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Telstra Default Swaps Drop to 12-Month Low Versus Peers: Australia Credit

By Sarah McDonald and Robert Fenner - Oct 20, 2011

Telstra Corp.'s plan to relinquish control of its fixed-line network to the government for \$11.3 billion has made [Australia](#)'s third-biggest non-financial borrower the most creditworthy versus global peers in a year.

Credit-default swaps on Telstra tumbled 13 basis points this month to 145 basis points, approaching the cheapest relative to contracts on telecommunications companies worldwide since October 2010, according to CMA and Bloomberg prices. Relative yields on its U.S. dollar bonds are falling faster than similarly-rated peers, Bank of America Merrill Lynch data show.

Telstra, the nation's largest phone company, won shareholder backing this week for the plan that will give it a guaranteed cash flow for at least the next decade as the government builds a fiber network across the island continent. The Melbourne-based company joins banks and miners in beating global counterparts in credit markets as investors seek assets in an economy forecast to expand 4.3 percent in 2012.

"There is more certainty over cash flows at Telstra, underpinned by the agreement," said Brad Newcombe, a director at FIIG Securities Ltd., Australia's largest specialist fixed-income brokerage. Compensation from the government for giving up control of the copper-wire network can be used to "reduce debt and keep the balance sheet looking solid," he said.

Yield Spreads

The extra yield investors demand to hold Telstra's \$1 billion of 4.8 percent bonds due October 2021 instead of Treasuries fell 29 basis points, or 0.29 percentage point, this month to 201 basis points, Bank of America Merrill Lynch data show. The yield premium A rated, U.S. dollar bonds sold by phone companies worldwide shrank 25 to 171 in the same period.

Craig Middleton, a spokesman for Telstra, declined to comment on market perceptions of the company's debt.

Telstra management agreed in June to shut down the copper-wire network and grant access to its ducts and trenches so the A\$36 billion (\$36.6 billion) National Broadband Network can be

built. By cooperating with the government, the company avoided sanctions including bans on buying more spectrum for wireless services and the forced sale of its pay television assets.

Telstra is better off by A\$4.7 billion taking the A\$11 billion compensation than trying to keep its slower copper wires and compete with the NBN, Grant Samuel & Associates Pty, a Sydney-based corporate and investment adviser hired to assess the deal, said last month. It also allows the company to focus on faster-growing mobile services as households scrap traditional fixed lines.

The agreement needs approval from antitrust regulators.

Stable Outlook

Moody's Investors Service will confirm Telstra's rating at A2, the sixth-highest investment grade, with a "stable" outlook if it gets the regulatory approval, the risk assessor said in an Oct. 19 statement.

With A\$14.2 billion of borrowings outstanding as of June, Telstra is the nation's third-most indebted non-financial corporate borrower rated by Moody's, behind BHP Billiton Ltd. and Westfield Group, the credit assessor said in a report last month.

"The situation Telstra faces now is a lot better," [Michael Bush](#), Melbourne-based head of credit research at National Australia Bank Ltd, said. "Have the uncertainties fully gone? No, but compared to the scenarios we were considering 12 or 18 months ago, things are much better."

Swaps Tumble

The cost of insuring the debt of Telstra against default is headed for its biggest monthly decline since July 2010, according to CMA, which is owned by CME Group Inc. and compiles prices quoted by dealers in the privately negotiated market. The contracts were 75 basis points cheaper than an index of default-swaps on phone companies worldwide on Oct. 17, the biggest discount in 12 months, data compiled by Bloomberg and CMA show.

Telstra swaps may narrow as much as 15 basis points compared with the broader Australian index, Bush said.

The Markit iTraxx Australia index of credit-default swaps on 25 companies rose 7 yesterday to 190 as of 5:23 p.m. in Sydney, according to Deutsche Bank AG. It reached a more-than two-year high of 239 on Oct. 4 as policy makers battled to contain [Europe's](#) sovereign-debt crisis, CMA prices show.

Australian corporate bonds have returned 2.5 percent since June 30, compared with a 2.4 percent gain for U.S. company notes and 1.3 percent for comparable securities globally, Merrill Lynch indexes show.

Fastest Growth

Australia's economy will expand at the fastest pace among Group of 10 nations next year amid Chinese and Indian demand for iron ore and coal, according to analysts surveyed by Bloomberg. The projected 4.3 percent growth in 2012 compares with 1 percent in Europe and 2 percent in the U.S., the forecasts show.

Rising coal exports and resource investment should help shield Australia from a global economic slowdown emanating from the U.S. and Europe, Deloitte Access Economics said Oct. 19.

The government estimates Australia's pipeline of resource investment at A\$430 billion, with about 40 percent of plans already at an advanced stage.

Average cash holdings at Australian companies have increased to almost A\$1.6 billion from less than A\$700 million in 2007, Moody's said in a Sept. 19 report. All of the A\$23 billion in rated corporate debt maturing in the next two years is investment grade, it said.

The average cost of credit-default swaps on Australia & New Zealand Banking Group Ltd., [Commonwealth Bank of Australia](#), National Australia Bank and Westpac Banking Corp., the nation's four biggest lenders, dropped this month to 174 as of Oct. 19, the cheapest relative to global banks in at least two years, CMA and Bloomberg data show.

Government Bonds

Contracts on Melbourne-based BHP, the world's largest mining company, were 145 basis points cheaper than an index of global peers on Oct. 17, the biggest gap since July 2009, the data show.

The benchmark 10-year bond yield fell 5 basis points to 4.43 percent yesterday, or 229 basis points more than similar-maturity Treasuries. The government issued a new line of debt maturing in 2027 yesterday, its longest-maturity bond since 1984. The A\$3.25 billion of 4.75 percent bonds, the largest offering on record, were priced to yield 4.88 percent, according to the Australian Office of Financial Management.

The gap between yields on Australian [government bonds](#) and inflation-indexed notes shows investors estimate consumer prices will rise an average of 2.48 percent for the next five years, down from 2011's peak of 3.14 percent on May 6.

Telstra swaps cost 2 basis points more than contracts on rival Singtel Optus Pty, compared with 17 on Aug. 22, CMA prices show. Sydney-based Optus, a wholly owned unit of Singapore Telecommunications Ltd., is rated A+ by [Standard & Poor's](#) with a "stable" outlook, while Telstra holds an A grade with a "negative" outlook, according to Bloomberg data.

Telstra had 12.2 million mobile services in operation at June 30 compared with 9.1 million at second-ranked Optus.

Telstra is “a good cash business going forward and the NBN agreement underpins that with 30 years of cash flow,” said George Boubouras, head of investment strategy at UBS AG’s Australian wealth-management unit. “The regulatory risk was there but not anymore.”

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