Korea bank funding: financing the financiers

Korean banks are among the most frequent — and the most respected — issuers in Asia. They come from a highly developed banking system and are able to offer investors strong risk controls, rock solid capital positions and a plethora of pricing benchmarks. But it is not without its problems. Revenue growth is anaemic, labour laws are restrictive and regulations on liquidity positions, while helping to reduce systemic risk, ensure that Korean banks struggle to match the profit margins of their rivals in the rest of the continent. It was in this context that EuroWeek sat down with a diverse range of key market players, including some of the biggest bond issuers from across Asia, to figure out what direction Korean banks are going in — and how they can make their journey there a smooth one.

Participants (in alphabetical order):
- Hang Suk Choi, head, investor relations, Korea Finance Corp
- Young Kook Joo, deputy head, international finance department, Busan Bank
- Namchae Kang, head, treasury team, Kookmin Bank
- Koh Kawana, co-head of debt syndicate, SMBC Nikko
- Daniel Kim, head of financial institutions, Asia, HSBC
- Helena Kim, associate, Latham & Watkins
- Jin Tae Kim, deputy head, international finance department, Daegu Bank
- Kyungwoo Kim, managing director, capital markets, Nomura
- Joonsuk Lee, deputy head, international finance group, Export Import Bank of Korea
- Jae Won Lee, head, finance team, Hyundai Capital Services
- Jin Young Lee, deputy head, international finance department, Hana Bank
- Stephen Long, managing director, financial institutions, Moody’s
- Hyun Hee Park, analyst, Moody’s
- Sangyong Park, chief financial officer, Hanwha Life

EUROWEEK: We have a variety of financial institutions on this panel that have experience in a number of different offshore markets. We’ll certainly get into markets like Malaysian ringgit or Thai baht later, but the natural place to start is with a discussion of the dollar bond market. We have seen significant volatility over the last year, but we’ve seen significant volumes as well.

Daniel Kim, HSBC: The bond market was very robust last year, especially for Korean borrowers. There were concerns over tapering and the US debt ceiling last year, and when these issues became a focus the market essentially hit a wall. But investors proved to be resilient, and the market picked up again in September.

There are some major inflection points that we should be looking out for this year. First, the tapering of quantitative easing, which is expected to start in the first two months of the year. Second, we have the debt ceiling negotiation yet again. That is likely to take place in late January or early February. These two issues are clearly going to provide a source of volatility, and it looks to me like this year is going to be a more difficult market.

Helena Kim, Latham & Watkins: There is a great demand for Korean financial institutions in the dollar bond market. There are always opportunities for these borrowers to access the US dollar bond investor base. The exact timing will depend in large part on policy decisions in the US and other economic and financial trends, but, based on recent history, it is clear that there is strong demand for Korean issuers even in a volatile market.

Jin Young Lee, Hana Bank: We are enjoying a very favourable situation and from my perspective it is a good time to fund even more. But we’re a commercial bank, so most of our assets are relatively short-term. We don’t want to take on a great deal of funding over and beyond what we need to fund these assets.

It is tough to pick the timing, but we’re confident that if we return to the market this year we will get a good response. We have seen strong demand from European and Swiss buyers and that is something we would like to take advantage of this year.

Hang Suk Choi, Korea Finance Corp: It is worth pointing out that all Korean financial institutions took advantage of the upgrade of the sovereign in 2012 [when Fitch, Moody’s and Standard & Poor’s all upgraded the sovereign by one notch, giving the country ratings of AA-, Aa3 and A+, respectively]. They took advantage of that momentum and managed to get some good deals closed in the offshore bond market.

The question is whether this momentum will carry on this year and the year after. Some issuers might have got
the wrong signals, feeling that they are guaranteed a good response as long as they come to the market. This could attract more and more issuers this year, even those who do not have dollar funding needs. That is a concern, especially given all of the event risks that Daniel mentioned.

Joonsuk Lee, Export Import Bank of Korea (Kexim): There were a lot of ups and downs in 2013. There was a great period at the start of the year, seeing spreads get pushed down to the lowest level since the 2008 financial crisis. But the Fed tapering announcement had a big impact and we started facing some hard times. We have now had some vivid signals that tapering is ending, so we expect there to be a rush to the bond market over the next month or so. We do not expect any dramatic change in investor sentiment or in the pricing level during the first quarter, but things could get tougher later in the year.

Jin Tae Kim, Daegu Bank: It is right that people focus on tapering and the debt ceiling issues coming up this year, but we saw those issues last year and the market was still strong. I’m expecting this year to be pretty strong for Korean issuers. There should not be any significant spread widening, because people already know that QE tapering is happening. It should not come as a surprise.

