Stock Market Review

6th bond issue by Gasan Finance Company plc

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The last week of October proved to be a very hectic one for the investing public. Within the space of a few hours on Monday October 21, both International Hotel Investments plc and Gasan Finance Company plc announced details of their new bond issues. A few days later, the Malta Treasury announced the offer prices for the two new Malta Government Stock issues totalling up to €180 million. On the other hand, FIMBank plc redeemed its seven per cent bonds on October 30 denominated both in euros and US dollars. Investors are now seeking alternative investment opportunities for the equivalent of €32.6 million returned to them by FIMBank plc yesterday.

The new IHI bond issue is for only €10 million and since this is below the total of €12.5 million up for redemption in March 2014, the public has very little chance (if at all) of successfully applying for some of these bonds since holders of the maturing bonds have preferential allocation. Although the rate of 5.8 per cent is below the coupon of the maturing bonds, a large majority of holders of IHI bonds would presumably accept the new terms thereby crowding out the amount that may be applied for by other investors.

On the other hand, while holders of the €20 million maturing Gasan bonds also have preferential allotment for the new bonds, the total amount being issued by Gasan is of €25 million. Hence an amount of at least €5 million is available for subscription by the public. This week's article provides some additional information on the Gasan Finance Company offering.

Gasan Finance Company plc launched a Bond Exchange Programme offering holders of the six per cent bonds (which will be redeemed on May 31, 2014) the option of surrendering all or a part of their old bonds in exchange for the new bonds with a coupon of 4.9 per cent per annum and priced at par (100 per cent).

The timetable for the Bond Exchange Programme coincides with the semi-annual interest payment on November 30. As such all holders of the six per cent Gasan Finance bonds will receive the six-month interest on these bonds irrespective of whether a decision is taken to surrender the old bonds or to keep them until maturity. Bondholders who accept to switch into the new 4.9 per cent bonds at par will on May 31, 2014 also receive the accumulated interest on the surrendered bonds for the five-day period December 1, 2013 and December 5, 2013. This is the date when interest on the new bond will start to accrue.

Holders of the maturing bonds are being given the option either to surrender the six per cent bonds now in exchange for the new offering of 4.9 per cent or to hold onto the six per cent bonds until May 31, 2014 and then receiving their capital upon maturity.

However, it is also important for bondholders to understand that those accepting to surrender their old bonds to re-invest in the new bonds will not receive any compensation for the interest differential of 1.1 per cent per annum being the difference between the coupon of the maturing bond of 6 per cent and the new bond of 4.9 per cent for the period between December 5, 2013 and May 31, 2014 (being the redemption date of the maturing six per cent bonds). Although acceptance of an exchange programme is always entirely at the discretion of bondholders, compensation for the interest differential had been made in the past to investors by other local companies.

Investors should also note that interest on the new bonds will be made annually on November 14, unlike the maturing six per cent bonds which pays interest semi-annually on May 30 and November 30.

Holders of the maturing bonds should have received a pre-printed personalised application form earlier this week and those wishing to take up the exchange offer would need to submit this form duly completed and signed to their financial intermediary by November 14.

An amount of just over €20 million is reserved for holders of the maturing bonds. Such applicants are guaranteed full allotment for the amount of maturing bonds subject to a minimum application of €1,000. Moreover, preferred applicants who wish to subscribe for additional amounts over and above the amount of bonds being surrendered will be given preference over other investors up to the maximum amount of €20 million which is being reserved for such applicants.

As such, it is likely that the portion reserved for new investors will amount to only €5 million. The offer period for this remaining amount opens on November 18.

This is the first corporate bond issuer (other than a bank) that is offering a coupon below five per cent per annum. The response from the public in this respect will very likely guide other issuers planning to launch new bonds next year. The new Gasan bonds at 4.9 per cent per annum are priced at a premium of circa 200 basis points (two per cent) over an equivalent eight-year Government bond. The extent of the premium that a corporate bond issuer should offer to compensate investors for the additional risk over the 'benchmark' is dependent on various factors including the profile and business activities of the company and its financial strength. The size of such a premium is a highly subjective and debatable topic. Given the present low interest rate scenario, it makes perfect sense for companies to issue bonds at this juncture and lock-in their obligations at attractive rates for a longish period of time. This should instigate other issuers to also tap the bond market next year.

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When debating the adequate rate of interest being offered by companies on their debt obligations, the fundamental strength of such issuers needs to be compared to other issuers in the market.

The financial analysis summary in relation to this issue annexed to the prospectus published last week by Gasan Finance Company provides a comparison of Gasan Finance to other general purpose finance vehicles across the market. However, many of these finance companies that have their bonds listed on the MSE are guaranteed by the group parent company and simply lend the money raised to the guarantor for its business activities.

On the other hand, Gasan Finance is one of the few special purpose vehicles that also has other property assets within the finance company from where it generates income. As such, Gasan Finance Company is not exactly comparable to other finance vehicles.

In my view, an analyst should consider the financial indicators of the Gasan Group as a whole and compare these to other established group companies such as the Tumas Group, the Mizzi Organisation and the Simonds Farsons Cisk Group.

Furthermore, the Gasan Group financials ought to be analysed rather than the financials of the issuer since the Mrieħel Gasan Centre is one of the main assets of the finance company. The centre is leased to Gasan Properties (a fully-owned subsidiary of Gasan Group Ltd) which in turn sublets some areas within the centre to other group companies. Additionally, one of the principal activities of Gasan Finance Company is to raise financing from capital markets which it then uses to finance the group's operations and capital projects. Presently, Gasan Finance Company plc has two loan agreements with group companies, namely a €15.8 million loan with Gasan Enterprises Ltd (which acts as the investment vehicle of the group holding various investments including the 12 per cent shareholding in Melita plc and the 9.06 per cent stake in MIDI plc) and a €5 million loan with Gasan Group Ltd (which is the parent company of the Gasan Group).

As such, these loan agreements clearly indicate that Gasan Finance is dependent on the operations of Gasan Group Ltd although the bonds are not guaranteed by the group company, unlike many similar issues in Malta. In view of the dependency on the Gasan Group, an investor ought to gain a better understanding of the group's current financial strength and its future outlook.

In this respect, the financial statements of Gasan Group Ltd for 2012 indicate a very strong interest cover of 3.9 times and a relatively conservative gearing ratio of 42 per cent.

A large part of the presentation delivered by chairman Joe Gasan to the numerous financial intermediaries last week provided very useful information on the origins and the current business activities of the Gasan Group.

The core activities of the Gasan Group are in four main areas: (i) automotive and marine; (ii) insurance and finance; (iii) property and (iv) engineering. The Group also has investments in other businesses including Melita plc, Chemimart Group, MIDI plc and in the Comino hotel and villas.

Mr Gasan proudly remarked that the Gasan Group was the first private company to launch a bond issue in 1994 as he was always of the view that companies should have diversified sources of funding.

He also explained that although the Gasan Group is not a public company with its shares listed on the MSE, it seeks to adopt similar corporate governance structures.

With respect to the outlook for the various business activities, Mr Gasan indicated that the property development area has various interesting projects in the pipeline. He made specific reference to the plot of land in Mrieħel located beside the Gasan centre which is being developed into a 10,000 sqm business centre. This project is being carried out jointly with the Tumas Group and Mr Gasan is confident that this could be another successful project given the substantial demand for good office facilities in the area supported by adequate parking.

Mr Gasan did not rule out the use of the bond market for some new property development initiatives. It is also likely that other companies will similarly use the capital market to fund their financing requirements and present viable investment opportunities to the investing public given the significant liquidity available across the financial system seeking a fair rate of interest.