Nick Kochan
Investigative journalist & freelance writer

079 7329 7490
author@kochan.co.uk

Nigeria issue takes Africa centre stage

When Nigeria comes to the market this month with a £500m sovereign bond, investors will scrabble to get a piece of it. The $500 million ten year bond will be heavily oversubscribed as African credit moves away from the fringe of the emerging market universe to dead centre.

Africa is flavour of the year. The former fear of defaulting and unstable African states has been replaced by a clamour for credits that are seen as the most dynamic part of the frontier market. The demand will in time be met a myriad of African states watching the market but lacking the confidence or credentials to sell their debt. Africa has a rarity value, says Standard Chartered's head of capital markets for Africa, Ade Adebajo. 'There is a growing appetite from emerging market funds for African debt, in recognition of the rarity value. The issues don't happen that often, so when you see it, you grab it. Ghana and Gabon issued in 2007. We are now three years on, and they haven't issued again.'

The ranks of buyers of African debt are swelling as the credit is reassessed. This is no longer just the province of the emerging market experts. Now broader investors want a piece of the action. So when Cote d'Ivoire launched a $2.3 billion issue earlier this year -- the result of a restructuring of the country's legacy Brady Bond issues -- 'real money investors who wouldn't normally be interested in a bond issued by a country without a rating came into the market', said one analyst. The Cote d'Ivoire bond exceeds the aggregate value of all other African bonds to date and accounts for 0.75% of the $400 billion Emerging Market Bond Index.

A revision of African fundamentals fuels the demand, says Adebajo. 'Even compared with other emerging markets, the African markets are on a much stronger footing relative to a number of developed nations. Investors see the risk of currency crisis or sovereign default in most African markets as fairly low. African sovereigns are viewed as offering long-term diversification benefits, and if you can get a decent size, so that it qualifies for the EMBI index, that helps in terms of liquidity associated with these bonds.' A quick recovery in the price of Ghana's bond, after the ravages inflicted by the economic crisis confirmed investors confidence in the country's fundamentals. One investor commented, 'If you sold all your Ghana because of the crisis, you would have underperformed the index significantly, because this bond has just rallied like crazy.'

He continues, 'Investors are sitting on cash and they need assets. If they can get sizeable enough chunks of African debt, there will be interest from international investors. Given the evidence in terms of the price performance of outstanding bonds, a benchmark issue of a B Rated African sovereign will be welcomed by the market, whether it's Kenya, Zambia, Ghana again, Uganda, Bukina Faso, or Mali. Debt from any of these countries would be welcomed by the markets. But whether they will do it themselves, I don't know.'

While the money is out there to lend, borrowers are less enthusiastic. Reasons for this come from a number of directions. First of all, multilateral lenders and donor countries continue to enforce rules restraining recipients of concessionary money from private market borrowing. Second, African states are being offered large cheques by China and may see no reason to go through the hoops required to go into the capital markets, even if this route better protects their independence.

079 7329 7490
author@kochan.co.uk

A third reason for the lack of enthusiasm is a long-standing suspicion of capital markets and their participants. Francois Ekam-Dick, managing director of Iroko Securities, says that 'Capital markets are viewed as extreme. They want to lend a lot one day, and nothing the next. Borrowers want to find the middle ground. People are playing it safe. You can have a debate about the speed of funding your growth. You need to do something that the country is comfortable with. Doing nothing is not good when you have a big funding need. They want to feel comfortable with the capital markets, they want to start building it up.' Ekam-Dick says that African governments perceive capital markets as fair-weather friends.

Yet there remain question-marks over the reliability of Africa's own issuers. Nigeria's arrival at the sovereign bond level, for example, came after a false start. This occurred prior to the last election, when the country issued a Request For Proposal to Merrill Lynch, JP Morgan and Citi, to lead the issue, but the issue did not go ahead.

Investor appetite for African bonds is greater than the supply, says Adebajo. This puts issuers in the stronger position, biding their time, and structuring issues in the way they want while not being beholden to the markets. Africa's presence in the sovereign bond index to date, is limited to three issues. These are from Ghana, a $750m bond issued in 2007, from Gabon, a $1b bond also issued in 2007, a $2.3b bond issued by Cote'd'ivoire in 2010. Senegal and Seychelles, have issued smaller amounts which do not feature in the index.

The recent success of African issues raises expectations for Africa issuance. Jan Dehn of Ashmore says, 'These bonds have been super good investments and we think that there is no indication anywhere that these countries have any intention of defaulting. These countries did not blow up, or fold; they did pretty well. The Ghana 2007 bond is currently trading at 115. These guys have traded up 15% relative to where they were issued, which is the highest they have ever traded at.'

