Liability Management continues to spark interest

Liability Management (LM) – bond buybacks, exchange offers and amendments to bond terms and conditions – was a key theme in the debt markets in 2004 as we saw a surge of transactions for corporates across Europe. Following a period of relatively muted activity in early 2005 the sceptics were questioning whether LM might have been a passing trend. However, a recent resurgence of activity in the LM arena has confirmed that this treasury management tool is here to stay.

WHY CORPORATES ARE MANAGING THEIR BALANCE SHEETS VIA THE BOND MARKET There are three main reasons for LM activity:

(1) Structural reasons, such as 'tidying up' of a debt profile often following an acquisition. Post an acquisition, companies may find they have outstanding debt that trades under different names and which adopts a different credit profile even if there is no actual subordination or difference in ultimate obligor. In this respect, LM can enable corporates to simplify their debt structures and homogenise their publicly traded bonds. Following the acquisition of Powergen, E.ON repurchased the outstanding, lower-rated, legacy bonds, which had the dual effect of enabling them to centralise funding within one main issuing entity and to remove an element of structural subordination. Another aspect of 'tidying up' bond issuance might relate to the removal of covenants or the amendment of terms, to which investors might be persuaded to give their consent in return for a suitable incentive.

(2) Reducing debt. Companies looking to deleverage can now actively target publicly traded bonds, whether via a public tender offer or simply buying back small amounts in the open market in a more discrete process. Deleveraging was the key rationale behind Michelin's recent cash tender for its 2009 euro issue. Additionally, in the current environment of general corporate deleveraging where many corporate treasuries have been accumulating cash, buying back debt can be seen as an investment alternative. With limited attractive investment alternatives as a result of low interest rates and increasing restrictions on tax-efficient schemes, some corporates regard buying back debt as 'investing' in their own credit (low risk by definition) and can thereby achieve a return above money market rates.

(3) Extending average debt maturity profile/smooth maturity profile. This has been one of the main drivers behind the LM activity. Companies seeking to take advantage of favourable market conditions in absence of a funding need are able to buy back an outstanding bond coming due shortly and replace it with a longer-dated bond (an 'exchange offer') – thus enabling companies to lock in low underlying interest rates and tight credit spreads. A similar strategy can be taken to smooth a corporate's maturity profile – reducing debt in years where there is a large amount falling due. A number of companies have repurchased bonds in the 'lumpy maturity' and refinanced via a longer-dated bond – thus reducing the refinancing risk and also terming out their existing maturity profile.

HOW CORPORATES GO ABOUT BUYING BACK BONDS
Despite the increased level of LM exercises there is no standard approach. It ultimately depends on the objectives of the company and the exact nature of the bonds in question (i.e. which investors hold the bonds, where they are trading). These objectives need to be clearly articulated to the market. Is the company looking to buy back an entire issue? Seek the best price? Change terms and conditions inherent in the documentation? Each exercise is therefore different in its own right and needs to be treated on a case by case basis.

The result of each transaction having its own unique features has led to the emergence of a wide range of liability management techniques. Whilst the basic strategies may be similar, i.e. Tender offer for cash, Exchange into new bonds or On Market Repurchases (OMRs), they can be augmented to include a number of additional features which can increase the success rate of a transaction including: early tender premium, consent solicitation (using the voting rights in the bond documentation to 'sweep up' remaining bonds once a high threshold is reached), etc.

IS IT WORTH THE EFFORT? Ultimately corporates need to weigh up the pros and cons of undertaking an LM exercise, in particular the financial impact. While the net present value of a transaction is positive, the hit to the profit and loss account in year one may be a deterring factor (although tax implications and the unwinding of associated derivatives can often help to offset this). Nevertheless, this tool can prove extremely useful for a corporate looking to actively manage its liabilities. In extreme cases some corporates are buying back and reissuing in the market on a regular basis as and when they see value. LM is a theme that both corporates and investors are becoming increasingly comfortable with and we should expect to see this trend continue in the debt capital markets.

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Bonds, Loans and Equities

Inmarsat Satellite operator Inmarsat is to float on the London Stock Exchange's main market, valuing the company at over £1bn.

This is the first time the UK market has seen a satellite company in an Initial Public Offering (IPO) here so quite an extensive investor education process had to be undertaken to prove to investors the strength of the business model.

"It took investors a while to understand the company, but once they had got through the education process, investors were keen. They liked the cash generative nature and high yields. There was very strong demand seen by the fact that the book was 10 times covered," one banker close to the deal told *The Treasurer*.

The company will use the funds it raises in the IPO to refinance existing debt and further its growth strategy. On 17 June shares were priced at 245p, the top of the 215p-245p range.

