2018

Spotlight on Global and GCC Debt Markets Activity

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Global debt markets activity is gaining momentum. US high-yield bonds are amongst the best performers - driven by companies seeking to refinance and an increased appetite by investors for high-yield debt.

The GCC debt markets have also surged in 2017, with sovereign debtors accounting for the lion's share, followed by corporates. This activity has been propelled by strong interest from regional and international investors, and cemented by a stable credit outlook.

Looking ahead, 2018 is set to be a busy year, as market participants try to stay ahead of monetary policy reforms, such as interest rate hikes by the US Federal Reserves and the European Central Bank's gradual tapering of its quantitative easing programme.

Getting to know different types of debt instrument

What are the main types?

High Yield Bonds (HYB)
High yield securities, with fixed or floating rate interest or dividend bearing obligations of an issuer rated below Baa/BBB by Moody's and S&P, respectively. These bonds are often marketed or sold to US investors under Rule 144a, and carry higher interest rates than traditional debt instruments.

Sukuk
An Islamic financial certificate, similar to a bond, but compliant with Sharia - Islamic religious law. The issuer of a sukuk sells a certificate to an investor group, and then uses the proceeds to purchase an asset, of which the investor group has a certain percentage of ownership. Subsequently, the earnings generated by the purchased assets are proportionally distributed to sukuk investors.

Euro Medium-Term Notes (EMTN)
Generally medium-term flexible debt instruments, that are traded and issued outside of the United States and Canada. The notes can be offered continuously, instead of all at once. Further, the issuers must maintain a standardised document (the "Programme"), which can be transferred across all issues and has a great proportion of sales through a syndication of pre-selected buyers.

What are their benefits?

High Yield Bonds (HYB)
Provide corporate entities with credit ratings below investment grade, access to debt markets. However, to compensate for the higher credit risk, they generally offer greater yields than government bonds and many investment grade corporate bonds. HYBs have shorter maturities than traditional bonds, providing investors with the opportunity to rapidly recoup their principal investment.

Sukuk
Represent an investment opportunity for investors seeking only Sharia-compliant debt instruments. The majority of sukuk structures are asset-based rather than asset-backed. In an asset-based structure, investors rely on the credit quality of the debtor to fulfill its payment obligations, while in an asset-backed structure, investors rely on recourse to the underlying assets as the profit return and return of capital are based on the asset itself.

Euro Medium-Term Notes (EMTN)
Generally offer more diversity and flexibility than traditional bonds. It can be issued in various currencies, sizes and maturities (normally five years), along with competitive underwriting costs. Once established, an EMTN programme offers the issuer the opportunity to drawdown from the programmes whenever funds are needed. EMTNs are offered on a continuous basis, whereas traditional bonds occur at a point in time.

Global debt markets

2017 witnessed robust activity for global debt markets, despite geopolitical uncertainty and fiscal policy headwinds. Borrowers were relatively active across global debt markets, benefiting from favourable economic fundamentals, such as low interest rates, high liquidity, tolerable levels of volatility and monetary inflation.

Looking ahead, 2018 is set to be a busy year, as market participants try to stay ahead of potential interest rate hikes by the US Federal Reserves and the European Central Bank's gradual tapering of its ongoing quantitative easing programme.

At the moment, the markets remain resilient against geopolitical uncertainties and monetary policy changes. However, we are starting to see a surge in both volatility and inflation levels, which in the long run could translate into an increase in debtors borrowing costs and credit default risk.

Highlights of major global debt transactions in 2017

USD 22.5 billion

AT&T issued one of the biggest international bonds during 2017.

USD 10.7 billion

France's sovereign green bond programme was one of the largest green bonds issued in 2017.

USD 9 billion

The Kingdom of Saudi Arabia issued the world's largest ever sukuk.

GCC debt markets

GCC fixed income issuances have surged in 2017, with sovereign debtors accounting for the lion's share, followed by corporates. This activity has been propelled by strong interest from regional and international investors, and cemented by a stable credit outlook.

We anticipate debt markets will remain active in 2018, although the recent rally in oil prices has eased short-term liquidity pressure. Despite this, GCC governments continue to rely on sovereign issuances to curb their budget deficit and fund their growth plans. The concern remains however, as to whether the potential oversupply in the debt market could result in an increase in the cost of borrowing in the GCC region and put a downward pressure on credit quality.

Highlights of major GCC debt transactions in 2017

USD 12.5 billion

The Kingdom of Saudi Arabia issued one of the most significant sovereign international bonds in the GCC.

USD 2.3 billion

Dubai Aerospace Enterprise Ltd issued one of the largest corporate bonds by a GCC based entity in 2017.

