Australian and New Zealand Debt Capital Markets in Review

9 March 2018

HSBC

Together we thrive

A Watershed Year for Australian & New Zealand Corporates in the Debt Capital Markets

By Sean Henderson

Previously head of Debt Capital Markets in Australia, Sean is now based in Hong Kong and Deputy Head of the HSBC DCM franchise in Asia Pacific.

The 2017 issuance landscape will be remembered by many market participants as one where market conditions remained robust through almost the entire year, generating unprecedented activity. Multiple deals jostled for access to the local A$ market, there were three notable US private placement (USPP) issuances from newly privatised electricity companies in NSW, and the level of bond issuance offshore was noteworthy for its volume and diversity. The rising importance of the RegS format in allowing Australian borrowers to meet their USD funding was again obvious, with strong Asian demand for a wide range of credits. In addition, a number of other markets that were once considered niche moved more into the mainstream, including green and unrated issues and developments in China's rapidly evolving Panda market. HSBC's view is that corporates across the credit spectrum in Australia and New Zealand have never had a greater range of choice in terms of potential currencies and investors to access and we hope that HSBC's presence in most of these markets continues to help our clients navigate to the best possible option.

The sanguine start that we had expected to 2018 was borne out through January, but the past two months have been more volatile. In conjunction with political noise, the gradual withdrawal of economic stimulus by the Federal Reserve, the European Central Bank and, to some extent, the People's Bank of China and Bank of Japan is something investors are watching closely, especially when combined with a rising rate environment. Investors are becoming more watchful as they look to balance their need to invest with their exposure to rising yields. It will be very important to adapt timing or currencies of issuance according to yields or rates expectations this year.

On behalf of the Debt Capital Markets team at HSBC, we look forward to working with you through the rest of 2018 and thank you for your continued trust and business.

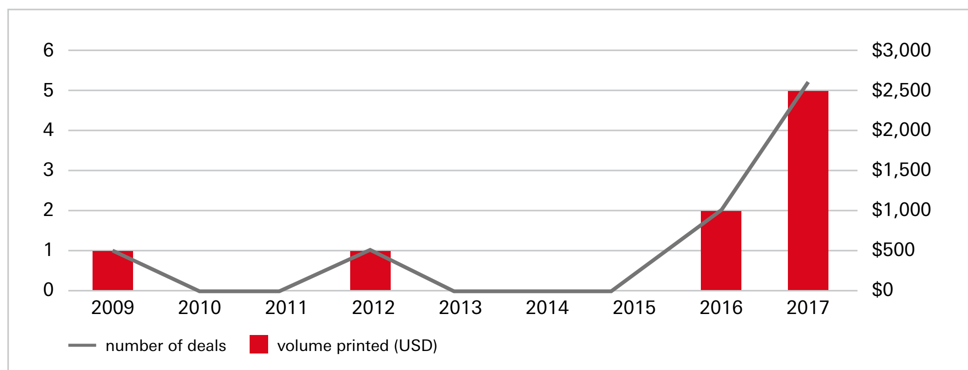
The Explosive Growth of USD Fixed Income Demand in the Asia-Pacific Region

By Andrew Duncan

Leading the local team across Australia and New Zealand, Andrew has a wealth of experience from working in London, Hong Kong and Singapore with HSBC in all aspects of DCM.

In retrospect, 2017 was remembered in Australia as the year of a constitutional crisis and Richmond breaking their AFL drought, but for the bond markets, it's the year Asian investor's fully embraced Australian and New Zealand corporates as part of the Asian capital markets construct. This delivered volume and diversification across the credit spectrum and currencies in an unprecedented way. Against a strong macro background, despite North Korean sabre-rattling, Japanese elections and an insurgency in the Philippines, Australian corporates delivered. New prints from Telstra, Incitec Pivot, Santos, Mirvac and SGSPAA added to issuances in previous years from Ausnet, Lendlease, Yancoal and Optus. SGSPAA, as one local example, has USD1.5bn of RegS-only denominated debt outstanding across three bonds, demonstrating the significant market capacity available.

