Tough time for convertibles

The equity-linked markets have had a rough ride in recent months, owing to heavy supply so far this year – $20bn from Europe alone – uncertainties over short-term interest rates and declining levels of equity volatility.

Because convertibles are structured around a bond and an equity option, the higher the level of market volatility, the more the equity option is worth, and so the higher is the convertible price. Five-year DAX volatility levels, for instance, have declined by some 15% since the height of last year's financial crisis.

As well as supply concerns, investors have experienced losses on recent offerings, particularly from the US internet sector. As a result, a number of companies have had to price their issues to sell, with generous coupons or low premiums. Some have had to cut back on size. Even then, deals have struggled to find acceptance with investors.

In the US, adding to the poor sentiment was the announcement by a swarm of issuers of intentions to bring convertibles to market last month. That closed what had been a window of opportunity. Combined with the back-up in the US high-yield and IPO markets, deals have struggled to get done. LSI Logic, CompuCredit and Arvin Industries all cancelled planned offerings after facing lacklustre demand.

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Cox Communications, the fifth largest US cable company, had to increase the coupon on its $650m Feline Prides offering. Merrill Lynch priced the deal with a 7% coupon – outside the 6.25% to 6.75% price talk – and the premium at 20.5%, almost at the bottom of the 20% to 24% price talk. The issue was priced 6%, cheap against its theoretical value. That brought in a book of 60 institutions, but even then the deal struggled.

Cox only pushed ahead because it needed to fund its acquisitions of Multimedia Cable TV's assets for $2.7bn and TCA Cable TV for $4bn. The company simultaneously issued a $347m common stock deal and $2bn in debt securities to fill its pockets.

Benchmark Electronics also had to pay up to get its deal done. The offering was reduced from $125m to $75m and priced with a 6% coupon, outside the 4.5% to 5% price talk, and a 20% conversion premium compared with price talk of 22% to 25%. Veritas Software reduced its planned offering of discount convertible bonds to $405m from $575m and its simultaneous convertible offering was cut to 9m from 12m shares.

McLeodUSA, a competitive local exchange carrier (CLEC), faced the roughest time. The company was forced to downsize its deal from $400m to $250m as comparable CLEC stocks began to fall on news that regional Bell companies had forged new pricing agreements with long-distance carriers.

In Europe, Spain's biggest ever convertible bond, a €600m deal by Banco Bilbao Vizcaya (BBV), fell victim to European investors' increasingly negative attitude towards equity-linked securities. The tone of the market was not positive when BBV came to market, but at the time, market professionals said the deal's difficulties also resulted from an investor-unfriendly structure and a lack of confidence in the pricing.

The premium was set at 12%, right at the bottom of the 12% to 18% range and considerably lower than the issuer would have hoped for. The bonds fell to a price of 98 soon after allocation, pulled down partly by a fall in the underlying stock price. IFR

Wal-Mart prices $5.7bn benchmark bond issue

Retailing giant Wal-Mart priced a gargantuan $5.75bn bond early last month, managing to keep it within or very close to its guidelines, despite the chaos in surrounding markets at the time. On the day the jumbo global was to be priced, credit spreads had widened by 11bp – 12bp overnight on rumours of derivatives losses at US banks and the forced unwinding of swap plays by hedge funds.

Undaunted, Wal-Mart was able to increase its offering for a second time to a final size of $5.75bn and price pretty much in line with 'talk'. Other corporate names to price late in the week missed talk by up to 25bp. In its first foray into the bond market since 1995, Wal-Mart sold securities in three tranches with demand in excess of $10bn from 515 investors, the broadest distribution ever achieved by a US corporate.

Generous

Investors, many of whom are fully allocated to financial names and eager to diversify, flocked to the issue. They said the spreads on offer were generous.

Wal-Mart will represent over 1% of the Lehman Brothers core bond index, making it a must-have security for indexed investors. US investors bought 90% of the issue with the rest being taken by Europeans. Over $1bn in demand was seen from Europe, evenly split between the five- and 10-year tranches.

During the extensive roadshow, investors were taken aback by the sheer size of Wal-Mart. For example, combining the second through fifth largest retailers in the world – Metro Holdings, Sears, K-Mart and Carrefour – would create a company that does not equal the size of Wal-Mart in terms of sales.

Investors also liked the fact that the company generates over $3bn in free cash flow per year, meaning it could pay off its acquisition of British retailer Asda in roughly three years. Proceeds of the bond deal are to finance a portion of its $10.83bn purchase of Asda. IFR