Kim, HSBC: Korean credit has always been viewed as a safe haven, so certainly the volatility points do not mean they cannot tap the market in 2014. It is more a question of pricing. Korean financial institutions should expect their funding rates to go up on a fixed rate basis, but this will swap to floating so an increase of rates is less of a concern.

EUROWEEK: Given the large expected supply from Korean issuers this year, how can issuers best manage the risk of competing supply? Is there a significant first-mover advantage?

Young Kook Joo, Busan Bank: We generally want to fund three months or even six months ahead of schedule, so we would like to be one of the early movers in the market this year. But we cannot expect to be the first issuer. For smaller banks like Busan, it is sensible to wait for KDB and Kexim to tap the bond market, take a good look at the response they receive, and then decide whether to follow suit.

Namchae Kang, Kookmin Bank: We also usually like to prefund three to six months in advance, but now we are taking a more cautious approach to the market. We are required to reserve cash deposits to cover three to six months of outflows, so we do not have to rush to the market unless pricing is very attractive to us.

This cash store gives us more negotiating power with investors because they know we are not desperate for funding in the short-term.

Jae Won Lee, Hyundai Capital Services: Because we are a non-bank financial institution, we do not have a pool of deposits that can help us fund our lending when we are not tapping the bond market. That means we do not always have the luxury of waiting for the perfect moment to issue. We have already identified five markets that have a low correlation with the dollar bond market, so if dollar investors are too demanding this year, we still have some alternatives. We understand that there may be a pressure for KDB and Kexim to always be the first Korean issuer in January. They should keep in mind that having state-owned banks set up a benchmark is beneficial for other Korean issuers. For example, our 2012 144A/RegS transaction was very troublesome because there was no proper Korean benchmark. We were hoping for either KDB or Kexim to come to the market before us to show proper price guidance for Korean Papers. However, they didn’t — and their absence gave us hard time in establishing pricing strategy.

Hyun Hee Park, Moody’s: One of the positive trends that we have seen over the last few years is Korean financial institutions expanding their offshore funding into non-G3 currencies. The proportion of foreign currency debt excluding G3 currencies was 17% at the end of 2012, compared to 12% in 2011. These are mainly Asian currencies, in particular Hong Kong dollars, Singapore dollars, Australian dollars and Malaysian ringgit. This is partly being driven by regulators’ focus to reduce the risk of over-concentration in certain funding sources and maturity profiles, but from a credit point of view it is definitely good to see.

Kim, HSBC: This is one of the reasons why there is not too much risk of crowding-out this year for Korean issuers, despite the heavy expected supply. Korean issuers have access to a lot of different markets. Even when you just look at dollar issuance, they are not just tapping the Reg-S market, they are tapping the 144A market and the SEC market. They have local currency issuance, private placements and, of course, the loan market.

Lee, Kexim: We have seen central banks coming to the market in a much bigger way this year. They were not previously a big part of the investor base, but after the upgrades they are much more hungry for Korean paper. That is something that will help deal with the increased supply next year.

Stephen Long, Moody’s: Korean banks have become much more nimble in terms of how they think about their funding requirements. There are two financial systems in Asia Pacific where banks require continued access to the wholesale market: one is Korea, the other is Australia. Australian banks have long been known as quite flexible issuers, tapping a variety of local currency markets. But Korean banks historically have tended to be a bit rigid, thinking in terms of fixed deal roadshows and rigid pricing targets. That is something that has definitely changed, and that is benefiting issuers greatly.
Korean Issuers Roundtable

**Kyuongwoo Kim, Nomura:** Korean banks have definitely made progress in diversifying their funding sources, not just finding new sources of demand from dollar investors, but also selling euro-denominated bonds, Kangaroo bonds, Thai baht, Swiss francs — all of these different currencies. The attitudes have changed. They have become a lot smarter over the last few years. This gives me confidence that their funding will not quite be so tough as it could be next year.

**EUROWEEK:** The benefits of diversification are obvious, but few issuers are really willing to push ahead with local currency deals unless the pricing they can get is at least comparable to the dollar market. What is the most attractive Asian currency market at the moment?

**Kim, Nomura:** The Samurai bond market has been a key part of our funding plans for several years, and usually that would be my immediate answer to you. But right now, I’m not sure if we are even going to return to that market unless pricing changes in our favour. We have approval from the Thai government to issue a Thai baht bond, and that is definitely something we will try this year. Hong Kong dollar and Singapore dollar bonds are quite attractive, especially because they have liquid swaps. The Australian dollar market is attractive too.

