The right formula

IN A QUESTION AND ANSWER SESSION, **JEAN-MARIE POT**, **PATRICK CALINSKI** AND **TIM McCANN** OF BNP PARIBAS, AND **OLIVIER KLARIC** OF SANOFI-AVENTIS, TELL THE TREASURER MAGAZINE ABOUT THE GLOBAL PHARMACEUTICAL COMPANY'S RECENT $7BN JUMBO ISSUE.

As global merger and acquisition (M&A) deal volumes recover in 2011, the new issue market is an increasing area of focus as part of the financing toolkit for corporate treasurers. Sanofi-Aventis's recent six-tranche $7bn jumbo issue to partially refinance its $20bn purchase of US biotech company Genzyme (see box, this page) – its inaugural US dollar bond – demonstrates the benefits of going to the bond market and some of the hurdles issuers face.

Following in the footsteps of the acquisition-driven bond issues from Merck in 2010 and Roche in 2009, overall M&A volume in the healthcare industries is on the up: according to Bloomberg, it hit $56bn in 2010 from $26bn in 2009[1]. IMS Health – a pharmaceutical and healthcare research provider – expects the value of the global pharmaceutical market to increase by between 5% and 7% in 2011[2].

WHAT ARE THE CURRENT TRENDS IN PHARMACEUTICAL CORPORATE MERGERS AND ACQUISITIONS?

Jean-Marie Pot: Despite three waves of corporate consolidation in the past 15 years, the pharmaceutical industry remains relatively fragmented, with each of the industry's main players holding a market share not exceeding 8%. Nevertheless, the 10 largest global pharmaceutical groups represent a total market capitalisation of $1,060bn. This means that the ongoing wave of consolidation will continue to offer multibillion-dollar deal opportunities.

M&A activity in the pharmaceutical industry can be categorised by three main types of deals:

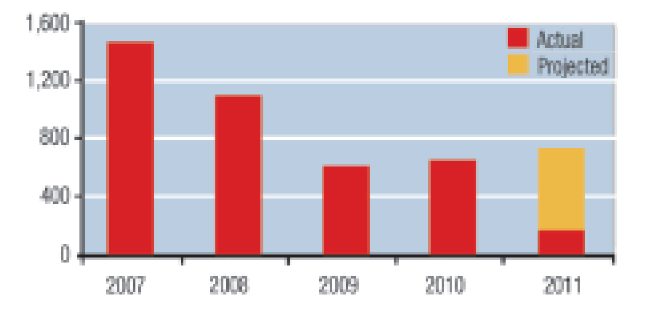
- **Jumbo transactions** These deals are mainly driven by size and synergy. Past jumbo transactions include the 2009 merger between Pfizer and Wyeth ($68bn), and the 2009 merger between Merck and Schering-Plough ($41bn). These jumbo transactions can also provide initiators with access to new areas of expertise and a reinforcement of R&D on a larger scale. For instance, the acquisition of Alcon by Novartis ($13bn), Genentech by Roche ($47bn) and the recent acquisition of Genzyme by Sanofi-Aventis (around $20bn) are examples of jumbo transactions driven by factors other than size.
- **Geographical expansion-driven deals** These deals mainly involve large groups looking to increase their presence in new territories or to develop their product offerings.

Financing the $20bn acquisition of Genzyme

Sanofi-Aventis priced its inaugural US dollar bond on 22 March to partially refinance its acquisition of Genzyme.

- Total size: $7bn (see The Treasurer's View box for breakdown).
- Six tranches: one, two, three, five and 10-year maturities (fixed and floating).
- Marketing: one-on-one conference calls on morning of launch.
- Demand: 2.5 times oversubscribed.
- Pricing: all six tranches inside or in line with guidance.
- Redemption if acquisition not completed: at 101% (except one- and two-year FRNs) by 30 September 2011.

Figure 1: Announced M&A deals, Europe ($bn)



Source: Dealogic

■ **R&D-driven deals** These transactions usually involve smaller R&D-led companies that have developed new products.

From a financing point of view, all these transaction types are challenging for corporates, notably because of their size, the possible currency issues and the legal environment.

HOW DOES M&A-DRIVEN BOND REFINANCING DIFFER FROM OTHER FORMS OF FINANCING?