USD Regs Issued by Australian Corporates (Source: Bloomberg, HSBC)



So what makes the RegS-only market different? Typically, corporates looking to access USD are advised to access the USPP or USD 144a/RegS market, and no doubt these markets work very well for certain issuers. However, the RegS-only market has some distinct advantages:

- It offers a smaller minimum deal size than the 144a/RegS market, at USD300 million, versus the USD500 million in 144a
- It is more flexible in terms of issuance documentation than USPP, typically requiring no covenants for an IG corporate
- It allows for forms of liability management, including on-market buybacks and consent solicitations, in order to reduce outstanding indebtedness, whereas the USPP market makes that more difficult
- It typically has lower transaction costs than the 144a/RegS market, as the roadshow and documentation costs are both markedly lower.

The growth in the Asian capital markets has been propelled by the vast growth in the savings and wealth of high net worth and middle classes across the Asia-Pacific region, particularly in the likes of China, Korea, Hong Kong, Singapore, Japan and Taiwan, with USD (but also AUD, CNH, SGD and JPY) being managed by a range of life insurance companies, asset managers, private banks, hedge funds, commercial banks and sovereign wealth funds. These investors continue to invest locally, however, given their surging funds under management (FUM), they have been directing a greater amount of time and energy to understanding and buying foreign credit. Australia, as a developed market in the region, is an attractive home for fixed income purchases.

The Incitec Pivot USD400 million 10 year and Telstra Limited USD500 million 10 year, both printed in RegS-only format, speak to this bias. For Incitec, investors were attracted to the fact that this credit was 'new' to Asia – there was no similar

company in the region with a blend of explosives and fertiliser manufacturing expertise. The fact that Incitec's physical operations and offices are mainly in Australia and the US didn't seem to concern investors, as they bid strongly for the new issue, with the order book almost nine times oversubscribed. Incitec was also able to utilise the new Asian Bond Grant Scheme run by the Monetary Authority of Singapore, and now being introduced by the Hong Kong Monetary Authority ('HKMA'), to reduce its documentation costs.

For Telstra, the decision-making was slightly different. As one of the highest profile Australian corporate issuers with over AUD16bn of debt capital market issuance outstanding, and an experienced issuer in both EUR and USD144a/RegS format, Telstra chose to head down the RegS path for three key reasons. Firstly, the refinancing needs were relatively small and finite, at around USD500 million. Secondly, the execution cost of printing a new USD RegS trade was significantly less than the 144a option – Telstra could leverage its existing EMTN programme and simply conduct a roadshow in the Asia-Pacific region. Finally, this allowed the company to engage and allocate to Asian investors, generating new relationships that will serve the company for years to come. The end result, a bond priced at T+95bps for a 10 year, was the most efficient 10 year USD bond issued by an Australian corporate for the year.

Snapshot:
Asian Bond Investor Survey

HSBC has partnered with S&P Global Ratings for the fourth time to deliver a semi-annual research paper, for which 176 institutional fixed income investors with a combined USD742.7bn AUM were surveyed across North America, Europe and Australasia.

Key findings:

- Asian markets are set to break the all-time G3 issuance record despite the tension in the Korean peninsula, showing strong resilience and investor appetite for Asian credit
- Investors are in search for yield in an environment where interest rates have been at historical lows for longer than most predicted
- Rising interest for Asian credit markets as 84.7% of investors are planning to increase their exposure
- Investors' main concern is an equity market correction over the next 12 months as major indices in the US have broken new record highs
- Investors have expressed their intention to buy more green bonds and, although Asian investors are tracking behind, we see a gradual improvement.