It is all a matter of timing. If you can pick the right timing, any of these Asian currency markets that I mentioned can offer you cheaper funding than the US dollar market. But it really depends on the movement of swap spreads, something that is not always predictable in advance.

**Lee, Hana Bank:** The Thai baht market is not very attractive at the moment, but that is one that we look at a lot. For me, the question is how important is diversification, really? We entered the Samurai market in 2011, but we did not go the market in 2012 and we did not go there last year. We did not want to pay up to the extent that there would be some reputational damage for us. There is a cost for diversification, but that cost should not be too high.

**Kim, Nomura:** The Samurai market has caught up quite fast with the US dollar market, and now it is the same, or even a little bit tighter, than the dollar market for some top notch issuers. The only thing that can hold some Korean issuers back from the Samurai bond market is that issuers can pay a little bit of a premium when compared to European issuers or Australian issuers, despite positive rating movements for Korean credits recently. We need to work to make sure that premium does not exist in the future, but it will take some time. But generally speaking, the market is very strong at the moment.

**Koh Kawana, SMBC Nikko:** Japanese investors look at dollar market levels and swap that back to yen. That is how they get their basic idea for price when meeting issuers. I don’t think many investors are trying to get a much better rate than the dollar market, it is just that as the basis moves, their price expectations move quickly.

Korean issuers are helped by the fact that domestic Japanese supply was pretty weak last year. That means Japanese investors are increasingly looking to foreign issuers to fill up their portfolios. Given their strong ratings, many Korean issuers are well placed to take advantage of that.

**Joo, Busan Bank:** We opted for a syndicated yen loan in the second half of last year rather than sell a Samurai bond. We managed to save around 20bp by turning to the loan market. The basis swap is an important factor, but even when the basis works, the Samurai market is not always the best option.

**EUROWEEK:** We have talked a lot about Korean banks plans for 2014, and the chances of big supply, but so far we’ve focused only on senior funding. What about the capital needs of Korean banks? How does Korea compare to the rest of Asia in terms of the transition to Basel III?

**Long, Moody’s:** Well, in some ways it is a bit slower because Korean regulators delayed the implementation of Basel III until the end of last year, whereas in most other Asian countries it kicked in at the beginning of last year. We’ve already seen new-style securities start to be issued in Asia, with Singapore and Hong Kong somewhat in the vanguard. Korea is a bit behind in terms of new-style securities, and we don’t yet have a clear sense of what the structure is going to look like.

Having said that, Korean banks are strong in capital terms right now. Most of the capital is coming from common equity so from our perspective the capital position of the banking system is not a significant weakness — in fact, it may be the biggest strength of Korean banks at the moment. The system is not in dire need of new capital.

**Kim, HSBC:** There is little discussion among banks about being the first to issue new-style securities. We’re still waiting for the terms to come out, as Stephen mentioned, and until then there is not really much anyone can do to prepare for the new framework.

**EUROWEEK:** The Korean won market clearly offers a captive investor base for the type of issuers we have on this panel. But from an investor’s point of view, how much does the market need to change in terms of structures, lower-rated deals, and general issuer diversity?

**Sangyong Park, Hanwha Life:** There are a lot of changes that should be occurring. Life insurers are big investors in the bond market, but we have a problem: we have a huge block of outstanding liabilities that are paying a high yield, and the yield is very hard to match in the domestic market. We have to go around the world, looking for the right...
investment to increase our returns.

We suffered quite a lot in 2012 and last year due to the interest rate changes. That made our situation a lot worse by widening the difference between the spreads we pay and those we can achieve in our portfolios. We’re not being helped by regulations which put some penalties on us for investing in longer-dated instruments. The FSC put greater risk weighting on perpetual bonds earlier last year, which makes them a lot less attractive from our side. Insurance companies need more opportunities to invest, and more chances to increase our returns. But it is hard to see how that can happen with some regulatory changes.

Park, Moody’s: The domestic bond market has been more affected by domestic credit issue than QE tapering. For example, since the Woongjin Group incident in 2012, it has been hard for issuers rated below single-A to get demand from investors, although banks tend to find it much easier to get demand. The first reason it is easier for them is the high credit profile of Korean banks. But it is also because of the short supply of bank debentures after the regulator’s adoption of 100% ceiling in loan-to-deposit ratio (LDR).

Park, Hanwha Life: The banking industry is not the only industry facing the risk of changing regulation: the insurance industry is facing Solvency II. That tightens how much credit risk we can carry, and really hinders our appetite for corporate bonds. Corporate bonds are very attractive from our side, but once we take this additional burden into account, things change dramatically. That will be the consensus for the next two or three years.

