Stock Market Review

Bond redemptions in 2012

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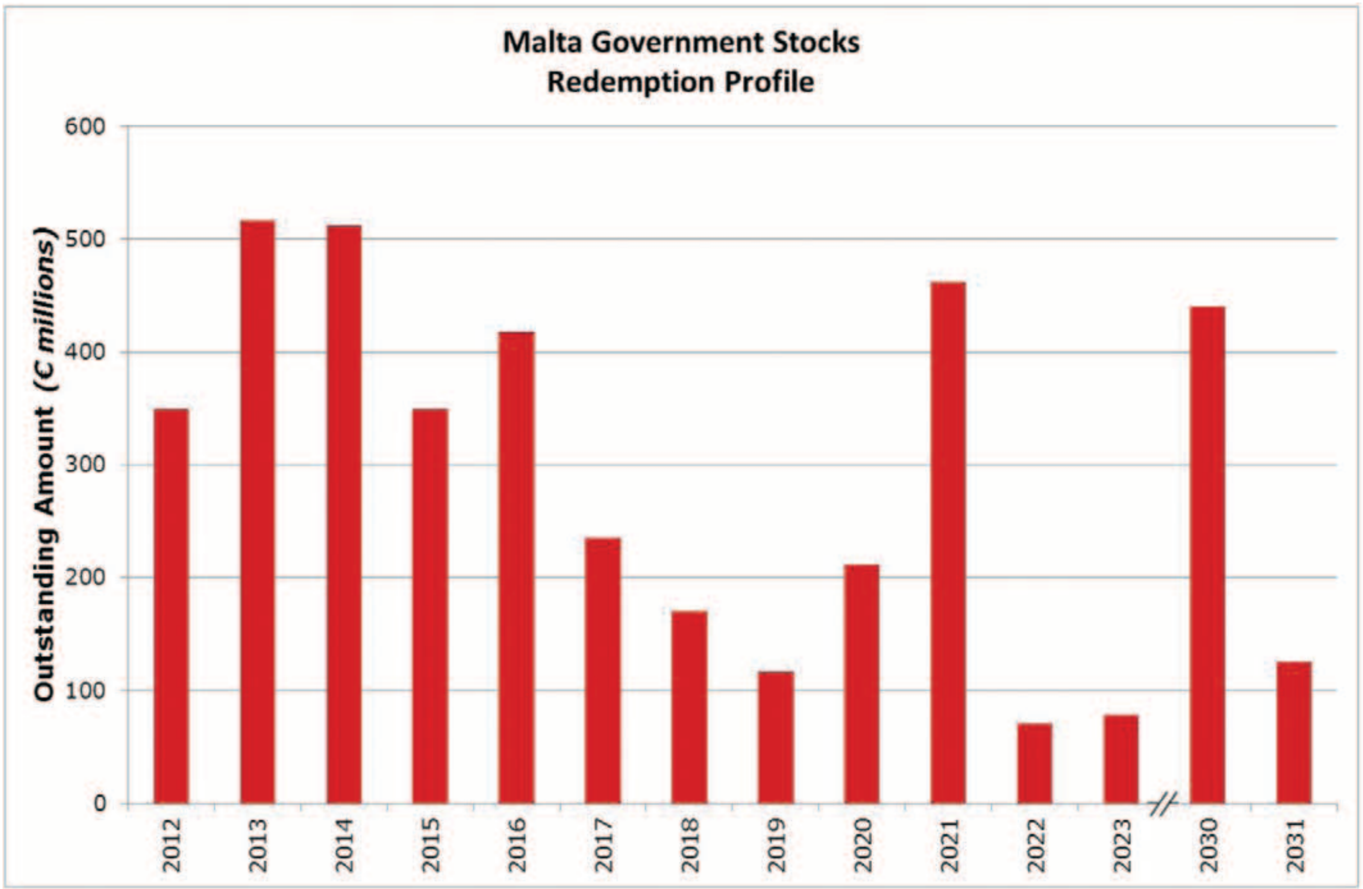

Next year, two Malta Government Stocks and three corporate bonds are due to mature. The redemptions of the three corporate bonds are of Corinthia Finance plc amounting to €14.6 million on April 8, Hotel San Antonio plc of €5.1 million on May 30, and Bay Street Finance plc of €2.7 million on June 26.

The original bond issues of Hotel San Antonio plc and Bay Street Finance plc had been for larger amounts. However, during the final quarter of 2010, both these companies carried out exercises to repurchase outstanding bonds from bondholders, reducing the current outstanding amount.

In October 2010, Bay Street Finance plc made an offer to all bondholders to buy-back their bonds at a price of 102 per cent. Bay Street Finance received acceptances totalling €3.7 million from bondholders, and following earlier purchases conducted on the secondary market, the company bought back 63.4 per cent of the original amount of bonds.