November 2017

USD645m and AUD200m multi-tenor USPP

Joint Placement Agent

November 2017

USD500m 3.250%10yr bond due 2027

Joint Bookrunner

October 2017

JPY12bn 20yr private placement due 2037

Sole Bookrunner

September 2017

Brambles

EUR500m 1.500% 10yr bond due 2027

Joint Bookrunner

September 2017

USD525m 3.700% 10.5yr, USD325m 4.500% 20yr, EUR500m 1.375% 8yr, GBP129m LM

Joint Global Coordinator, Joint Bookrunner & Sole Dealer Manager

July 2017

Incitec Pivot Limited

USD400m 3.950% 10yr bond due 2027

Joint Bookrunner

June 2017

USD500m 3.500% 10yr bond due 2027

Joint Bookrunner

April 2017

SGD300m 3.900% 10yr bond due 2027

Joint Bookrunner

April 2017

Barminco

USD350m 6.625% 5 non-call 2yr bond due 2022

Joint Bookrunner

March 2017

Westfield

GBP300m 2.125% 8yr bond due 2027 and GBP500m 2.625% 12yr bond due 2029

Joint Bookrunner

March 2017

SCENTRE GROUP

USD500m 3.750% 10yr bond due 2027

Joint Bookrunner

February 2017

HKD1.75bn 3.29% 10yr bond due 2027

Sole Bookrunner

Benefits to be Found Amongst Regional Demand for Loans

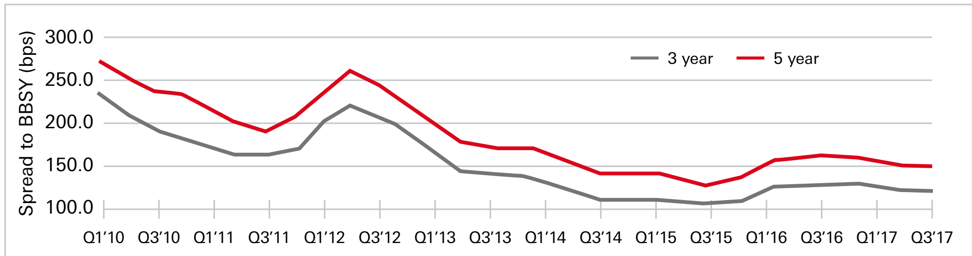
By Michael Rossiter

Originally a Loan Syndicate specialist, Michael has recently taken on greater responsibility including the structuring of high yield bonds.

Local corporates who diversify their funding sources outside the major banks continue to benefit from improved pricing and terms – and HSBC has been at the forefront of helping to develop this expansion of credit to Australian and New Zealand borrowers.

Credit margins, which increased in 2016 on the back of higher wholesale funding costs for the majors and increased volatility and weakness in wholesale credit markets, returned to 2014/15 levels during 2017. Anecdotally, though, we hear there have been an increased number of banks ‘de-selecting’ themselves, through reducing holds or increasing pricing to be removed from refinancing processes. The interest in seven year loans continues to grow as well, though there are early signs that banks will need to compete with interest from onshore institutions such as superannuation funds that traditionally concentrated on equities and fixed income.

Loan Credit Margins – Graph 2 (Source: HSBC)



One of the reasons that credit spreads have compressed in recent quarters is the increasing liquidity available in the market. This liquidity has primarily been provided by two sources: increasing numbers of onshore, non-bank financial institutions being prepared to enter the market and provide funding (including in the leveraged and term loan space) and offshore lenders setting up branches onshore in Australia to deepen their understanding of the local landscape.

Offshore lenders, particularly Asian banks, continue to aggressively target new lending opportunities and have even been loosening investment parameters (in terms of minimum ratings or maximum commitment levels) in order to increase their transaction pipeline. These banks are charged by head office with increasing their exposure to geographies and names outside of their home markets. Australia's strong track record of economic growth has meant it has become a priority market – Japanese, Chinese, Taiwanese and other South-East Asian banks have rapidly built small local operations capable of deploying AUD10 – 50 million ticket sizes for local corporates, particularly those with an Asian expansion angle.

