

## Stock Market Review

# Analysing Malta's corporate bond issuers

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The European Central Bank reduced interest rates by a further 50 basis points on November 6 on the back of the global coordinated rate cut also of 50 basis points on October 8. ECB president Jean Claude Trichet did not rule out further easing of monetary policy and various commentators expect a eurozone benchmark rate closer to 2 per cent during 2009.

In the light of this scenario, investors holding bank deposits or Treasury bills are likely to seek higher rates of return from longer-term investments. Local corporate bond yields vary from 5.1 per cent per annum to 9 per cent *per annum*. Good quality corporate bonds are therefore expected to remain in strong demand and new bond issues should remain popular as long as pricing is commensurate with the company's risk profile, project feasibility, competing market interest rates and general market conditions at the time of issue.

As such, whereas it has been the practice generally to only keep track of the annual financial performances of those companies which have their equity listed on the Malta Stock Exchange, it is also important to follow and analyse the annual accounts of bond issuers. While a fair degree of analysis is normally conducted at the initial launch of a bond issue due to the availability of financial information by issuers, corporate bond issuers should increase their efforts to make more timely information available to allow the market to monitor the state of affairs of borrowers during the lifetime of the bond.

This will help advisers and investors understand the ongoing ability of the company to cover periodic interest payments and to be in a position to meet the eventual repayment of the bond. This is especially important locally since bond issuers in Malta are not rated by approved rating agencies. On the other hand, when seeking to purchase bonds on the international markets, investors can verify the issuer's rating prior to investing.

Companies rated BBB and higher are classified as "investment grade" with the highest rating being AAA. Such ratings fluctuate depending on a company's financial performance and future outlook which would alter an issuer's risk profile. It is recommended that local bond investors get accustomed to ratings classification and accompanying descriptions through the respective rating agencies websites ([www.moody.com](http://www.moody.com); [www.fitchibca.com](http://www.fitchibca.com); [www.standardandpoors.com](http://www.standardandpoors.com)).

Equity investors would tend to mainly focus on the bottom line of a company's results, i.e. the after-tax profits, since this figure normally influences the amount of dividend that could be paid to shareholders. Furthermore, the level of profitability would normally also impact a company's share price in the market. On the other hand, bond investors should focus on the company's operating profit and compare this to the total interest expense on bank loans

and other borrowings. This so called "interest cover" indicates the ability of a company to meet its interest payments.

Apart from the interest cover, investors should also take into account the amount of equity in comparison to a company's level of debt. This helps analysts understand the extent of the company's leverage and whether the outstanding debt could be rolled over at a later stage. The debt to equity ratio, also known as the gearing ratio, measures the relative proportion of equity and debt used to finance a company's assets.

Thirty one bonds are presently listed on the Malta Stock Exchange of which 24 feature on the Official List while those companies which have a very limited track record are listed on the second-tier market - the Alternative Companies List. All bonds are denominated in euro with the exception of the 8 per cent Bank of Valletta plc 2010 bond denominated in US dollars. In many instances companies create a special purpose vehicle, i.e. a finance company to undertake the bond issue. In such circumstances investors should analyse the performance of the group company or guarantor which receives the proceeds of the bond issue from the finance company.

The tables show the interest cover and gearing ratio of the existing issuers of bonds. Bank of Valletta, HSBC and the European Investment Bank have been excluded since such ratios are not really appropriate to banks. Also excluded are the October 2007 figures of AX Holdings Ltd since their financial statements have not been published while the CareMalta Group only published its abridged accounts and such accounts are not sufficient to calculate the interest cover. Moreover the accounts of Mariner Spa, the guarantor of the Mariner Finance bonds, are not available since the company is not registered in Malta.

On the Official List, the highest interest cover is that of the Gasan Group with a ratio of over seven times. Gasan also has the best gearing ratio. In fact as at December 2007 the Group's cash and financial investments exceeded the total level of debt largely following the sale of its shareholding in Melita Cable plc during the year for a value of €71.7 million.

Simonds Farsons Cisk also has a very high interest cover of 6.6 times and this is followed by the individual companies forming the Mizzi Organisation Group with an interest cover of over five times. On the other hand, the lowest interest cover is of GlobalCapital closely followed by United Group. The United Group and Eden Leisure Group are the most leveraged companies with a debt to equity ratio of 2.4 times implying that the level of debt is close to three times the amount of capital and retained earnings.

On the Alternative List, the Annual Report of Pavi Shopping Complex plc for the year to April 30, 2008 reveals an interest cover of almost 3.4 times followed by the guarantor of the Big Bon bond issue with a cover of 2.3 times. The interest cover of Mediterranean Investments Holding and GAP Developments cannot be computed since these are still in start-up phase and do not have sufficient revenue to cover interest payments for the time being.