**EUROWEEK**: How attractive is the Korean won market from an issuer’s perspective?

Choi, Korea Finance Corp: Our bonds have been very well received by institutional investors in Korea. They not only participate in our current deals, but tell us that they have given us high credit ceilings, so there is plenty of room for more. Investors largely seem to be chasing high quality names, so that gives us an obvious benefit. We have never had difficulty issuing bonds in the local market.

Kang, Kookmin Bank: We only really turn to the local market for very short-term funding, but that tends to come from the interbank market. We are much more reliant on foreign investors. It does not seem like we would get competitive pricing in the Korean won market compared to what we have established in dollars.

**EUROWEEK**: How does the pricing available in the loan market compare to the bond market, both domestically and offshore?

Choi, Korea Finance Corp: We do not see much difference when we compare the loan market to the private placement market. FRN investors are typically banks anyway, so we are really appealing to the same investor base in both cases. The situation is very different for corporations, but for those issuers who want floating rate liabilities, there is not that much difference.

Kim, Daegu: We have seen some pretty big cycles in both loan and bond market pricing since the Lehman Brothers crisis, but the speed that pricing changes is different. Loan pricing tends to react a lot slower than the bond market, so it is all a question of choosing whether you want the fast moving pricing or you want the pricing that is still not catching up with the new reality. Right now, the loan market is a little bit too expensive because it has not followed bond market pricing lower.

**EUROWEEK**: What about using the ABS markets to fund?

Lee, Hyundai Capital Services: We have been participating in ABS issuance over the years. We usually tap the domestic ABS market around two or three times a year and the international market about once or twice a year. There are a few reasons for constantly tapping the international ABS market. First, due to minor rating differences, there is little price competitiveness in the domestic market. In the domestic market, Hyundai Capital Services has an AA+ rating, and auto ABS is rated AAA. Due to this small rating gap between secured and unsecured bond, the price difference is minimal.

Second, due to oversupply of handset ABS from telcos, the domestic ABS price is high and even close to that of domestic unsecured bonds.

Lastly, in the international market, ABS has price competitiveness due to rating differences between our ABS and unsecured bonds. Due to the underlying assets, our auto ABS has a AAA rating in the international market compared to our BBB- standalone rating. This rating gap allows ABS to gain price competitiveness.

The overseas ABS market is very attractive for us, and we try our best to keep in touch with overseas investors.

Kang, Kookmin: We were the first Korean bank to sell a covered bond, when we issued a $1bn five year deal in 2009. That deal is coming up for repayment this year, but we think it is unlikely we will return to the covered bond market soon. It depends on price. We estimate that, right now, we could get a cost saving of about 10bp by turning to the covered bond market.
bond market. But that also ties up some of our healthy assets. We're now thinking that the best approach will be to pay off that covered bond with a senior bond.

Kim, Daegu: It will be interesting to see how things unfold in the covered bond market. Will we get a pricing advantage? It is hard to see that the advantage will be that great because we will not be getting a triple-A rating, and that is the rating that many covered bond investors are used to.

Kim, Nomura: The funding cost between covered bonds and senior bonds is normally about 40bp-60bp for European issuers, about 40bp for US issuers and only about 20bp for Korean issuers. That is not such a big cost saving considering the structuring costs and the time it takes to create a covered bond.

EURO WEEK: Let's zoom out for a moment and look at the banking sector as a whole. We have seen some attempts in the past to create mergers, or even just to sell bank stakes, but these have not always been successful. What is the chance of further banking system consolidation in Korea?

Park, Moody’s: There are a few deals in the works. The spin-off of KDB and Korea Finance Corp is scheduled for July this year, and the government is going to make another attempt to sell Woori Finance Holdings. We believe it will be more successful this time, because it is splitting the bank into separate business units and selling them off individually. We think the government will face the least difficulty in selling Woori Investment and Securities, and regional banks. But it may encounter challenges to find bidders for Woori Bank. It will have to bear a large financial burden given the size of Woori Bank. More generally, the profitability level of the Korean banking system has been under pressure and we don’t see strong chances of things getting better going forward. This limits Woori Bank’s strategic appeal.

If another bank acquires Woori Bank, then it would face the challenge of overlapping branches and related labour union issues. We have already seen that Shinhan and Hana are trying to cut down on their branch network because mobile banking and internet banking are somewhat taking over from their branch channels. But any bank that would want to buy Woori Bank would find labour issues, at the very least, so there are no obvious buyers for Woori Bank.

Korean banks are very cautious. They will not try for a big merger in the overseas market, although they might try to buy very small overseas banks in southeast Asia, for instance. But we don’t see a large mergers or acquisitions happening soon.

