2006 Deals of the year

WITH NOMINATIONS FOR THE DEAL OF THE YEAR AWARDS DUE IN BY 20 NOVEMBER, **PETER WILLIAMS** REMINDS READERS OF JUST HOW BIG A YEAR IT HAS BEEN BY LOOKING BACK AT THE DEALS HIGHLIGHTED IN *THE TREASURER* OVER THE PAST 12 MONTHS BY ROBERT LEA, CITY CORRESPONDENT OF THE *LONDON EVENING STANDARD*. MEMBERS OF THE ACT AND EACT MEMBER ASSOCIATIONS MAY VOTE FOR ANY DEAL, NOT JUST THOSE LISTED HERE.

In December 2005 **Wolseley**, the world's largest distributor of heating and plumbing products and a supplier of building materials, raised $1.2bn through a private placement of fixed and floating senior unsecured notes. The transaction will refinance existing facilities due to mature within the next two years.

Following strong investor demand, the transaction was more than double the company's initial target, moving from $500m to $1,200m and becoming one of the largest traditional private placements financing in recent history. Group Finance Director Steve Webster declared himself "delighted".

In the same month, media companies **ITV** and **BSkyB** entered the market. ITV raised £325m in euro sterling issues with a 2015 maturity, and BSkyB followed its example, raising £1bn through a three-part bond.

Along with the January sales at the start of the year, **Kingfisher** raised £380m via a €550m seven-year Eurobond issue which attracted strong support. One interesting feature was that the issue contained an investor protection clause against the takeover of the group, an element which provoked a lot of discussion in the treasurer community. **France Telecom** pocketed just less than Kingfisher when it raised £350m through a 20-year sterling bond to add to the other €61bn of loans and bonds on its books.

Perhaps one of the more unusual transactions in 2006 was the stock exchange float of **Britvic**, which resulted from its three longstanding major shareholders all deciding they wanted to sell. A successful exit saw the company valued at float at nearly £500m.

In our March issue, the London market was described as "in the grip of unprecedented major merger and acquisition activity". Just days before **BAA** was due to close its highly successful multiple-tranche bond issues financing the £1.25bn acquisition of a majority stake in Budapest airport, news broke that Spanish giant Ferrovial was eyeing up the airports operator. The bond issuance – back then described as looking set to be one of the deals of the year – became the subject of a change-of-control clause discussion. The result? A late stage insertion – described by one BAA adviser as "a no brainer" – of a change-of-control clause in BAA's £1.9bn bond issue to enable investors to be repaid at par in the event of a takeover.

BAA described the clause as a matter for its long-term relationship with the debt market.

Elsewhere in March, the European junk bond market was set alight by the highest-yielding bond issue yet seen this side of the Atlantic. UK privately owned chemicals giant **Ineos** issued a €1.75bn 10-year bond yielding 7.875% – less than the previously guided 8% – and a separate $750m 10-year bond at 8.5% to refinance bridging loans on its $9bn purchase of Innovene.

National Grid took advantage of the growing appetite in the Eurobond market with a €750m issue offering 48 basis points over mid-market swaps as part of a €6bn medium-term note programme. It was announced the group's $7.3bn acquisition of US energy supplier KeySpan would be funded through bond markets this side of the Atlantic.

Tesco chipped in with its own contribution to the change-of-control clause debate in May by declining to concede to European investors' demands for takeover protection arrangements in its short-dated issue. In a four-tranche bond issue raising nearly £1.2bn, Tesco refused to include a takeover clause in its €500m five-year euro-denominated bonds. Tesco Group Treasurer Nick Mourant said: "We think it is reasonable that investors can make up their own minds on

OTHER HIGH-PROFILE DEALS THIS YEAR, BY JULIA BERRIS.

AIR FRANCE-KLM
As an unrated company Air France-KLM deserves credit for its offering in July. A long seven-year €550m issuance with January 2014 maturity increased its issue size to €600m when the book was rapidly oversubscribed.

