

Debt Private Placements

Applying Concepts from Bonds to the Public
and Private Debt Markets

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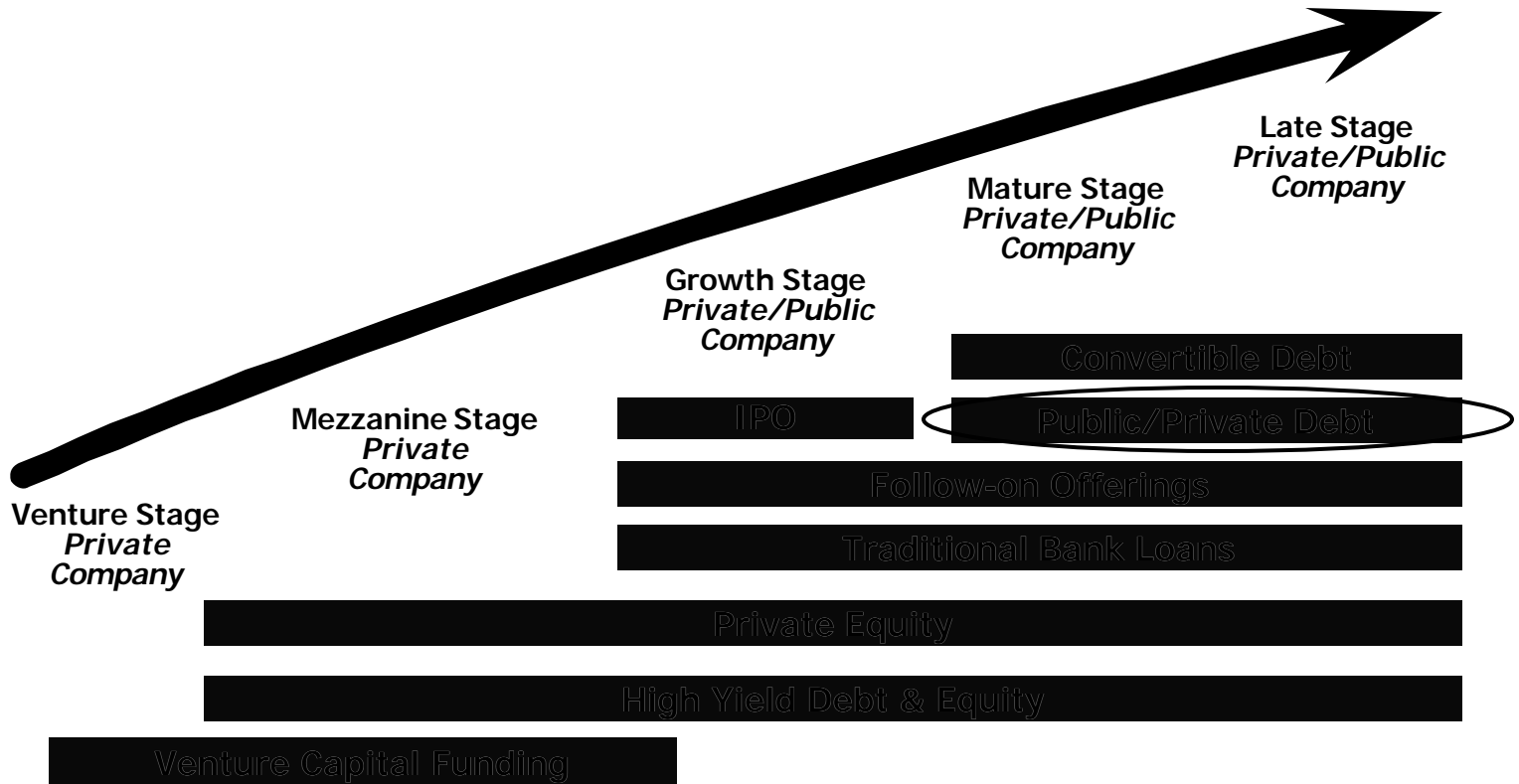


Agenda

- Debt Market Alternatives
- Debt Private Placements Overview
- Mechanics of Private Placements
- Internship Opportunities
- Q&A



Debt Market Alternatives



Debt Market Alternatives

- Private Placement
 - Direct sale of debt or other securities by a company to sophisticated investors, primarily life insurance companies and pension funds.
 - Exempt from registration with the SEC.
 - Issuers do not necessarily have a debt rating.
- Public Bond Offering
 - Sale of debt securities by an issuer through the public capital markets, subject to SEC rules and registration requirements.
 - Issuers must be rated by S&P and Moody's.

