Should Danajamin borrow to guarantee others' borrowings?

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DANAJAMIN Nasional Bhd has a highly specialised role in enhancing the capital market — it guarantees corporate debt issuances, allowing the debt papers to command stronger ratings, which then translates into a better take-up from investors.

But last week, the company ventured into new territory by issuing its first-ever debt paper — a RM500 million subordinated sukuk murabahah with a tenure of 10 years.

This is an interesting change in direction for a company that has had no need for debt over the past seven years since its inception. Recall that it started off with RM1 billion in capital from the government. Today, its capital base has grown to nearly RM1.6 billion due to retained earnings.

It might seem peculiar that a company that guarantees the borrowings of others is going to the market to borrow money, especially since it is 50:50 controlled by the Ministry of Finance and Bank Negara Malaysia — two entities that it can certainly rely on for additional capital at a pinch. Furthermore, its sukuk is unsecured.

Danajamin chief executive Mohamed Nazri Omar tells The Edge that the move is simply a part of a broader capital management strategy.

"As a prudent financial institution, we need to have a comprehensive and realistic capital management plan. This was pointed out to us by Bank Negara," he explains.

"Previously, the only option we had was calling for shareholders' funds. It is realistic for us to be able to call on shareholders, but it isn't comprehensive. We should have other sources. So, that is why we did this exercise — to put a capital management plan in place to show that we can tap other sources."

It is worth noting that Danajamin had ample capital prior to the issuance. The group does not publish its current capital adequacy ratio (CAR), but ratings reports by RAM Rating Services Bhd and Malaysian Rating Corp Bhd peg the group's CAR in excess of 300%. The minimum required, under the risk-based capital framework by Bank Negara, is only 130%.

On this basis, Danajamin's CAR would have expanded to about 400% post-issuance.

Subordinated debt is not cheap either — it comes at an annual rate of 4.8% or RM24 million a year. Danajamin plans to reinvest the said funds in the short-term money market. Nonetheless, the net impact will result in a negative cost of carry.

Even Nazri admits that the company does not need the additional capital right now — it is more than comfortable with its CAR. But it was important to show that its capital management plan was executable, and merely writing a report detailing the plan is not good enough, he says.

"You can put it in writing, but how realistic is it? So, we have to put it in place to show that it is there, it is ready to go," says Nazri.

Thus, Danajamin lodged a perpetual RM2 billion sukuk programme with regulators. The programme was good for any combination of senior sukuk (rated AAA) or subordinated sukuk (rated AA, unsecured).

Of the RM2 billion, Danajamin chose to issue RM500 million. Why?

"Last time, you could set up a programme and have a two-year grace period. Now, [with] the new SC (Securities Commission Malaysia) requirements, if you do a programme, you must issue something. I can't have a programme in place as a standby but not issue anything. An initial maiden benchmark issuance is required," he explains.

"The next question you have to ask is, what is the correct size? We are guided by our advisers. To get a good price, you need diversity and liquidity. We were guided by the advisers, [who said] don't do too small. We could have done RM100 million first, but it would have been too small."

Based on the take-up of the sukuk, however, it is clear that Danajamin has no trouble raising money from the market. In fact, the issuance is said to have been incredibly attractive, with a profit rate of 4.8% per annum.

One local fund manager says, "Yes, it is a double-A rated paper that is unsecured. But this is Danajamin you're talking about. Who are the shareholders? MoF and Bank Negara. And Danajamin is guaranteeing other issuances. There is no way such an entity will be allowed to fail. At 4.8%? Of course everyone in the market will be fighting to subscribe for it. It is a very high return for a paper that is perceived to have very low risk, despite what the rating might say."

Nazri agrees with the assessment — that it is easy for Danajamin to issue debt. "Yes, we are confident that we can do the issuance. But the question is, at what price (profit rate)?"

Based on data from Bond Pricing Agency Malaysia, the current yield for conventional 10-year AA1 corporate papers is 4.84%. Danajamin's 4.8% profit rate is only slightly cheaper.

RM500 million, now what?

Some might argue that RM500 million is a huge sum to raise just to prove that Danajamin's capital management strategy works.

Nazri is quick to brush aside concerns that the company may not be able to tap its shareholders for capital. The last time it had to tap them for additional capital was about four years ago, and it was only for a sum of RM100 million, he points out.

Furthermore, he stresses that the negative cost of carry is tiny compared with the group's profits. In FY2016 ended Dec 31, Danajamin booked a net profit of RM125.5 million, up 5.1% year on year.

Nonetheless, it falls to Nazri to ensure that the fresh capital is put to use.

Based on the current trend of issuances, he conservatively estimates that Danajamin will take about five years to fully utilise the capital.

"As a rule of thumb, we can gear up to around 7.5 times our capital. So RM1 billion of capital can be used to guarantee RM7.5 billion of debt," he explains.

Note that Danajamin guaranteed about RM5.3 billion worth of debt as at June. Nazri anticipates that the group will guarantee between RM1.2 billion and RM1.5 billion of debt this year. Next year, the figure could increase to between RM1.5 billion and RM2 billion.

That said, it appears that Danajamin has bigger ambitions. Nazri says it hopes to begin guaranteeing a wider range of issuances, in particular the ones by smaller corporates.

"Right now, we mainly guarantee issuances by mid to large-sized corporates — about RM100 million and above. But our clients are typically closer to the RM500 million size. We aspire to do more issuances closer to the RM100 million mark," Nazri explains, emphasising that Danajamin will maintain its stringent processes and only work with commercially viable companies.

He says this is well within Danajamin's mandate. At the same time, "it shows that as a responsible government-linked company, we are able to stand on our own two feet instead of just relying on the government", he adds.

While these aspirations cannot be faulted, Danajamin's performance will not be judged by its growth alone. Instead, its success will be gauged by its ability to weather the worst financial turbulence that comes its way.