



New Bond Issues – Matters Arising

“The stock market is but a mirror which provides an image of the underlying or fundamental economic situation. Cause and effect run from the economy to the stock market, never the reverse.” - John Kenneth Galbraith

As we seek to enter into another phase of our development as a market/nation, we welcome the move towards a less risky investment instrument as represented by the use of corporate bonds by quoted companies.

This move, a usual preserve of blue chip value firms, has now become an attractive avenue for our financial institutions to bridge the gap between the critical capital levels and the need to have working capital.

Whether this is a reaction to the CBN intervention or a deliberate effort to shore up their capability to continue business in the light of the continuing southward march of the equity market, the development presents a learning opportunity for the market.

THE BOND MARKET AS AN ALTERNATIVE IN HARD TIMES

Simply put, a **corporate bond** is a debt security issued by a company and sold to investors. The backing for the bond is usually the payment ability of the company, which is typically money to be earned from future operations. In some cases, the company's physical assets may be used as collateral for bonds.

Corporate bonds are considered higher risk than government bonds. As a result, interest rates are almost always higher, even for financial institutions, especially in this climate.

Corporate bonds have a standard coupon payment structure while some have call provisions to allow for early prepayment if prevailing rates change.

At the very least, corporate bonds, i.e. debt financing, are a major source of capital for many businesses along with equity and bank loans/lines of credit. Generally speaking, a company needs to have some consistent earnings potential to be able to offer debt securities to the public at a favourable coupon rate.

The higher a company's perceived credit quality, the easier it becomes to issue debt at low rates and issue higher amounts of debt. Most corporate bonds are taxable with

terms of more than one year. Corporate debt that matures in less than one year is typically called "commercial paper", an over flogged product in the Nigerian banking system.

Government Bonds on the other hand are sovereign and sub-national debt instruments with a guaranteed fixed income, significantly immune from the vagaries of market fluctuations. These bonds are tradable in the secondary market, therefore providing the opportunity of conversion to cash in case of urgent cash needs or possibility of earning a higher yield on investment safety of principal and interest is assured.

Lately, the Nigerian government through the DMO has deployed this tool in the financing of domestic debt vide the issuance of bonds, as against the issuance of treasury bills which are short-term instruments.

This is a welcome move.

This is more so when viewed against the backdrop of the NCM suffering from both liquidity and market confidence crisis, escalated by the CBN actions of late.

With investors seeking for new avenues for funds withdrawn from the NCM or/and available for investment in stable and better yields, the key attraction post 2008 has been the sovereign and sub-national debt instruments like the Federal Government of Nigeria, FGN, bonds and state governments' bond. For instance, investors staked N422.04 billion on FGN bonds as at September 4, 2009 against N205.89 billion invested in the market last August 2009. Owing to this development, the bond market is now very active, compared to few years back when it was almost dormant.

As at September 9, 2009, transactions at the over-the-counter, OTC, market for FGN bonds showed that investors bought about 383.5 million units, worth N422.04 billion changed hands. While the equity market has been witnessing a slide since June 2009, 32 out of the available 39 bonds were traded as at September 7. According to the Nigerian Stock Exchange, NSE, monthly summary for August 2009, the insignificant increase in the market value of the 308 listed securities was as a result of the influx of new investors that came into the bond market.

BROAD STREET Journal

The Broad Street Journal in his review of the bond market found that the market has been receiving increasing patronage. For instance, the Debt Management Office, DMO, a federal government parastatal, recently issued bonds worth about N1.73 trillion shortly after the debt market was rejuvenated. The agency revealed that the feat earned the country about 98.72 per cent success rate, with total of N1.708 billion allotted to various bidders within the period.

An analysts proffers the trigger for such market success – "The Lagos State government has transformed the state of infrastructures in the state with the bond it raised last December. Every investor is interested in what the issuer does with his money and as long as they see proofs with an assurance of getting returns on initial capital, they will subscribe to such stakes without any doubt."

