

Rising Bond Buybacks Supports the Case for EM Corporates

By Carlos Gomez, CFA

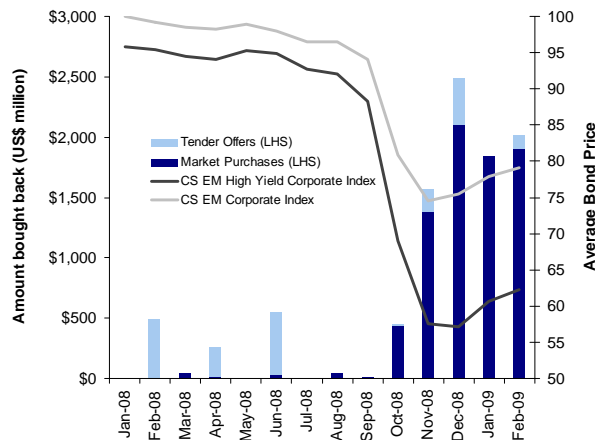
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Background

Emerging markets (EM) corporate bond issuers have been active buyers of their own bonds as prices dropped sharply in the 4th quarter of 2008. In the past twelve months, we have accounted for US\$9.7 billion of EM corporate bonds (and convertibles) denominated in US\$ or Euro that have been bought back in tender offers (\$2 billion) and in open market repurchases (\$7.8 billion). Given that most issuers are not required to report their open market repurchases, the actual amount should be higher. An interesting observation is the sharp rise in open market repurchases to about US\$ 2 billion per month when bond prices suddenly dropped in late 2008 (see Exhibit 1). The average price of EM high yield corporate bonds dropped to 56 cents, offering yield of 26% in November 26th 2008, according to Credit Suisse Emerging Market Corporate Index. Our estimates indicate that the average price of tender offers and market repurchases executed during the past 12 months is 65 and 68 cents, respectively. Open market repurchases continue at same rate despite the slight price recovery in the past weeks and these are expected to continue as long as bond prices remain at distressed levels. The number of EM corporate bonds trading at distressed levels (spread of over 1,000 bps) rose to 449 (\$162 billion) in December 2008 from 25 (\$5.7 billion) in December 2007, representing about 60% of all corporate bond outstanding, according to ING. While current prices reflect a sharp increase in corporate defaults rates in 2009, these imply a much higher default rate than estimated. JP Morgan expects defaults in Asian high yield corporate bonds to reach 11% in 2009 while the bonds are currently trading at an implied one-year default rate of 23%.

Exhibit 1: EM Corporate Bond Buybacks/Tenders



Source: Bloomberg, Credit Suisse, Companies

Exhibit 2: Most Active Corporates

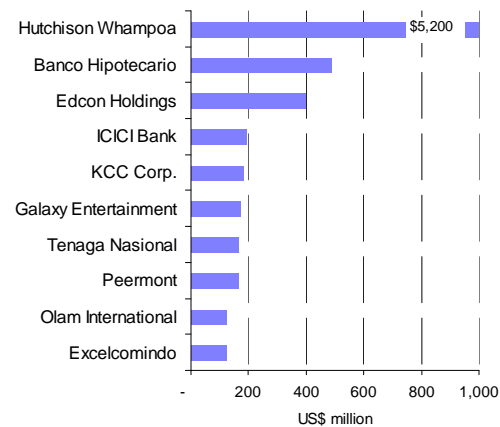
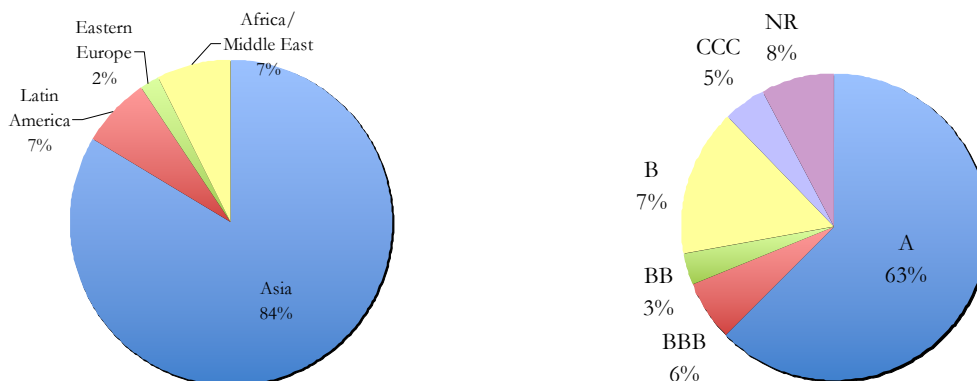


Exhibit 3: EM Corporate Bond Buybacks/Tenders, by Geography and Issuer Rating (current)



