

SOVEREIGN BONDS

Opportunity knocks

A skillful and opportunistic borrower, Turkey has always been clever at spotting the right time to come to market to achieve its financing requirements. But as investors look to cut back their emerging market exposures to minimal levels, the sovereigns gain could be the loss of other Turkish asset classes. **Savita Iyer-Ahrestani** reports.

Turkey is a highly skilled, successful and steady borrower that has never disappointed foreign investors. Ever since Turkey first issued foreign currency bonds on the international markets it has been hailed as a sophisticated issuer. Many argue it is comparable to any Western nation in its ability to swiftly gauge the markets and play them accordingly.

"Turkey is a regular, capable and heavy issuer of Eurobonds and with that comes a lot of experience in debt management," said Ed Parker, sovereign analyst for Turkey at Fitch Ratings in London.

Case in point: the US\$1bn, eight-and-a-half year bond Turkey sold in January through HSBC and Citibank. The issue, sold at par, came with a coupon and a yield-to-maturity of 7.5% and a spread of 501 basis points over US Treasuries. More importantly, the issue was placed during a period of brief reprieve in one of the worst months for global financial markets, Parker said. The Turkish government spotted that window of opportunity and executed the deal in record time.

"Getting that issue size away so early in the year and in those market circumstances is a good example of the technical capacity of the Turkish government," Parker said. "I would expect them to issue more bonds this year, depending on market sentiment, especially since their Eurobond spread levels are relatively moderate in the current circumstances."

The only downside for Turkey is that, with such an adept sovereign borrower absorbing much of the investor demand for Turkish exposure, there may not be much left over for other asset classes. (See separate story, *Bursting with promise*.)

With US\$1bn of its planned US\$3bn in 2009 issuance done, Turkey is in a good position and foreign investors – who have always shown considerable support for Turkish sovereign issues, not least for the great yield they offer – are likely to look with just as much interest at forthcoming issues. Turkey will certainly seek to issue more debt internationally, according to sources – when markets permit, and in whatever currency, structure and tenor makes

most sense to the Treasury at the time. Just as it did in January, the sovereign is more likely to tap the markets opportunistically, sources say, in light of the ongoing market troubles.

Of course, foreign investors continue to paint Turkey with the same brush they have used for all emerging markets. Things are not as easy as they were in previous years. But the fact that Turkey has never defaulted on its debt and has never had any problems in paying redemptions stand the nation in good stead for future sovereign issuance, said Zeynep Aslan, a director at investment firm Turkisfund Sicav in Istanbul.

"Many other countries that have defaulted more than once on their debt obligations are rated higher than Turkey," Aslan said. "Turkey offers higher interest rates but it also has higher credibility, and given the debt history, you can be sure that you get your money back. The very first thing an investor checks – and more so at this time – is for an exit door. In this respect, I can see Turkey being a good investment."

According to Paul Bizsko, senior emerging markets strategist at RBC Capital Markets in Toronto, local Turkish investors currently hold about 60% of outstanding Turkish Eurobond debt. "This represents a relatively captive investor base for the sovereign, which should also help it to issue external debt," Bizsko said.

Turkey has now successfully tapped international bond markets five times. In September 2008, the sovereign successfully placed a US\$1.5bn, 10-year global bond – an issue that was priced attractively enough to secure healthy international interest and enabled the Treasury to raise half of its remaining 2008 issuance target in one go. The deal, co-led by Deutsche Bank and UBS, priced within 12 hours of its mandate announcement and came in line with 7.05% yield guidance, equivalent to 334.4 basis points over US Treasuries.

And last June, Turkey issued a US\$500m retap of its 7.25% March 2015 bonds, which were first sold in October 2004. Demand for the issue, co-led by JP Morgan and HSBS, reportedly exceeded US\$1bn.

Bursting with promise

Corporate bonds have never been a major feature of the Turkish financial landscape, but some are predicting it could rear its head in the second half of the year and beyond, filling the vacuum left by the shriveling loan markets. But the path to fruition for this new market will not be smooth: risk adverse investors are more inclined to stick with what they know at times of high uncertainty.

Savita Iyer-Ahrestani reports.

“ I expect that in the second half of 2009, we’ll see Turkish corporates issuing bonds in a more benign environment. Most of the companies that have high borrowing requirements are blue chip issuers, and I don’t think they will have any difficulties in finding investor appetite, both domestically and internationally. ”

Even in the good old days, Turkish corporate borrowers were not very active players on the international capital markets. There have been some public issues, of course, and a fair number of private placements, but they have been overshadowed by a prolific sovereign whose bond issues have always met with resounding success. Consequently, only a handful of Turkish issuers have availed of the Eurobond market in past years. The rest have generally opted to fund themselves domestically.

And they have been quite successful at that, thanks in large part to the availability of cheap bank financing – either through syndicated loans or bilateral lending by Turkish banks.

“Over the past five to 10 years, Turkish corporates have been accessing relatively cheap funding for their financing requirements,” said Mehmet Mazi, head of emerging markets at HSBC in London. “This is one of the main reasons why the corporate bond market in Turkey has not been that active.”

Now, though, the dynamic has changed: Turkish banks have not been spared by the general downturn that continues to dog the banking sector worldwide. “They are stretched because of the global crisis and they do not have the capacity to lend as they used to,” said Mazi.

This is probably one of the main reasons why Turkish corporates – which by most estimates have about US\$30bn in refinancing requirements for this year – may start to look toward the bond markets, international as well as domestic, for their funding needs.