Loan Case Study: Pact Group's AUD150 million revolving facility

Pact Group Limited (Pact) is a Melbourne-based, ASX-listed packaging company that approached HSBC for assistance in targeting Asian banks for a new 5 year syndicated loan facility, reflecting its growth into Asia. HSBC acted as sole Mandated Lead Arranger and Bookrunner for a new AUD150 million syndicated facility distributed to three other Asian lenders at competitive pricing, and inclusive of a new accordion feature to provide Pact with further flexibility in future transactions. The transaction achieved Pact's objectives of further diversifying its banking group.

December 2017

AUD900m Revolving Facility

Mandated Lead Arranger and Bookrunner

November 2017

AUD245m Revolving and Term Facility

Sole Mandated Lead Arranger and Bookrunner

October 2017

USD675m Revolving and Term Facilities

Mandated Lead Arranger and Bookrunner

September 2017

AUD850m Unitranche Financing

Sole Mandated Lead Arranger and Bookrunner

July 2017

USD370m Revolving Facility

Sole Mandated Lead Arranger and Bookrunner

July 2017

USD600m Revolving Facility

Mandated Lead Arranger and Bookrunner

June 2017

AUD917m Revolving Facilities

Mandated Lead Arranger and Bookrunner

June 2017

AED520m Revolver
USD212m Term Loan Facility

Mandated Lead Arranger and Bookrunner

April 2017

USD1.2bn Term Loan Facility

Sole Mandated Lead Arranger and Bookrunner

March 2017

AUD900m Revolving Facilities

Mandated Lead Arranger and Bookrunner

January 2017

AUD500m Term Loan Facility

Mandated Lead Arranger and Bookrunner

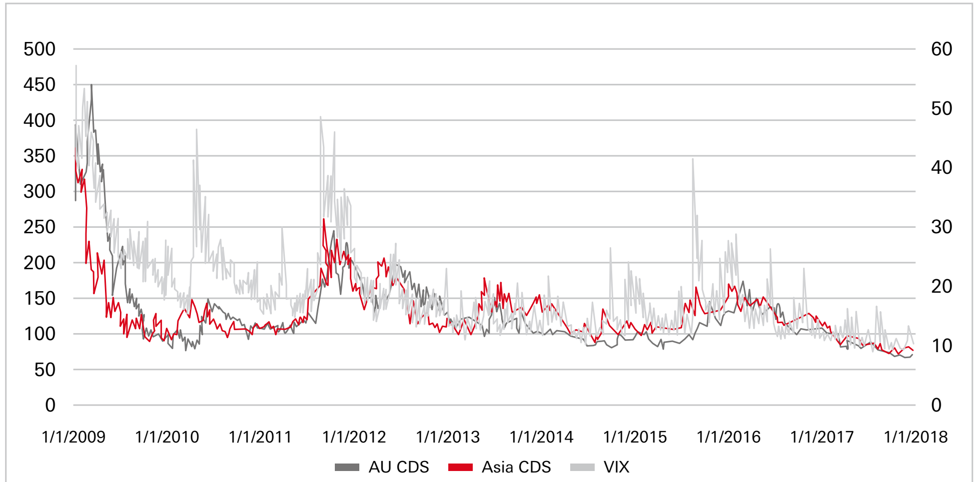
Credit Markets Show Ability to Digest Greater Complexity

By Joel Morton

Structures and executes a wide range of corporate debt capital market transactions and is based in Melbourne.

The influx of cash into the pockets of investors, fuelled by macro-trends, such as the deployment of central bank balance sheets, and the rise of wealth being managed in the Asia-Pacific region, has helped drive credit spreads to the lowest levels since the global financial crisis. If we look back briefly at the way credit default swaps (a broad indicator of credit risk) have acted in the last three years (see graph), we see that apart from a brief spike caused by Chinese stockmarket instability, credit spreads have generally trended lower, and were at an 8 year low at the end of 2017.

