NEWS
FEATURE

SSAs: small taps to keep running

Supranational, sovereign and agency (SSA) Kangaroo issuance approaches have changed significantly in recent years. Demand dynamics have driven down average deal size – and there is evidence that most issuers are happy to print when they encounter demand rather than wait for momentum to build.

BY LUCY SYMONDS

SSA Kangaroo bonds – new line launches and taps – are being issued in smaller volumes than previously seen, to the extent that some SSA Kangaroo market participants describe the sector as effectively Australia's own private-placement arena.

According to KangaNews data, the average tranche size printed by SSAs in the Kangaroo market has been in decline for all of the current decade (see chart on facing page). The decline became precipitous from 2013, and appears to have led most SSAs to adapt their issuance strategies around this dynamic.

This change in average tranche size has seen the SSA sector split between the – ever-dwindling – group of issuers that strongly favour only increasing lines via benchmark-sized trades and the majority, that have adjusted their strategies to allow for smaller-sized trades.

THE VALUE OF VOLUME

On May 24 this year, conversation around Kangaroo issuance strategy again came to the fore when World Bank priced an A$800 million (US$591 million) increase to its January 2021 Kangaroo line. The tap was the largest high-grade Kangaroo deal this year to date. World Bank's Washington-based lead financial officer, Andrea Dore, confirms that the issuer's current strategy is to target A$150 million for 10-year paper and A$300 million in the five-year part of the curve as minimum issuance sizes in Kangaroo format.

Some market participants say issuers that are able and willing to take the risk of not issuing while demand momentum builds receive a notable benefit from doing so. In private, a number of intermediaries also suggest that issuer willingness to scoop up demand as soon as it appears – even in very small parcels – is not ideal for the longer-term health of the market.

Demand tension sets Kangaroo SSAs that stick to a minimum deal size apart from their peers, intermediaries say. By letting momentum build – and allowing investors occasionally to benefit from smaller bids in the secondary market – these names support their curves. Even if they occasionally miss out on a bid in the near term, they are likely to benefit down the track from a wider, more supportive potential investor base.

The volume of the World Bank's recent increase could cause other SSA issuers to reconsider their own Kangaroo issuance strategies, says Rod Everitt, Sydney-based head of Australian dollar syndicate at Deutsche Bank. "When World Bank comes to Australia it's seen as a market event. The market needed a good-size print and hopefully this will make other borrowers think about whether the funding strategies they are currently deploying are the right ones," Everitt argues.

World Bank is not alone in having a minimum deal-size strategy, but the list of similar issuers is small and, bankers say, dwindling. It tends to be limited to top-tier SSA names with large programmes – though intermediaries credit L-Bank for respecting demand conditions despite its relatively smaller issuance requirement. Asian Development Bank is another name that tends to stick to larger issue sizes, while European

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ROD EVERITT DEUTSCHE BANK

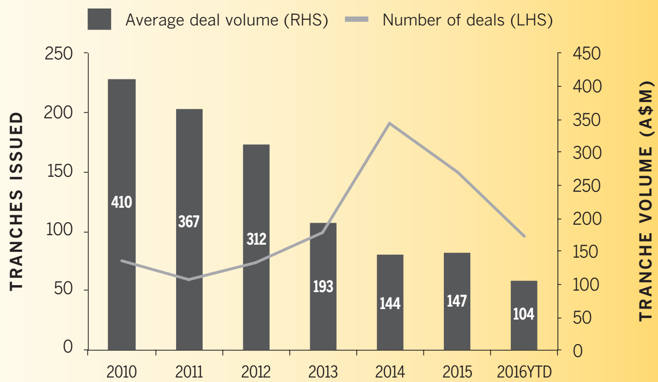
Investment Bank (EIB) and KfW Bankengruppe (KfW) also tell *KangaNews* they will not print just any volume.

Jorge Grasa Arias, capital markets officer at EIB in Luxembourg, confirms that the supranational has a clear strategy when it comes to tapping Kangaroo lines. "In keeping with our approach of issuing large, liquid, benchmark-sized trades that are attuned to specific product and currency markets, we have minimum size targets. These targets are naturally calibrated to market circumstance and demand," he says.

But even EIB has had to adapt to the realities of contemporary demand. "As the Kangaroo market has seen a material reduction in the average issue size in recent years, we too have responded along with the rest of the issuer community. In the current context, EIB's minimum size for taps stands at A$200 million in the mid-part of the curve and A$100 million for the longer end," Grasa Arias adds.

Lars Ainsley, manager new issues, capital markets at KfW Bankengruppe (KfW) in Frankfurt, says the agency's main driver for issuance in the Australian dollar market is to issue when there is demand. But it retains a threshold. "We generally assess the minimum tap size on a deal-by-deal basis but we won't reduce the minimum size below A$100 million. KfW's track record in the year to date proves us right and underlines our strong commitment to the Kangaroo market," he claims. "Even in a market environment with smaller ticket sizes KfW aims at providing liquidity to the Kangaroo market. We do this via the issuance of liquid bonds in a decent size at attractive pricing."

NUMBER AND AVERAGE SIZE OF SSA KANGAROO TRANCHES ISSUED



SOURCE: KANGANEWS JUNE 23 2016

VOLUME TAKERS

Kangaroo intermediaries extol the virtues of letting price tension build – and at times, though rarely in public, suggest that some issuers would benefit from a little more discipline in this respect. However, they are also universally quick to acknowledge that demand circumstances have changed and that many issuers are simply not in a position to wait for sufficient demand to support a multi-hundred-million dollar print to build.

Tom Irving, managing director and head of Asia syndicate at TD Securities in Singapore, argues that very few SSA issuers are able to stipulate a rigid minimum tap strategy in the Kangaroo market given the range of elements that can affect the size of transactions.