Simon Ailes, Director of Corporate Finance at Inmarsat, said: "It was well received, pricing was oversubscribed by 10 times and priced at the top of the indicative price range."

Investors were predominantly UK based, with three quarters of the deal taken up by British investors, 12% were US based while the remainder was evenly split among other European investors.

The success of Inmarsat's IPO will encourage other satellite companies to float. Several companies are currently eyeing the European market, but it's not yet clear whether they will choose to list in the UK, said the banker.

Inmarsat's customers include the US and UK defence departments, shipping company Maersk, Shell, CNN and BBC. JPMorgan Cazenove and Morgan Stanley are joint sponsors for the flotation which is expected to raise around $690m (£380m) in a primary offer.

BAE BAE Systems signed its $3bn term loan in April that will partly fund its acquisition of US competitor United Defense Industries. The one-year loan, underwritten by Dresdner Kleinwort Wasserstein and Goldman Sachs International, for Europe's largest defence contractor was "cleverly" thought out, as the company "had joined-up thinking making the acquisition happen through the loan, but also making sure they had the synergy with market take-out," said a banker close to the deal.

"It's flexible and you only really pay for it if you use it. That's the advantage over the capital markets. Making sure they dovetailed it; that's what was impressive. It could have had a credit changing impact but the treasury team managed it well," said the banker.

BAE's proposed acquisition will also be financed with the proceeds of a placing of new ordinary shares.

GlaxoSmithKline GlaxoSmithKline, the pharmaceutical giant, was in the market in June with a bond issue of €1.5bn. The dual-tranche offer represents the company's first visit to the euro market since its five and six-year euro issues in 2003.

Sarah Jane Chilver-Stainer, Group Treasurer of GSK, told *The Treasurer*: "The bond issue was very well received in a jittery market. There had been no corporate issuance at the long end in euros since the turbulence following the downgrade of Ford and GM and we weren't particularly confident of a large book size. However, by the time the book closed, the lead managers had received orders totalling over €3bn."

GSK took advantage of the low rate environment and was rewarded by strong investor take up.

Speaking on the company's choice of timing for the bond issue, Chilver-Stainer said: "We have been watching falling yields in euros for some time. At launch, euro swap rates were approximately 50bp below market rates from the previous month. We were keen to access low absolute rates in euros, as well as euro investors and the long end. This is our first long euro issue."

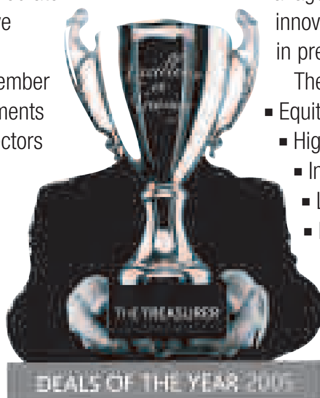
The order book was twice oversubscribed, as lead managers Citigroup, CSFB and HSBC built a book in excess of €3bn. Investor take up of the €750m 20-year tranche attracted primarily pension funds and insurers, demand for the €750m seven-year tranche came from a broad investor base of asset managers, funds, central banks and insurers.

Send news of deals to Michelle Perry, mperry@treasurers.co.uk.

Deals of the Year 2005 – excellence in treasury

Welcome to *The Treasurer's* 8th annual Deals of the Year Awards. The Deals, with their unique corporate treasury perspective celebrate the success of the most innovative debt and equity deals completed between October 2004 and September 2005 and recognise the achievements of the treasurers and finance directors involved.

Following the success of last year's awards – where we received a record number of nominations and votes – nominations are now invited for the 2005 shortlist. Any reader may nominate a deal completed since 1st October 2004 which they feel meets one of the following criteria: sound treasury management, efficient pricing, optimal or innovative structure or relative success in prevailing market conditions.



The categories are:

- Equity & Equity-linked
- High-yield Bond
- Investment-grade Bond
- Loans
- Mid-market Financing
- Securitisation & Structured Finance.

Deals will be judged by a panel of treasurers and advisers, including: Matthew Hurn, Group Treasurer, Dixons plc; Francis Burkitt, JPMorgan Cazenove; Simon Collins, KPMG Corporate Finance; Karl Fenlon, Head of Tax and Treasury, Hanson PLC; Ian Fitzgerald, Director, Lloyds TSB; Martin O'Donovan, ACT; Andrew Vaughan, Group Treasurer, Mitchells & Butler; Paul Watters, Standard & Poor's Credit Market Services; Robert Williams, Group Treasurer, Allied Domecq.

Nominations should be submitted to Mike Henigan at mhenigan@treasurers.co.uk. Please indicate in no more than 75 words why you think the nominated deal should be considered.

For further details and up-to-date information visit www.treasurers.org/thetreasurer/doty.cfm