REFINANCING ARQIVA

THE UK'S LARGEST-EVER WHOLE BUSINESS SECURITISATION TRANSACTION OUTSIDE OF THE REGULATED UTILITY SECTOR TOOK PLACE THIS YEAR. ROGER BURGE EXPLAINS HOW IT HAPPENED

Earlier this year, Arqiva completed the largest-ever whole business securitisation (WBS) transaction in the UK outside of the regulated utility sector. It involved 19 lenders, the biggest-ever sterling B- rated bond issue and the greatest index-linked swap restructuring and refinancing. The transaction delivered seven times leverage at a blended capital markets debt cost of 5.6%. Shareholders supported the transaction with a contribution of £867m, £400m of which was new money.

Arqiva is the UK's leading communications infrastructure and media services company. It provides the infrastructure that the public service broadcasters and mobile network operators need to meet their national coverage obligations. The group owns 1,154 television broadcast towers and 8,700 active wireless sites, together with two out of the three commercial digital terrestrial television spectrum multiplexes. It also up-links 250 channels to the Sky satellite via five teleports. Arqiva is a private company with shareholders that include infrastructure investors Canada Pension Plan and Macquarie.

Arqiva was created in 2007 through the merger of NTL Broadcast and National Grid Wireless, and financed with leveraged loan facilities. These facilities were due to expire from July 2014 onwards. EBITDA was £400m for the year to June 2012, with total leverage of 8.5 times equity. Due to its high leverage and the fact that its debt was at floating interest rates, Arqiva entered into £2.6bn in 20-year interest rate and inflation swaps in the year of the merger. The inflation swaps were put in place to hedge Arqiva's high proportion of index-linked turnover. The low initial coupon on these swaps, and the principal amount, both accrete in line with the retail prices index, with the principal accretion repayable in a bullet payment at the end of the 20-year term. The counterparties had a break clause in the swap contracts at the expiry of the facilities in 2014. While the swaps continued to effectively hedge the floating rate exposures, the fall in nominal and real rates since 2007 meant that they were significantly out of the money, further adding to the leverage from the loan facilities.

The Arqiva treasury team (pictured from left to right): Chris Parr, Tony Winterbourn, Sam O'Keefe, Cristina Arango, Alison Wooller, Eileen Tindall and Roger Burge

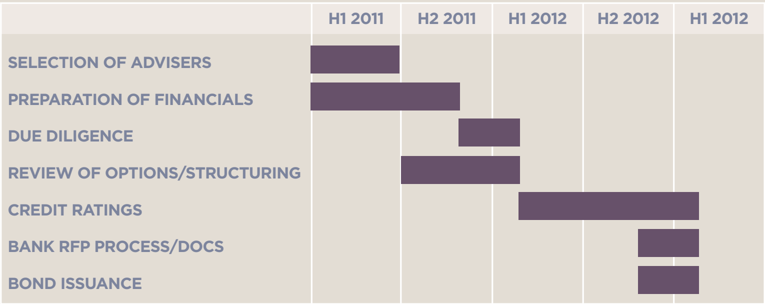
Choosing advisers and a refinancing structure

The refinancing process began in November 2010 and closed 28 months later in February 2013. The table (left) shows the various phases of the transaction.

The scale of the refinancing meant that we needed to hire advisers to help us with financial modelling, structuring advice and managing the bank request for proposal (RFP) process. We hired an independent financial adviser instead of an investment bank so that we had a free hand in allocating bond mandates at a later stage. This was going to be important given the amount of balance sheet capacity that we would need, particularly to roll over our long-dated swap contracts. Following a competitive process, we selected Rothschild.

To access the bond markets, we would need credit ratings. But Arqiva is a private company with no obvious rated comparables. Combined with our target leverage, this was going to be a challenging assignment. So we hired HSBC,

REFINANCING TIMETABLE



one of our existing lenders, as a ratings adviser to support us through the process of getting rated. Finally, we hired Allen & Overy as Arqiva's counsel, and Clifford Chance to represent the banks in due course. This period also saw the arrival of a new CEO – John Cresswell from ITV – and a new CFO – Phil Moses from BT.

> We need a strong balance sheet to deliver the mission-critical services that we provide to our customers

By June 2011, we were ready to roll and we set about reviewing our options. We would need to access the bond markets to successfully refinance, but our existing facilities didn't allow this. As a result, we decided to repay them in full, along with the costs of the transaction – requiring £3.8bn of new money in total. We identified two options for structuring the refinancing:

- Start with a leveraged loan and high-yield bond structure and then look to migrate towards an investment-grade rating over a number of years; or
- Use a WBS structure to provide an investment-grade issuance platform on day one, with a high-yield holdco bond ranking behind the WBS to increase the total debt that we could raise.