The benefits of oil production has given the Gabon bond a boost and it is trading even higher than Ghana's at 117, after being issued at par. Markets have mixed feelings about this bond, in spite of the yield performance. On the one hand, they are impressed that the government has a programme of buying back the bond from the markets. The finance ministry is using an oil based sinking fund to reduce the outstanding amount, and this now stands, three years after issue, at $878m. On the other hand, they are little less than impressed that one of the projects for which the bond's proceeds will be used, was to build a mausoleum for the late President Bongo of Gabon. Bongo, a controversial figure on the African stage, died two years after the bond was issued, by which time the structure had been built and the funds spent. One market observer commented, 'From an investor's point of view, they were probably going to build one for themselves anyway; it was just a bit distasteful that they came out and announced it about a month after they issued the bond.'

Every emerging market bond house wants a piece of the action, says Dehn. 'Who owns Ghana? Everybody owns Ghana. Who owns Gabon? Everybody owns Gabon. Now you may be overweight or underweight on the index, depending on your views on these credits. But everybody who has exposure to emerging markets is likely to have exposure to those two countries too. These countries are now formally and permanently integrated into the global capital market. Regardless of the short term exposure people choose to take to their currency. This is one of the important transformative elements of the sovereign debt dollar market.'

Dehn continued, 'It's really critical that Gabon and Ghana in particular issued long term sovereign dollar bonds. There are investors that are going to continue to maintain an exposure to Africa by

079 7329 7490
author@kochan.co.uk

owning these bonds. If you only had a local currency bond, it would have been a very short term exposure. You would have gone in there for the currency alone, and then with the devaluations that happen during the crisis, you would have cut your exposure, and you probably wouldn't have looked at that region again for a long time. By holding the dollar bonds in your portfolio, you have an umbilical chord between yourself and Africa.'

This belief in Africa's prospects explains heightened investor interest in the $500m Nigerian 10-year bond. Major emerging market funds say it will be a landmark issue which will be included in the JP Morgan Emerging Markets Bond Index (EMBI). The queue for a piece is expected to be long. Kevin Dally of Aberdeen Asset Management says, 'we expect it to be many times oversubscribed. It will most likely be priced between the level set by Gabon and that set by Ghana.'

Nigeria could have been bolder in the amount it raised in their sovereign bond, given the large economy and the scale of its oil production, say investors. One said, 'They could have done $1 billion. When a government issues a $500 million bond, $3-400 million of it will go straight into some passive investment account. People that just have the same exposure but that country has the index. So, they buy it because they now have the same exposure as the index and they're neutral to the index, and they sit on it and never trade it.'

Dally says, 'That's a relatively small amount. The majority of the bond will simply end up in accounts and not get traded very much. This is not a big bond issue, when you take into the account the amount of interest and excitement there is in emerging markets. The amount of free flow you're going to get on a $500 million bond issue is pretty small.'

The lack of scale of the Nigerian bond could prove self-defeating, says Dehn. 'When the free flow is small, the amount of bonds that get traded every day is relatively small. Then you end up with a lack of liquidity and the bid offer spread tends to be quite wide; the bonds don't respond very much to fundamentals and they don't deliver some of the signals the bonds were supposed to deliver to policy makers. It also means that you can't be sure you can trade out of the position because you can't trade very big amounts. It means you can't actually put on big trades, and so the bond is not that useful. The government has underestimated the appetite in the market.'

Ekam-Dick comes to the defence of the Nigerian Debt Management Office and its director, Dr Abraham Nwankwo. He rebuts the argument that the country could borrow more. 'Let the guys borrow what is reasonable. The point is, do you want to run, slow, medium or fast. Borrowers should not fall into the trap of borrowing all that the capital markets want to lend.'

Internal political and administrative issues cloud the Nigerian scene, say investors. They point to the issue's timing close to the Nigerian presidential elections. The country would need parliamentary approval to raise the amount, and this would require amending the Nigerian financing law accompanying the budget. They say that the best hope for a larger issue will come after the election, when a new round of bond issuance becomes possible.

Symbol rather than size is the priority for the Nigerian government, argue many investors, who say the country wants to put down a marker to investors, indicating its economic competence. One debt manager at Deutsche Bank who did not want to be named says, 'a presence in the international markets gives them the recognition they want to attract in foreign direct investment. This is not about raising money, even though their infrastructural needs are great.' Dehn confirms this view. 'They don't need the funds. They have enough resources from oil, tax revenues and domestic bond

079 7329 7490
author@kochan.co.uk

issuances; but they believe that a sovereign bond is a vital piece of the financial infrastructure of the country. It is the benchmark against which sovereign risk is measured. If you know what the sovereign risk is, then you can price corporates on that curve very easily. The real interest in the market at the moment is in the corporate debt, not the sovereign debt. It's probably a good time to get a sovereign bond, if they really want your corporates to borrow. The bond is an integral part of the financial structure of any country. A house should have a roof, it's just the way it is.'

