

DEALS IN FOCUS

The transactions that got the primary markets talking

Senegal's new 2021 bond tightened over 100bp after issue, indicating a continued appetite for frontier market debt. Investors even suggest there is room for further tightening

SENEGAL

On only its second visit to the international debt markets, the government of Senegal raised \$500 million in a 10-year deal; joining Ghana, Nigeria and Gabon in the select group of sub-Saharan African countries to complete a benchmark-sized transaction.

Investors were positive on the deal both at and after launch, with the bonds tightening significantly in the secondary markets. The bonds, which carry a nominal coupon of 8.75%, were priced at a discount of 97.574 to yield 9.125% at issue. By May 16, the offer price of the bonds had risen to 105, with the yield falling to 8%.

According to the lead managers, the level of investor interest was particularly satisfying for the borrower. "The government of Senegal is rightly pleased to have repositioned itself amongst its peers in the international capital markets," says Florian von Hartig, global head of debt capital markets at Standard Bank, joint-bookrunner on the deal with Standard Chartered.

An eight-day roadshow preceded the deal, with presentations held in New York, Boston, Los Angeles, London and Switzerland. The Senegalese minister of economy and finance and other members of the finance ministry, the treasury and the BCEAO (Central Bank of West African States) were in attendance to answer investor questions.

This process helped broaden the appeal of the issue, says von Hartig. UK accounts took 37% of the deal, with US investors purchasing 30%, the rest of Europe 29% and Asia 4%. The investor

Deal terms: Republic of Senegal
Date of issue: May 6, 2011
Size of deal: \$500 million
Maturity: May 13, 2021
Coupon: 8.75%
Issue price: 97.574
Issue spread: 9.125% (UST + 596.4bp)
Ratings: B1/B+ (Moody's/S&P)
Bookrunners: Standard Bank, Standard Chartered Bank

base was also diverse with asset managers accounting for 64%, hedge funds 24%, banks 5%, insurance companies 4% and other investors 3%.

Senegal's previous international issue was a five-year deal in December 2009. The 2014 Eurobonds were limited to a non-benchmark size of \$200 million, under conditions set by the country's participation in the International Monetary Fund and World Bank's highly indebted poor countries (HIPC) debt relief programme.

Pricing

In looking to price the 2021 bond, the country was constrained by the market performance of the outstanding 2014s, says Salman Ansari, global head of sovereigns and supranationals at Standard Chartered. The motivation behind the new deal was therefore twofold: the government not only wanted to raise \$500 million of non-concessionary funds to finance its new Dakar toll highway, but also wanted to improve its international standing in the markets. To achieve the

second objective, the deal included an exchange offer for the 2014 bonds.

"The transaction was priced at a yield equivalent to US Treasuries plus 596.4bp, which was well inside the US Treasuries plus 680bp level of the 2014 notes prior to launch," says Ansari. "The exchange offer with the 2014 bondholders allowed Senegal to achieve a significant maturity extension and minimise refinancing risk."

Investors holding \$155 million of the 2014 notes, representing 77.5% of the initial amount, agreed to exchange their holdings. That majority support enabled Senegal to call the remaining 2014 notes at par. While a 100bp-plus tightening of the 10-year notes less than two weeks after launch might lead to suggestions of mispricing, Ansari says a premium needed to be paid to holders of the 2014s to ensure a successful exchange.

"Investors referenced its price in the secondary market as a benchmark for the new issue," says Ansari. "The key goals on this deal were to retire the 2014 Eurobond and extend Senegal's maturity profile. To achieve this, existing investors required some level of premium."

The secondary market tightening was certainly beyond that seen for other African sovereigns in May. Between April 29 and May 13, the average yield to worst on Barclays Capital's EM Africa sovereign index fell from 5.69% to 5.56%.

Investors who participated in the Senegal exchange offer were probably the happiest group of all.

"We participated in two ways, exchanging our old holdings of the 2014 bond and also bought more of

the 2021s,” says Graham Stock, chief strategist for Insparo Asset Management. “It was an attractively priced deal, given the macro picture and relative to the pricing of other African sovereigns like Nigeria, Ghana and Gabon.”

Other investors agreed the issue price was fair, with the closest comparables Ghana (rated B), Nigeria (B+/B1) and Gabon (BB-). Ghana’s 2017 8.5% issue currently trades at 6%; Gabon’s 2017 8.2% bonds currently yield 5%; while Nigeria’s 2021 bonds, which carry a coupon of 6.75%, now trade at 6.2%.

