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HIGHER PREMIUM ON FCCBS A BIG DRAW FOR LOCAL COMPANIES

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India Inc's foreign acquisition and capex plans have led to many corporates tapping the overseas market for funds, especially through FCCBs. In the first two months of '06, Indian companies have already raised $1.4bn while the total issuance in the Asia-Pacific region has been around $1.9bn.

This is around 74% of total issuance from the Asian markets (excluding Japan). In '04, cumulative Indian FCCB issuance stood at $2.3bn.

Corporates tapping the FCCB market span a wide spectrum of industries — automobile, aviation, cement, pharma and sugar. Among the major issues likely to hit the market are Jet Airways ($500m issue), M&M ($200m) and also McDowell ($250m).

A host of companies are in the process of getting shareholder approval for raising funds through ADRs, GDRs or FCCBs. These include Wockhardt ($500m), Matrix Laboratories ($200m), Cipla ($200m) and HCC ($100m). Companies which have already taken approval are HCC for $150m and McDowell.

Wockhardt is likely to go in for a $250-m issue in the current financial year. Most of these companies are likely to raise money through the FCCB market, while some would raise funds through the GDR route.

Sources said Aban Lloyd is also planning to raise funds through FCCB issuance but is yet to finalise the figure. And, though not confirmed, Dr Reddy's Lab is likely to raise money in the overseas market through a GDR or an FCCB.

An FCCB is a quasi-debt instrument, convertible into a company's equity share at the option of the investor, at a specified strike rate.

The interest component in FCCBs are generally much lower than bond issuance or loan syndication and most of them are zero coupon. The yield-to-maturity (YTM) for FCCBs normally ranges between 4% and 7%, while smaller companies have higher YTMs.

Manisha Girotra, MD and chairperson (India) of UBS Securities, said FCCBs have caught the fancy of Indian companies and international investors. "A huge appetite for Indian paper and an increasing interest from Japan and the Middle East are driving the market. We expect the strong issuance trend to continue for the next six to eight months."

Companies which have already raised money from the FCCB market in the current calendar year include Ranbaxy ($400m), Tata

Motors ($100m), L&T ($100m), Monnet Ispat ($60m), Jaiprakash Associates (125m euro with a greenshoe option of 45m euro) and Videocon Industries ($90m).

Incidentally, Ranbaxy has already got shareholder approval to raise up to $1.5bn. According to Vallabh Bhansali, chairman of Enam Financial Consultants, an FCCB is a compromise between the coupon and the conversion price. “There is good appetite for Indian equities, but it is also a risky instrument,” he said.

The major advantage for companies hitting the FCCB market is the premium on existing pricing, which ranges anywhere from 30-70% compared to equity markets. Jet Airways, which will tap the market in a couple of weeks, is likely to raise money at a premium of between 40% and 50%. Ranbaxy raised money at a premium of 60%

Apart from large corporates, a host of small companies have either hit or are expected to hit the FCCB market. These include Simbholi Sugar, Mawana Sugar, United Phosphorous, Amtek, Gujarat Ambuja Exports and Bilcare.

A senior industry official said the growth in FCCB issuance is partly because of regulatory arbitrage — it’s much simpler and quicker to raise money through FCCBs or GDRs compared to domestic issues.

“While the difference in the cost of fund-raising in the domestic and foreign markets has narrowed, Indian corporates prefer foreign markets now,” he said, adding that the higher premia in FCCBs is the icing on the cake.

And, while most Indian companies have been able to raise FCCBs with ease, smaller companies still find it difficult to exploit this route. For instance, one of the consumer durables companies which recently accessed the market, had to downsize its issue size from $300m to $90m.