

Best Deal Emerging Europe 2006

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A global high-yield sell-off caused spreads on the 10-year section of Turkey's sovereign curve to widen by 180 basis points in May-June 2006, although the market had partially recovered. The accompanying slide in the Turkish lira provoked the central bank to enact a swift series of interest rate rises totalling 425 basis points.

Political tensions began to rise ahead of an election year in 2007 and a key period of negotiations with the EU. Moreover, in the first week of September 2006, the Republics of Philippines and Colombia, two of the other big names of emerging market sovereign issuance, announced debt exchanges.

This was a challenging environment for the Republic of Turkey to engage in its first piece of voluntary liability management, even after the sovereign had returned to the international market in August 2006, reopening its 2014 bond for \$500 million. Moreover, debt exchanges always imply greater market exposure than a straight bond issue, due to the extended time period necessary for the tendering process.

"There was a limited window of opportunity after the mid-year sell-off. With the World Bank/IMF meetings later in September, there was really only one week available, and we did not want to wait any longer, as there were other financing objectives for the year still to be achieved after Turkey had been out of the markets for so long," says Phil Bennett, global head of public-sector financing and risk strategy at Citigroup.

The timing proved justified, as Turkey was not immune from the widening yields on US Treasuries later in September, when Federal Reserve announcements disappointed market expectations that American inflation was on the way down.

Non-competitive

Despite the busy schedule on international capital markets, Turkey's debt swap was concluded on a non-competitive basis, with the launch of \$1.5 billion in new 10-year paper, carrying a coupon of 7%. This amount significantly exceeded the initial minimum target of \$1.0 billion. In total, \$1.17 billion was issued to mop up paper tendered from seven existing illiquid issues that had outstanding maturities of only two years and much higher coupons, of about 9.875-12.375%. A further \$330 million was distributed to new investors, against an impressive cash book of \$1.75 billion.

"We wanted to keep it simple and transparent and focused more on proving our capacity to execute such deals. In this regard, we believe the deal was very successful," Tekin Cotuk, director of international finance at the Turkish Treasury, tells Emerging Markets.

"Participation was spread across all eligible old notes and achieved a flattening of the hump in Turkey's redemption profile. All of these objectives were achieved despite the challenging market conditions, in which emerging markets globally came under pressure in the last two days of the exchange offer period."

The amount of old debt tendered reached \$1.05 billion, or around 14% of the \$7.4 billion eligible for exchange, and this was in line with the issuer's wishes to focus on maintaining a low premium, rather than size.

“Sometimes countries do these trades and aim for 50% participation, and they pay a lot more. This was a very efficient transaction for Turkey, and there was a real demand from investors to extend their holdings with low friction, so it met their needs too,” says Greg Makoff, head of emerging market liability management at Citigroup.

Sophisticated

The deal was therefore well received by existing bondholders for demonstrating Turkey's growing sophistication as an issuer. “We are very pleased that the exchange was supported by both international and local holders in equal measure,” says Cotuk at the Treasury.

Muge Eksi, executive director in the financing group at Goldman Sachs, notes that investors would have struggled to source such big amounts of longer-dated paper in the secondary market, given the overall scarcity of emerging market sovereign debt. “As a result, Turkey was basically able to price the new issue flat to its curve in the secondary market.”

Moreover, Eksi observes that the precedent set by the exchange created a new tool for the Turkish Treasury, bringing them closer into line with other large emerging market issuers, such as Brazil and Mexico, which use this technique almost annually.

Cotuk comments: “We spent a considerable amount of time on technical issues such as taxation and accounting. Having sorted out these issues and having existing documentation in place, we expect that another exchange operation would be completed more quickly.”

This increased ability to move swiftly and take advantage of good market conditions will be vital for Turkey, which is estimated by Standard & Poor's to have the highest debt rollover ratio of any rated European sovereign, at about 34% of total debt stock in 2007. Year-to-date, Turkey has borrowed \$3.4 billion on international capital markets with an average maturity of 14.6 years, which is much more favourable than the profile of bonds issued during the years of financial turbulence at the start of the current decade.

“This issuance pattern helps a lot in terms of building a smoother maturity profile, and further liability management operations would be an extra contribution to this pattern,” Cotuk concludes.