GALLAHER
Demand from the market was high for tobacco company Gallaher's long seven-year bond issued in September 2006. The BBB-rated €500m bond is due in April 2014 and received nearly €2bn worth of orders. A change-of-control clause was not included due to the inclusion of a 125bp step-up in the event of downgrade to junk status.

LINDE
Linde made history this year with the first ever sterling hybrid bond issuance, using it to finance the acquisition of energy company BOC.

The sterling tranche increased from £200m to £250m and was priced at gilts plus 345bp, achieving a coupon of 8.125%. The €700m the risk of a takeover in that period."

Away from the bond market, **Laird Group** – now a player in the technology and security market – raised £117m, net of expenses, in a rights issue to refinance a recent string of acquisitions and put in place funding for future deals. The four-for-17 rights issue was priced at 325p a share, a discount of 26% to the prevailing share price.

While World-Cup fever took hold in June, insurance group **Royal & Sun Alliance** called in $500m of yankee bonds converting them into sterling perpetual notes to sit alongside a tranche of the sterling perpetuals already issued by the group. It was the first major cross-currency exchange since the introduction of international financial reporting standards (IFRS) and Royal & Sun Alliance said the yankee bonds – first issued in 1999 – were not recognised as regulatory capital by the Financial Services Authority.

In the same month, *The Treasurer* reported that century-old **Debenhams** had returned to the stock market with a £1.675bn flotation raising £950m to finance its plans to expand its portfolio and double from its current size to 240 locations. The pricing at 195p was at the bottom of the 195p to 250p indicative range and the business came to market with a net debt of £1.2bn. Private equity investors retained a 30% stake in the retailer.

Staying in the high street over the summer, fashion house **New Look** took a trendy financing route, raising £359m through a payment-in-kind loan designed to raise a dividend for the chain's venture capital backers. But the structure also indicated that New Look is looking at a flotation back on the stockmarket within an 18-month window from the end of this year. With a nine-and-half-year maturity, the loan cannot be called or bought back within the first six months but it can be called at par for the following 18 months. If an IPO happens, the plan is to redeem the loan.

Ever busy **Wolseley** followed up last year's record-breaking private placement with a heavily oversubscribed €2.8bn five-year revolver, scaled up from €2bn after commitments of more than €3bn were received.

The German corporate debt market was one of the features of this year. In the autumn, **E.ON** announced a €32bn borrowing plan to finance the €29bn acquisition of Spanish energy company Endesa. Other German deals of note included the €14bn of funds raised to back the abortive takeover by **Merck** of arch-rival Schering, and the €12.5bn refinancing of **Volkswagen**. Along with the Linde deal described in the box below, these deals represented some of the biggest transacted during 2006.

THE TREASURER
Deals of the Year

THE CATEGORIES

Equities/equity-linked · High-yield bonds · Investment-grade bonds · Loans · Mid-market · Securitisation/structured finance

September also saw football club **Arsenal** refinanced through a £260m bond issue secured by fixed and floating charges on the Gunners' new Emirates Stadium and its match ticket revenue.

The third quarter of the year saw acquisitive **Premier Foods** set out its stall for further shopping sprees by funding its takeover of Campbell's UK with a bold one-for-one rights issue raising £458.5m and putting in place new borrowing facilities topping £1bn.

In the same month **British Land** cut the cost of its annual interest bill through a £1bn multi-tranche debenture restructuring secured on the UK's largest security pool of assets valued at £1.8bn.

And to round off the month German industrial giant **Siemens** confirmed the arrival of hybrid bonds with a two-part euro/sterling-denominated £1.36bn bond – a €900m bond with a coupon of 5.25% and £750m offer paying 6.125%.

Both tranches had a 60-year maturity and, if a 10-year call option is not utilised, revert to paying coupons of 225 basis points three-month Euribor and three-month Libor respectively. Hybrids' increased popularity can be marked down to rating agencies relaxing their view on the issues making hybrid bonds attractive in refinancing takeovers as they help to ease the strain on debt ratings.

tranche was priced at mid-swaps plus 312.5bp, achieving a coupon of 7.375%.The transaction was significantly oversubscribed and the issue was priced at the tight end of the revised price guidance.

