

Bonds in as investors stay cool on hybrid issues

Hybrid issues are trickling back after the GFC but the more simple bond issues are in greater favour, writes **Mark Lawson**.

Perhaps two years ago, before the global financial crisis started to affect Australia, hybrid issues were increasing in popularity with both investors and organisations hoping to raise money.

New issues of these instruments, which are neither plain debt nor straight forward equity, are very few and far between. There is also no sign that the market will turn soon, although the reasons for this market pause are a matter of debate.

An exception is Santos's recently launched, \$500 million-plus Euro-bond denominated hybrid, although this is for the European rather than the local market.

One reason for the absence of hybrids both locally and internationally, particularly from Australian banks which used to issue them, is that the banks are waiting for regulatory uncertainties to be cleared up by the release of the Basel III (a set of rules covering permitted capital and liquidity ratios for banks). Those rules have now been released.

Another is the remaining general uncertainty in the market, particular as major share floats are also not doing well. Another, perhaps more persuasive reason, is that investors put money into hybrids in previous years only to be disappointed.

Brad Newcombe, director of fixed income research at FIIG Securities, which specialises in fixed interest investments, says that a popular form of hybrid before the crash was the so-called step-up securities.

These involved a bond with a return of say, 2.3-2.5 per cent above the bank bill swap rate with a set date by which it had to be redeemed.

If the issuing company chose not to redeem the bonds they would be required to increase the interest rate, perhaps by 2 or 3 percentage points, he says.

The new Santos instruments, which count as equity, will run for 50 years. But after seven years Santos can either redeem them or increase the interest rate by 1 percentage point.

Newcombe says that the market



Photo: TANVA LAKE

One reason for the lack of hybrids is that banks are waiting for the release of Basel III.

expected the corporations issuing step-ups before the financial crash to redeem them, rather than pay extra for the debt but then the GFC disrupted normal financing and the issuers were happy to pay extra percentage points to keep the debt in place.

Newcombe says that he believes the market will now shift away from hybrids to "more simple structures" which means bonds.

One group ready to endorse that forecast is Primary Health Care which is now issuing \$150 million five-year bonds under new Australian Securities and Investments Commission rules. Macquarie University also recently issued \$250 million worth of 10-year bonds, although both Macquarie and Primary remain rare examples of Australian organisations outside the finance industry issuing bonds.

Two recent examples of bond issues that are more typical of the market

are Bank of America recently selling \$1.2 billion of three-year bonds, and Credit Suisse issuing \$600 million of five-year bonds.

Vivek Prabhu, a portfolio manager at funds management group Perpetual, says that those who wanted to issue hybrid instruments are probably waiting for "a bit more clarity" in the market.

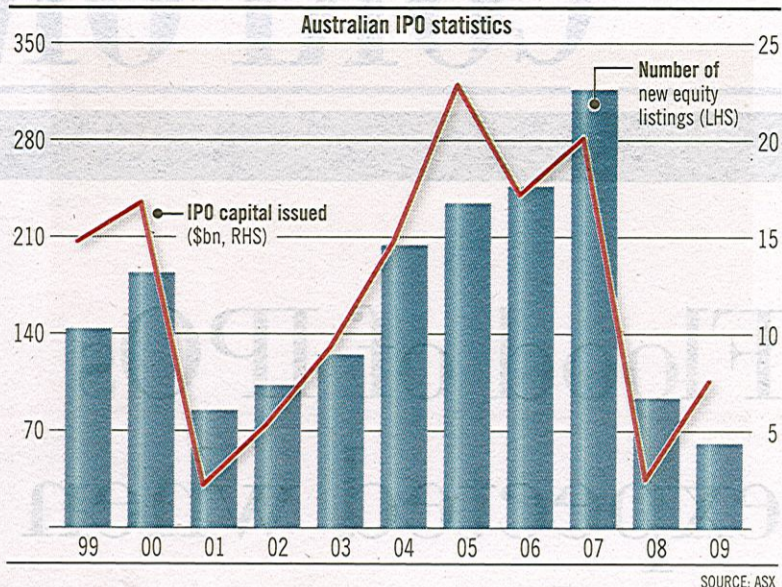
But it will be interesting to see what happens when major issues reach their reset date, such as a major issue by Fairfax Media which is due to reach its reset date in April of next year, he says.

The Fairfax step-up bonds, in turn, illustrate the difficulty of valuing issues other than plain bonds. In April, Fairfax will have to choose whether to redeem the \$300 million bonds at face value, convert them into ordinary shares or opt to continue the credit line at an increased interest rate.

The choice of converting, redeeming or stepping up the bond issue is forced on the issuer by international accounting rules. Unless there is some uncertainty in the issue then it may be classified as equity rather than debt.

Another problem in valuing hybrids is that bonds have an established place in the debt hierarchy in the event of a corporate collapse, usually ranking as senior debt, while hybrids could rank anywhere.

Cool climate for deals



Flood of IPOs wait on market mood

From page 1

STUCK IN A DOWN MARKET

- The level of backlogged IPOs is at a record high because the market is not attractive, being up one day and down the next.
- Investors are baulking at paying above market valuations for shares in floats.
- The majority of companies can afford to wait for markets to improve before floating.

administration. The car maker, which is 61 per cent owned by the US, is trying to raise between \$US12 billion and \$16 billion.

If the IPO proceeds it will become the second-largest in US history, behind Visa's \$US19.7 billion initial offering in March 2008.

Another well known international company waiting for its chance to list is popular internet telephone service Skype. The company is tipped to be trying to raise \$US100 million and could be the largest IPO in the technology sector since Google in 2004.

IPO markets may be shut in Australia, Europe and the US, but in India they are open for business.

"The IPO market in India has been explosive," Ries says.

"The level of oversubscription has been outstanding".

During the year 46 companies in India have listed, raising about \$US8.5 billion and there are more to come, including Coal India, which is selling a 10 per cent stake in the company to raise \$US2.7 billion.

On average IPOs in India have had an oversubscription of 14.6 times.

"The irony about India is that it has mostly been foreign investors picking up the stock," Ries says.

"People who won't take part in an IPO in the US or Europe have been buying all this Indian stock in companies you've never heard of."

While the market at home may

have been rough, it hasn't deterred some companies from pushing ahead with a listing on the Australian Stock Exchange.

The performance of the debutantes has varied widely, and has been a little on the cool side since Myer's infamous debut in November last year.

Hunnu Coal takes the cake as the best float recently. The Mongolian coal explorer has put on 340 per cent since listing early this year.

Hunnu Coal is hoping to produce thermal and coking coal for the Mongolian and Chinese markets and recently announced it had been granted an option to acquire another Mongolian coal project.

Of the listings on the stock exchange this year, more than half have been mineral explorers and most have raised small amounts to fund exploration in the range of \$10 million to \$20 million.