# TRUST ME – I'M A BANKER

BRUSHING UP ON YOUR BARGAINING TECHNIQUES WILL PUT YOU IN A STRONGER POSITION TO PUSH FOR A BETTER DEAL, SAYS KEITH PHAIR OF THE BANK RELATIONSHIP CONSULTANCY.

Market trends are now working against the interests of most treasurers. When my earlier article on bond markets was published in April 2000, a E 2bn-E 3bn deal was considered enormous. Such deals now seem modest in comparison with the huge deals negotiated by telecoms companies to fund 3G licensing. France Telecom's record $16.4bn multi-tranche offering in March followed British Telecom's $10bn and E 9.8bn deals at the turn of the year and Deutsche Telekom's $14.6bn of last summer. The overwhelming size of such deals crowds out more typically sized financings. Banks focus on large liquid issues for league table position, seriously disadvantaging less frequent corporate borrowers undertaking smaller issues.

**BANKS ARE PLAYING HARDER TO GET.** Banking consolidation is also making life difficult. Many companies now report that banks are pulling back from lending. The banks themselves are concentrating on maximising fee revenues, and, consequently, by reducing their lending and commitments, they are pushing companies to meet their credit needs elsewhere, such as in the securities market. This push has become more aggressive during 2001 and more companies are consequently having to rethink their financing strategy and diversifying funding sources. Companies may often be under-prepared when coming to market, conceding on covenants and pricing because they lack bond market experience. Accordingly, they are favoured targets for the banks, even if their deal size is small.

Anxious borrowers may be on particularly weak ground with respect to ratings-based covenants, especially if they are forced to use the sterling sector, where covenant pressures are highest. Ratings-based covenants provide a 'comfort blanket' for investors but they may not be as essential to a good night's sleep as is often claimed.

Inexperienced negotiators may have little choice but to believe what the banks tell them, which skews the deal in favour of underwriters. Additionally, as a result of banking consolidation, there are fewer sources of information for treasurers who want to evaluate several alternative markets.

**SO WHAT CAN A CORPORATE TREASURER DO?**

- establish a strategy for funding and bank relationships so the company is not forced to seek a solution under duress or at short notice;
- ensure that the company is in a position to negotiate assertively with banks and underwriters; and
- isolate the key negotiating points, taking external advice if necessary.

## ☐ INSIDIOUS COVENANTS

Leading UK institutions have been at the forefront of the past year's quest for tougher covenants on corporate bonds. The standard debates over cross-default and negative pledge are increasingly sidelined by rows over demands for:

- coupon step-ups of 25-100bp per notch, triggered by rating downgrades;
- asymmetric racheting of coupons; and
- investor put options at par, in event that rating downgrades follow a change of control.

Although institutional investors scrutinise deal terms, retail investors tend to pay little attention to covenants – and neither group often actually reads the prospectus itself! Covenants are cyclical in nature, with investors focusing only at times of stress or when they see a good negotiating opportunity. It is difficult to stop giving covenants once the process has started or a two-tier market could develop in the company's debt. Treasurers should avoid multiple sets of covenants such as Stagecoach's 'materially prejudicial' redemption clause, which in April 2000 forced redemption of its sterling deal, leaving a more recent euro deal outstanding.

Some treasurers enjoy doing deals and are tempted into thinking they can do everything in their domain equally well. This is entirely understandable if they are experienced in the particular transaction process but otherwise can be very risky. It is rash to assume that your first bond deal will be 'correctly' priced, whatever the bank marketeers might say, and there may be significant opportunity costs and/or adverse long-term consequences. Faced with a bank hungry to maximise its earnings and unable to defend the company's position because of a lack of time and/or expertise, treasurers should be very wary indeed. Banks hold virtually all the cards – they have the experience and control your access to the funding, but you are there to champion your company, so ensure you are in a position to disagree. Position yourself to be assertive. Bankers might ask for wider pricing, covenants or other sweeteners, but may well deal without them – so why give anything extra? If your expectations are reasonable, then negotiations should be a matter of give and take, not just give.

