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Business Day P 9

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Tapping bond markets now a more viable financing option

LESS is more. That would make a good motto for Finance Minister Trevor Manuel, who has slashed government's borrowing and paved the way for big changes in the local financial markets.

The finance department released budget figures last week for the three months to June which were a reminder that government is borrowing only small amounts of money on the capital market.

The dramatic reductions over time have huge implications for the financial markets.

A look at the latest numbers suggests the conservative budget targets will be met — or even surpassed — and government might end up borrowing even less than budgeted.

Once again, revenue increases are outpacing the budget projections, while spending growth appears to be lagging a bit. Revenue in the first quarter of the fiscal year was up 9,6% against a budgeted rise of 7,2%. Spending requisitions — that is, amounts requested by departments and provinces but not necessarily spent — were up 7,8%

against a budgeted target of 8,1%.

PLJ Financial Services economist Dawie Roodt is particularly encouraged by the financing side of the budget. Government could end up borrowing much less on the local capital market than budgeted.

Manuel budgeted to issue about R10bn in long-term loans; this could be reduced to about R5bn, says Roodt. Last year borrowing was less than R3,5bn, kept down by use of finance from the SA Special Risks Insurance Association (Sasria).

Compare these figures with long-term loans of almost R40bn issued in 1994 and you get the picture. This is nothing short of a massive reduction in borrowing by government; a structural change in the capital market.

The reduction of government's role in the capital market has opened the way for other borrowers who can meet investors' appetites for longer dated assets.

One of the key borrowers is the Infrastructure Finance Corporation (Inca), which is a privately owned infrastructure debt fund.

Inca boldly goes where others would not dare: it lends money to viable local authorities. The company plays an important role in mobilising private finance for infrastructure spending.

Inca raised R100m from the bond market this month at a relatively expensive yield of about 170 basis points over comparable government bonds. Barbara Agnew, the company's treasurer, says Inca now plans to tap the market quarterly to improve the tradeability of its bonds.

The last time it raised finance was a year ago and its lack of visibility in the market has resulted in a liquidity premium.

The reduction in government's borrowing has paved the way for the revival of a municipal bond market in SA. Inca, which took over Sanlam's municipal bond portfolio, wants to play a pivotal role in establishing a municipal bond market.

However, it finds itself in competition with the Development Bank of Southern Africa in setting up the market.

Spending on infrastructure has slowed down at the local

Arnold Steyn

government level, but the Development Bank expects expenditure to pick up rapidly after the local government elections.

Given the financial mess in which many local authorities find themselves, however, it will be some time before their financing needs have a substantial effect on the local markets. Still, the Development Bank has remained an active borrower on the capital market, raising R1bn last month.

Other parastatal borrowers, such as Telkom and Transnet, have kept a

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low profile this year. The really important development has been that listed companies are tapping the bond market. Standard, Absa, and Sasol have launched bonds which were well supported.

Paul Hewitt, director of debt origination at Standard Corporate & Merchant Bank, says: "Less government funding creates space for corporate issuers. The emergence of a corporate bond market will lead to more accurate credit pricing over time."

The corporate bond market provides investors who require longer dated assets with more options, as well as providing borrowers with an alternative source of longer term finance.

In theory, tapping the bond market should be lucrative for companies, as they avoid the regulatory costs that add to banks' cost of funding.

In practice, though, SA companies have often been able to raise relatively cheap finance from banks. Also, many blue-chip firms were cash flush until recently.

Marc Hussey, JP Morgan's vice-president of debt capital markets in SA, says SA banks in the past chased after market share, which benefited their corporate clients. "But now there is a greater focus among banks on return on equity and assets, which suggests that corporate borrowers will increasingly look at the bond market

as a source of finance."

One of the drawbacks is, however, that as the market gets off the ground, corporate borrowers may find themselves paying a novelty premium.

Sasol, which had no long-term debt before its R900m issue this year, paid about 85 basis points over the equivalent government cost of funding. Some analysts say Sasol paid a premium; others disagree.

Still, given Sasol's big expansion programme, its undervalued share price at the time and its sound balance sheet, the bond market made sense as a financing choice. Investors queued up for the bonds.

JP Morgan's Peter Worthington estimates that this year will see between R8bn and R10bn in borrowing on the capital market by non government issuers. "We have seen about half of that so far, and we expect next year to bring about the same level of activity."

As government has pulled back from the capital market, so other borrowers are beginning to step forward to capitalise on investors' appetite for long bonds.

Will investors' appetite be enough to establish a vibrant municipal bond market? Will SA blue-chip companies increasingly tap the corporate bond market for finance? If the answer to both questions is yes, SA's markets will become more efficient in the allocation of capital.

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