Roadchef motors on with a recipe for success

Robert Rees of Barclays Capital examines the funding of the Roadchef acquisition by Nikko and Cabot Square.

Barclays Capital's funding of the purchase of Roadchef by Nikko and Cabot Square represents the most recent example of the application of capital markets techniques to the acquisition markets. This is often referred to under the general title of 'securitisation', a term that has now become so widely used that its meaning is at best confused and at worst incorrect.

Securitisation used to be applied specifically to the financing of a large pool of independent receivables. It now refers to a more general funding of any number of cash streams, corporate or otherwise. So securitisation has become a short hand for any deal more complex than a straight corporate credit transaction. It will be convenient to retain this rather woolly categorisation when discussing the Roadchef transaction.

A question of funding

Roadchef, a company that was mainly owned and controlled by an individual, had for a time been looking to expand through acquisition and organic growth. In the past, such opportunities were difficult to fund given the company's size and private structure. The changing nature of the motorway service area (MSA) market (the major portfolios having changed hands recently) and the potential for some valuable acquisitions made it important that Roadchef restructured to allow for the raising of new capital.

Roadchef is the third largest MSA company in the UK, after Granada and Welcome Break. The sector is dominated by these three companies, with other operators collectively owning less than 10% of the market. In particular, the Blue Boar chain of four stations and the Take a Break station were becoming more and more detached in terms of size from the majors, and it looked likely that they would have to sell up. Acquisition of these two companies represented a good opportunity for Roadchef to become a little closer in size to the other two major competitors.

The solution to the funding question was to bring on board financial investors in the equity of the company and to prepare the corporate structure to ensure that large-scale long-term funding could be put in place relatively quickly. Such funding would need certain characteristics (*see Figure 1*).

Barclays Capital and Nikko worked with the company to prepare the structure that would cover these issues and arrived at a dual financing deal:

- a short-term bank bridging loan based on the ability of the sponsoring bank to produce a longer-term bond take-out – with the potential to increase on further acquisitions;
- a structured bond transaction that uses the ability of the UK bond markets to lend for terms of more than 20 years with repayments spread towards the later dates;
- a covenant structure that allowed for further borrowing for certain prescribed reasons;
- a senior/subordinated structure to ensure best rating and hence pricing for the maximum amount of debt, which also provides the most extensive gearing for the company; and
- an element of floating rate debt that could be repaid at little penalty.

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FIGURE 1
Characteristics of the funding

- A long term to take advantage of the lengthy nature of the business and assets, and to raise the most money possible;
- back-ended repayment to allow for some growth in the cash flows in the earlier years;
- abilities within the structure to add on debt as and when new acquisitions require funding;
- a source of short-term liquidity while the longer-term structure is being arranged; and
- an amount of debt repayable at little or no penalty to allow for repayment in the event of an IPO or secondary funding at a later date.

In essence, the long-term funding, supported by a bank bridge, comprised two classes of senior and one of subordinated bonds as shown in *Figure 2*.

Roadchef's strengths

In addition, the business lends itself to such finance – a prerequisite for the use of the capital markets and a factor that some protagonists occasionally forget. Not all industries will support such an approach, and Roadchef again gives a good example of the main points that apply.

First, Roadchef is a highly positive cash-generative business in a sector where, notwithstanding recent publicity about car use, no one actually believes

FIGURE 2

A breakdown of the long-term funding

Class	Rating	Principal amount	Description	Final maturity
A1	A	£45,000,000	Floating rate notes	2010
A2	A	£123,000,000	Fixed rate notes	2023
B	BBB	£42,000,000	Fixed rate notes	2026

This structure clearly demonstrates the basic features of the structured bond market as applied to acquisitions. Key among these features are:

- the use of subordinated tranches to enhance the rating of the majority of the debt and to replace to some extent equity;
- the use of liquidity facilities to smooth short-term fluctuations in cash flow; and
- strong controls over the future activities of the group, through borrowing, disposal and change of business covenants.

that motorway traffic will reduce in the long term. Second, with the combination of planning restrictions, capital cost of entry, and government regulation, it is difficult, at least from the supply side, to envisage growth in competition from new entrants. Some of the income is indeed pre-contracted (ie the revenue from petrol sales) and provides a base cash flow of high credit quality.

In summary, the lack of volatility and basic strength of the business makes it ideal for long term cash flow-backed finance. This underlying view, enhanced as described earlier by covenants and tranching structures, allowed the rating agencies to give the structure as a whole an investment grade rating, with the senior bonds at a level of A.

Bank bridging structure

The strength of the structure was of great importance, particularly since the bonds were issued into what is generally viewed as the most difficult market conditions in many proponents' memories. What is more, the opportunity to purchase the Blue Boar and Take a Break chains came in the midst of structuring and documentation, increasing the debt size from around £140m to around £210m. The bank bridging structure allowed for these purchases to be funded quickly prior to a longer-term issue, and for the effects of such an increase to be incorporated into the bond funding before the marketing and sale of such funding.

As in most bids, speed was of the essence, and so the ability to provide cash quickly was key to the successful conclusion of the deal. At the same time, the amount of money required would not have been feasible in the banking market, in which the shorter maturities do not allow for repayment at a sensible level and for debt service cover. A bond take-out was therefore necessary to provide comfort for the bridging bank.

Market conditions

The existing market conditions provided a difficult background into which to launch bonds of A and BBB credit rating. However, the strength of underlying demand in the UK institutions became apparent as Barclays Capital canvassed the market.

Although short-term concerns centred on liquidity, the basic demand for decent credits at premium yields was still very much present. Large falls in gilt-edged yields, together with a perceived global liquidity crunch, had led to a widening in margins, and this was apparent from the final margins achieved for the issue (230bp for the A rated bonds and 300bp for the BBB subordinated bonds) compared with those a year earlier for Welcome Break (95bp and 130bp, respectively). However, on an absolute basis, the costs to the borrower were among the lowest achieved for financings of this type. Just as important, the bonds were well placed with the core UK institutions. Yield margin was undoubtedly a major factor in their investment intentions, but it is also worth noting that an understanding of the underlying credit story was prerequisite to any positive investment decision, as was, crucially, the perception of ongoing liquidity and trading support in the secondary market from the sponsor of the issue.

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One of the effects of the events of late 1998 was to remove from the secondary market a considerable amount of liquidity. Whereas prior to such events, the perception of secondary market liquidity was less of a factor, and probably only a pricing matter, there has been a hardening of attitude among investors who now demand a higher level of commitment to market making in bonds sponsored by the relevant bank.

Thus, not only does the structure of the bond have to provide sufficient comfort on credit, and a pricing in line with expectations, but the sponsoring bank must also be seen to be a long-term supporter of secondary trading in the UK bond markets.

Conclusion

It is difficult to summarise a complex deal of this nature in a short article, but the Roadchef transaction demonstrates well the fundamentals that apply to 'securitisation' in the UK market. The regulated nature of the business, the long-term assets, and the non-volatile cash flows provided underlying credit support, the structuring techniques borrowed from the project and securitisation markets enhanced this credit in the most cost-efficient manner, and the long-term investment intentions of the UK institutional market provided the end-user demand to allow for successful bridging and final sale of the bonds. ■

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