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CBA's \$500m deal short of expectations

RETAIL BONDS

Paulina Duran

There were high hopes for Commonwealth Bank of Australia's inaugural retail bond. It was tipped as the deal to kick-start the moribund local retail bond market and even provide a fund-raising alternative for major banks.

But the \$500 million deal, which is due to close on December 15, hasn't lived up to the hype.

"This is a very positive move for the market, it shows leadership by the bank and sets a very good standard of disclosure in the market," Mallesons Stephen Jaques partner Shannon Finch, who advised on the deal, says.

However, the initial size of the deal — as opposed to the \$1 billion-plus the market was tipping — looks discouraging at first glance.

"One would be very disappointed with that size after first announcing \$500 million," a senior banker not involved in the transaction says.

"If you only expect \$500 million you probably announce a

\$250 million deal at the beginning, with the expectation that you can then announce a \$500 million deal, so the outcome would appear more successful."

That's not to say the deal hasn't been a success.

CBA treasurer Lyn Cobley says the bank is happy to be a market leader, and already market players are tipping that other major banks will follow suit with a similarly structured retail bond.

"Adding the retail bond issue is consistent with our name in funding markets. We have opened new markets in a number of different jurisdictions, such as the first retail Italian bond issue earlier in the year and the first Thai baht issue last year," Cobley says.

"We are seen as market leaders and believe it's a very positive thing for CBA to show leadership in the funding markets."

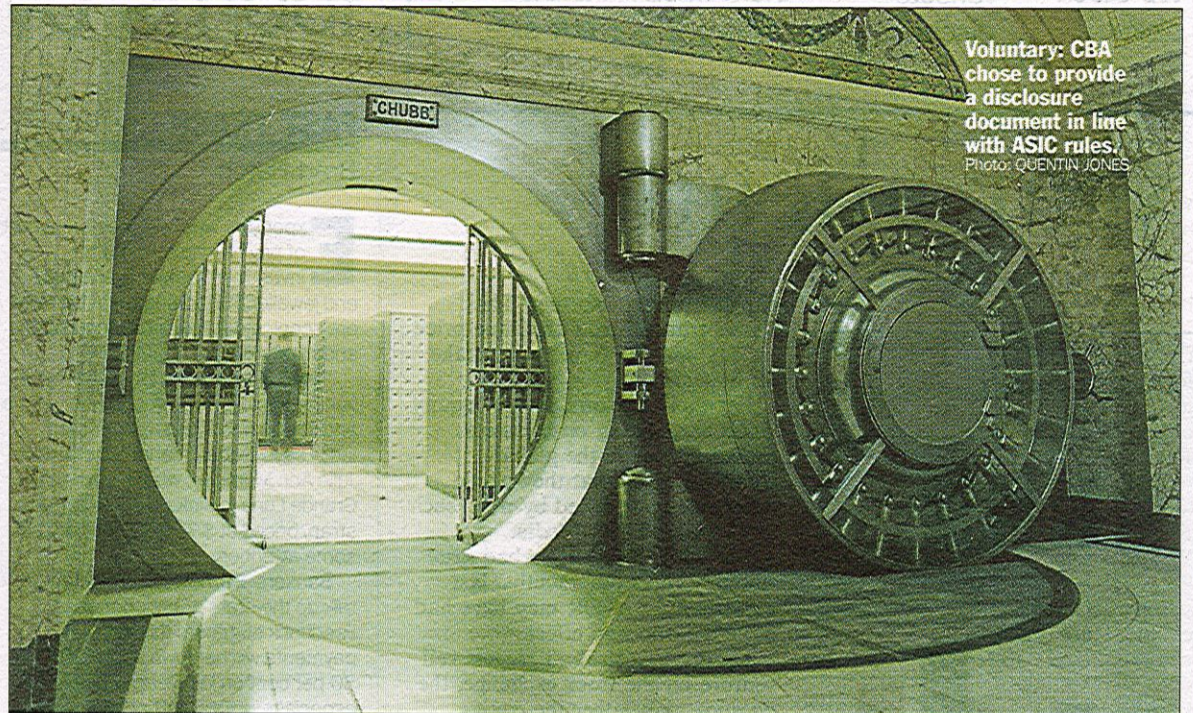
Cobley says the bank worked on the retail issue for several months, in consultation with advisers, lawyers, government agencies, cornerstone investors and brokers, on a range of issues extending from regulatory and disclosure requirements to investor appetite, pricing and market timing.

