

DEMERGER C&W

Convertible bonds

C&W 5.75% 2014

What is new fair value?

Summary Terms

Isin	XS0468712863
Name	C&W 5.75% '14
Maturity	24/11/2014
Outstanding	
Call	
Data	15/12/2012
Trigger/price	130%/100%
Put	-
CB ccy	GBP
Equity ccy.	GBP

Equity

Ticker	CW/ LN
Name	CWW
Market Cap	£2.4Bn
Spot	90p
Consensus	4 Buy
(since 03/26)	3 Neutral

Competitors *Market Cap (£Bn)*

Colt (<i>Ba3/BB-</i>)	1.15
Iliad	3.72
Fastweb	1.01
Tele2	5.04
United Internet	2.45

The demerger took effect on 26 March 2010 but the new conversion ratio will only be set after 20 trading days.

Announced in November, the demerger of Cable & Wireless Plc into two businesses means a new underlying/issuer for bondholders: Cable & Wireless Worldwide (CWW).

CWW is specialised in communications services to large enterprise, reseller and carrier customers. 52% of revenue come from IP, data and hosting (71% of margin) and 46% from traditional voice (27% of margin). It operates globally, but its core market is the UK (UK's biggest fibre network – 90% of revenue). It provides connectivity in 153 countries.

After CWW was legally split apart from Cable & Wireless Communications, S&P raised its rating on CWC from BB- to BB, implicitly recognising that CWW's risk profile had depressed the rating.

The agency also said it would not cover CWW.

This risk measurement was already reflected in the pricing of the CB (issuer credit spread 360bp vs. 5Y CDS 260bp).

Valuation of CB before demerger

CB price	111%
Underlying	148p
Issuer credit	360bp
=> IV	24.7%

To factor in the change in the underlying, the conversion ratio (NCR) will be adjusted based on the formula given at the time of the issue:

$$NCR = ICR \times \frac{1}{20} \sum_{n=1}^{20} \frac{An + Bn}{APn}$$

An: Daily VWAP over 20 days, CW Worldwide shares x Worldwide Demerger Ratio (=1).

Bn: Daily VWAP over 20 days, CW Communications shares x Communications Demerger Ratio (=1).

APn: Daily VWAP over 20 days, CW Worldwide shares.

This implies a current NCR of 87 447 vs. Initial Conversion Ratio = 54 318.

The final ratio will only be calculated after the trading session of 26 April 2010.

Convertible Research

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Valuation of new CB

Based on previous assumptions (credit 360bp, IV 24.7%), the theoretical price of the New Cable would be 107.3% vs. a market price of between 110.6% and 111.4%.

► However, can we “realistically” stick to this volatility estimate for CWW when the underlying has only been trading for three days?

► We can also ask where the real credit risk lies?

CWC straight bond 8.75% 2012 is currently trading at about 340bp, knowing that CWC's in theory has a more conservative risk profile than CWW, and 5Y CDS is trading at 260bp. These levels give an indication of the possible maximum tightening

Sensitivity of theoretical price

		Crédit			
		300bp	360bp	400bp	450bp
V	20%	106,6	104,8	103,7	102,3
O	25%	109,3	107,5	106,4	105,0
L	30%	111,9	110,1	109,0	107,6

Assumptions which frame the market price.

This table suggests that the CB would be “fairly priced” at between 110.8% and 111.5%.

Theoretical directional gain in the event of takeover bid

With its scope now clearly defined, the new company becomes an obvious target in a consolidating sector.

CB price + accrued: 113.1%

Price of underlying: 90p

Takeover premium: 20%

Post-bid price: 108p

Theoretical price of CB: new ratio resulting from COC (113 949) x 108p, or 122.4%

Implied gain: 10.8%

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