According to Abraham Nwankwo, director-general, DG, DMO, the positives recorded so far can be attributed to the co-operation of the various regulatory agencies within the financial services industry. According to him, the renewed interest has been aided by the exit window provided by the NSE OTC secondary market for the FGN bonds traded on the NSE, which ensures liquidity for the bonds.

The key attraction it seems is that while it is true that the bond principal is guaranteed if it matures, a bond does not have to be held to maturity. At anytime, a bond can be sold in the open market, where the price fluctuates sometimes dramatically.

The benefits inherent in government bonds include the exemption from tax and on interest income on the investment. Aside from diversifying investment portfolio without increasing risk, the instrument can be used as collateral in other financial transactions.

THE NEW APPROACH FOR CORPORATE BONDS

The news yesterday that UBA plc will be holding an EGM on Friday, October 02, 2009 at the Yar'Adua Centre, Abuja, FCT to seek the endorsement of its shareholders to raise N500bn additional capital.

This would have passed as a normal news item for the market that has now embraced the corporate bond market option to address the gap left for institutional investors in the wake of the stock market meltdown. This was coming on the heels of other announcements for bonds, namely:

- 📍 First Bank of Nigeria (FBN) Plc – N500billion
- 📍 GT Bank Plc – N200billion
- 📍 Diamond Bank Plc – N200billion
- 📍 Oando Plc – N200billion
- 📍 NAHCo (Aviance) Plc – N5billion

But this was no ordinary news.

In the release sent out by the bank and highlighted by Boason Omofaye on his daily market analysis programme on Channels TV, the statement made by bank's Group Chief Finance Officer, Mr. Victor Osadolor made a curious reading.

In the release he stated that the proceeds from the N500bn capital raising will go into infrastructure funding, **opportunistic acquisitions** and the consolidation of the bank's channel and IT infrastructure across Africa.

THE UBA PLC N500BN BOND

Recall that UBA Plc in March 2007 issued a N54billion hybrid offer to the market that was adjudged successful. In that offer, it posited that the funds were to be used for Domestic and International Branch roll-out, branch upgrade, ATM roll-out, Non-ATM electronic channels, operating expenses and office/process automation.

To now come back and ask to raise money, in part, for the same reasons as adduced in 2007 is disingenuous, to say the least.

Further, the notion that a public issue is to be made for the purposes of a speculative business opportunity is stretching reason a bit too far. That should not be allowed nor should it be encouraged.

This gives us concern as to what the banks knows about the on-going sanitisation by the Sanusi Lamido Sanusi led CBN audit that it is acknowledging. If it is aware therefore that the CBN is going to make offers for a bank or a list of banks from which it has cherry picked, the market has to know and weigh that.

More importantly and this goes for UBA, FBN, Diamond and GT Bank; the issues surrounding their corporate bonds needs more clarity.

Key questions to be asked will include the following:

- ❶ What is the coupon rate for the bond envisaged?
- ❷ When will it open?
- ❸ What would they use the proceeds on?
- ❹ What is the expected pay back on the acquisitions they intend to make?
- ❺ What will be the weighted average cost of capital (WAC) the bank will be operating with?
- ❻ How will the change in the WAC affect their lending business?

These issues need to be addressed to enable investors and analysts alike understand what is going on. This new market must not be approached as we did the equity markets and for a bank to be seeking debt capital to fund its operations, the utilisation of such funds becomes a key consideration.

It is noteworthy to comment that a bank like Zenith Bank Plc, a net placer of funds in the interbank market is not seeking to raise bond financing and this raises concerns as to what is the driver of this development beyond the obvious market meltdown challenge we are fed with.

Interestingly, and as we will see with the commentary on FBN, the issues are less than clear at this point and we may see a situation where these banks do not meet the set target only to turn around and retort that whatever they raised is the first tranche (given as in the case of UBA, the tenor of 7 years) of the bond offer. So how do we gauge the market performance of the fund raising exercise where the tranches are not disclosed upfront?

