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Junk issuers buoyed by huge appetite for debt

by Jonathan Shapiro

Australian companies are capitalising on red-hot credit markets to sell increasingly risky debt at lower rates, and local credit fund managers are reporting increased appetite for the asset class.

A decline in corporate debt spreads to multi-year lows is allowing good quality Australian companies to sell debt at historically low levels while global investors' desperation for higher yields is helping lower rated companies access the capital markets.

The Markit Australia iTraxx Index, which is regarded as a benchmark for local borrowing conditions, has hit a four-year low at levels not seen since April 2010, when concerns about European sovereign debt began to escalate.

A fall in credit premiums combined with falling global interest rates and relatively calm market conditions mean junk-rated and un-rated borrowers are able to access the debt capital markets.

"Over the past two months domestic credit spreads have contracted making debt funding more attractive to a wider range of corporate bond issuers, but the relative pricing between A and BBB companies means investors remain well compensated for taking on additional risk," Perpetual Investments deputy head of credit Vivek Prabhu said.

Earlier this month, embattled Qantas Airways became the first "junk" rated company to issue bonds into the local market, issuing $300 million of eight-year bonds at 400 basis points over the bank swap rate, or a yield of 7.96 per cent. Less than three months earlier Qantas pleaded for a government guarantee.

Other un-rated and junk-rated Australian borrowers have sold debt to investors through the Singaporean and US dollar bond markets in recent months. Transfield raised $US325 million of lowly rated B+ of bonds on May 7 while unrated G-8 Education sourced $S175 million ($149 million) of three-year bonds from the Singaporean market.

Property sector raises $400m

Last week, fixed income broker FIIG facilitated a $100 million placement for Adani Abbot Point, the largest ever raising conducted by the broker which has traditionally has private investors and self-managed super funds as clients.

Risk-averse local institutions that are typically restricted to buying investment grade bonds have also been piling into new deals. Australia's property sector has been particularly active, raising a combined $400 million since May 2014 with CFS Retail Property, Bunnings Warehouse Property and Federation Centre issuing bonds of between five and seven years, at rates of between 4.67 per cent and 5.19 per cent.

"Overall, the trend for more companies to issue credit into the local retail market is a positive thing, but not all of the non-investment grade issues delivered into that market this year have necessarily been suitable for retail investors," Laminar Group executive director Chris Black said.

As well as participating in some of the bigger deals brought to market by NAB and FIIG, Laminar Group has also been active in providing more direct loans to smaller Australian corporates looking to raise between $5 million to $10 million, and intends to continue doing both.

"In Europe, smaller credit managers have been making more direct loans to corporations over the past couple of years. Now we are starting to see that trend in Australia, but our banking and financing sector is in much better shape so the market dynamic is different," Mr Black said.

Australian companies have raised about $3 billion in the local debt markets so far in 2014, a slower pace than the $4.47 billion raised at this stage in 2013, according to Thomson Reuters data. But companies have taken advantage of greater risk appetite to raise longer-term debt, with the average maturity increasing to 5.9 years from 5.7 years in 2013.

“Increased demand could help Australian corporates wanting to issue long-dated debt stretch the maximum duration achievable in the local market out from seven to 10 years," Realm Investments manager Andrew Papageorgiou said.

Falling spreads help mortgage lenders

Mortgage lenders have also benefited from favourable conditions in the credit markets. Earlier this year, non-bank lender Pepper raised $500 million through the sale of RMBS backed by non-conforming or sub-prime mortgages. So far almost $7 billion has been raised by banks and non-bank lenders in the securitisation markets at ever declining spreads.

Retail investors that bought ASX-listed hybrid securities during the issuance rush of 2012 have also benefited from declining credit spreads with securities that paid rates of about 8 per cent appreciating by between 3 per cent and 8 per cent in face value.

The best-performing corporate hybrid has been Crown Casino’s, which paid a spread of 5 percentage points over the bank rate and trades at 9 per cent above face value.

Australia’s AA rated banks have benefited from the decline in global credit spreads. Last week ANZ Banking Group issued $1 billion of three-year bonds at just 0.53 percentage points above the bank bill rate, or just over 3 per cent.

The ASX-listed market has also seen a material decline in credit spreads that has allowed investors who piled into high-yielding corporate hybrids in 2011 and 2012 to book profits

Lower local borrowing costs reflects a global decline in credit spreads as investors take on more risk to increase returns in a low-interest rate environment. The US 10-year rate has fallen sharply from 3 per cent at the start of the year to 2.5 per cent, prompting investors to turn to corporate debt to earn higher returns.

Borrowing costs for high-yielding, or junk-rated companies, are at multi-year lows as measured by the average premium above the risk-free US 10-year bond rate.

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