Stock Market Review

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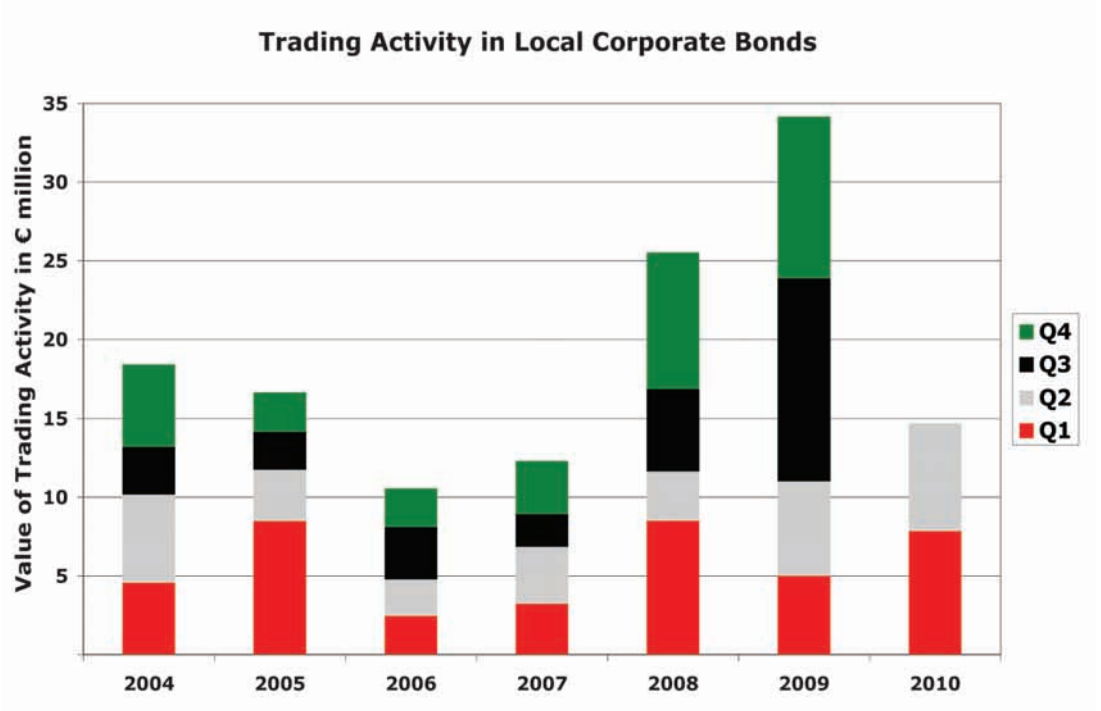
Excess demand for corporate bonds spills into secondary market

Investor appetite for fixed interest securities is very evident from the huge success registered in the many bond issues that have taken place in recent months. In addition to the two issues of Malta Government Stocks in February and May, 10 companies tapped the bond market since the start of the year. A total value of just over €550 million was offered so far this year, however, total demand exceeded €850 million leaving unsatisfied demand of circa €300 million seeking re-investment.

This continuous thirst for new fixed-interest securities on offer in the primary market has started to spill over into the secondary market as evidenced by the graph. During the first six months of 2010, €14.7 million worth of corporate bonds were traded through the Malta Stock Exchange trading mechanism, representing a 33.6 per cent increase from volumes traded in the corresponding period last year.



The improved level of trading activity in the corporate bond market is good news for investors and is a reflection of the increased popularity of this medium of investing among local investors. This is also very evident from the strong increase in the number of registered bondholders. While a few years ago, a company's bond register rarely surpassed the 2,000 mark, it is not uncommon nowadays for a company to have over 4,000 bondholders following a bond issue.

Many tend to wait for new issues to come on offer to make an investment. This is likely to change with more investors inclined to acquire bonds on offer in the secondary market in view of the heavy over-subscriptions for new issues and the likelihood of a smaller number of new issues coming on offer.

Apart from another tranche of Malta Government Stock issues expected early next month, the next corporate bond issue is unlikely to hit the market during the summer months. As a result, investors will be looking out for any supply of bonds already listed on the MSE to satisfy their investment requirements. Some corporate bonds have become more liquid in recent months and a more active two-way market is slowly developing, although this could improve dramatically should market-makers appear on the local exchange.

Financial institutions could also become more active and in the process help to promote the secondary market. They could also, at times, act as a buyer of last resort in some selected bonds emulating the role of the Central Bank of Malta stockbroker in the market for Malta Government Stocks. This would encourage an even wider range of investors to participate more actively on a daily basis in the market, in the knowledge that if the need arises to sell one's investment prior to maturity, it would be relatively easy to do so. Such a development could also help reduce the high level of over-subscription in new issues to the benefit of all concerned.

Admittedly, some investors may be deterred from participating in the secondary market because prices are generally at a premium to par value, however, this must be seen in the light of the overall return being achieved over the lifetime of the bond (i.e. the 'yield to maturity').

Many investors who have been investing in overseas bond markets even before the establishment of the local stock market understand this situation. Others are sometimes deterred by the amount of accrued interest which they have to fork out to acquire bonds in the market. This becomes problematic, especially with those bonds which pay interest only on an annual basis and are approaching the interest payment date. For a number of weeks until the payment date, trading activity in such bonds generally comes to a halt. As such, companies offering new bonds should actively consider resorting to semi-annual interest payments since this helps their bond to be more widely traded by investors, and therefore more liquid.

The bond buy-back programmes being conducted by a number of issuers in recent weeks is another means of providing added liquidity in the market. Such programmes are likely to increase in the future in view of the commitments by bond issuers to build up a sinking fund. It is very likely that a number of these companies will resort to the acquisition and cancellation of their own bonds rather than investing the funds that have to be set aside to satisfy their regulatory sinking fund obligations.

This is possibly what is currently happening at PAVI Shopping Complex plc. In recent weeks, this company announced that it acquired a total of €780,000 of its own bonds from the market and possibly also indicating to the market its healthy cash flow situation.

Only recently, Hotel San Antonio plc also announced that it would consider buying back up to €2 million worth of its own bonds, while in recent days Bank of Valletta plc repurchased and cancelled a total of USD1,416,000 of the 8 per cent BOV USD bonds due to be redeemed on October 2.

With the European Central Bank widely expected to maintain interest rates at the current historically low level of one per cent possibly well into 2011, the appetite for fixed interest securities by local investors may persist at least over the next 12 months. Given the extent of unsatisfied demand in the marketplace and the strong possibility of an absence of any rate hike over the next year, more companies may be enticed to tap the bond market under current conditions. When interest rates start rising, it is likely that investor demand will wane for some time.

While a fair number of companies have raised money in the market over recent years, there is a constant need for companies from different sectors to follow suit. This enables investors to diversify their bond content in their portfolio allowing them to spread their risk.

Admittedly, such fund-raising exercises entail certain costs, but more companies seem to be encouraged to follow this financing route given the long-term benefits that ought to accrue to them such as (i) a higher public profile for the company; (ii) the advantages of adhering to more stringent reporting obligations; (iii) the addition of non-executive directors providing guidance and advice on the overall strategic direction being employed; and (iv) the potential benefits of having a loyal investor base should another group company require to raise funds at a later date.

Overall developments over the past few years in the local bond market seem to indicate that the market now needs the constant attention of the regulators and the market practitioners to ensure its proper functioning to the advantage of all investors and the economy as a whole.

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