The market is a lot wiser now and any firm coming to the market must raise its level of disclosure and engagement with market analysts and the investing public.

THE FBN PLC N500BN BOND

Francis Idaewor wrote in this piece on FBN:

FBN is the stock I follow most in the course of my analysis not because I own shares in it but because of its footprint in the Nigeria financial system. A stock that has turned itself from an investor delight to an investor dislike over a period of steady wrong decision making. FBN is a great company but with an ill-equipped management in place! Did I say that right? Its management is the WORST? Yes WORST! Even more than worst given the realities and positioning it has.

We all knew the incident of 2006 when FBN came to the market to raise N100 Billion (thru rights and IPO) and in the process raised more than N700 billion. Money poured in from all over the world but unfortunately FBN and its regulators said it can only keep N250 billion and not a kobo more.

I personally called the Director General of the Nigerian Stock Exchange – Prof. Ndi Okereke-Onyuike, sent her series of emails, met with her one-on-one during one of her road shows in the then gloomy days in Atlanta and made her see reasons why FBN should keep that N700 billion.

I called SEC's El 'Faki and as well followed up with emails making him see reasons why FBN should keep the whole money raised.

I called my former boss Sanusi Lamido Sanusi - SLS (whom I fondly call SLS while he was my direct boss at UBA then) who was the Chief Credit Risk Officer at FBN at the time and told him they need the whole fund because I saw this wave coming. I told

SLS that FBN will come to the market for more money by 2010 and his response was my analysis are unfounded.

Today, we all know the story as it is - FBN is in the market again seeking to raise N500 billion thru a bond offering. What a shame! This is a credibility and integrity problem FBN has dug for itself!

For me, FBN just lost its corporate identity and credibility. You can compromise anything in a company but not integrity and credibility. How would FBN explain to its customers, potential investors that it now needs the money it rejected in 2006? What manner of credibility loss is that? To that end, it is possible that FBN's N500 billion bond offering may end up failing and if that happens, they have to explore other alternatives. What happened here?

It's very disturbing and frustrating to see a Bank that reject more than N500 billion three years ago now coming to the market seeking same. Investors will immediately interpret it as meaning a potential going-concern problem. That is a big credibility problem right in there and like you know credibility is the greatest threat to a company bottom line

That being said, one of the major management problems FBN will stand to face in the coming years is the rate of stock price dilution. I think they have diluted the stock far more than its initial valuation. It makes absolutely no sense diluting the stock further; instead FBN management should focus on buying back as much outstanding shares on the company's book and create more value for shareholders.

If I were on FBN Board, my first recommendation would be to commit at least 5 to 10% of the Bank's profits towards share "Buy Back" thru the next five years and I bet you that by 2013 FBN would trade at not less than between N300 and N500 / share - IF and ONLY IF those profits they declare are real and not mere paper profits. This will create far more reaching value for shareholders than diluting the price. Why would you dilute a stock when the price is already very cheap? I mean more than cheap!

THE ISSUES TO NOTE

Firms like NAHCo was able to articulate what it seeks to do with the bond offering of N5bn it seeks to raise just as it was able to define clearly its utilisation and market reality driven by the merger with Aviance worldwide and its continuing leadership position in its market (considering the bungling of the privatisation of Skypower Aviation by the BPE/Vice-Presidents Office); and the articulated plans by Oando Plc; one can look forward to a shift in the investment mindset from CP's to CB's.

The issue with the banks is not so straight forward. Ever since the successful GT Bank offer to international investors in 2007; the bond market utilisation for banks has stuttered till now. What and where this takes us remains unclear.

However, given the history and trajectory of how our new markets work, the advent of new entrants should be taken cautiously. Yet, we realise that there are no better investment outlets at this time and as such we will share a cautious optimism with the market on this development.

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