

**Option Finance – Monday, June 8th 2009
(Translated by Calyon)**

The event – Eurazeo funds itself with exchangeable bonds

Rather than selling its shareholding in Danone to raise cash, Eurazeo has chosen to issue bonds exchangeable for the Danone shares, thus profiting from their upside potential.

In what was a pure coincidence, just a few days following Danone's announcement of its capital increase, Eurazeo finalized an issue of bonds exchangeable for Danone shares. Although Eurazeo's finance department had been working for three months on the issue's launch, when warned of Danone's project, the investment firm had to delay its transaction by a few days. "The timing of our transaction was particularly tight given the announcement of Danone's capital increase," explains Philippe Audouin, a member of the executive board and chief financial officer at Eurazeo. "Moreover, if we had wrapped up our financing prior to Danone's transaction, that would surely have been negatively viewed by the subscribers to our transaction. The two deals competing with each other would have caused tension in the market for the lending and borrowing of shares which was required by hedge fund-type investors for both transactions."



Philippe Audouin, chief financial officer, Eurazeo

"This transaction enables us to leave behind the margin call system to which we were subject for the previous financing."

A tight timeframe

After the announcement of the terms of Danone's capital increase, the cost of lending and borrowing the share went from 35 bp to more than 150 bp in just a few days.

As a result, Eurazeo waited until May 28 to wrap up its funding transaction, which was initially planned for €500 million. This move is part of the group's cash management strategy, which involves placing its surplus funds in the shares of major liquid companies such as Veolia Environnement, Air Liquide and Danone. In order to liquidate around 40% of its shares in Danone, in which it has a 5.21% stake, and given the sharp drop in markets over the past year, Eurazeo preferred to issue exchangeable bonds rather than simply sell its shares at the current price. "The transaction as structured enables us to capture the share's upside potential up to €45.25 per Danone share, the equivalent of an upside of 25% relative to the introduction price and 36% relative to the share price on June 3," explains Philippe Audouin. In other words, when the bonds mature in five years, if the Danone share price is higher than €45.25, the bondholder will receive one Danone share for each bond. On the other hand, if the price is lower than €45.25 he will receive one share and cash to make the total up to €45.25. Another advantage of this transaction is that Eurazeo will continue to receive the dividends paid by Danone, thus helping to pay the bond's 6.25% coupon. In addition, given the stock's yield of around 3%, the cost to Eurazeo will amount to only around 3.25% before tax and slightly more than 2% after tax. "This represents a very competitive funding cost, especially for a five-year maturity," adds Audouin.

The issue, which matures in 2014, also makes it possible to refinance a €420 million line of credit due in 2011, thus extending the maturity of Eurazeo's debt. This bilateral line of credit put into place last year was collateralized with the Danone shares. This financing included a margin call system: in the event of a drop in the share price, Eurazeo had to pay the difference between that and the reference price established when the guarantee was put into place. "The new transaction enables us to leave behind the margin call system to which we were subject for the previous financing," explains Audouin. Oversubscribed by more than three times, Eurazeo's exchangeable bond issue amounted to €610 million and could reach €700 million if BNP Paribas and Calyon, the issue's lead banks and bookrunners, exercise their greenshoe option.

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Eurazeo extended the maturity of its debt from 2011 to 2014.

The first exchangeable bond issue in France for three years

It had been more than a year since an issuer entered the European exchangeable bond segment and nearly three years in France, where the last issue – in 2006 – involved the French company Artémis, which issued €800 million in bonds exchangeable for PPR shares.

The Eurazeo deal thus reopens the exchangeable bond market, a niche that appeals to the same investors as the convertible bond segment, which was reopened with the ArcelorMittal deal at the end of March.

"Convertible investors are currently showing a strong appetite which facilitated Eurazeo's bond issue," says Benoît Bout of Calyon.

While issuers of exchangeable bonds target the same investors as do those of convertible bonds, the credit risk for an exchangeable bond lies with a different company than for the exchange option - not the case with convertible bonds, for which these two elements are backed by the same entity.

The two products are nonetheless highly similar. As with convertible bonds, exchangeable bonds enable the issuer to fund itself at a more attractive cost than traditional bonds because the sale of the exchange option reduces the financing cost. However, with IFRS, the accounting for the product has a disadvantage compared with that for a traditional bond since the option must be taken to profit and loss, introducing an element of result-calculation volatility that is poorly understood by companies. **"This financing method is more suitable for companies that have shareholdings, such as investment companies or holding companies, for which investors are more concerned with net book value than current earnings," explains Bout.**

Bankers do not exclude, however, that other issuers will take advantage of this market, and in particular those that want to limit the effects of price declines on their shareholdings while, within certain limits, profiting from their upside potential.



By Saphia Gaouaoui