest. The deal splashed onto the market in December to a very positive response.

The deal involved two tranches – a €10bn 364-day and a €5bn five-year revolver. It was the largest deal to enter the European market in 2002.

The deal was well-managed, with a tailor-made syndicate strategy inviting existing relationship banks to participate in selected brackets. The goal was to rationalise outstanding facilities after a period of acquisition, to bring the various entities together under one umbrella financing platform.

The deal also gave E.ON the financing necessary to complete further acquisitions in line with its group strategy. The group actually managed to complete an acquisition while the deal was being syndicated – an almost impossible feat in most instances.

It gave the combined group the chance to negotiate attractive terms, with tight margins and no financial covenants – a difficult achievement in the existing, difficult market.

The deal was oversubscribed, and had broad international participation, with 41 banks globally involved. The deal was a key part of a larger financing program for the year, including a €7.5bn bond launched earlier in 2002.

It was a well-executed benchmark deal that met the needs of the company and offered innovation in terms of structure.