We chose the latter option, in order to give us a stronger balance sheet to support our ongoing investments. We need a strong balance sheet to deliver the mission-critical services that we provide to our customers, and to ensure that we have reliable ongoing access to the capital markets. The WBS option added significant complexity and time to the ratings process and increased the legal work due to the amount of structuring involved. But we wanted to preserve our ability to develop and manage our business.

Preparation of historic and projected financials

As Arqiva is a private company, it had published limited financial information – just its statutory accounts. In order to have access to the full range of markets, we took an early decision to prepare all of our disclosures to a standard that complied with Rule 144A of the US Securities Act. This was a time-consuming exercise that involved constructing the detailed year-on-year comparatives and commentary needed to fulfil the 'management disclosure and analysis' section of a 144A bond prospectus. We also needed long-term projections (25 years) that would be able to withstand the scrutiny of an external due diligence process, three rating agencies and our existing and potential new lenders. We concluded that we needed to build a new long-term planning model to enable third parties to understand the key drivers of the financial projections. This was a challenge since we needed to engage with a large number of colleagues in the business to agree a specification that they could work with, and that would be fit for our purposes.

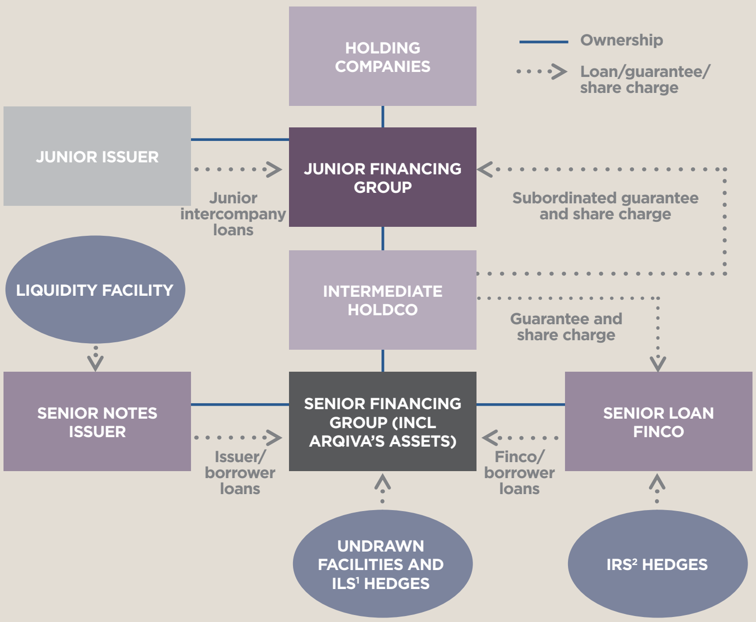
Commercial and financial due diligence

Armed with our new financial model and financial projections, we hired Deloitte to write a full due diligence report on our projections for the lenders. The level of attention to detail and scrutiny that the Deloitte team brought to the engagement was something that Arqiva's finance and business teams had not previously encountered, and it required a significant amount of project management to keep the assignment on track, and to provide the level of detailed analysis and justification that the process required. While painful at the time, the due diligence exercise left us in a much stronger position to tackle the rating agency and bank review processes that would follow. With hindsight, it was probably the most critical part of our preparation.

Credit ratings

In parallel, we had been working with HSBC to pull together the Arqiva credit story – the 'ratings book' of approximately 100 slides, which set out the key information that the agencies would need to perform their analysis. In February 2012, we organised all-day management presentations for each of Standard & Poor's, Moody's and Fitch. These involved our CEO, CFO and the MDs and FDs of each of our divisions. The ratings process, beginning with a confidential ratings assessment, then moving to the final credit rating with the three agencies, would turn out to be long, complicated and difficult. Arqiva's business had no direct comparables in the UK or elsewhere, and we were looking for investment-grade ratings at around six times debt/EBITDA, using a WBS structure that had been primarily used in the past for regulated utility companies, largely in the water sector – not for communications infrastructure businesses. In all, it took us seven months to secure the indicative ratings we needed on the capital structure at BBB flat for the WBS and B-/equivalent for the proposed holdco bonds. We >

WBS STRUCTURE



1 INDEX-LINKED SWAP; 2 INTEREST RATE SWAP

ran more than 200 modelling scenarios for the agencies during the process.