The continent's limited showing in the sovereign marketplace is due to a history of debt and default problems. These came to a head in the 1980s, when multilateral agencies took charge of many African economies, providing bailouts. One condition set by the IMF and World Bank restricted countries in the Heavily Poor Country Initiative (HIPC) from tapping commercial markets for non-concessionary or private sector funds. The borrowing restraints are proving increasingly irksome to sovereigns interested in tapping global market funds. One investor said, 'IMF rules are a hot political subject. There are a lot of bilateral discussions at a sovereign level. They are looking at sustainability in debt management, prudence, fiscal management.'

Nigeria's entry into the sovereign debt markets comes four years after the country concluded negotiations with the Paris and London Clubs of lenders with a $20 billion payment, to settle its outstanding obligations. The many other countries eager to tap private money are still locked in negotiations and hamstrung by pressures from Washington for a settlement.

The rise of a new and more sophisticated manager to the helm of Treasuries in many sub-Saharan countries gives investors the confidence that the debt spirals of twenty years ago will not be repeated. Ekam-Dick says that the 'financial managers in many African countries have understood the importance of liability management. They want to diversify their borrowing, and they realise that they should only borrow what they can pay back. There is a new and more sophisticated set of officials in African governments who are eager to understand, and over time embrace the capital market disciplines.' The Deutsche bank manager concurs. 'The technocrats in charge are comfortable with taking decisions. There is a desire for greater transparency and a willing to disclose more. They recognise the advantages of greater disclosure. Despite having major challenges in terms of infrastructure, they are inclined to be prudent in terms of taking on international debt. This encourages investors that we won't have a situation where people come out to double up debt that has already been forgiven or restructured. They are taking prudent and determined measures not to repeat the problems of the past.'

These managers also have the experience of building local capital markets, so going into the international market is less of a leap. The Deutsche Bank manager commented, 'There has been substantial progress in terms of debt restructuring, forgiveness through to negotiated transactions. This has put the balance sheets of some of these countries in much better position. There is a more proactive approach to developing the domestic fixed income capital markets and this has given them more confidence in terms of accessing the international debt capital markets. They are comfortable with the domestic yield curve and they realise that it is important to access the deeper global pool of capital.'

The arrival of rating agencies at 15 sub-Saharan African countries has added to transparency (long an investor bugbear), and governments are taking pains to show how funds are to be used and where they will be held. Investors gained comfort from Ghana's level of disclosure when it launched its $750 billion issue. It announced that it would put the money into an escrow account where the proceeds of the bond could be monitored. Dehn says, 'The money was then earmarked, and then it was published in a separate document, so you can see where the money has been spent.' Part of the proceeds was designated to fund the Kumasi Accra highway, the main arterial route in Ghana. Some was also earmarked for projects which have been vetted in terms of their return, to ensure they could produce enough economic returns for the country so that they could raise enough revenue to repay the bond. Dehn says, 'They essentially put the money into an account where you could monitor the proceeds of the bond. It was laid out in a separate document, so you can see where the money has been spent.'

Financial managers in Zambia, Tanzania and Kenya are shortly expected to push the button on plans to issue sovereign bonds, hoping to benefit from the tailwind of a successful Nigerian issue. Adebajo says, 'They are revisiting the whole idea of accessing the international capital markets. Some are looking for ratings, others are debating whether they issue an RSP for banks to respond. They will closely monitor the Nigerian issue. Some sovereigns might access the markets , but not through the conventional Eurobond format. They might come in through non-conventional and alternative funding routes, such as Islamic finance.'

Kenya is closest to issue a bond, says Dehn, he says it may come in the first part of next year. Tanzania will follow shortly afterwards. 'Within a few years, we would see a doubling or tripling of the number of African countries that have entered into the index. All the new countries that are coming into the emerging market asset class are going to be in Africa. The entire emerging market asset class needs Africa to develop and come in, because we are running out of bonds. You can't just have countries graduating out of the asset class, we need countries to come in as well.'

Internal factors could hamstring the progress to market of some countries, warns one investor. 'While we will see a significant number of African nations issuing bonds over the next five years, we must understand that African bureaucracies do tend to work very, very slowly so it may be some don't get their act together in time. They may miss today's wave of investor enthusiasm for African credit.'