Global and Local Credit Indices since the GFC – Graph 3 (Source: Bloomberg, HSBC)



The effect of this contraction has been marked, with investors globally needing to adjust investment parameters further down the credit spectrum to earn the same fixed yields as they did previously. This challenge has been further exacerbated in areas such as Europe where benchmark yields are negative. Investors have reacted to this challenge in different ways – in Taiwan, for example, although there has been some softening of the traditional hard floor of an A- credit rating, longer dated investors have also been offering to invest in 20 year and 30 year tenors, so that the yield of the instrument matches their investment targets.

Locally, we have seen an expansion in credit investment in those names that are either explicitly rated high yield (Ba1/ BB+/BB+ or lower), or unrated (though unrated can be either investment grade or high yield, generally it tends toward the latter), fuelled by the same investment thesis. These types of names yield higher so are therefore more attractive on a return basis if the risk can be justified. There is a smaller universe of investors, so investors who pursue the opportunities are often competing with less peers to have bonds allocated to their portfolios.

During 2017, the AUD market has seen a combined AUD725 million of new issuance (or about 1% of the overall market in AUD) from unrated or high yield issuers, of which over 75% was new funding, rather than the refinancing of existing instruments. This eclipses the volumes printed in the unrated class in previous periods (2016: AUD474 million, 2015: AUD560 million), including trades from names such as Qantas, Alumina Limited, Qube Limited, Mcphersons's and G8 Education. Discussions with investors in the early weeks of 2018 suggest that

this broader trend is set to continue as an ever increasing number of market participants reference their willingness to look at more esoteric structures in a bid for increased yield.

The standout transaction of 2017, which demonstrated Australian unrated credit's ability to attract strong onshore institutional support, and attract Asian and even European-based investors, was SEEK Limited's floating rate 5 year AMTN, its debut issuance in the capital markets. At the time, Treasurer of SEEK Ed Collis was quoted by trade magazine KangaNews in regard to the ability of investors to do their analysis outside the formal credit rating process – "Given we [weren't] seeking large volumes we believed we could rely on investors to do their own credit work," Collis said.

Bond Case Study: SEEK Limited's AUD175 million 5 year floating rate notes

- On Tuesday, 11 April 2017, HSBC acted as a Sole Global Coordinator and Joint Bookrunner for SEEK's debut bond issuance, an AUD175 million 5 year Floating Rate Note
- The bond set a record for the AUD market, representing the largest ever corporate transaction in unrated, senior unsecured format
- The transaction also saw broad institutional investor distribution, a first for the unrated bond markets in AUD and was based off SEEK conducting a comprehensive roadshow, meeting over 45 investors across Asia and Australia
- Post roadshow, SEEK announced a 5 year AMTN transaction in FRN format, with the end transaction pricing at the tight end of initial guidance, and significantly upsized from initial indications of AUD100 million
- HSBC's role as Global Coordinator included sole-arranging SEEK's debut EMTN programme, acting as sole roadshow co-ordinator, and Billing & Delivery bank on the notes.

SEEK's bond recently won the Kanganews award for 2017's Best Unrated Corporate Transaction of the year.

The Development of Green and Sustainable Financing

By Rory Fletcher

Rory Fletcher recently joined HSBC DCM, based in New Zealand, after a long stint with HSBC's DCM team in the global HQ in Canary Wharf, London.

Given that Europe remains the epicentre for the global push into sustainable finance, we wanted to ask Rory a few questions on the topic.

Q: What's a Green bond?

A: The short answer is that Green bonds are used to fund projects that have a positive environmental and (or) climate benefit. The heightened focus among corporates on sustainability and the increasing size of investor side mandates for socially responsible assets has been a marriage made in heaven. Issuance of Green bonds has exploded.

Q: What are the advantages of issuing a Green bond?

A: There are a range of different reasons for issuing a Green bond. The most obvious ones are listed below:

It demonstrates innovation. It is becoming a more mainstream product, but issuing in Green format is still a useful means of differentiating one's debt from peers.

It provides great publicity and positive profiling in what is a growing market. That makes them useful for both internal and external marketing purposes.