Korean corporations: ready for a volatile year

Korea’s corporations are well placed to speak about the best way for Asian issuers to approach the international debt markets. Their longstanding relationships with US dollar investors have given them a wealth of experience in offshore bond sales, but they are also among the few Asian companies that can access the famously cautious Japanese investor base, as well as a variety of other markets. These diverse funding options clearly give Korean companies an advantage over some of their rivals, but they in turn lead to hard questions about exactly where — and when — to fund. EuroWeek finds out the strategies of some of biggest corporations in the country.

Participants (in alphabetical order):
Koh Kawana, co-head of debt syndicate, SMBC Nikko
Daniel Kim, head of financial institutions, Asia, HSBC
Helena Kim, associate, Latham & Watkins
Jun Hwan Kim, general manager, finance strategy team, Korean Air
Kyungwoo Kim, managing director, capital markets, Nomura
Soo Hyun Kim, finance team head, Posco Energy
Gary Lau, managing director, corporate finance, Moody’s
Bang Ho Lee, finance team head, Korea National Oil Corporation
Chris Park, senior credit officer, Moody’s
Jae Kyung Park, head, finance team, Posco
Tong Wook Shim, senior vice president, finance department, Posco
EUROWEEK: The dollar market is clearly a crucial source of funding for Korean issuers, but there is a lot of uncertainty around what will happen in 2014. It is not so much the direction of US rates that is uncertain, but the timing of the move upward. What is the best way for Korean corporations to handle this uncertainty?

Daniel Kim, HSBC: The advice that we give to our clients is clear: now is the time to come to the market. That is advice they are hearing more and more, given all of the noise around the Federal Reserve’s tapering.

Gary Lau, Moody’s: The tapering issue is certainly causing some volatility in the market. The start of the year was very strong, in the summer the US dollar market was very slow, and then in September things came back again. But despite this volatility, Asian issuers are increasingly looking for more diverse funding sources, and in particular for longer tenors. That is not something they can often get in their domestic markets, so there is a natural source of supply from Asian issuers in the US market — and especially from Korean issuers.

Tong Wook Shim, Posco: We are preparing a ¥50bn Samurai bond issuance, which is for the repayment of dollar bonds that mature in the first quarter of 2014. We decided to issue the deal before the end of 2013, because we were expecting tapering to start quite early. It now seems the US government may delay the tapering, so I can’t be sure whether this was the best timing or not.

Bang Ho Lee, Korea National Oil Corporation: We have been actively watching the US dollar, and it is clear that the market is becoming more volatile. We want to do our funding as early as possible for this reason, although that principle applies even to other foreign currency markets. We want to fund as soon as possible in the new year.

Jae Kyung Park, Posco: Every major central bank keeps injecting liquidity into the market, but it cannot last for much longer. Corporations need to enjoy the euphoria this monetary policy creates. It is a very good time to come to the debt market. We have W1.3tr that will mature this year, but we have already started prefunding that already. We issued W700bn last month in the Korean won market, and the remaining amount will be done in the Samurai bond market, where we will sell around ¥50bn. That is the plan for us.

Why the Samurai bond market? This is actually to refinance ¥700bn in US dollar debt that is maturing in March this year, but we are changing our funding market. This is partly because we have a yen surplus, so there is less FX risk for us. We have a plan to reduce our foreign currency denominated debt, and the fact that we have a yen surplus helps drive us to the Samurai market. But it is, most of all, because the yen is the one currency where the funding cost is lower than the dollar or the same.

EUROWEEK: The dollar bond market has clearly been volatile over the last few months, which is something that is making some Asian issuers rely more and more on investors in the region, rather than those in London or New York, for instance. Is this likely to continue?

Kyungwoo Kim, Nomura: European and US investors still have much more capacity than those in Asia, but we’ve seen a lot of deals from Korea that the proportion of investors from Asia has grown a lot. In the future, Asian investors will take a larger share of Asian dollar bond deals, especially the dollar bonds from Korean issuers. Their interest is hiking significantly.

There is still big demand from Europe and the US, however, and these investors can be more flexible. We have arranged several large private placements for Korean companies over the last 12 months, finding some demand from European investors. This is something we expect to continue. We are expecting about $38bn of redemptions from Korean issuers this year, which is a big jump from last year. That breaks down into about $28bn in the US dollar market, $8bn in the Samurai market, and the other $2bn from other currencies. It is going to be a big year this year.

Helena Kim, Latham & Watkins: The dollar bond market was very active at the start of last year, given the global economic climate, low rates, and the huge demand for high-quality Asian issuers. That certainly tapered off in the middle of the year, but the market activity has picked up again. The dollar bond market remains the dominant market for Korean issuers, and we expect that things will pick up further in the first quarter of this year.

