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Singapore Perpetual Bond Investors Hope Never Means Three Years

by Christopher Langner

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Singapore's richest investors are hoping that "never" means about three years in the bond market.

Holders of perpetual notes with no set maturity face the island's first redemption options in September, when three companies including oil services firms Ezra Holdings Ltd. and Swiber Holdings Ltd. can choose to repay securities sold in 2012. While Ezra says it plans to pay off the notes and refinance, their yield has surged more than 200 basis points over the last year to 14.2 percent, suggesting it may be costlier to replace them. Swiber faces the same test after saying it plans to redeem its bonds, which have added more than 230 basis points.

Private banks have snapped up the bulk of Singapore's S$9.5 billion ($7.1 billion) of corporate perpetuals on behalf of wealthy clients, reckoning the companies would repay the notes at their soonest chance rather than incur higher interest rates when a so-called step-up coupon takes effect. While that would offer some compensation if the debt stays alive, any mishaps could shake faith in securities that have funded about 15 percent of the island's corporate debt over the last four years.

If any issuers choose not to pay in September, "there would be some discomfort among investors when they realize that what they've been holding is not necessarily going to be paid off at the time they expected," said Vishal Goenka, the Singapore-based head of local currency credit trading at Deutsche Bank AG. "There is nothing right or wrong, issuers have already told them from the beginning the option was there, but there would be some confusion."

Affluent Locals

The absence of a maturity date means perpetuals usually offer higher yields than bonds with one. Companies are taking advantage of Singapore accounting rules that count the notes as equity and a tax law that exempts interest payments, while affluent local investors earning just 0.1 percent from their cash deposits are lapping up the riskier investments.

"We intend to call the perpetuals in September 2015 and we are exploring a variety of refinancing options to do so," a spokesman from Ezra said by e-mail April 30. Swiber has "sufficient internal resources to redeem the perpetuals," the company said in an e-mail on the same day.

Ezra must repay a S$225 million bond due on Sept. 7, or 11 days before the call on its S$150 million of perpetual notes. The first securities were issued at a coupon of 5 percent while the perpetuals offered a fixed return of 8.75 percent. The offshore marine company had $158 million of cash at the end of February, according to Bloomberg-compiled data.

Two Payments

Swiber reported an operating loss in 2014 and had $166.3 million of cash at the end of the year. The company has a S$95 million bond due in June and an S$80 million perpetual paying 9.75 percent that can be redeemed on Sept. 25.

The other call occurring that month is on Ezion Holdings Ltd.'s S$125 million perpetual bonds on Sept. 14. The marine logistics company's notes are trading above par.

The recurring payment on perpetuals lifts significantly after the date when the company is first allowed to buy them back. Investors often interpret that as a sign the bonds would be redeemed at their first call, according to Deutsche Bank.

If any company chooses not to redeem in September, the coupon for each note will rise by more than 300 basis points, according to data compiled by Bloomberg. That would still be lower than the current secondary yield on Ezra's and Swiber's perpetuals.

Lower Yield

"Swiber has said they will call the perpetuals back by refinancing," said Chee Keong Yeak, an equity analyst at Maybank Kim Eng Securities in Singapore. "Right now, it seems like it depends on their relationship with the banks to get a lower yield to refinance the bonds."

In December 2008, Deutsche Bank irked global investors by not repaying perpetuals at their first call, citing high replacement costs. Over the following three days, a Bank of America Merrill Lynch index of riskier debt from some of the world's largest lenders lost 1.7 percent. The Association of British Insurers called the bank's decision a "setback for the stabilization of banking markets."

The lack of a perpetual's maturity date, in spite of the incentive to redeem at the first call, allows issuers to treat that debt as equity in their books, according to Choon Yuen Hui, who heads the debt capital markets practice at Singapore lawfirm Wong Partnership. That reduces the companies' leverage even as interest payments increase.

Tax Benefit

"If structured properly, accountants will be happy to treat such securities as equity," said Hui. At the same time, the interest payments are tax deductible "in a manner no different from traditional bonds," he added.

Non-bank companies in Singapore have issued more than S$9 billion of perpetuals since April 2011, when waterworks firm Hyflux Ltd. issued the first note. That's about 15 percent of all corporate debt excluding government and banks issued in the period. The amount of notes that can be redeemed for the first time rises to S$1.1 billion next year and surges to S$4.9 billion in 2017.

"The impact on the market is hard to judge" if any issuers choose not to repay, said Dilip Parameswaran, the Hong Kong-based head of Asia Investment Advisors Ltd. "The Singapore dollar market is small and dominated by domestic institutional and retail investors. They may have invested based on an expectation of call, and may be disappointed if the bonds are not called."

As companies consider the cost of refinancing, he said, "if the secondary yields are higher than the step-up coupon, then it makes no sense for the company to call the perpetual."