So despite the secondary tightening, Senegal’s issue still carries a yield well above its peers. Of those, the closest comparable to Senegal is Ghana, according to Kevin Daly, a portfolio manager in Aberdeen Asset Management’s emerging markets fixed income team. “In terms of fair value, a spread of 200bp over Ghana is about right.”

That could change over time, he adds. “The market has a higher comfort level with Ghana because it has been in the market for some time. It is more of an obvious commodity export play, whereas Senegal is not. From that perspective there is more comfort with Ghana and hence it trades at tighter levels, but is 200 basis points fair value? Arguably Senegal should trade tighter to Ghana.”

Other investors saw the high issue yield as being necessary for the deal to reach benchmark status. “They had to price it to sell it,” says John Bates, head of the fixed income team at Silk Invest. “They were trying to bump up the size to \$500 million in order to get into the benchmark indexes.

“In the beginning people came in for a quick hit, bought short-term and traded out,” Bates adds, as an explanation for the tightening spread. “Now it is a few weeks after the sale, the so-called real money has basically digested the whole issue. The bonds seem to have stabilised and are trading at more balanced levels.”

Some investors saw the deal as an opportunity to diversify in the currently shallow pool of African credit. This likely pushed up the demand and helped tighten the spread, believes Sergei Strigo, head of emerging markets debt at Amundi Asset Management.



“When Senegal came out it was a decent credit for the spread offered, as it was falling in between the 300bp spread on Ghana, Gabon and Nigeria,” he says.

For investors looking to go even further down the African credit curve, he points to the Ivory Coast and Republic of Congo’s restructured bonds as ones offering higher yields. But there are clear risks to that strategy. “The majority of these African credits have been very volatile: just look at Ivory Coast, which is still in default technically having missed a coupon payment. Investors like Senegal’s bond and the fact that it is now in the benchmark. We’re happy to hold it at these levels,” says Strigo.

Macro outlook

Although not among the leading performers of non-oil exporting sub-Saharan Africa economies, Senegal’s recovery from the global financial crisis has at least been steady. The IMF’s projections for the country’s growth for 2010 and 2011 were 4.2% and 4.5%, following two years where GDP growth averaged 2.7%. However, having stated in its 2010 country assessment that the risk of debt distress in Senegal was relatively low, the IMF in April warned of potential pressure on the country’s debt load due to increasing inflationary pressure caused by rising food and fuel prices.

Daly argues Senegal’s macroeconomic growth is not as assured as its resource-rich neighbours. “At the roadshow the only comment I made in terms of the biggest risk was the fiscal deficit [4.8% in

2010, according to the IMF, although this will rise to 5.8% as a result of the highway financing]. In relative terms it has a lower fiscal deficit than Ghana [6.8% in 2010], but from a trajectory standpoint Ghana is on a declining path, whereas the fiscal deficit in Senegal is on an increasing path. So that would probably be the one area to flag up.”

Other investors note macroeconomic risk constitutes a major part of investing in African credit. “The Senegalese economy has a structure that is relatively fragile by the standards of more developed emerging markets, and means the level of debt that the economy could sustain is lower than it might be in southeast Asia and eastern Europe,” says Insparo’s Stock. “But it is fairly typical for Africa and is reflected in the pricing.”

One of Senegal’s main attractions is its relative political stability. The potential for political unrest to affect the debt issue was raised during the roadshows, says Ansari at Standard Chartered. “There were a few concerns related to political stability given that the [national] elections are expected to take place in 2012. However, most investors took comfort from Senegal’s long history of democracy and track record of smooth electoral transitions.”

“The economy is looking stable,” says Strigo. “The fact the currency of the West African Monetary Union [the CFA franc, which Senegal uses] is pegged to the euro is helpful in mitigating market volatility.”

Others point to the benefits to Senegal of extending its international funding out to 10 years. “It pushes the maturity profile of its balance sheet into the future and removes any of the large repayment hurdles it had coming up,” says Bates. “That is positive for Senegal.”

Senegal’s issue could inspire other sub-Saharan African sovereigns, with Zambia and Angola potential issuers in the international markets in the second half of 2011. If they do tap the markets, there is likely to be interest from investors, says Bates.

“There’s a lot of interest in this region because people are starting to wake up to the long-term potential of Africa.

It is one of the last frontiers of true industrialisation on the planet,” he says. ☉

Gillian Carr