Banks are not averse to bluffing in an attempt to maximise fees. Underwriters are adept at painting a gloomy picture about market demand, even occasionally 'unintentionally' misleading the client about market conditions. Treasurers can easily find themselves listening to plausible reasons why they must widen the pricing. If a client baulks at expenses or detailed covenant terms, banks will often assert a precedent and may blithely add that investors have come to

**TABLE 1**

### POST-LAUNCH PERFORMANCE OF RECENT BOND ISSUES FOR UK AND SELECTED FOREIGN CORPORATES

| Launch date | Issue Description | Size | Launch spread | Closing spreads for the days following launch | | | | | | Average spread move |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | +1 | +2 | +3 | +4 | +5 | +6 | |
| Sept 00 | Telefonica 7.75 2010 | $2.5bn | 204 | 193 | 189 | 194 | 189 | 200 | 192 | -11bp |
| Sept 00 | Marconi 7.75 2010 | $900m | 205 | 202 | 203 | 205 | 204 | 209 | 205 | 0 bp |
| Sept 00 | Hanson 7.875 2010 | $750m | 215 | 215 | 217 | 214 | 214 | 212 | 217 | 0 bp |
| Oct 00 | Unilever 7.125 2010 | $1.75bn | 160 | 162 | 163 | 161 | 156 | 158 | 155 | -1bp |
| Dec 00 | Transco 6.125 2006 | £250m | 95 | 97 | 102 | 100 | 98 | 100 | 99 | +4bp |
| Dec 00 | BritishTelecom 6.875 2011 | e 2.25bn | 214 | 210 | 211 | 207 | 200 | 194 | 195 | -11bp |
| Apr 01 | Avon Energy 6.625 2006 | £360m | 168 | 166 | 164 | 166 | 166 | 164 | 164 | -3bp |
| Apr 01 | John Lewis 6.375 2012 | £200m | 150 | 148 | 146 | 144 | 144 | 144 | 144 | -5bp |
| Apr 01 | Delhaize USA 8.125 2011 | $1.1bn | 305 | 289 | 291 | 292 | 288 | 285 | 280 | -17bp |
| Apr 01 | Allied Domecq 6.625 2011 | £350m | 194 | 190 | 187 | 187 | 186 | 185 | 185 | -7bp |
| May 01 | Unilever 5.125 2006 | e 1.0bn | 50 | 51 | 49 | 50 | 51 | 51 | 51 | +1bp |
| May 01 | Worldcom 7.25 2008 | £500m | 210 | 196 | 193 | 189 | 190 | 187 | 187 | -20bp |
| May 01 | Innogy 6.25 2008 | e 500m | 144 | 139 | 141 | 140 | 137 | 135 | 135 | -6bp |
| June 01 | WPP Group 6 2008 | e 650m | 122 | 119 | 121 | 119 | 121 | 122 | 124 | -1bp |
| June 01 | HJ Heinz 6.625 2011 | $750m | 143 | 135 | 134 | 138 | 136 | 137 | 136 | -7bp |
| June 01 | J. Sainsbury 5.625 2008 | e 800m | 96 | 93 | 93 | 92 | 93 | 93 | 92 | -3bp |
| July 01 | National Grid 6.5 2028 | £360m | 145 | 139 | 136 | 137 | 137 | 137 | 136 | -8bp |
| July 01 | National Grid 6.125 2011 | e 750m | 130 | 125 | 125 | 122 | 123 | 123 | 123 | -7bp |
| July 01 | British Airways 7.25 2016 | e 250m | 215 | 206 | 203 | 203 | 203 | 203 | 205 | -11bp |

NOTES:

a) Data on early trading was unavailable for other recent issuers such as P&O Princess, Vodafone and BOC Group. Subsequent trading in these issues was some distance from the launch spread.

b) The above table includes yankee, global and euro issues. In multi-tranche issues, only the benchmark 10-year tranche has been quoted.