He tells *KangaNews*: "We know of a number of SSA issuers that, as a matter of course, will not execute small tap transactions. But there aren't too many who put a definite minimum on tap volume for any part of the curve."

Laura Fan, head of funding at Inter-American Development Bank (IADB) in Washington, argues that market conditions have contributed to a change in sentiment around tap volumes in the Kangaroo sector. She comments: "In the past the minimum tap volume we would issue was A$100 million. However, given how markets have developed over time we have had to make changes to our minimum size requirement, and we now consider taps as small as A$25 million."

One reason for the change is the state of the intermediary sector. Dealers' reduced ability to hold inventory has been much discussed, and has forced many sectors – with SSA Kangaroos being one of the most obvious – to scale transactions to demand.

Eugenia Kaplun, from Rentenbank's funding team in Frankfurt, says: "The changing regulatory environment meant we had to evaluate the business decisions behind our tapping strategy. Banks are more and more exposed to internal and regulatory pressure, resulting in smaller inventory positions. Our prudent strategy to set the minimum increase size to A$50 million ensures that our bonds are fully placed with buy-and-hold investors."

Another important factor driving issuers' ability to stick to minimum deal-size requirements is that most SSAs do not benefit from the same name-specific caché as the likes of World Bank. The brutal reality is that plenty of reverse-enquiry flow is happy to move onto the next SSA if one is not ready to issue.

Oliver Holt, head of Australian dollar syndicate at Nomura in Hong Kong, tells *KangaNews* that name-specific factors

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LAURA FAN INTER-AMERICAN DEVELOPMENT BANK

helped drive World Bank's most recent transaction – but that the issuer has itself helped grow this investor loyalty precisely because of its issuance strategy. "Primarily, World Bank continues to benefit from perceived scarcity value, and it is very clear that the January 2021 line won't be tapped again in the coming weeks," he explains.

Even so, Harald Eikeland, director, debt syndicate at ANZ in Sydney, argues that many issuers may have to take advantage of a bid when it is there or risk seeing it soaked up by a similar borrower. "Demand is definitely transferable across names, and if the investor isn't able to buy one name they can and will buy another similar credit," he confirms.

Irving adds: "I agree that there is generic SSA demand but there are also smaller, more specific pockets of demand within this dynamic. It may not be as particular as individual issuers – demand could be transferable between issuers from Washington and the Europeans, for instance."

"We currently focus on 2026 maturities and at this end of the curve we issue small taps that are in line with the cash Japanese asset managers have available," van Dooren reveals – though even at this duration he says the issuer's preference is to keep to a minimum tap size of A$25 million. According to KangaNews data, BNG has only issued below its A$25 million minimum once, in April this year, when it printed a A$20 million increase to its August 2026 line.

According to Eikeland, the difference in demand dynamics between the middle and long end of the Australian dollar curve needs to be taken into account when considering individual borrowers' issuance strategies. "In the mid part of the curve you don't see small taps occurring in the same way as you do in 10-year tenor. In the mid part of the curve issuing larger, less frequent transactions allows the bonds to build tension, and in the end perform well. It also gives investors more confidence around the liquidity of the line."

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FLORA CHAO INTERNATIONAL FINANCE CORPORATION

For Daniel Chandler, Sydney-based director, debt capital markets at RBC Capital Markets, what works for one name might not be the appropriate strategy for another. He comments: "World Bank has a large following, from which some issuers do not benefit. While it is encouraging to see a large print it is also important to bear in mind that there is always a place for the smaller trade sizes in this market."

TENOR SHAPES BID

The other major determinant of what is possible in terms of Kangaroo deal size is the tenor being addressed. The Kangaroo market has a long track record of providing issuers with a rare global-market opportunity to match-fund in the long end. But market users admit long-dated demand, while substantial, is narrow. It has been driven by a very small number of funds, which want capacity filled as it emerges.

Investor behaviour therefore provides issuers with a marker for what volume they can hope to achieve in each transaction. Larger, more infrequent deals in the mid part of the curve may benefit from demand tension. Smaller taps in the long end of the curve provide a platform for meeting pockets of demand quickly.

While Bart van Dooren, head of funding and investment relations at BNG Bank (BNG) in The Hague, tells *KangaNews* the agency's issuance is not related to matching assets with liabilities, he reveals that the liquidity provided by long-end Japanese buyers keeps BNG coming back to the Australian market.

Flora Chao, senior funding officer at International Finance Corporation (IFC) in Singapore, says the investor landscape dictates the supranational's willingness to issue small deals. "Investor dynamics are precisely what is behind our rationale for small tap volumes. At the exact point when money becomes available to investors we want to take advantage of the demand while it is there."

Chao adds: "In the belly of the curve we prefer larger syndicated issuances when tapping a bond. But because the investor landscape is unique in the longer end of the curve, we tend to accept smaller issuance sizes when increasing our bonds. I would say we stick to a A$25 million minimum, with the option of going lower should compelling reason present itself."

For now, market participants seem reasonably confident that the Kangaroo mid-curve will retain somewhat more discipline around minimum deal sizes – at least relative to the long-dated market with its specialist and focused demand characteristics.

However, Eikeland believes small taps are likely here to stay in the long end – and are increasingly regarded as inevitable in the mid-curve, too. "A few years ago there was stigma around smaller deal sizes in the middle part of the curve – if you did a deal at A$50 million or below it was perceived to be weak. This is not so much the case anymore, though I think there is still a perception that size counts in middle-curve tenors. Frequent SSA Kangaroo issuers will continue to look at the middle part of the curve as a point where they need to issue a certain size." •