It ties in nicely to the core mission of most businesses.

It leads to investor diversification and sees a larger number of investors able to participate. The broader point here is that no normal investor is restricted from investing in Green, whereas Green investors are restricted from investing in conventional bonds. So that opens up larger pools of liquidity.

It can lead to a pricing benefit given that additional demand. That is difficult to quantify, however, the Euro market in particular has good examples of issuers that have Green bonds trading inside non-Green equivalents. Other currency markets are expected to follow suit.

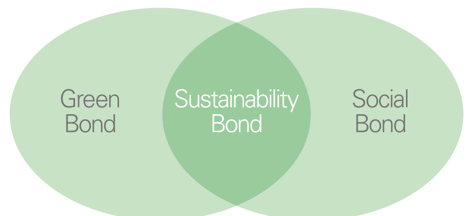
The same is true of secondary market trading where we see Green bonds outperform non-Green ones. That is once again the product of the increased number of fund managers able to purchase.

It is simple to execute off a standardised documentation platform. It simply requires additional language in the Use of Proceeds section. There are then the Green specific documents (Green Bond Framework and Second Party Opinions), but those can lean on the sustainable reporting already done.

It has large scale support across the globe among regulation and policy committees.

Q: What's the difference between a Green Bond and a Social Bond?

A: In many ways these two subcategories are incredibly similar, but where a Green bond seeks to address specifically environmental goals, a social bond seeks to address existing social issues or challenges, such as a lack of housing or the need for greater education for a particular group.



Q: How would I go about issuing a Green bond?

A: First, we would develop a Green bond framework, which is a document that identifies the Green use of proceeds, outlines the process for evaluating Green projects, references the manner in which those proceeds will be managed and ultimately comments on allocation reporting. Then, we would engage a third party to provide an opinion that this Green bond framework meets the Green Bond Principles and finally we would look to structure and market a green bond instrument, along a process that is materially the same as an ordinary fixed income issuance.

Q: Are there any examples of locally issued Green or Social Bonds?

A: Yes, in fact HSBC led the first Green Bond issued by an Australian corporate name, Stockland's EUR300 million bond back in October 2014, which allowed it to finance the conversion of some of its real estate assets to more energy efficient footprints. Since that time we've seen all four major banks issue green bonds, the first green USPP from Hallett Hill wind farm, the first Green securitisation, and the first NZ Green bond framework and bond from Contact Energy. More recently, HSBC led QBE's first Social bond, an inaugural gender equality issuance.

Q: Why do investors buy this asset class?

A: Green bond investors look to purchase assets that align with a relevant set of principles, under the aegis of their institution's commitment to an international agreement (Paris Green Bond Statement – part of COP21; Montreal Carbon Pledge; UNEP Positive Impact Manifesto) but investors have also joined in their own groups to commit to act together, for example, the Investor Network on Climate Risk. Ultimately, investors are acting because their stakeholders' and institutional view is that addressing climate change is an important corporate responsibility.

Q: How has HSBC demonstrated its commitment to sustainable financing?

A: In conjunction with a market leading Green bond team within Debt Capital Markets, HSBC has also been at the forefront of sustainable issuance and research. In November 2015, HSBC issued a EUR500 million green bond, which funded eligible investment in projects of renewable energy, energy efficiency and sustainable water management and has since continued to build on that platform. HSBC has recently promised US$100bn to fight climate change so if I were a betting man I would assume there would be more Green bonds on the way!

This commitment is recognised at the top of the house, with former HSBC CEO Stuart Gulliver on record as saying, "There is a business imperative as well as a moral imperative to get involved in green financing … HSBC has a strong commitment to sustainable development and will continue to work with customers, clients, governments and business to respond to the climate challenge."