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Rationale for corporate bond buybacks

When bond prices are trading at a deep discount, as they currently are, buyback bonds could be one of best investment decisions for companies with strong liquidity. In this uncertain economic environment, it even makes economic sense for a company to postpone discretionary capital expenditures and instead use the cash to buyback bonds that offer rate of returns of 30-50%. Galaxy Entertainment, a casino and hotel operator in Macau, provides a clear case for buying back bonds. In December 29th, 2008, the company launched a tender offer and spent \$86.4 million of its own cash to retire \$170 million of its \$600 million in outstanding notes due in 2010 and 2012, at an average of 49 cents. The company will save about \$37 million in annual interest payments and will generate a profit of \$83.6 million (before taxes). The IRR of the buyback was close to 45%, which is higher than its ROE (negative in 2006-2008) and likely higher than the potential IRR from planned capital expenditures/expansion projects. The majority of issuers we identified used internal resources to buy back their debt, however several issuers such as Asia Aluminum and Independencia said they plan to fund their tender offers through local financing. We suspect that some repurchases have also been funded directly by shareholders.

Implications of buybacks for investors

The sharp rise in buybacks suggests that issuers are taking advantage of the current generalized market distress to make a profit and reduce leverage. Companies are also aware that buying back debt is an effective way to ease investor doubts about their financial health, signal balance sheet strength, and are supportive for their bond and stock prices. The strong pick up in corporate buybacks across all emerging markets, issuer ratings, and industries is indicative that current bond prices and implied default rates are too pessimistic, supporting the view that the market distress is systemic in nature. Investors can take advantage of the market distress by building a diversified bond portfolio that should offer significant upside when the market recovers.

Exhibit 4: EM Corporate Bond Tender Offers

Country	Issuer	Coupon	Maturity	Ratings (S&P/Mdys)		Original	Outstanding	Buyback	Date	Average price	Status	
Argentina	Banco Hipotecario	6.00	12/1/2013	B-	N/A	406	243	163	2/27/2008	88.50	Completed	
Argentina	Banco Hipotecario	6.00	12/1/2013	B-	WR	411	119	292	2/27/2008	89.50	Completed	
Hong Kong	City Telecom	8.75	2/1/2015	B+	B1	125	89	36	2/28/2008	95.75	Completed	
South Africa	Consol Glass	7.63	4/15/2014	BB-	B1	659	585	75	4/14/2008	86.00	Completed	
South Africa	Peermont Global	7.75	4/30/2014	B	B3	816	653	163	4/28/2008	89.00	Completed	
South Africa	Edcon Holdings	8.83	6/15/2015	B-	Caa1	989	593	396	6/24/2008	55.00	Completed	
Indonesia	Excelcomindo	7.13	1/18/2013	BB-	Ba2	250	128	122	6/27/2008	101.00	Completed	
Argentina	Alto Palermo	11.00	6/11/2012	B-	NR	120	115	5	9/12/2008	78.00	Completed	
Hong Kong	City Telecom	8.75	2/1/2015	B+	B1	125	125	0	10/1/2008	98.00	Cancelled	
South Korea	KCC	0.00	10/30/2012	BBB	N/A	1000	817	183	11/11/2008	80.00	Completed	
Russia	Renaissance Insurance	12.50	5/25/2012	N/A	N/A	135	61	74	11/25/2008	45.00	Estimate	
Argentina	Alto Palermo	7.88	5/11/2017	B-	N/A	120	115	5	11/25/2008	39.80	Completed	
Singapore	Olam International	1.00	7/3/2013	N/A	N/A	300	182	118	12/5/2008	65.00	Completed	
Brazil	Banco Mercantil do Brasil	8.50	11/8/2010	B	Ba2	175	152	23	12/17/2008	85.00	Completed	
Kazakhstan	Intergas	6.88	11/4/2011	BB	Baa1	250	179	71	12/17/2008	84.50	Completed	
Macau	Galaxy Entertainment	9.88	12/15/2012	B	B3	350	294	56	12/29/2008	45.00	Completed	
Macau	Galaxy Entertainment	7.32	12/15/2010	B	B3	250	136	114	12/29/2008	53.00	Completed	
Brazil	Brasil Malls	9.75	Perpetual	BB-	N/A	175	175	0	1/21/2009	55.00	Cancelled	
Kazakhstan	Intergas	6.38	5/14/2017	BB	Baa1	600	540	60	2/4/2009	70.00	Completed	
India	Jubilant Organosys	0.00	5/24/2010	N/A	N/A	53	50	3	2/12/2009	69.00	Completed	
India	Jubilant Organosys	0.00	5/20/2011	N/A	N/A	189	144	45	2/12/2009	69.00	Completed	
Brazil	Independencia International	9.88	1/31/2017	B	B2	225	225	0	2/18/2009	63.00	Cancelled	
Brazil	Independencia International	9.88	5/15/2015	B	B2	300	300	0	2/18/2009	63.00	Cancelled	
China	Asia Aluminum Holdings	8.00	12/23/2011	C	Ca	450			3/1/2009	27.50	Proposed	
China	Asia Aluminum (Holdco)	14.00	5/25/2012	N/A	N/A	180			3/1/2009	13.50	Proposed	
China	Asia Aluminum (Holdco)	12.00	5/25/2012	N/A	N/A	355			3/1/2009	13.50	Proposed	
China	Nine Dragons Paper	9.88	4/29/2013	BB-/*	N/A	975			3/9/2009	48.00	Proposed	
Taiwan	Promos Technologies	0.00	2/14/2012	N/A	N/A	284			3/21/2009	26.50	Proposed	
								Total		2,004	Average	64.14

