BIG IS BEAUTIFUL FOR BT

ANDY LONGDEN (left) AND LES WINNISTER OF BT HIGHLIGHT THE ISSUES FACED WHEN MANAGING £30BN OF DEBT.

Over the past 12 months, with third generation (3G) spend escalating and its European footprint expanding, BT has been busy in the capital markets. In March 2000 BT's net debt stood at £8.7bn. This figure was already significantly up on the previous year (£1bn). With 3G auctions planned across Europe for the summer of 2000, it became clear that BT's debt would increase further from year end levels if it succeeded in winning licences. We already had in place more than $30bn-worth of commercial paper (CP) programmes, across both euro and US domestic markets. In addition the euro medium term note (MTN) programme was increased to $20bn in readiness for the increased funding requirements of the group.

MULTICURRENCY REVOLVING CREDIT FACILITY. With CP outstandings set to increase significantly, we set about negotiating a facility to back-up both our CP and MTN programmes. An analysis of future spending options identified a worst-case potential requirement of £16.5bn.

BT negotiated a multicurrency revolving credit facility with a group of 11 quality relationship banks ABN AMRO, Bank of Tokyo-Mitsubishi, Barclays Capital, Bayerische Landesbank, Citibank/SSB, Deutsche Bank, HSBC, Mizuho (IBJ), Lloyds TSB, Royal Bank of Scotland and Société Générale.

The deal was finalised at a time when BT's credit rating was AA+ and equity markets were strong. It also took place before the conclusion of the German 3G cellular licence auction and BT's acquisition of the share that it did not own in Viag Interkom. Despite pressure from the banking market to syndicate the transaction, BT insisted on maintaining the club and on making full use of existing relationships with its closest and most dependable banks. The very significant value of this became apparent some months later.

Initially, the consequences were that upfront fees were well below an equivalent size syndicated facility. The fee structure of the deal was as follows: an upfront fee of 2.5bp and a commitment fee of 10bp a year, rising to11.7bp for a rating of A minus or lower. The drawn margin varied between 32bp and 47bp, depending on the size of drawings and the rating at time of drawdown. This ensured that on an undrawn basis, the facilities minimised the cash cost to the group. The deal was structured as a 364 day facility, thus proving friendly to bank balance sheets, but with a vital one-year term out option. BT also ensured that it had robust documentation.

Strong relationships already existed with the 'club banks'. The facility promoted stronger ties to the benefit of all parties, and all 11 club banks were willing to enter into a new £5.5bn facility in July 2001 on the expiry of the old deal.

Soon after the signing of the facility in August 2000, BT completed the Viag Interkom German cellular acquisition, financed initially by short-term CP and short-dated MTNs. From May to September 2000, BT issued opportunistically into strong investor demand, particularly from Japanese institutions. In total, £7bn of MTNs were issued at highly attractive rates. The group's strategic intention was to refinance short-term debt through both long-term debt and also equity issuance via the IPO of subsidiary operations.

GLOBAL DOLLAR BOND. BT's first step to terming out its CP outstandings was to target the US market. The US was crucial to tapping the widest possible investor base and position BT's credit story with investors worldwide. The onerous regulatory requirements of a SEC-registered bond were further complicated by the changes within BT's structure. With due diligence constraints narrowing the opportunity to come to market – already limited by the number of telco names looking to issue in an environment of receding credit appetite by investors – BT had to move quickly in late 2000.

Strong market execution was needed In order to sell an inaugural global bond against a backdrop of extreme market volatility. The flexibility and decisiveness of BT's senior management helped the lead managers execute the largest dollar-denominated corporate bond in history, supported by outstanding execution from SSSB, Merrill Lynch and Morgan Stanley.

The offering was well received by dollar global investors, allowing BT to achieve size and maturity objectives at historically attractive financing levels. The deal placed four large, liquid tranches in the dollar market with maturities spanning the yield curve. A critical factor in the success of the offering was the roadshow effort and momentum building process. Deal-specific information was delivered to the market, by the right people, at the right time. The highly

'BT'S DECISION TO TARGET THE EUROBOND MARKET SEPARATELY FROM THE US MARKET PROVED INSPIRATIONAL'

successful roadshow yielded hit ratios of 82.1% for one-on-one meetings, 72.7% for Bloomberg visits, 60.2% for group conference calls and 47% for group meetings.

As the book achieved critical mass, the three joint-leads were able to size the transaction accurately to optimise the issue. The final orderbook exceeded $16bn, consisting of some 375 investors and enabled BT to increase the transaction to $10bn from its original launch size of $6bn-$8bn.

The transaction re-opened what was essentially a closed new issue market and injected a much-needed large, liquid issue that trades well in the secondary market.

