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## PECO Energy's Dual Deal Successful Tender Paves Way for Refunding

By David Hoffman

After convincing a majority of its existing bondholders to tender their noncallable bonds in a modified Dutch auction, Philadelphia-based **PECO Energy** is planning to issue up to \$300 million of pollution-control refunding bonds this week through an unusual deal split between two Pennsylvania authorities.

The **Montgomery County Industrial Development Authority** will issue up to \$217 million of bonds for the company, and the **Delaware County Industrial Development Authority** expects to issue up to \$90 million. Preliminary pricing is expected tomorrow, but the actual sale is scheduled for Wednesday. The Montgomery County bonds will carry a final maturity in 2034, and the Delaware County bonds will be due in 2021.

Bonds issued by both authorities are expected to feature identical structures, according to **Joseph Fichera**, a managing director with **Prudential Securities Inc.**, which is managing the Dutch auction, and is the lead underwriter for the DCIDA portion of the deal. Fichera said PECO is leaning towards issuing the Delaware County bonds with a five-year mandatory put, and expects the company to issue the MCIDA bonds in the same manner.

That feature would essentially permit the utility to reprice and restructure the bonds after five years, allowing it to consider changing the term of the bonds — for instance, changing them to a variable-rate structure. Pricing on the long end of the yield curve has deteriorated relative to intermediate-range bonds, and it makes more sense economically to issue the intermediate bonds now, **Lehman Brothers** are the co-

lead managers for the Montgomery County agency's portion of the deal, said **Gerald Birkelbach**, MCIDA executive director. Birkelbach said a final structure for the deal had not yet been agreed to. He added that even though the authority has the approval to issue up to \$217 million of bonds, it will probably only issue about \$110 million.

The bonds — which are expected to receive a Baa2 rating from **Moody's Investors Service** and a BBB-plus rating from **Standard & Poor's** — would be unsecured and have no first mortgage on the facilities, Fichera said. The ratings

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would be based solely on the credit strength of the company. Some of the debt will be subject to the alternative minimum tax.

Despite the relatively low ratings, Fichera said he expects the deal to sell well because PECO is such a well-known and respected public utility. The company sold over \$4 billion worth of taxable debt in March to recover stranded costs it incurred after the recent deregulation of the utilities industry in Pennsylvania, and that deal was well received by the market.

The weighted average cost of the transition bonds, which carried maturities ranging from 1.3 years to 8.9 years, was approximately 5.8%. Yields ranged from about 50 basis point to slightly more than

100 points above yields on Treasuries with comparable maturities.

Most fund managers watching the activity around PECO's latest tax-exempt deal said they believe it will also do well. Even though the utility is a corporate credit, the public power sector as a whole is a fairly stable one, despite recent turmoil surrounding deregulation.

**Maureen Newman**, a high-yield fund manager with **Colonial Management Associates Inc.**, said while public utilities companies are having to adjust to a new environment, investors must be careful not to paint the entire industry with one brush. Whether a utility is a good investment depends on factors such as the rates power companies charge, and how well they are managed, Newman said.

**Rob Hornick**, a senior director with **Fitch IBCA Inc.**, which gives PECO's senior secured debt an A-minus rating, said his agency looks favorably at the company, even though the bundled power rates it charges its customers are slightly higher than its competitors'. PECO, however, is guaranteed a steady flow of revenue because it is an energy generator used by other power companies, and it is highly unlikely that a competitor will invest in the equipment to take that away, Hornick said.

Newman also said she didn't think the market would be less receptive to PECO's latest deal just because it sold over \$4 billion of taxable debt earlier in the year.

"If [the sale] had any impact on [PECO's] balance sheet, then that would be considered as part of the analysis process, but the fact they just came to market really by itself will not have a big impact," Newman said. "There's also different

buyers in the tax-exempt versus taxable market, so you're not trying to get the same people to buy more bonds. You've got a new audience."

One factor that could become a concern for potential investors, however, is the merger between PECO and the Chicago-based **Unicom Corp.** announced last week, said **Bill Veronda**, a high-yield fund manager for **PaineWebber Inc.** Unicom owns **Commonwealth Edison.**

"The initial thought is how will this affect this PECO issue that's coming?" Veronda asked. "Commonwealth Edison is badly strapped with very expensive nuclear plants that came in well over budget and give them a high cost of power."

Fichera said he didn't think the merger would adversely affect the deal partly because it was a "merger of equals." According to a press release issued by officials from the power companies last week, the new holding company — which has not yet been given a name — will be run by a board of directors split evenly between PECO and Unicom. The new company's headquarters will be in Chicago, but generation and power marketing operations will remain in Philadelphia.

But the upcoming PECO offering is not just unusual because of the merger, or the fact that two different authorities will act as issuer for two practically identical issues. The deal also stands out because of the tender offer made to bondholders. It will be the third such deal Prudential has run.

"One of the great things about this [tender] process, and why we tell people to look at it, is that it is highly flexible to the extent that you are not committed [to a structure] until you see the offers and look at your alternatives," Fichera said. "There are no commitments that could blow the economics of the deal."

The tender offer is a way to take out noncallable bonds without using derivative structures such as swaps. In an analy-

sis Prudential performed for PECO in April, it determined the utility could produce \$572,000 a year more in cash savings by using a tender refinancing then it could if it used an above-market swap.

According to the Prudential report, a tender refinancing produces savings from the large differential in the old coupons versus the new coupon, taking into account all the tax effects and funding requirements of the premium. The yields on the outstanding bonds PECO hopes to take out go as high as 7.6%.

The large up-front swap payment given issuers in an above-market swap is not the equivalent of net present value savings of a

tainty as to whether you'll get many bonds in," said one derivatives banker. "You could end up having a tender offer and get 10% of the amount you want. To the extent that you're not successful and can't buy them in, you have to figure out how to get them in otherwise and that may mean you have to do another structure."

But Fichera said the upfront costs of a tender program are insignificant, and all refunding alternatives — including swaps — can be considered until the bonds have been tendered. The issuer then determines what makes the most sense economically, he said.

**Prudential's Joseph Fichera says he does not believe the "merger of equals" between PECO Energy and Unicom Corp. will adversely affect PECO's dual-issue deal.**



traditional refinancing as accomplished in a tender refinancing, according to the Prudential report. That is because the issuer essentially repays that payment by continuing to pay an interest rate that is above the issuer's current market rate, Fichera said.

Some of those specializing in derivatives, however, say Prudential's claims are overblown, and do not take into account certain risks associated with tender refinancing. They say the biggest risk is whether enough bondholders will agree to sell back the bonds and at what price. The deadline for bondholders to submit their offers to PECO was Friday, and it was expected that some would not make an offer.

"The biggest issue with tender programs is there is a high degree of uncer-

Also, the issue of what to do with those bonds that are not tendered is one that has not adversely affected those tender deals that have come before PECO's, Fichera said. In every tender deal managed by Prudential, over 50% of the bondholders have agreed to sell their bonds back to the issuer. Any bonds left outstanding in the upcoming PECO deal would remain outstanding, and would not affect the success of the deal, he said.

"It's sort of looked at as an internal hedge," Fichera said. "If interest rates do go lower then the company can save on the refinancing. If interest rates go higher, then they've done this tender and locked in savings. As a complete package, this is a good hedge against uncertainty going forward for the company." □



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