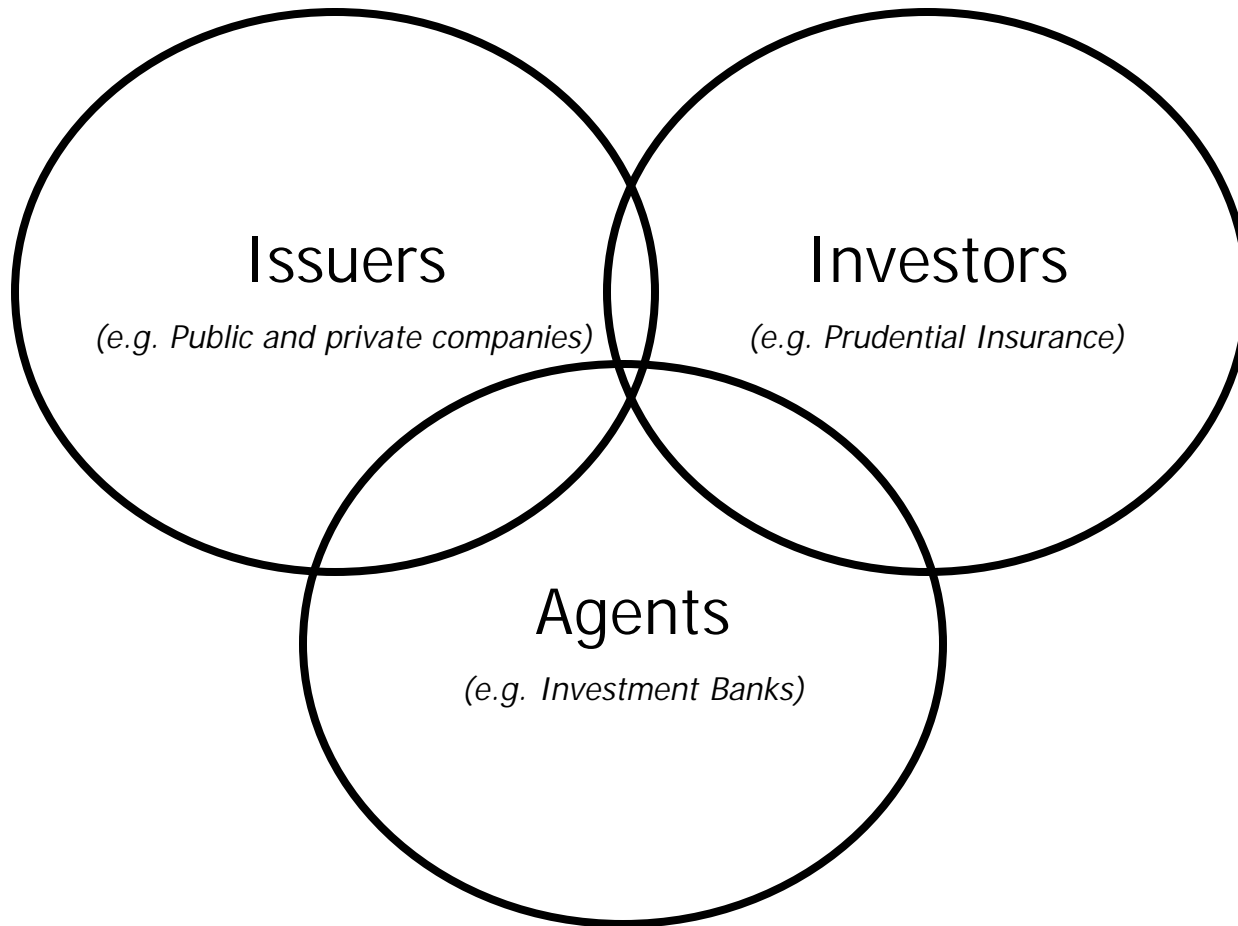


Debt Market Alternatives

- Benefits of Private Debt
 - Accommodates smaller issue size than public markets
 - Longer and more flexible maturities than the bank debt market
 - Flexible debt covenant structures
 - Controls information disclosure for private companies or sensitive public companies
 - No rating required, which can be expensive and time consuming
 - Faster process than public deals
 - Enables issuers to raise long-term debt if public bond markets are experiencing disruptions