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Exhibit 5: EM Corporate Bond Open Market Repurchases

Country	Issuer	Coupon	Maturity	Ratings		Original	Outstanding	Buyback	Date	Average price	Status	
				(S&P)	(Mdys)							
India	ICICI Bank	6.63	10/3/2012	BBB-	Baa2	2000	1950	50	3/11/2008	99.00	Completed	
Indonesia	Ciliandra Perkasa	10.75	12/8/2011	NR	B2	160	155	5	4/17/2008	100.75	Completed	
South Africa	Foodcorp	8.88	6/15/2012	B	B2	487	472	15	4/15/2008	70.00	Completed	
South Africa	Foodcorp	8.88	6/15/2012	B	B2	461	428	32	6/17/2008	74.50	Completed	
Argentina	TGS	7.88	5/14/2017	B-	B2	500	450	50	8/8/2008	79.00	Completed	
Taiwan	Promos	0.00	2/14/2012	NR	NR	350	338	12	9/23/2008	73.00	Completed	
Argentina	Banco Macro	8.50	2/1/2017	NR	B2	149	125	25	10/10/2008	46.00	Completed	
Hong Kong	Hutchison Whampoa	5.45	11/24/2010	A-	A3	1500	1178	322	10/15/2008	NA	Estimate	
Hong Kong	Pacific Basin	3.30	2/1/2013	NR	NR	390	329	61	10/17/2008	65.70	Completed	
Bulgaria	Petrol AD	8.38	10/26/2011	CCC	Caa2 /#:	130	128	2	10/22/2008	52.00	Completed	
Hong Kong	Noble Group	6.63	3/17/2015	BB+	Ba1	700	680	20	10/28/2008	44.00	Completed	
Indonesia	Ciliandra Perkasa	10.75	12/8/2011	NR	B2	155	146	9	10/31/2008	94.00	Completed	
India	ICICI Bank	1.87	2/27/2012	NR	Baa2	500	469	31	11/3/2008	64.00	Completed	
Malaysia	IOI Resources	0.00	1/15/2013	NR	NR	600	563	37	11/5/2008	79.60	Completed	
Argentina	Telecom Personal	9.25	12/22/2010	B-	NR	240	212	28	11/6/2008	74.80	Completed	
Taiwan	Bank Sinopac	0.00	12/22/2009	NR	NR	176	162	14	11/6/2008	85.50	Completed	
South Africa	Savcio Holdings	8.00	2/15/2013	B+	B2	163	157	6	11/10/2008	65.00	Completed	
Hong Kong	Hutchison Whampoa	5.45	11/24/2010	A-	A3	1178	0	1178	11/15/2008	NA	Estimate	
Thailand	Bangkok Dusit Medical	3.75	7/12/2011	NR	NR	92	62	30	11/19/2008	108.00	Completed	
Thailand	Thoresen Thai Agencies	2.50	9/24/2012	NR	NR	170	161	9	11/25/2008	54.75	Completed	
South Africa	New Reclamation Group	8.13	2/1/2013	B	B3	262	242	20	11/27/2008	40.00	Completed	
Argentina	TGS	7.88	5/14/2017	B-	B2	450	420	30	11/28/2008	50.10	Completed	
South Africa	Savcio Holdings	8.00	2/15/2013	B+	B2	157	154	3	12/3/2008	65.00	Completed	
India	ICICI Bank	2.50	6/14/2010	NR	Baa2	500	472	28	12/3/2008	82.00	Completed	
Thailand	Thoresen Thai Agencies	2.50	9/24/2012	NR	NR	161	131	30	12/4/2008	60.00	Completed	
Indonesia	Ciliandra P Fin Pte Ltd	10.75	12/8/2011	NR	B2	146	141	5	12/12/2008	65.00	Completed	
Hong Kong	Hutchison Whampoa	6.50	2/13/2013	A-	A3	3500	1750	1750	12/15/2008	NA	Estimate	
Singapore	Olam International	1.00	7/3/2013	NR	NR	182	181	1	12/17/2008	66.60	Completed	
Argentina	TGS	7.88	5/14/2017	B-	B2	420	405	15	12/19/2008	52.75	Completed	
Hong Kong	Pacific Basin	3.30	2/1/2013	NR	NR	329	324	5	12/24/2008	77.40	Completed	