JMP: M&A transactions and the bond market do not share the same dynamics. M&A transactions are driven by the negotiations between the two companies and the equity story.

In contrast, the bond market is driven by macroeconomic news flow, sovereign risk scenarios, central bank policies, investor appetite for specific asset classes, and so forth.

As a result, M&A transactions usually have to be backed by bank financing, which is refinanced when the market conditions are optimal. M&A-driven bond refinancing is often characterised by the issue size.

The larger scale of these refinancing exercises requires a clear and accurate financing strategy to be defined from the outset in terms of new bond parameters, such as the currency, maturity, marketing strategy, allowing the issuer to take out the right amount, optimise the funding cost and balance the debt profile.

WHAT ARE THE ADVANTAGES OF THE BOND MARKET AS PART OF A TREASURER'S CORPORATE M&A STRATEGY?

Patrick Calinski: It is difficult for treasurers in large or even medium-sized corporations to think of their group's financing strategy without considering the bond market at some point. This is even truer within the specific context of an acquisition, where the bond market offers three main advantages.

First, a bond is a useful non-dilutive instrument to diversify a company's funding sources by reaching out to a wide community of institutional investors.

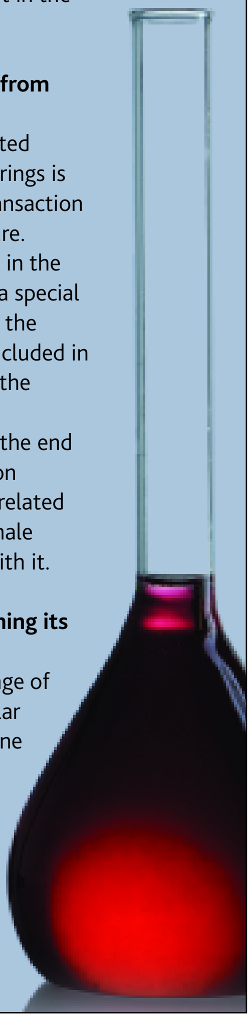
Second, it is a tool for deleveraging the banks' balance sheets. Usually, an acquisition bank loan features several facilities, one of which is designed to use the proceeds of a bond issue to pay down the loan. This is crucial given the greater constraints on bank lending in the aftermath of the financial crisis.

Third, the bond market provides for much longer maturities than the customary five to seven years accessible via bank loans. This is an advantage for issuers looking to secure long-term financing or wishing to lengthen their average debt maturity.

The syndicate view: executing a $7bn jumbo issue

What are the obstacles to the effective execution of a jumbo new issue?

Tim McCann: Sanofi-Aventis's $7bn bond offering is the largest in the US so far this year. One of the challenges with any jumbo bond financing is structuring it to achieve maximum pricing efficiency and avoid paying significant new issue concessions. By issuing bonds in six tranches from one-year to 10-year maturities in both fixed and floating formats, Sanofi-Aventis was able to tap into several different pockets of demand and achieve very attractive pricing levels. An added benefit is that the company now has a very smooth maturity profile which will enable it to use cashflow to pay down debt in the next few years.



How does M&A bond refinancing differ from other bonds?

TMC: One of the ways in which M&A-related financing is different from other bond offerings is that the proceeds are used to finance a transaction which is expected to close in the near future.

To protect both the issuer and investors in the event that the acquisition does not close, a special mandatory redemption clause is added. In the Sanofi-Aventis offering, this feature was included in all of the fixed rate tranches, and requires the securities to be redeemed at 101% if the acquisition of Genzyme does not close by the end of September 2011. This type of redemption feature has become fairly typical in M&A-related financings. Investors understand the rationale behind this feature and are comfortable with it.

How did Sanofi-Aventis go about launching its $7bn bond?

TMC: Sanofi-Aventis had the extra challenge of this transaction being its inaugural US dollar bond offering. Given the amount of headline risk in the market, there was a strong desire to execute the trade in one day. The company marketed to investors via an internet roadshow and conference calls with key investors on the morning of execution. The company's strong credit rating also helped to facilitate a rapid execution process.

WHAT CHALLENGES DOES BOND REFINANCING RAISE?

PC: Aside from the extensive legal and marketing documents that must be prepared ahead of the launch of a new issue, the refinancing route is a process involving the close monitoring of market conditions, whatever the size and currency the issuer is contemplating. The larger the amount an issuer wishes to take out, the greater the need for monitoring.