As a result, the original issue amounting to €7.6 million was reduced to €2.7 million which will be redeemed next June at the par value of 100 per cent. Bay Street had obtained full financing from its bankers to meet the bond repurchase programme conducted in 2010 as part of a general re-organisation of its financing facilities. In the offering document sent to bondholders last year, Bay Street had stated that it had no intention at the time to roll-over the bonds upon maturity and the remaining bondholders will receive a cash return from the company with the annual interest payment in June 2012.

Similarly, in December 2010, Hotel San Antonio plc made an offer to its bondholders to repurchase their bonds also at a price of 102 per cent. However, the offer was not as successful as that conducted by Bay Street Finance. Hotel San Antonio only managed to repurchase €0.68 million from bondholders, representing 11.7 per cent of the original amount of outstanding bonds.

These bonds were subsequently cancelled reducing the original issue to €5.1 million. Hotel San Antonio had also obtained bank financing to buy back the bonds and to cover the redemption of the bonds in May 2012 and to carry out further improvements to the hotel. As such, as in the case of Bay Street, Hotel San Antonio is likely to proceed with a cash redemption to all bondholders in five months' time. Corinthia Finance plc last approached the bond market in August 2009 with a successful €25 million issue mainly to cover the redemption of the 6.7 per cent 2009 bonds. The company is expected to make an official announcement in the first quarter of 2012 to explain its plans in respect of the €14.6 million bond maturing on April 8, 2012.

On the other hand, in view of the large amounts of Malta Government Stock redemptions taking place in 2012, 2013 and 2014, the Treasury recently launched a switch auction programme. In each of the coming three years, over €500 million is up for redemption and in view of these sizable amounts, the Treasury launched an initial exercise by offering to exchange up to €200 million of the 2012 MGS issue due on September 30 at a price of 103 per cent into a new five-year MGS issue – the 4.3 per cent MGS 2016 (IV).

The exchange auction was successful with the Treasury receiving bids in excess of the €200 million limit but accepted bids totalling €158.1 million in the 4.3 per cent MGS 2016 (IV). The Treasury subsequently cancelled €159.9 million (nominal) of the 5.7 per cent MGS 2012 (III), reducing the total amount outstanding of this stock to €268.9 million (nominal).

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The successful switch auction helped reduce the total MGS redemptions for 2012 to €348.9 million – this includes the €80 million MGS maturing on May 24. However, the total amount of new MGS issuance to take place next year will be in excess of this amount since the government will also be required to finance the projected budget deficit. In fact, during the 2012 Budget, the government earmarked a total of €700 million in new issuance for next year.

In view of the sizable amounts being redeemed also in 2013 and 2014, the MGS switch auction is likely to become a key feature of the new issuance calendar in the coming years.

Demand for fixed interest rate securities remains high in the local market and this was evidenced once again in last month's MGS issue where demand from retail investors amounted to an extraordinary €134.1 million – mainly for the 20-year bond. While local investors have always retained a high allocation to bonds in their investment portfolio, the evolving eurozone crisis continued to increase risk aversion thus contributing to the continued thirst for lower risk investments. Demand also increased following the reversal in recent weeks of the interest rate rises earlier on in the year. Interest rates have thus returned to their all-time lows and are likely to remain low for an extended period of time.

Recent statements by the major central banks indicate that this low interest rate environment is likely to persist for another two years due to the eurozone crisis and its expected impact on global economic performance. Given this backdrop of continued low interest rates and a recessionary economic environment, the strong demand for fixed interest securities evidenced in recent years is likely to persist in 2012 and beyond.

Aside from MGS issues which have continued to satisfy investor appetite, there were limited corporate bond opportunities for retail investors on the local market since the new Listing Policies were introduced in August 2010. Bank of Valletta plc was the only corporate issuer to tap the bond market this year.

The new Listing Policies introduced additional obligations and amended other conditions for bond issuers leading to a situation where non-financial companies are finding the policies unworkable. This development led to a renewed consultation process with some industry practitioners, and the new policies are currently being revised with a workable solution hopefully being found during the course of the first part of 2012 in the interest of the market as a whole.

While it is important that these new policies achieve the objectives of the MFSA (i.e. that of safeguarding the interest of the local retail investors), it is equally vital that the amendments also enable companies to retain the option of seeking funding directly from the capital market through the issue of investment instruments to retail investors.

In view of the low interest rates on term deposits offered by the larger local commercial banks, a lack of local bond issuance may continue to tempt investors to be exposed to higher risk by seeking improved returns in overseas markets which would not normally fit into their risk/return profile.

Unfortunately, in recent months, this has resulted in many retail investors getting exposed to undue risk through investments in certain foreign bonds (not necessarily of the plain vanilla type) and complex financial products suffering substantial losses in value in the process. Such a reality must also be considered to safeguard the interests of local retail investors.