Those issues highlighted seem to have been rather generous to investors. The spreads shown are, in all cases, against the principal reference bond quoted by the lead manager at launch. Some issues, such as BT's December issue, also reflect spreads narrowing in the market which was triggered by the emergence of the issue itself – the market having widened in anticipation of the issue. Some issues were also launched almost simultaneously with others: for example, Marconi's yankee was priced only three hours after Telefonica's global bond and, at the time, had a rating two notches lower.

*Source: Bloomberg (mid/mid BGN spreads versus the reference Government bond at launch)* expect such a precedent or clause. In effect, banks will often try to talk the terms wider.

It is common for a first-time entrant into the market to be faced with a bank insisting on a new issue/new name premium to attract investors to the deal – this is often nonsense, or at least an exaggeration. Negotiating from an equal position will force the bank to substantiate such assertions. Another favourite tactic is to compare a client's deal with other carefully chosen 'similar' issues, by indicating where your company should be placed relative to another company – this is usually entirely a matter of judgement. Each company is unique and its market status depends, in addition to ratings, on how the issuer is perceived – which, of course, may be influenced by how the company's credit is marketed to investors.

Deals can often be mispriced, usually in favour of the underwriters and investors. For example, if an issue is re-offered to investors at +210bp over Government bonds, a well-priced deal should trade just inside (say +208bp) once the syndicate breaks, perhaps being bid at the same spread the investors just paid. A fairly priced deal should allow the underwriter to make their fee – but not a windfall – and should leave investors content rather than gleeful. If the same deal were to tighten swiftly to 200bp, then the corporate issuer loses out because 10bp has been left on the table to be shared between the underwriters and the investors. An acceptable margin of error may be 2bp-3bp – any more than that and the deal is mispriced. Immediate spread tightening of an issue is *prima facie* evidence that it was priced too cheaply. Table 1 shows that such mispricings are no longer rare or confined to smaller companies.

Pricing too cheaply can have significant opportunity costs. On a £500m 10-year issue, the present value of leaving 5bp on the table is roughly £2m. As some issuers seem to have sacrificed much more. Deals targeted towards retail investors are particularly susceptible to mispricing, as retail investors (such as wealthy individuals, small private banks) will often pay a premium for the comfort of having familiar issuers' bonds in their portfolios. Often the pricing benchmarks cited by the banks reflect the appetite of institutional, ratings-driven buyers – not the broader market applicable to the issuer in question. The pricing of debut issues for 'brand name' corporates is therefore much more of an art than it might at first appear.

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**IT'S A JUNGLE OUT THERE.** Try to avoid going to the market at the same time as the 'elephants' because your deal may be ignored if there is a huge deal on offer when you are trying to borrow. You may not get a deal done at all unless you are priced cheaply or have a truly outstanding story to tell.

Treasurers should be rigorous in choosing their lead manager(s) – the correct choice is fundamental to a deal's success. It is crucial to be well informed and therefore negotiate on equal terms. Place yourself at a disadvantage and you will not get the best deal possible – and a single basis point could easily cost £250,000 or more.

Remember that the spread rarely moves in your favour when the negotiations approach their conclusion, so it is important not to be lulled by the apparent ease of the process in the early stages, especially in the pre-mandate phase. Treasurers must review their bank relationship strategy, to ensure it is sufficiently robust and flexible for increasingly difficult markets.

Equally important is the ability of your team to negotiate fairly priced bond issues, now that the balance of power is shifting towards the banks. If the negotiating team needs bolstering, it should be noted that it is now possible to obtain independent specialist advice. The most valuable currency for treasurers involved in tough negotiations is information, so remember, external input may unearth previously disguised opportunities to bargain from a position of strength.

Keith Phair is Senior Consultant for Capital Markets at The Bank Relationship Consultancy.
**kphair@bankrelations.co.uk**
www.bankrelations.co.uk