EUROWEEK: How much of that refinancing do you think will end up in the loan market instead of the bond market?

Kim, Nomura: Generally speaking I believe the loan market funding cost is slightly more expensive than the bond market recently. It cost somewhere between 25bp-30bp more for the same tenor, although it’s a case by case.

The loan market has typically been the cheaper alternative, but quantitative easing has pushed bond yields so low that bonds are now the cheaper option. This is something that is likely to last for the time being.

Kim, HSBC: It is very difficult for banks to provide foreign currency loans to Korean corporations at cheaper rates then they get in the bond market, but for the higher beta regions across Asia, it may be cheaper in the loan market.

Shim, Posco: If we issue a corporate bond, the usual term is seven years, occasionally 10 years. But in the loan market we can borrow for as long as 15 years, so in the case of big overseas projects we use the loan market. It seems that loans are more expensive, however. This is partly because of this longer-term potential, of course, but even when you adjust for the difference in maturity it appears more expensive.

Lau, Moody’s: One observation we have had when talking to issuers is that bank loans tend to have much more restrictive covenants than bonds. Even assuming that pricing is equal, bonds offer a bit more because they have this flexibility — and they are also much more visible.

Lee, KNOC: We have a big funding target, so we use both the bond and the loan markets, but the lion’s share of our funding comes from the bond market. We prefer the bond
Korean issuers predominantly turn to the bond market when they are trying to raise yen, but we do see some financial institutions turning to Japanese banks for loans of tenors between one and three years. Those loans are very competitive to the bond market.

Koh Kawana, SMBC Nikko: Japanese yen liquidity tends to be quite high, but the dollar-yen basis swap is a very important consideration which can really change the economics for issuers. The basis swap was not very attractive for yen borrowers at the start of last year, so you saw a lot of issuers sticking to the dollar market instead. In the second half, the swap moved into much more attractive territory, and we saw a lot of issuers, not just from Korea but also from Australia and the Nordic countries.

Right now, pricing in the yen market is roughly comparable to the dollar market and we hope that is going to hold during the first half of this year. I’m quite optimistic that volumes will be the same or even larger this year, but unfortunately these flows really do depend on the basis.

Kim, Nomura: The five year basis swap from six month yen Libor to three month US dollar Libor has tightened from 100bp to 80bp over the last six months or so. That gives a lot of benefits to potential Samurai issuers from Korea. The dollar market clearly offered the best pricing in 2012, thanks to the impact of quantitative easing. But over the course of last year, the Samurai funding cost was similar or even slightly better than dollars subject to the issuer’s credit story.

We recently helped Commonwealth Bank of Australia and the government of Poland turn to the Samurai market, and both of these deals were great success stories. These sorts of deals will continue to thrive in the market, and Samurai issuance will stay active for the time being.

Jun Hwan Kim, Korean Air: We have not turned to the international bond markets, but we have done several transactions backed by a Korean sovereign-rated bank, so that has given us good access to global capital market investors. We have focused especially on the Japanese yen market, because we have a lot of revenue for Japan. We’re now processing our next Japanese yen ABS transaction, and we have already have positive feedback from investors.

It would be not that easy for us to get an investment grade rating from Moody’s or Standard & Poor’s, so we would keep more focus on high yield investors [if we came to the international bond market], provided that the pricing level is acceptable for us. That is something we are exploring for 2014 but we are still unsure whether we will go ahead. It does not seem the best time to access the high yield market right now.

Kim, Nomura: There are obviously big macro policy changes from the US going on, and that is going to have a negative impact on the high yield space this year. That makes it very tough to picture a busy market this year.

Lau, Moody’s: High yield issuance was dominated last year by the Chinese property sector, and when you exclude that sector from the figures, issuance was really not very strong last year. European and US investors are more focused on high grace names, and new issuers in the high yield market will probably need some time before their bonds fly.

Kim, HSBC: One of the things that marks Korean issuers out as different from others across Asia is that you do not really see any speculative currency views. The ministry of finance is quite involved in the whole offshore borrowing process, so corporations need to be clear what the use of proceeds is and exactly how they are going to hedge any currency risk that arises.

Park, Posco: This is true. This is why we are going to the Samurai market, because there is a natural hedge in place. The idea of putting natural hedging in place stems back to our founder, who was not a finance expert, but who had a strong intuition for the market.

Lau, Moody’s: It is important for credit analysts that, when we are looking at rated entities that issue a lot of foreign currency debt, we take a hard look at their exposure. We are happy if they hedge this exposure, but if this is not done, there can certainly be an impact on their ratings given the volatility in the currency market.

