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Tesco Cuts Debt Cost With First Dim Sum Bond: Corporate Finance

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Aug. 26 (Bloomberg) -- Tesco Plc's 725 million-yuan ($113 million) Chinese bond sale costs the U.K.'s largest supermarket chain almost half what its competitors would probably pay to raise money in Europe as it expands into the world's fastest- growing major economy.

The securities, known as dim sum bonds, were sold yesterday at a yield of 1.75 percent, according to a company statement.
That compares with yields of 2.96 percent on retail-company debt with an average rating one level higher than Cheshunt, England- based Tesco's, Bank of America Merrill Lynch indexes show.

Tesco joins companies from restaurant chain McDonald's Corp. to construction equipment-maker Caterpillar Inc. in the U.S. in issuing yuan-denominated debt in Hong Kong to take advantage of cheap financing. Investors are eager to deploy the 553.6 billion yuan that official figures show laid in the former British colony's bank accounts at the end of end-June.

"This market gives international borrowers an opportunity to diversify their investor base," said Vishal Goenka, the head of local-currency credit trading at Deutsche Bank AG in Singapore. "Yields are low."

The yield on Tesco's inaugural dim sum bonds is lower than those on its existing, similar-maturity notes in European currencies. The world's third-largest retailer, whose sales growth has lagged behind U.K. rivals, plans to open more than 20 stores in China by year-end, Shanghai Daily reported in July, citing Tesco China Chief Executive Officer Tim Ashdown.

Pound, Euro Bonds

The company's 600 million pounds ($978 million) of 5 percent bonds maturing in February 2014 yield 2.03 percent, and its 600 million euros ($866 million) of 5.125 percent securities due in February 2015 yield 2.23 percent, according to data compiled Bloomberg.

"China is an important market for us and represents a great growth opportunity," Tesco CEO Laurie McIlwee said in the statement announcing the sale. "This is a new and innovative way of funding our business."

Tesco is rated A3, four steps above non-investment grade, by Moody's Investors Service and an equivalent A- by Standard & Poor's.

WM Morrison Supermarkets Plc's 150 million pounds of 6.5 percent bonds due August 2014 yield 2.37 percent, Bloomberg data show. The debt was issued in 1999 by Safeway Ltd., which WM Morrison, the smallest of the U.K.'s four biggest supermarket owners, took over in 2004. The notes are rated A3 by Moody's.

Baht, Ringgit

Tesco has also sold bonds denominated in Thai baht and Malaysian ringgit in the past two years to fund its expansion into Asia, according to data compiled by Bloomberg. Its 2.5 billion baht ($83 million) of 3.02 percent notes due February 2013 and sold last year yield 3.83 percent, Thai Bond Market Association prices show.

The company reported first-quarter sales growth that fell below analysts' estimates June 14 amid "constrained demand" for general merchandise items such as electronics. About 70 percent of its profit growth last year came from Asia and Europe, according to the company, whose market share in the U.K. has hovered at about 30 percent for more than five years.

Tesco reduced net debt by 1.1 billion pounds to 6.8 billion pounds in fiscal 2011 ended Feb. 26. The drop exceeded the company's 7 billion-pound target, helped by "strong cash generation in the seasonally important second half of the year," financial statements posted on its website show.

Leverage Target

"During the year, we repaid 926 million pounds of our debt early and repaid 777 million pounds of maturing bonds," Tesco said April 19. "We expect net debt to fall further in the years ahead."

Tesco said it's targeting a ratio of lease-adjusted net debt to earnings before interest, tax, depreciation, amortization and rent -- or Ebitdar -- of 2.5 times.

Tesco entered China in 2004 and has a network of more than 100 stores in 10 provinces, according to its website. It employs more than 27,000 staff and says it serves more than 4 million customers every week in the country. Elsewhere in Asia, it has a presence in India, Thailand, Malaysia, Japan and South Korea.

Dim sum bond sales have soared to 109.6 billion yuan this year with Tesco's deal, up from 35.7 billion yuan for the whole of 2010, according to data compiled by Bloomberg.

Retailer Offerings

The market, which is open to both institutional and retail investors, is supported by record yuan deposits in Hong Kong that jumped from 89.7 billion yuan in June 2010. Investors betting China's currency will appreciate more than those of other emerging nations have caused a surge in deposits in Hong Kong that's driving demand for yuan debt.

Tesco is the third retailer to sell dim sum bonds in Hong Kong and the first based outside of China, Bloomberg data show.

Intime Department Store Group Co., a Beijing-based retailer of apparel, cosmetics and home appliances, sold 1 billion yuan of 4.65 percent bonds last month due July 2014 that now yield 4.46 percent, according to Bloomberg prices. Luxury department-store operator PCD Stores Group Ltd. issued 750 million yuan of 5.25 percent bonds due February 2014 this year that now yield 5.54 percent.

Hopewell Highway Infrastructure Ltd. opened the dim sum bond market for non-financial borrowers in July 2010, Bloomberg data show. The Hong Kong-listed operator of expressways in the Pearl River Delta was followed a month later by the first international non-financial borrower, Oak Brook, Illinois-based McDonald's. Since then, Peoria, Illinois-based Caterpillar, the largest maker of construction equipment, raised money in the market.

Proceeds from the offerings were used to fund their businesses in China.

"Risky credits will have a hard time tapping this market, but for good names, they're probably going to find more support than elsewhere," said Becky Liu, a credit strategist at HSBC Holdings Plc in Hong Kong.

HSBC has arranged the most dim sum sales this year, Bloomberg data show. It helped organize Tesco's sale, along with Standard Chartered Plc.