The stage is certainly set for corporate issuance, said Meltem Citici, CEO of

Maxis Securities in London. Back in 2006, the Turkish government had already equalised the tax treatment between government bonds and corporate bonds. It has recently passed legislation to allow for a domestic credit rating agency. These steps go a long way toward spurring issuance and increasing investor interest in Turkish corporate debt.

“I expect that in the second half of 2009, we’ll see Turkish corporates issuing bonds in a more benign environment,” Citici said. “Most of the companies that have high borrowing requirements are blue chip issuers, and I don’t think they will have any difficulties in finding investor appetite, both domestically and internationally.”

Perhaps influenced by the Turkish sovereign – a skilled issuer international investors hold in high esteem – Turkish corporates have over the past few years become quite adept at financial planning and management, said Zeynep Aslan, a director at investment firm Turkisfund Sicav in Istanbul. Most have established separate finance departments that focus on cost and debt management, she said, and they are always looking for ways in which they can expand their borrowings.

Turkish corporates also seem to be in a relatively good position vis-a-vis other emerging market borrowers that have been hammered as a result of the crisis. This could go a long way in helping them with their overseas borrowing endeavors. Although they have US\$30bn (another US\$10bn if banks and financial institutions are factored in) in refinancing requirements this year, they have been able to roll roughly 70% of debts coming due – “fairly respectable in light of global conditions, [and given] that the roll rate for Russian corporates has been 20% to 30%,” said Paul Biszko, senior emerging

CORPORATE BONDS

“We’re only now seeing Russia’s Gazprom coming to the market – it’s the first emerging market issuer and it is sovereign-linked. People may start to migrate down the risk curve, but if we look at the universe of rated corporate issuers in Turkey, they are typically lowly rated, so it would be a good while before investors get there.”

markets strategist at RBC Capital Markets in Toronto.

Turkey’s banks will be the first to issue Eurobonds, predicted HSBC’s Mazi, followed by utilities, electricity and telecom companies. Finally, bigger companies like Koc Holdings will come to the market. “I don’t know if all these companies need money, but if you can borrow cheap for five or ten years, why not?” Mazi said.

But how cheap and how easy will it be to get money from investors? They have been so badly burned for the better part of a year that they remain extremely risk averse. Before the crisis there was a great deal of interest in higher yielding debt: “Investors went to companies with a good story that were not capitalised enough, and from Turkey, we did private placements sizing between €50m and €150m for small companies,” Mazi said. “This naturally stopped last year because the investor base has deteriorated. I think it may come back but it is hard to predict timing.”

Home is where the heart is

Emerging markets risk is certainly low priority for investors worldwide, most of whom are still expecting further calamity to hit them from leftfield. Investors appear to be concentrating their capital closer to home. So what is the real scope for Turkish corporate issuers?

“We’re only now seeing [Russia’s] Gazprom coming to the market – it’s the first emerging market issuer and it is sovereign-linked,” said Raymond Hill, an analyst covering Turkish corporates for Fitch Ratings in London. “People may

start to migrate down the risk curve, but if we look at the universe of rated corporate issuers in Turkey, they are typically lowly rated, so it would be a good while before investors get there.”

Given the current spread levels, it would also be relatively expensive for Turkish corporates to borrow internationally, Hill said. The macro environment in Turkey comprises high interest rates and inflation, both of which show signs of moderating but remain high. This not only continues to make it difficult for corporates to “issue at a price at which it makes economic sense,” but serves to deter overseas investor interest.

Fortunately, Turkish banks are in better shape than many other banks in Central and Eastern Europe. Being relatively small with low leverage, most are still in a position to fund the corporate sector if companies are unable to borrow money through the overseas Eurobond market.

Overall, investor perception toward Turkey is relatively favourable, according to Biszko, not only because of its banking system but also because government debt dynamics have improved substantially over the past six or seven years. Turkey’s US\$40bn-\$50bn deal with the IMF is imminent (see separate feature on the IMF), and this should also help foster positive sentiment toward the country.

But when it comes to corporate bond issuance, these kinds of macro factors may not be sufficient. The illiquidity of the Turkish corporate Eurobond market is a major factor that will inhibit new issuance, said Turkisfund’s Aslan. Since there have been no Turkish corporate

bond issues over the past two years, investors will have to hold onto any new issue that comes out until it is close to maturity. Notwithstanding global credit conditions, this in itself is reason enough why investors may not be interested in Turkish corporate bonds, Aslan said.

Conversely, domestic interest in lira-denominated corporate bonds is rising, Aslan said, and it is quite likely that Turkish corporates would be able to borrow quite easily in the domestic market. “Domestic investors in Turkey are very educated in financial instruments because the inflation and interest rates have always been so high, that you had to protect the value of your money,” Aslan said. “Domestic investors would definitely be interested, but because of their knowledge, they will also be able to differentiate between companies, so even they are not likely to lend to an unknown company.”

There is definitely a large base of domestic investors that would be keen on buying Turkish corporate bonds, HSBC’s Mazi agrees. Turkish local investors are not happy with the interest rate they’re getting on bank deposits and they are looking for higher yielding assets.

“The lira interest rate is more affordable now and the government has plans to lower the transactional costs for corporate borrowers,” Mazi said. “Everything depends on local regulation but so long as the government provides the right infrastructure, I think we will see a booming lira corporate market, as there is a lot of liquidity in the local market.”

“The lira interest rate is more affordable now and the government has plans to lower the transactional costs for corporate borrowers. Everything depends on local regulation but so long as the government provides the right infrastructure, I think we will see a booming lira corporate market, as there is a lot of liquidity in the local market.”