Chris Park, Moody’s: It really depends upon a company’s specific circumstances, but most Korean companies try to hedge via either natural hedges or financial instruments.

EUROWeek: How does the Korean won market compare to the dollar bond market, in terms of pricing, size and maturities?

Kim, Latham & Watkins: The differences between the two markets are quite natural, given the significant difference in the investor base that you have available to you in each market.

The US dollar investor base is bigger and more diverse, so there is an appetite for larger issues, longer maturities and more diversified forms of financing. In addition, it is the natural place to fund for Korean issuers who are starting new projects abroad or those who are looking to acquire foreign companies.

We are used to seeing more standardised deals and issuances in the Korean won market. In many ways that means Korean domestic issuers are more familiar with the market and know what to expect from it. This means the Korean domestic won market may seem more accessible to Korean issuers in the short run. But it may not see as many diverse products and different terms and maturities that you may see in offshore markets.

Park, Moody’s: It is a very good place to fund when you look at standard, plain vanilla type of products. Investors are very aware of the companies they are investing in since there is a lot of repeat issuance.
Kim, Korean Air: As I mentioned, our main funding source is the domestic bond market. But we want to diversify our funding sources, so we are trying to reduce our reliance on the local market and expand in the international market.

We can easily approach the Korean domestic market and at this time it is more difficult to approach the global capital markets. But we think this dynamic will change in the future, as we become more familiar to international investors.

Shim, Posco: We have the opposite situation. We are trying to rely more on the Korean won market, simply to reduce our FX risk. But actually, I don’t think there is a big difference between the global market and the Korean won market. The domestic market has improved a lot. The Financial Supervisory Board is continually improving the process of issuance, so it is quite easy to come to the market. Local yields have fallen quite a lot compared to the dollar market. The size available from investors has grown a lot. The market is really developing quite quickly.

Kim, Nomura: The corporates attending this conference are really the best of the best in Korea, so pricing for these corporations is quite attractive right now. But there is a significant polarisation of investor interest between lower-rated and higher-rated names.

It is not only much harder for lower-rated issuers to get funding, but it is also difficult for them to enjoy the benefits of falling yields when they do come to the market. It is a big problem for smaller companies, because if they cannot get demand from Korean investors, then the chances of them getting demand from overseas investors is very small.

EUROWEEK: Are you seeing maturities expanding in the Korean won market?

Kim, Nomura: There are some signs that maturities are increasing. There was a very interesting example last September, when Korean Expressway raised W100bn from a 50 year bond, the longest maturity deal we have seen in the market so far. It was symbolic to show that these long maturities are possible in the KRW market.

Park, Posco: We issued a W700bn bond last month, and for the first time we added a 10 year tranche as part of this financing package. This was quite impressive for us. It showed us that there has been a good development in the market, because these sort of maturities were not possible before.

Kim, Korean Air: This is certainly a good development, but it is something that is going to be a lot more difficult for relatively lower-rated companies to take advantage of. We are expecting domestic investors to stick to higher-rated companies for the next few months at least, because they have got into some trouble with recent volatility in the market and, for now, they seem quite cautious.

Park, Moody’s: The reason for the general lack of very long tenors in the local market is partly because few issuers are willing to pay higher funding cost needed to get long-term financing. Korean life insurers are sitting on tens of trillions of very long-term liabilities, and they need long-term assets that can match these liabilities. That means the demand for long-term bonds is always there. The problem is that they are, naturally, more expensive than a five year bond, for example.

EUROWEEK: There has been a push for more Asian cross-border issuance going on for several years, most notably through the efforts of the ASEAN+3 Bond Market Forum. Korean issuers have proved among those most able to get demand in southeast Asian currencies. Can you tell us a little bit about this experience?

Kim, HSBC: The demand is certainly there for Korean credits, whether you look at Malaysia, Thailand or other markets across Asia. The big issue is the cost of funding. The proceeds of these deals are invariably swapped back into dollars and that makes the swap market a very important piece of the puzzle.

If you look at the Malaysian ringgit market, for instance, it is more expensive than the dollar market on an after-swap basis right now, so that’s not really an option for issuers. We have seen a few Korean issuers tap the Thai baht market, which is still competitive. But it is hard to gauge how much issuance we will see in these currencies this year.

Park, Posco: We have had several bankers coming to us and trying to convince us to sell offshore renminbi bonds. We take quite a simple approach to the markets. We prefer to stick to the Japanese yen and dollar bond markets, since these are markets that we know well.