Debt Private Placements Overview



Debt Private Placements Overview

| | |
|------------------------------|--|
| <u>Investors</u> | Primarily insurance companies desiring fixed income investments |
| <u>Deal Size</u> | Ranges from \$10 million to \$700 million |
| <u>Credit Quality</u> | Mostly investment grade (BBB- and above) |
| <u>Security Types</u> | Generally senior to other debt |
| <u>Maturities</u> | Typically 3 to 30 years |
| <u>Interest Rates</u> | Fixed rate at a spread over U.S. Treasuries of comparable average life |
| <u>Timetable</u> | 6- to 12-week process from engagement to funding |
| <u>Fees</u> | Agent receives 50 – 100 basis points of face value of deal |



Mechanics of Private Placements

Pricing

- Common pricing terminology is “Coupon”
- Coupon Rate = US Treasury Interest Rate + Credit Risk Spread
 - US Treasury Interest Rate is the current rate for the note/bond with same maturity as private placement.
 - Credit Risk Spread is the premium demanded by investors for assuming the credit risk of investing with the issuer.
 - Spread expressed in basis points (100 – 400).
 - Coupon referred to as “T plus (spread)”
- Issuer pays interest (coupon rate times remaining principal) to investors on a fixed amortization schedule.



Mechanics of Private Placements

Coupon Example:

Find the coupon for a private placement with 10 year maturity and a credit risk spread of 250 basis points.

First: Find interest rate for the corresponding 10-year US Treasury bond...

4.375% (as of 10/24/02)

Second: Add the spread...

2.50%

Answer:

$4.375\% + 2.50\% = 6.875\%$



Mechanics of Private Placements

Maturities and Amortization

- Bullet: No principal payments until last period of maturity.
- Straight-Line Amortization: Equal payments of principal throughout maturity period.
- Other Amortization: Principal payments weighted towards the beginning or end of the maturity period based off of issuer and investor preferences.



Mechanics of Private Placements

Average Life

- Terminology for describing the maturity of a private placement with a unique amortization schedule.
- Average Life is the expected value (in years) of the principal payments as a percentage of the total face value of the notes.
- Expressed as “Actual Maturity/Average Life”
 - Example: \$40 million senior notes with maturity of 20/14.5 years priced at T + 250.



Mechanics of Private Placements

Calculating Average Life and Coupons

Find the average life and coupon for \$100MM in senior notes with a spread of 250 basis points and the following principal payments:

- \$20MM in years 2 and 3, and \$60MM in year 4.

First: Calculate the average life

| Year | Principal Balance at Start of Year | Principal Payment | Principal Balance at End of Year | Percent of Total Principal | Expected Value |
|------|------------------------------------|-------------------|----------------------------------|----------------------------|----------------|
| 1 | \$ 100,000,000 | \$ - | \$ 100,000,000 | 0.0% | 0 |
| 2 | \$ 100,000,000 | \$ 20,000,000 | \$ 80,000,000 | 20.0% | 0.4 |
| 3 | \$ 80,000,000 | \$ 20,000,000 | \$ 60,000,000 | 20.0% | 0.6 |
| 4 | \$ 60,000,000 | \$ 60,000,000 | \$ - | 60.0% | 2.4 |