MIH, however, had disclosed in their recent Prospectus that the com-

#### INTEREST COVER

Issuer	Guarantor / Parent Company	2007
<b>Official List</b>		
Gasan Finance plc	Gasan Group Ltd	7.20
Simonds Farsons Cisk plc	Simonds Farsons Cisk plc	6.58 <sup>1</sup>
Mizzi Organisation Finance plc	Mizzi Holdings, Consolidated Holdings Ltd, General Soft Drinks Ltd, Kastell Ltd	5.12
Dolmen Properties plc	Dolmen Properties plc	4.46
International Hotel Inv. plc	International Hotel Investments plc	3.45
Tumas Investments plc	Spinola Development Co Ltd	3.05
Eden Finance plc	Eden Leisure Group Ltd	2.29
Corinthia Finance plc	Corinthia Palace Hotel Co. Ltd	2.00
United Finance plc	United Group Ltd	1.74
GlobalCapital plc	GlobalCapital plc	1.68
AX Investments plc	AX Holdings Ltd	N/A
Mariner Finance plc	Mariner S.p.A	N/A
CareMalta Group Ltd	CareMalta Group Ltd	N/A
<b>Alternative Companies List</b>		
Pavi Shopping Complex plc	Pavi Shopping Complex plc	3.39 <sup>2</sup>
Big Bon Finance plc	Alhambra Complex Ltd and Alhambra Trading Ltd	2.31 <sup>3</sup>
Hotel San Antonio plc	Hotel San Antonio plc	1.86
Bay Street Finance plc	Bay Street Holdings Ltd	1.65
Mediterranean Investments Holding plc	Mediterranean Investments Holding plc	N/A
GAP Developments plc	GAP Developments plc	N/A

<sup>1</sup> Based on financial year ending 31 January 2008

<sup>2</sup> Based on financial year ending 30 April 2008

<sup>3</sup> Based on financial year ending 30 April 2008

#### GEARING RATIO (DEBT TO EQUITY)

Issuer	Guarantor / Parent Company	2007
<b>Official List</b>		
Gasan Finance plc	Gasan Group Ltd	(0.14)
International Hotel Investments plc	International Hotel Investments plc	0.30 <sup>1</sup>
Dolmen Properties plc	Dolmen Properties plc	0.30
Simonds Farsons Cisk plc	Simonds Farsons Cisk plc	0.52
GlobalCapital plc	GlobalCapital plc	0.55 <sup>2</sup>
Corinthia Finance plc	Corinthia Palace Hotel Co. Ltd	0.67
Mizzi Organisation Finance plc	Mizzi Holdings, Consolidated Holdings Ltd, General Soft Drinks Ltd, Kastell Ltd	0.77
CareMalta Finance plc	CareMalta Group Ltd	1.31
Tumas Investments plc	Spinola Development Co Ltd	1.40
Eden Finance plc	Eden Leisure Group Ltd	2.40
United Finance plc	United Group Ltd	2.40
AX Investments plc	AX Holdings Ltd	N/A
Mariner Finance plc	Mariner S.p.A	N/A
<b>Alternative Companies List</b>		
Mediterranean Investments Holding plc	Mediterranean Investments Holding plc	(0.03)
Big Bon Finance plc	Alhambra Complex Ltd and Alhambra Trading Ltd	0.69
Pavi Shopping Complex plc	Pavi Shopping Complex plc	1.40
Hotel San Antonio plc	Hotel San Antonio plc	2.02
Bay Street Finance plc	Bay Street Holdings Ltd	2.42
GAP Developments plc	GAP Developments plc	16.07

<sup>1</sup> Based on 6-months ending 30 June 2008

<sup>2</sup> Based on 6-months ending 30 June 2008

pany has sufficient liquidity to meet interest payments until the Palm City Residences complex welcomes its first tenants in 2009 and the company begins receiving rental income. Moreover MIH has more cash than debt while the GAP Developments gearing ratio exceeds 16 times! The company which is developing over 300 apartments on the former Holiday Inn site has amassed debts of €72 million (apart from capital creditors) compared to shareholders' funds of only €4.5 million.

Another aspect which ought to be taken into consideration is the security attached to the issue. Some bonds, especially those related to hotel or property financing, are secured by properties held in a trust for the benefit of bondholders in the eventuality of default. While this is surely comforting, one must also determine whether the valuation attached to the property is indeed in line with current market conditions.

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