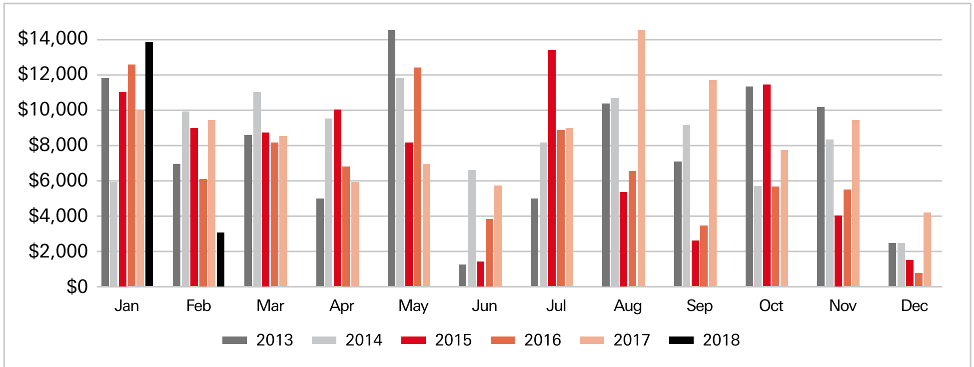
A$ Credit Market Hits its Straps

By Callum De Forrest

Runs AUD trades for global issuers including Sovereigns, Banks and Corporates from the Syndicate desk in Sydney.

For what was once regarded as a vanilla Financial / SSA based market, 2017 saw a fundamental shift in investor appetite towards diversification. While demand for corporate issuance has been evident for the last few years, domestic investors had been reluctant to pay the spreads offshore markets offered. Last year that changed and, coupled with aggressive demand out of Asia, particularly for utilities, we saw a 176% increase in corporate issuance. While we are unlikely to see the same percentage growth through 2018, we continue to expect the composition of corporate issuance in total A$ outstanding to grow.

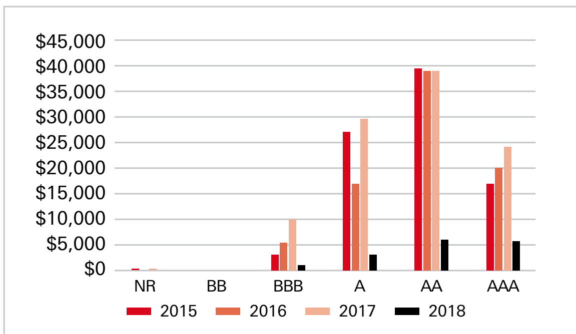
Monthly issuances 2013-YTD2018 (AUDm)



Not only has corporate issuance increased, but the tenors available to issuers have also lengthened from the typical 5 year point. While 5, 7 and 10 year remain the norm, we were a JLM on a 15 year trade for Deutsche Bahn, the longest public corporate trade in A$. This is a tenor only government and SSA issuers have historically been able to print.

The combination of strong Asian demand and the aggressive need for domestics to diversify has seen deal sizes increase. Large multi tranche deals for Verizon and Ab InBev, around the A$2bn area, show the Australia market is maturing into a sophisticated, reliable funding source for issuers. We expect to see new global names look to access this market through 2018 following the success of those trades.

Issuances by tenor



Investors have not only shifted their focus to corporates, they are willing to accept global docs. Historically this market has been domestic / Kanga doc dominated, however investors are willing to accept trades using global docs like EMTN / SEC if it gives them access to new issuers.

December 2017

AUD750m
3.000%
Joint Bookrunner

September 2017

AUD425m 7yr – 3.500%
AUD175m 10yr – 3.800%
AUD150m 15yr – 4.050%
Joint Bookrunner

September 2017

Volkswagen Financial Services

AUD225m 5yr – 3.500%
AUD100m 5yr FRN – BBSW+130
Joint Bookrunner

June 2017

AUD55m 15y
BBSW+47.875
Sole Bookrunner

May 2017

AUD25m 10y
BBSW+47
Sole Bookrunner

May 2017

Volkswagen Financial Services

AUD441m 1.81yr ABS Class A Notes – BBSW+95
AUD25m 2.89yr ABS Class B Notes – BBSW+165
Joint Bookrunner