SAINSBURY

Sainsbury issued two commercial mortgage-backed securities and raised approximately £2.07bn of secured debt. The transactions were secured indirectly against 127 supermarkets with an investment value of £3.55bn. The deal stacked up as cheaper debt and a cut in a groaning pension deficit and was described as "the corporate treasurer's version of the perfect supermarket buy one, get one free".

STANDARD LIFE

Standard Life completed its £2.22bn IPO in July. The book was three to four times oversubscribed due to a rising market and an attractive valuation. The price range was set at 210p-270p, and was ultimately 230p – significantly higher than expected.

Four core accounts demanded a large amount of stock, with orders as much as £500m. Members sold £1bn of stock and ordered £1.35bn, although the latter was scaled back to £1.07bn to ensure enough for institutions.

WELLCOME TRUST

Medical research charity Wellcome Trust became the first charity in the UK to issue a bond on the public markets. Its AAA-rated £55m 30-year bond will help to increase funding for the charity's long-term investment and annual spending.

XSTRATA

Swiss-based miner Xstrata launched a landmark rights issue to fund the acquisition of Canadian nickel company Falconbridge.

The one-for-three rights issue is one of the largest ever, and raised £2.9bn to help fund the acquisition which completed in August this year. The proceeds from 235.8 million new shares priced at £12.65 each and will be used to refinance a portion of the $7bn bridge loan Xstrata secured to fund the Falconbridge deal.

Deal Analysis environment

PETER WILLIAMS ANALYSES THE FACTORS THAT HAVE HELPED TO SHAPE THE DEAL ENVIRONMENT IN 2006.

Over the year corporate results have been generally encouraging, with a broad range of companies producing strong profitability and equally strong cashflow. Lower interest rates in the last decade have also helped company profitability to improve through a reduction in interest payments on debt and from a retirement of higher interest rate debt and its replacement with lower interest rate debt.

EQUITY A feature of the markets is the continuing level of share buybacks. Share buybacks are likely to amount to over 3% of the value of the UK stockmarket capitalisation this year.

In the latter part of 2006 the UK IPO market stalled failing to recover after the fall and instability in global equity markets which led to a round of cancelled or delayed floats in May and June this year. Investors are looking hard at IPOs to ensure they are not paying over the odds. Where value is identified, funds are being committed but there seems to be a return to realism with investors being selective and tough on pricing. But is it all gloom? Research suggests that European venture-backed companies are using the IPO market to raise growth capital rather than as an exit for original investors. One trend appears to be public offerings occurring on entrepreneurially focused smaller exchanges such as Alternext and Deutsche Bourse. It is medium-sized companies which have appeared most in the takeover limelight, with overseas bidders and private equities again the dominant players. One factor the market can't ignore is the continuing sales of UK equities by pension funds as part of the major diversification programme which many treasurers are heavily involved with. Estimates are that pension fund equity sales have been running at £4bn each quarter over the last two years.

But the overwhelming feature is private equity. $283bn was raised globally by private equity firms in 2005, of which 30% was from Europe. The momentum has not flagged in 2006.

HIGH YIELD AND INVESTMENT GRADE BONDS The bond market has witnessed an increase in borrowing as companies increased investment. The nature of investment ranged from expanding operations, merger and acquisitions (M&A) activity and leveraged buy outs. The recent wave of investment and inter-sectoral consolidation kicked off in the final quarter of 2005 when it became clear that the ECB would resume its hiking path and companies rushed to jump ahead of the tightening momentum. The most striking increase in issue activity has been among investment grade companies as highlighted by the slipping credit quality.