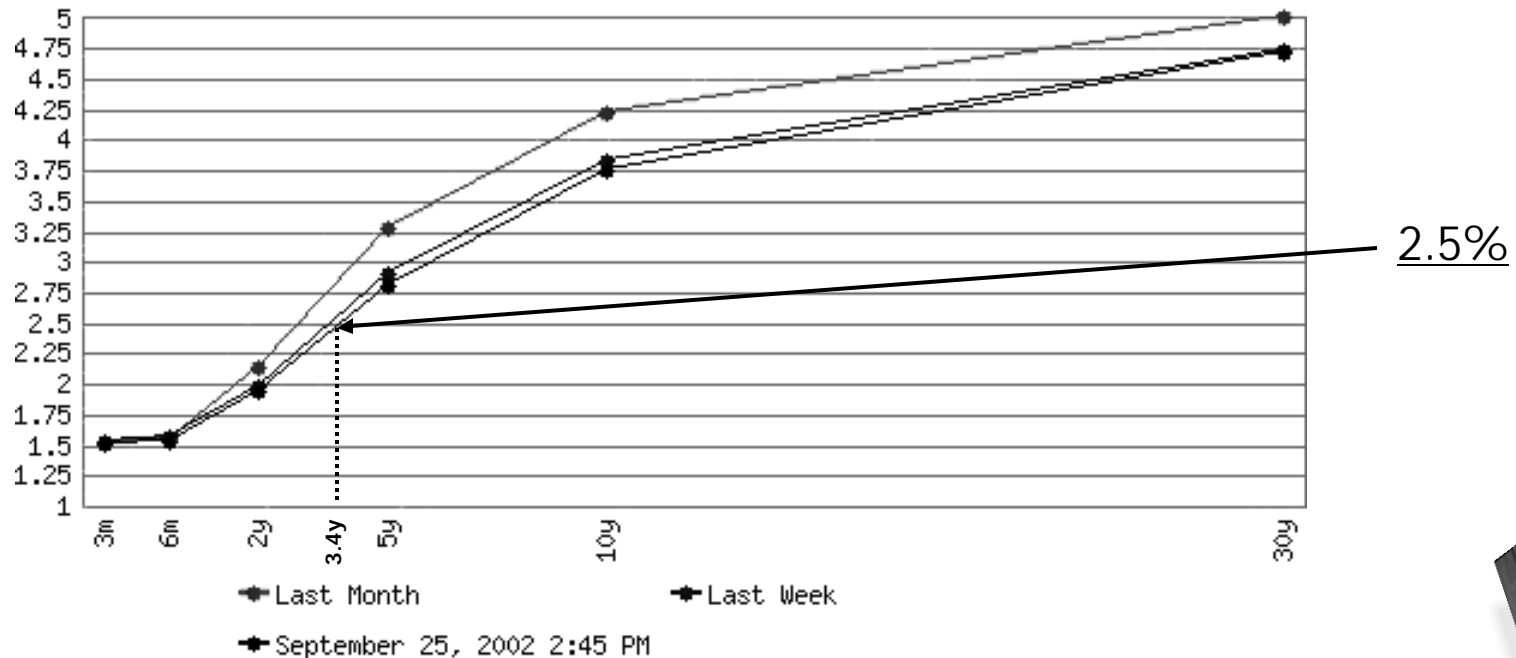
Total Average Life: 3.4



Mechanics of Private Placements

Calculating Average Life and Coupons

Second: Find the corresponding US treasury rate. This can be roughly estimated from the yield curve, or calculated using Bloomberg.



Mechanics of Private Placements

Calculating Average Life and Coupons

Finally: Calculate the coupon

2.5% treasury rate + 2.5% credit spread = 5.0% coupon



Mechanics of Private Placements

Arbitrage Opportunities

- Lowest treasury rates in 40 years should provide issuers with an incentive to issue new debt, or at least a chance to refinance existing debt.
- However, the investors are demanding much higher spreads, and removing opportunities for issuers to “arbitrage” with the low interest rates.

Treasury yields tumble...

Yield on the 10-year Treasury note; bond yields fall as bond prices rise



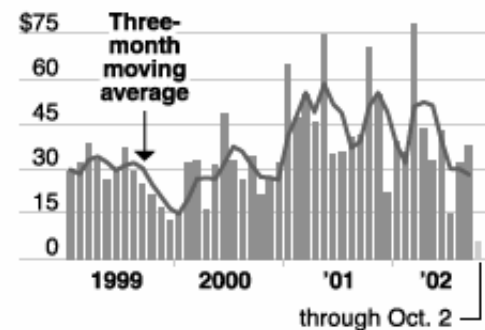
But corporate spreads widen...

Difference between yields on investment-grade corporate bonds and comparable Treasuries



And this year, issuance stalls

Investment grade corporate bond issuance, in billions



Sources: WSJ Market Data Group; Merrill Lynch; Thomson Financial



Internship Opportunities

- Sales and Trading Investment Banking
 - Corporate and Treasury Bond Sales
- Debt Capital Markets Investment Banking
 - High-Grade Public Bonds
 - High-Yield Public Bonds
 - Private Placements
- Investment Management
 - Buy-side portfolio managers
- Corporate Finance
 - Corporate cash and treasury management



Q&A

Questions?

