From The Times

April 12, 2007

Safeway departure was first step on road to bid rivalry

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RECOMMEND?

It all started in September 2005 with the seemingly innocuous announcement that Simon Laffin, the former finance and property director at Safeway, was joining CVC Capital, the British private equity firm, as its European retail adviser.

Buyout groups take on consultants and advisers from industry all the time — but Mr Laffin's appointment was different. The 14-year Safeway veteran was to begin work on CVC's most ambitious project to date: the buyout of J Sainsbury, Britain's third-biggest supermarket chain and the first FTSE 100 company potentially to fall prey to private equity.

Crucially, Mr Laffin was also an old friend of Justin King, Sainsbury's chief executive. The two worked together at Mars, where Mr Laffin was a senior accountant, and had been friends for 20 years.

Donald Mackenzie, CVC's managing director, was leading the team. They hired one of Goldman Sachs's top dealmakers, Richard Campbell-Breeden, to advise on the potential acquisition, and work on what would be Europe's biggest private equity deal soon began.

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However, it was not until February 1 this year, 18 months later, that news of CVC's plans was forced into the open by this newspaper after a source said that the buyout firm was planning a bid.

The following morning, on February 2, CVC, Blackstone and Kohlberg Kravis Roberts confirmed that they were considering an offer for Sainsbury's, sending its shares rallying and thrusting a trio of very private private equity firms into the spotlight.

Overnight, rival buyout groups and bankers scrambled to get involved. Cinven, another UK buyout group, met Texas Pacific Group (TPG), its American rival, and the two held tentative talks, brokered by Merrill Lynch, about forming a bidding team.

Yet news that TPG, one of the world's largest private equity firms, could run against them made the CVC-led group quickly open the door and invite TPG in. They accepted and Cinven was promptly shut out.

Sainsbury's advisers, Morgan Stanley and UBS, started to get their house in order, dusting off the group's property valuation and making a case for Sainsbury's value under Justin King, its chief executive, who was widely credited with a recovery at the group.

Several weeks passed with no word from the CVC group. Progress was hampered by the fact that Mr Campbell-Breeden and Mr Mackenzie both took time out to hit the ski slopes for half-term. Eventually, on March 6, Sainsbury's went to the UK Takeover Panel to issue the consortium with a deadline of April 13 to come up with a fully financed bid or walk away.

As CVC and its partners stepped up efforts to pull off Britain's biggest debt-backed buyout, so the trade unions stepped up their attacks against the industry, labelling private equity as job-cutters and asset-strippers.

Insiders said that the private equity firms began to get very nervous about launching a bid for fear of union backlash. Some, particularly Blackstone, began to get cold feet.

Nevertheless, Mr Mackenzie was determined to press on and on March 12 the CVC group quietly approached Sainsbury's board with preliminary details of its offer.

The board, led by Sir Philip Hampton, was keen to do a deal, but said that they could not proceed until the group had reached agreement with Sainsbury's pensions trustees. They themselves had taken on an adviser, Penfida.

Sir Philip secretly was hoping to hear back from the bidders the following week, but things started to get tricky. After three weeks of talks, the trustees and private equity bidders could not reach agreement on the company's £477 million pension deficit or further contributions to the scheme.

With the clock ticking, the private equity group took the unprecedented decision to bypass the pension trustees and go back to the Sainsbury's board with an offer. They had to work quickly because Sir Philip was willing to extend the Panel deadline, but only if the board was in "meaningful discussions" with the consortium beforehand.

Last Thursday sources said that Mr Mackenzie had telephoned Sir Philip with an indicative offer of 562p a share. He hoped that would be enough to gain access to Sainsbury's books to complete due diligence and return within a week or two with a firm bid.

Yet no sooner had the offer been lodged than things started to go badly wrong. The Sainsbury family, which had stayed out of the limelight, roared in from the sidelines, saying that they would reject any bid below 600p.

Mr Mackenzie and his partners were knocked for six. All the signs had been that the family, led by Lord (David) Sainsbury of Turville, who controls 7.75 per cent of the stock, were willing to sell.

Frantic negotiations ensued over the Easter weekend, most of them by telephone, as Mr Mackenzie and Mr Campbell-Breeden were again away on holiday, this time at their respective villas in the South of France.

With the leading figures absent from the talks, Sainsbury's board, which was minded to recommend the offer, found itself in the difficult position of trying to persuade the Sainsbury family to back the bid.

The Lords would not be persuaded. The bidders worked around the clock on Sunday, running the numbers to squeeze out the extra pennies needed to get the family onside. Mr Mackenzie finally telephoned through a raised offer, of 582p a share, on Monday afternoon. The board put the offer to the family, but they refused to budge.

In a last-ditch attempt, Sainsbury's advisers met representatives of Lord Sainsbury on Tuesday morning in a town house owned by the Sainsbury family in London.

But, as one insider present at the meeting said, "it was clear they had no intention of changing their view".

The strategies

What CVC planned

— Invest £3bn over four or five years in new stores and extensions

— Open 3m more sq ft of retail space

— Offer employees and management a 15% stake in the company

— Offer existing shareholders 25% of the company via “stub” equity

— Divide the company into separate property and operating companies and carry out sale and leaseback of 125 stores securitised by Sainsbury's

What Justin King plans

— Raise sales by £2.5bn by end of three-year plan in 2008

— Achieve £400m of cost reductions

— Annual investment of 1 to 1.5 percentage points of margin through buying efficiencies

— 8-10% more space at cost of £1.3bn over two years

What they said . . .

The CVC camp

“Presumably David Sainsbury wants to sell his shares at between 600p and 700p. Given that he wants to give all his money away in his lifetime, I hope they are long livers in that family”

The Sainsbury family

“I do not, and never have, objected to any bid in principle, but emphasise I would only support one that I believe would make the business better and stronger. Sainsbury’s success has been based on a strong balance sheet and a largely freehold property base. Eroding these attributes would make the company more vulnerable to competitive pressures, which is not in the best long-term interests of the company, its customers, its staff, its shareholders or its pensioners” — Lord Sainsbury of Preston Candover

The Sainsbury’s board

“The key preconditions were outside the control of the board and related to the consortium’s proposed financing structure. The board explored with the consortium whether the key preconditions attached to the proposals were capable of being satisfied or could be revised, but the consortium concluded that this was not possible”

Robert Tchenguiz

“I have made a long-term investment in a property company that has a retail business”