The (simplified) WBS structure chart for the transaction is shown on page 49.

Bank RFP process

Once we had initiated the ratings process, we began to engage with banks to get them up to speed with Arqiva's business and to get feedback on a suitable structure to feed into the ratings process. We didn't want to end up getting a rating on a structure that would be undeliverable in the bank and debt capital markets. We met with 30 banks on an informal basis while the ratings process was ongoing, using a lot of the same material. This meant that when we obtained our indicative ratings in the autumn, we could launch our RFP into a banking market that was familiar with our credit. The banks also knew which structure was coming, and were able to turn round our request in a matter of weeks.

We asked for balance sheet commitments of up to £400m from 12 banks. The request included removing the break clauses for the remaining 14-year term of our £1.3bn inflation swaps in exchange for day one pay-down of principal accretion that had rolled up since 2007 and regular pay-down in future. We were also extending the break clauses on the £1bn of interest rate swaps that were still needed to match the three- and five-year maturities of our new term loan facilities. The total mark-to-market value of the swaps that we rolled over, including the present value of the increased margins payable, was £1.5bn. Despite the size of commitments that we were requesting, the response to the RFP was overwhelming. We eventually signed up 20 banks, and were able to rebid the long-dated swap pricing, reducing the cost significantly. With a larger group of banks, commitments were reduced significantly, and we also had ample capacity to ensure that the loss of a bank or two before closing wouldn't delay our timetable (we did actually lose one the night before closing).

FUNDING SOURCES AND COSTS

SOURCES	£M	GROSS LEVERAGE LAST 12 MONTHS	USES	£M
NEW SENIOR BANK FACILITIES	1,586		EXISTING SENIOR BANK FACILITIES	2,843
NEW INITIAL SENIOR NOTES	750		EXISTING JUNIOR BANK FACILITIES	463
WBS SENIOR DEBT	2,336	5.6X	INFLATION HEDGING ACCRETION	277
NEW JUNIOR NOTES	600	1.45X	HEDGE BREAK COSTS	106
SHAREHOLDER CONTRIBUTION	867		UPFRONT FEES AND EXPENSES	88
BALANCE SHEET CASH	29		CASH	54
TOTAL SOURCES	3,831		TOTAL USES	3,831

UNDRAWN FACILITIES	£M	MATURITY
SENIOR CAPEX FACILITY	400	5 YEARS
SENIOR WORKING CAPITAL FACILITY	100	5 YEARS
SENIOR LIQUIDITY FACILITY	200	364D

Bond issuance

With our banks and bookrunners lined up in December 2012, we were fast approaching completion. We had been working hard on our prospectus disclosures throughout the past six months and our finance team had been lined up to deliver six-month financials by early February to get us in the market during the lull that occurs when 144A issuers' numbers 'go stale'.

We were aiming to raise £500m in BBB sterling bonds and £600m equivalent B- holdco bonds across sterling and US dollars. We started to pre-market the holdco bonds in January in the US and the UK with a 'pink' preliminary prospectus to give our bookrunners the confidence to sign our bridge facility and to launch the deal. After all, this was going to be the biggest holdco bond ever issued. Initial meetings went well and we launched both deals on 12 February 2013. More than 100 investor meetings and calls later, we were able to upsize the investment-grade issuance to £750m, pricing at 250bps over gilts – the tight end of our target range. We secured so much demand in the sterling book for the holdco bonds that we were able to cancel the US dollar tranche, delivering the biggest sterling bond ever issued with a B- rating.

On 28 February, we closed the refinancing, securing over £5bn in total commitments from our shareholders, new and existing lenders and the bond markets. This allowed us to pay off all of our existing debt, put in place new capex and working capital facilities, roll over our hedging portfolio and set up our new long-term investment-grade issuance programme. As a result, we would be able to continue to access the bond markets to pay down our new three- and five-year term loans and support our business.

REFINANCING: ARQIVA'S ADVICE

- **Start early.**
- Prepare the business thoroughly with third-party diligence.
- **Use experienced financial and ratings advisers.**
- Run key activities in parallel and plan ahead for the next steps in the process.
- **Don't turn down any bank that has an appetite for your credit.**
- Don't underestimate the workload involved with preparing documentation.

Roger Burge is director of treasury and corporate finance at Arqiva