Higher interest rates are expected, and indeed are starting to curb the appetite for investment-related transactions. This will in turn slow down borrowing and ultimately the deterioration in credit

EXCELLENCE IN TREASURY: MAKE YOUR VOICE HEARD

Members of the ACT and EACT member associations have a say in who wins the Deals of the Year Awards. Members are invited to nominate up to five deals (which can be any deals, not just those listed on these pages) which they feel demonstrate excellence in treasury and match the criteria listed below. Nomination forms are included in this issue of *The Treasurer*, or you can log on and nominate your favourites at www.treasurers.org/goto/doty.For more details, please contact Mike Henigan at mhenigan@treasurers.org, or phone 020 7213 0723.

WHAT ARE THE CRITERIA? The basic criterion is that a deal shows "excellence in corporate treasury", demonstrated by any of the following: sound treasury management, efficient pricing, optimal or innovative structure, and relative success in prevailing market conditions. Deals may be in any currency but the company must have a UK or European listing.

Only corporate deals are considered. Deals from supranational, agencies, municipals, and financial institutions will not qualify.

And only deals completed between 1 October 2005 and 31 December 2006 will qualify. There are six main categories in this year's Deals of the Year Awards:

- Equities and equity-linked;
- High-yield bonds;
- Investment-grade bonds;
- Loans;
- Mid-market (borrower has a turnover up to the equivalent of £500m and a market capitalisation under £1bn, or equivalent); and
- Securitisation and structured finance.

There is also a separate Trends category where the judging panel identifies a trend among the nominated deals and chooses the best of those deals that exhibit that trend.

Finally, an **OVERALL WINNER** is selected from the category winners.

WHEN DO WE KNOW? The winning deals will be announced at the Deals of the Year Awards lunch (attendance by invitation only) on 19 January 2007. Details of all the winning deals will appear in the January/February 2007 issue of *The Treasurer*.

quality within the investment-grade cohort in the medium term. On a less positive note, however, higher interest rates are beginning to negatively affect the credit quality of speculative-grade issuers by increasing debt repayments.

Since Q1 2006, bond markets' investors seemed relatively conservative in their approach to risk. Since then there has been a broad rebalancing of positions across different rating classes of debt. This rebalancing may have come at the expense of equity as investors set out to diminish their overweight in stocks, by switching towards lower-rated debt. Both a rebalancing of investors' position across asset classes and a better than expected macroeconomic performance help explaining why spreads have remained so tight in spite of a deteriorating credit cycle and higher benchmark interest rates.

LOANS The overwhelming impression in the loans market is the amount of liquidity there is. The dominant feature remains recapitalisations, where volumes have remained big. A third of all leveraged buyouts are recapitalisation-driven.

The market remains confident as the default rates appear low and stable. One emerging trend has been the huge growth in the mezzanine volumes. According to S&P, the volumes achieved in the first half of 2006 outstripped the volumes seen in the whole of 2005, with first-half 2006 figures reaching €8.4bn in Europe.

Mezzanine has become the subordinate debt instrument of choice for the private equity market. The final trend in this market is the big growth in second lien, overstepping the $8bn mark in the first half of 2006 which, like recaps, means greater volume of deals completed in the first six months of this year than in the whole of 2005.

MID-MARKET The outstanding feature of the mid-market is the increasingly complex debt structure being put in place in companies by treasurers, bankers and advisers. A transaction today is likely to have multiple layers of debt – senior secured, second line, unsecured, high yield, payment in kind securities and shareholder loans.

This complex and more aggressive structure is going hand in hand with a continuing investor boom. The driving force behind the good times is the mid-market reliance on institutional tranches. In 2001, institutions represented 7% of the funding of the market; by the end of this year that figure is likely to have risen to 36%.

The mid-market is not immune to recapitalisation fever. In the mid-market covenant levels have reduced and so have levels of debt to EBITDA and yields. In the last quarter of 2006, the inevitable question is where the mid-market is heading in 2007. It is hard to see why market conditions should not remain strong and in particular there is no suggestion of any imminent reversal in the current high levels of liquidity.

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