CBA's status as an authorised deposit-taking institution enables it to issue debentures without an offer document.

But the bank chose to provide a disclosure document broadly in line with the Australian Securities & Investments Commission's class order on vanilla bond prospectuses, complying with the minimum standard for corporate issuers.

In the past year, only three companies have issued fixed-income securities accessible to retail investors.

ALE Property Group issued \$125 million in 4½-year hybrid notes in May — mainly



Voluntary: CBA chose to provide a disclosure document in line with ASIC rules. Photo: QUENTIN JONES

taken up by institutional investors; Primary Health Care sold \$152.3 million in bonds — the first retail bond under the new ASIC disclosure rules designed to make it easier to meet disclosure requirements; and private equity-owned Healthscope also launched a \$175 million in hybrid instruments.

The limited deal flow, together with CBA's latest issue, signals the retail bond market is not going to be a multi-billion dollar market any time soon.

Instead, it is looking like the bulk of the market will be made up by small issues from the smaller sized and slightly "off the beaten track" companies.

The major banks however, are being more than good corporate citizens by backing the nascent retail bond market, and are likely to be well represented on it, with Westpac tipped to follow CBA's deal in the first part of next year.

"We would expect this market to be part of the stable of alternative funding tools," CBA's Cobley says.

Market experts say the move by the banks is consistent with strategies to capture investors set to reassess their deposit holdings when the removal of the government guarantee takes place next year.

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Companies on the other hand, are largely financed by banks — approximately 66 per cent — with 32 per cent of their funding sourced

dealfocus

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in equity markets, according to AMP Capital.

For some, CBA's deal is as much about diversifying funding sources as it is about testing the bank's private banking and retail portfolio network.

Investors are expected to demand a higher allocation to fixed income over time, driven in large part by the \$416 billion in the superannuation fund pool invested by self-managed and small super funds.

CommBank Retail Bonds Series 1 Tranche A, as the bonds are called, pay an initial coupon of 6 per cent, moving to a floating margin of 105 basis points over the bank bill rate for five years.

Their pricing competes more with the fixed 6.4 per cent rate a CBA five-year term deposit pays than with other, lower rated and riskier types of listed fixed income securities, or with the 7.27 per cent yield (10.3 per cent including franking credits) of an equity play on the bank stock.

Unlike term deposits, however, CBA's listed bonds pay a floating rate, transferring any benefits from increases in interest rates to investors and allowing them to exit their investment through secondary markets.

"The bond market is the easiest way to access fixed income investments. People with money in superannuation funds should be allocating a lot more of their assets to the retail bond market for diversification," director at fixed income broker FIIG Securities Brad Newcombe says.

"The potential demand is huge," he adds.

Besides setting a disclosure benchmark for the next retail issue, CBA's deal was innovative in that it saw brokers cut distribution fees in half to 50 basis points in expectation of large deal sizes and more frequent issuance, should other banks and companies follow the bank's lead, and taking into account the less risky characteristics of the securities.

"The lower participating broker fees also come down to the much lower risk asset and its broader appeal," a joint lead manager broke said.

Commonwealth Securities is leading the issue, along with lead managers Citigroup Global Markets, Evans and Partners, and RBS Equity Capital Markets.

FIIG Securities, Ord Minnett and Patersons Securities are co-managers of the deal. Lead managers get an extra fee of 25 basis points.



LYN COBLEY Commonwealth Bank treasurer

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