HEDGING JUMBO DEBT ISSUANCE. Throughout the period of increasing debt, markets were targeted primarily for investor appetite. This gave rise to significant currency and interest rate risk, which was most apparent with the $10bn global issue because BT has insignificant unhedged dollar assets.

Hedging $10bn of debt back to sterling involved a huge array of derivative products: sterling interest rate swaps, dollar/sterling basis swaps, dollar swap spread locks, dollar interest rate swaps, US treasury hedges and margin hedges. Different swaps were transacted at different stages of the process. Managing information dissemination to avoid markets moving against the company was key, and ensuring sufficient counterparties existed to provide liquidity and diversification was even more important.

Credit risk became the major issue to manage, given the size of the bond issue and the fact that it spanned the yield curve out to 30 years. The existence of the club banks helped enormously in negotiating the necessary credit lines. The lead banks were also invaluable in providing hedging in the lead up to the deal and advice throughout the exercise. On the day of pricing, more than 10 banks were involved in swapping BT out of fixed dollars into a combination of fixed and floating sterling. A good indication of the scale of this operation is that to solely manage the interest rate and currency risk of its debt portfolio BT currently has more than 100 cross currency and interest rate swaps in place.

MULTI-TRANCHE EUROBOND OFFERING. With $10bn of dollars successfully swapped back to sterling, we turned our attention to the euro market. Other issuers had previously tapped markets simultaneously, however, with debt levels forecast to peak at £30bn, we felt a split approach would maximise the debt we could term out. With three club banks as joint leads (Deutsche Bank, Barclays and HSBC) BT came to market as soon as the markets reopened after the New Year holiday. No slow bureaucratic culture here – several banks interested in winning mandates were still on holiday when the deal was awarded.

BT's decision to target the eurobond market separately from the US bond market proved little short of inspirational. Just one month after the largest ever corporate dollar bond, BT offered six tranches in its first euro issue (four euro and two sterling denominations). The deal totalled €9.7bn and was the largest ever eurobond issue. It was also the largest ever fixed rate corporate euro issue and the largest ever corporate sterling issue.

The success of the deal again highlighted the importance and benefits to an issuer of carrying out a thorough roadshow. BT's management visited 10 European cities over the course of one week to meet investors and explain its strategy to reduce debt. In total 541 individual clients placed orders, with a total order book of €17bn.

In an environment where investors had recently made record losses holding telecom paper, it is an impressive achievement to have launched an issue of such size, especially when one considers that the next largest issue was €5.4bn (France Telecom). Within four weeks BT had been able to issue $20bn of term debt. This is a strong endorsement of the strategy of targeting the two markets separately. It was also to prove very timely, as the market, and the rating agencies, in particular, began to change their view on the sector with profound consequences for BT's borrowing capability.

COLLAPSE OF EQUITY VALUATIONS. The strategy to finance the group temporarily with short-term debt and then by a combination of short- and long-term debt was directly underpinned by rating agency assurances that BT's credit rating would not be reduced to below single A (the critical threshold for the A1/P1 CP ratings) providing about £10bn deleveraging was achieved during 2001.

The collapse in technology, media and telecoms (TMT) equity valuations in early 2001 resulted in rating agencies reversing their earlier assurances, on the basis that falling equity prices reduced the likelihood of telcos achieving their disposal targets. For BT, this had the effect of creating a financing time bomb, as the group had, at its peak, £12bn of short-term debt maturities. CP spreads began to widen, but, more importantly, the first signs of capacity constraints appeared. In October 2000, BT had issued a $3bn floating rate note (FRN) with a one-year maturity off its US domestic 4(2) CP programme at a yield to investors of just over Libor plus 5bp. By March 2001 this paper was trading at 120bp over Libor. By April 2001, with BT on credit watch for downgrades from mid single A, CP markets had virtually dried up.

With close to £30bn of net debt BT could not afford short-term debt markets to dry up. The position would have been extremely uncomfortable but for the $20bn of long-term debt recently issued. More importantly, it would have been virtually untenable without the £16.5bn back-up facility. Because BT had such a strong bank facility, it was never at a risk of being unable to refinance its short-term debt. This allowed the group time to fully assess all strategic options and ultimately allowed the group to meet UKLA requirements for working capital adequacy when it launched the record-breaking £6bn rights issue in May, thereby saving the expense of underwriting fees.

This is an outstanding example of treasury risk management and provides three very valuable lessons. First, when managing escalating debt in the face of acquisitions, big is definitely beautiful in terms of debt issuance. Second, the value of having back-up facilities in place, 'just in case' should never be underestimated. Finally, as was demonstrated by our MTN and CP floater issuance, fund opportunistically when you can – not when you have to.

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