But if we were to move into a different currency, the best option would probably be the offshore renminbi market. We have many businesses in China and they need some renminbi, so this is certainly something we are considering for the future.
EUROWEEK: It would be good to get the bankers’ perspective on this. Do you agree that it would be difficult for Posco Energy to get a maturity of more than two years? How can the company increase its chances of getting longer maturity financing?

Kawana, SMBC Nikko: It is debatable. There is a chance to get a three year deal or maybe even longer if the size is limited. The Bank of Japan is still flooding money into the market, but the government has an inflation target of 2%, which is making people question when interest rates are going to go up. Japanese investors always have a preference for shorter maturity deals, but the speculation over interest rates is making them even more biased towards the short-end at the moment.

Park, Posco: We are working on a Samurai bond and for us a three year term is acceptable, but we are hoping to fund all of it with a five year deal if possible. This is quite challenging, but we’re willing to take on that challenge. We want to see if our name recognition with Japanese investors will help us get this five year deal.

Kim, Nomura: Japanese investors are definitely more inclined towards short-term deals, but it heavily depends on the credit quality of the borrower. Debit issuers certainly cannot expect more than two or three year tenors, but Posco is one of the most active and popular issuers in the Samurai market.

Japanese investors have no problem investing in longer tenors for European and US names, so while it is challenging for Korean issuers to move out further, there is certainly a chance for Posco to achieve it.

Kawana, SMBC Nikko: Japanese investors will take the shortest deal available to them, but that doesn’t mean that they cannot be encouraged to move out to longer maturities. Most issuers tend to give them a lot of options — two years, three years, five years — and investors naturally go with the shorter maturities in the current market conditions. But if the issuer makes a firm choice, and only offers a five year tranche, they may find it easier to get demand.

Park, Posco: This makes a lot of sense to us, and we’re thinking that is the best approach in the beginning stages. It doesn’t make sense to confuse investors with multiple tranches. You can always add more tranches at the last moment if there is not strong enough demand for the longer tranche.

EUROWEEK: Korean borrowers are not only facing an increasingly volatile dollar bond market in the wake of Ben Bernanke’s tapering comments in May last year, they are also getting some pressure from regulators to reduce their reliance on foreign currency funding. What are your expectations over how this will play out this year?

Lau, Moody’s: We will continue to see volatility in the dollar bond market this year, since investors are going to be asking a lot of questions about how fast interest rates will go up. But the dollar market will still be a very important source of funding for Korean corporations. The trend of disintermediation will continue to gather speed, and the fact that more and more foreign investors are committing funds to Asia will certainly help this.

Shim, Posco: We will probably not issue any more debt this year, because we have a stress on our credit rating. My mission this year is to reduce our level of debt, so I will focus on non-debt financing.

We will keep a close eye on the market — and of course, these plans may change — but right now, we do not think we will come to the bond market this year.

Kawana, SMBC Nikko: International investors are focusing on Fed tapering and Japanese investors are focused on their own rate rises, but liquidity is very strong right now. The market may be more liquid at the moment than it has been at any point since the Lehman crisis. This is a very good opportunity for issuers to come to the market. The swap market is an important factor, and of course issuers will still need to worry about timing, but I am very hopeful that this year will be busy.

Kim, Nomura: We believe that the Federal Reserve will start its tapering in January, despite the relatively dovish comments recently by Janet Yellen.

The US dollar will become slightly less attractive than other funding currencies if tapering actually happens, and the heavy redemptions we have coming this year will mean issuers will face a tough choice over which market they choose to fund in.

Lee, KNOC: We will have greater funding needs this year than we had last year. We know that Fed tapering is coming at some point, so we want to make sure that we hit our funding target as early as possible. The majority of our funding will come from issuing dollar bonds, but we also want to return to Asia’s local currency bond markets as well as issuing Kangaroo and Samurai bonds.

Kim, Korean Air: We want to balance Korean won and international bond issuance this year. We certainly need to closely monitor the tapering issue, as well as the policies of the Korean government, but we hope to be ready to move quickly this year — selling bonds as soon as a good opportunity arises.

Kim, Posco Energy: We will be funding about W200bn this year, which we will rely on the domestic market for. We will certainly need to worry about timing, but I am very hopeful that this year will be busy.

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Kim, Latham & Watkins: We expect the international bond investors to continue their interests in Korean issuers and their offerings this year. There are always market risks, including those affected by global economic climate, and this year will not be an exception.

However, we believe Korean issuers are very well placed to continue funding this year. Global bond investors may increase their focus on Korean issuers, especially given their credit quality and historical performance, if the market becomes more volatile and the investors look for something of a safe haven.
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