USD 1.25 billion

The Islamic Development Bank issued one of the largest corporate sukuk by a GCC based entity in 2017.

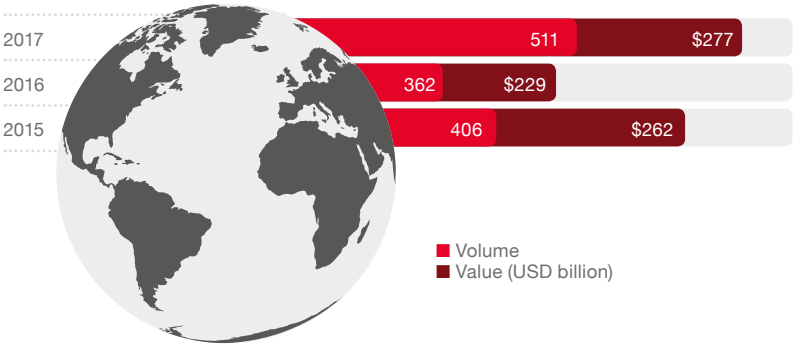
Spotlight on US high-yield bond activity by global issuers

Although the recent increase in public bond activity has been witnessed across all types of bonds, a particularly strong market performance was seen from high-yield bonds in 2017, with investors looking for medium risk investment returns, between high risk equity investments and low risk investment grade debt instruments. Whilst high-yield bonds were popular amongst non-US investors, the majority of high-yield bond activity occurred in the US, which had its strongest year since 2014.

2017 was the strongest year in the US high-yield debt markets since 2014, reversing a downward trend with 511 deals raising USD 277 billion, representing an increase in activity from 2016.

The US high-yield market was primarily driven by companies seeking to refinance, resulting in two thirds of activity and dollar value raised this year used for refinancing.

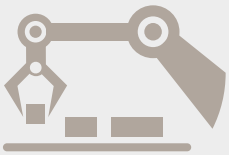
US high-yield debt markets:



Source: PwC 2017 Annual US Capital Markets Watch

2017 high-yield volume and value by sector:

$85bn 33%



Industrial Products

$57bn 19%

Consumer Markets

$48bn 18%

Energy Utilities & Mining

$38bn 13%

Technology, media and telecommunications

$30bn 13%

Financial Services

$12bn 3%

Health Services

$7bn 1%

Pharma & Life Sciences

Source: PwC 2017 Annual US Capital Markets Watch

The oil and gas sector had its best year since 2014, with 74 deals raising USD 39 billion, up 54% from 2016. After showing signs of a late 2016 recovery in energy prices, 2017 saw greater stability in energy prices which resulted in strong participation from oil and gas issuers looking to refinance their existing debt.

Average spreads across high-yield bond types decreased 65 bps on average. The increase in appetite for risk in addition to the search for yield led bond investors to seek the more speculative bonds such as those rated CCC+ which had a sharp increase in demand and tightened spreads, with 57 deals in 2017 compared to only 22 in 2016. As a percentage of all issuances, CCC+ rated bonds accounted for 11% of all issuances, compared to only 6% in 2016.

Certain financial reporting and regulatory considerations for bond issuers

What financial information do I need?

Typically the offering memorandum will contain two or three years of historical audited financial information (subject to the requirements of the listing stock exchange).

Interim financial information may also need to be included depending on the relevant regulatory requirements and investor expectations. These can be local GAAP or IFRS, however certain local GAAPs are considered more acceptable in the bond market than others.

Further, pro forma information could be required to give effect for any significant events that have occurred, or may occur, such as acquisitions or disposals.

What are the regulatory requirements?

The first step is to determine the stock exchange on which the instrument will be listed. A gap analysis against the listing requirements needs to then be performed, followed by development of an action plan to remediate the identified gaps.

It is important for the issuer to prepare and gather in advance the required information that will be needed during the bond issuance, to have a dedicated team within the business who can run the issuance with support from advisors and to have robust financial reporting controls to withstand any subsequent regulatory review.

Bond issuers need to also ensure the regulatory authority review process is properly managed, and updates required to the offering memorandum are promptly addressed.

What should I consider when issuing debt?

There are a number of structuring issues that need to be considered early on in the process, such as which entity of the Group will issue the debt instrument. There are also opportunities available to maximise the accounting and taxation attributes of the group structure, which are often overlooked.

What are the common types of covenants?

Covenants are finalised based on inputs from various parties. Typical covenants include a fixed charge coverage ratio (EBITDA against interest expense), leverage ratio (debt to EBITDA), and restricted payments covenants that limit certain discretionary cash outflow such as dividends and debt repayments.

It is also a common covenant requirement to provide quarterly financial statements to the bond holders.

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