Singapore	Olam International	1.00	7/3/2013	NR	NR	181	40	141	12/29/2008	66.60	Completed	
India	Reliance Communication	0.00	3/1/2012	NR	NR	1000	975	25	12/29/2008	69.00	Completed	
China	Nine Dragons Paper	9.88	4/29/2013	BB- /#:	NR	300	284	16	12/29/2008	30.00	Completed	
India	ICICI Bank	6.63	10/3/2012	BBB-	Baa2	1950	1870	80	12/31/2008	81.30	Completed	
India	ICICI Bank	5.75	1/12/2012	BBB-	Baa2	750	745	5	12/31/2008	80.80	Completed	
Argentina	Telecom Personal	9.25	12/22/2010	B-	NR	602	600	2	1/5/2009	88.30	Completed	
Thailand	Bangkok Dusit Medical	3.75	7/12/2011	NR	NR	62	58	4	1/6/2009	105.00	Completed	
Hong Kong	Pacific Basin	3.30	2/1/2013	NR	NR	324	317	7	1/9/2009	81.50	Completed	
Hong Kong	Hutchison Whampoa	6.50	2/13/2013	A-	A3	3500	1750	1750	1/15/2009	NA	Estimate	
India	Aurobindo Pharma	0.00	5/17/2011	NR	NR	200	172	28	1/16/2009	53.60	Completed	
India	Tulip Telecom	0.00	8/26/2012	NR	NR	150	132	18	1/20/2009	50.50	Completed	
India	Reliance Communication	0.00	3/1/2012	NR	NR	975	965	10	1/21/2009	65.70	Completed	
India	Reliance Communication	0.00	5/10/2011	NR	NR	500	490	10	1/21/2009	79.00	Completed	
South Africa	Savcio Holdings	8.00	2/15/2013	B+	B2	154	149	5	1/22/2009	61.80	Completed	
India	Mahindra & Mahindra	0.00	4/14/2011	NR	NR	200	196	4	1/24/2008	91.00	Completed	
Brazil	Banco Mercantil do Brasil	7.75	5/8/2012	B	Ba2	100	98	2	1/27/2009	75.00	Completed	
Argentina	Telecom Personal	9.25	12/22/2010	B-	NR	200	196	4	2/2/2009	96.50	Completed	
Hong Kong	Hutchison Whampoa	7.00	2/16/2011	A-	A3	1500	0	1500	2/5/2009	NA	Completed	
India	Jubilant Organosys	0.00	5/20/2011	NR	NR	200	189	11	2/5/2009	NA	Completed	
India	Jubilant Organosys	0.00	5/24/2010	NR	NR	75	53	22	2/5/2009	69.00	Completed	
Argentina	Banco Hipotecario	11.25	6/21/2010	B-	Ba1	150	121	29	2/9/2009	42.00	Completed	
Argentina	Banco Hipotecario	9.75	11/16/2010	B-	NR	250	246	4	2/9/2009	42.00	Completed	
Thailand	Thoresen Thai Agencies	2.50	9/24/2012	NR	NR	139	122	17	2/10/2009	75.00	Completed	
India	Hotel Leela Venture	1.00	9/16/2010	NR	NR	76	65	10	2/12/2009	NA	Completed	
India	Aurobindo Pharma	0.00	5/17/2011	NR	NR	172	166	6	2/12/2009	61.30	Completed	
Malaysia	Tenaga Nasional	7.63	4/1/2011	BBB	Baa1	600	435	165	2/12/2009	53.00	Completed	
India	Tulip Telecom	0.00	8/26/2012	NR	NR	132	120	13	2/17/2009	53.00	Completed	
India	Moser Baer India	0.00	6/21/2012	NR	NR	150	145	5	2/18/2009	25.00	Completed	
Hong Kong	Titan Petrochemicals	8.50	3/18/2012	CCC-	Caa2	400	315	85	2/20/2009	25.00	Completed	
India	Hotel Leela Venture	0.00	4/25/2012	NR	NR	100	70	30	2/23/2009	99.00	Completed	
								Total		7,833	Average	68.08

Includes EM corporate bonds and convertibles denominated in US\$ and Euro bought back through deeply discounted voluntary tender offers and open market repurchases

Source: Bloomberg, Companies