April 2017

AUD175m 5yr FRN
BBSW+230
Sole Global Coordinator and Joint Bookrunner

April 2017

AUD600m 10yr Kangaroo
3.200%
Joint Bookrunner

March 2017

AUD300m 4yr
BBSW+81
Joint Bookrunner

March 2017

AUD400m 5yr
BBSW+105
Joint Bookrunner

February 2017

AUD40m 10y
BSW+49
Sole Bookrunner

January 2017

AUD50m 10y
BBSW+55
Sole Bookrunner

RMB Bonds – New Connections

By Timothy Yip

Timothy Yip is currently head of HSBC's Qianhai Securities JV Debt Capital Markets team. Qianhai Securities was established with HSBC as majority shareholder in 2017 in order to provide HSBC's global clients with access to the Interbank, and Onshore Debt Capital Markets, alongside other investment banking products.

To continue with the question and answer theme we thought we would ask the broader HSBC DCM team to provide a bit more detail around the Panda bond market. HSBC recently became the only foreign bank able to act in a leading role across both segments of the Panda bond market and as such we thought it would be a good time to get an update from them.

Q: Please can you remind us what a Panda bond is?

A: Panda bonds are RMB-denominated bonds issued onshore using Chinese law and Chinese documentation. It is important not to confuse these with Dim Sum bonds. Those are RMB-denominated bonds issued offshore using MTN and GMTN programmes.

Q: What have been the main developments in the Panda bond market in the recent past?

A: There have been two main areas of development in the market. The first concerns the market's durability. The People's Bank of China (PBOC) has made it its mission to continue opening this market to further high quality issuers. That has been geared towards sovereigns and supernationals, but is now seeing an increasing number of corporates look to gain access. The second large development has been around foreign participation. Through the Bond Connect scheme foreign investors are able to invest directly in the Panda bond market. International investors currently hold less than 2% of the total outstanding amount of debt issued in the Chinese debt markets, but the increase of Bond Connect participants and the substantial turnover that has been seen since the inception of the scheme suggest that this foreign money will have a material impact on the market.

Q: The Panda bond market is split into two segments. Please can you comment on how the two differ.

A: The market is split into the following:

1. The China Interbank Bond Market (CIBM) under the regulation of the PBOC and National Association of Financial Market Institutional Investors (NAFMI).
2. The Exchange Market under the supervision of the China Securities Regulatory Commission (CSRC).

The Interbank market is the larger of the two and has been responsible for c. 90% of issuance and almost all foreign issuance. Public issuance and private placements are both possible in that market and the latter has been popular among foreign issuers due to the less stringent accounting requirements. The Exchange market is responsible for the remaining 10% and has, until now, been the reserve of more local, red-chip businesses. There is an increasing push towards aligning these two markets so as to reduce the opportunity for regulatory arbitrage and standards are slowly beginning to merge, however, that will be a gradual process.

Q: Is it possible to raise funds in the Panda market and then take them offshore?

A: The Panda bond market is designed to have funds raised and then used in China, however, the regulators are aware that money is being taken offshore. The broader relaxation in capital controls thus means that it can be broached on a case by case basis, however, it should be noted that it is easier to do so if the quantum in question is smaller.

Q: How is HSBC positioned to act in the Panda bond market?

A: It is against that backdrop that HSBC is in a position to act in a leading role across both those markets. The details are as follows:

- CIBM: HSBC Bank China (HBCN) has been awarded a lead underwriting licence for the issuance of Panda bonds by non-financial corporates in the onshore CIBM having previously been restricted to junior underwriting roles or financial advisor roles. HSBC has been able to act in that capacity for public sector and financial clients for some time, however, our underwriting capabilities are now complete with the addition of the corporate license.
- Exchange Market: Through HSBC's new onshore securities company, HSBC Qianhai Securities (IBCN), HSBC has received pre-approval from the CSRC to underwrite all bonds in the Exchange Market.

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