The treasurer's view

What were your funding requirements?
Olivier Klaric: At the time of the bond issuance at the end of March 2011, Sanofi-Aventis was engaged in a tender offer to acquire Genzyme Corporation for around $20bn. This acquisition, which is expected to close early in the second quarter of 2011, will be financed from the proceeds of recently issued US commercial paper (for $7bn), available cash, drawing on the $5bn bridge facility negotiated in October 2010 and proceeds from the $7bn bond.

Why did Sanofi-Aventis choose the US dollar bond market?
OK: The US dollar bond market was chosen for two main reasons:
- To get access to a strong pocket of liquidity while obtaining financing directly in US dollars. Bond investors were keen to diversify their portfolios while buying some very good quality paper (Sanofi-Aventis is rated AA-/A2 with a stable outlook). The order book reached over $17bn in a few hours.
- To obtain very attractive financing conditions on a standalone basis and compared to other markets, including our European medium-term note domestic programme. Sanofi-Aventis closed a $7bn financing composed of six tranches at very attractive yields and coupons:
  - $1bn of notes due 2012, bearing interest at a rate of three-month US dollar Libor +0.05%;
  - $1bn of notes due 2013, bearing interest at a rate of three-month US dollar Libor +0.20%;
  - $750m of notes due 2014, bearing interest at a rate of three-month US dollar Libor +0.31%;
  - $750m of notes due 2014, bearing interest at an annual rate of 1.625% (yield of 1.672%);
  - $1.5bn of notes due 2016, bearing interest at an annual rate of 2.625% (yield of 2.735%); and
  - $2bn of notes due 2021, bearing interest at an annual rate of 4% (yield of 4.126%).

All in all, Sanofi-Aventis expects an initial average cost of financing of below 2% for its acquisition of Genzyme.

What were the challenges?
OK: The main challenge was timing: Sanofi-Aventis was willing to pre-finance its acquisition of Genzyme in the best possible conditions, while taking the chance to issue in acceptable market conditions, despite strong market volatility due to the Japanese disaster and the Middle East situation. Sanofi-Aventis managed to initiate and close its bond offering in no more than three weeks, which was quicker than the five weeks initially scheduled, to take advantage of the first accessible window in the market.

Which factors are important in choosing your banking partners?
OK: The banks chosen were part of our acquisition facilities negotiated in October 2010, as well as strong renowned professionals in the US dollar bond market.

Bond market refinancing is also a strategic exercise, even more so in the context of M&A because deals will be highly visible in the financial community and analysed in detail. Fixed income teams involved in the process (mainly origination and syndicate units) are particularly vigilant about monitoring the economic calendar, financial news flow and any events that could affect market stability.

Advising the issuer of its best interest and finding a balance between global market conditions and expected investor demands are a bookrunner's main challenge throughout the process.

WHAT OTHER FACTORS SHOULD TREASURERS CONSIDER? RISK MANAGEMENT? RATINGS ADVISORY?
JMP: Treasurers have to take into account many factors, including asset and liability management, currency risk and interest rate risk (optimising the fixed and floating rate mix).

Ratings are also a key issue for treasurers, especially within the pharmaceutical industry, if they want to keep their access to the bond and bank markets and pursue their acquisition strategies. The role of banks in this process is to provide clients with a global and detailed view of risks and offer a range of solutions to address them.

HOW DO BANKS ADDRESS THESE CHALLENGES?
PC: To ensure a smooth transaction from start to finish, issuers should give themselves access to a full range of advisory solutions and services before the execution phase – for example, rating advisory, accounting, legal expertise and capital and risk management. Options they should analyse include capital market financing, credit risk management solutions and relevant hedging, while having access to credit research is always useful.
JMP: In M&A scenarios, the corporate will want to see the bigger picture, from corporate and structured finance to equity and debt capital markets, and also feel that their relationship is a close and confidential one.

[1] Bloomberg, 2011 M&A Outlook, page 9.
[2] IMS Health, "IMS Health Forecasts Global Pharmaceutical Market Growth of 5-7 Percent in 2011, Reaching $880 Billion," 6 Oct 2010.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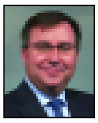
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