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Banco Espirito Santo sells equity-linked hit

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Goldman Sachs and Morgan Stanley have priced a \$1bn exchangeable for Portugal's Banco Espirito Santo in what is only the second equity-linked issue in the European, Middle East and African market this year.

The coupon, at 1.25%, was set at the top of the 0.75%-1.25% range, and at 37.5% above the reference price the exchange premium marks the low end of the 37.5%-47.5% range.

A banker working on the deal said: "Although pricing resulted in worst conditions for the issuer, at the top of the coupon range and the bottom of the exchange premium, we are still happy to have completed the transaction. We have raised \$1bn for a single-A rated bank on a 1.25% coupon, which is clearly a success in these markets."

The banker said: "BES has looked at other ways of funding and found that debt markets are not an option in current conditions. I would clearly expect more equity-linked instruments coming to market in the near future."

The bond, issued through Espirito Santo's fully owned subsidiary **BES Finance**, is exchangeable for shares in Brazil's largest bank **Banco Bradesco**. BES Finance was established in 1998 and is incorporated in the Cayman Islands.

The \$1bn exchangeable adds to the \$10bn of debt that BES Finance already has outstanding. Paulo Ferreira, head of funding of BES in Lisbon said this is the first time BES Finance has issued an equity-linked instrument.

Ferreira said: "The exchangeable gives investors the possibility to invest in Portugal and to take part in its expected growth."

The paper has a three year maturity and carries neither a call nor a put. There is a change of control protection on Bradesco, but no change of control protection with respect to BES.

No intention to divest

The paper has a three year maturity and becomes exchangeable after one year. However, Ferreira told *EuroWeek* that: "BES does not intend to conduct a physical settlement of the bond. We are aiming for a cash settlement of the paper."

The reference price for the bond was set at R43.61 a share. The shares traded at R27.07 on the Brazil stock exchange yesterday (Thursday).

Paul Compton, an equity-linked analyst for SunGard Monis said: "In case the bond is exchanged, the issuer, BSP Finance will look at the average share price of Bradesco for 20 business days prior to the strike date. The bank will then pay investors the cash equivalent of the average share price. The paper thus works as a convertible, although no shares will change hands at the time of redemption."

He said: "The issuers use the shares in Bradesco as a sort of collateral to keep their cost of capital low. If Bradesco's shares perform well over the next three years, it will cost BSP quite a lot to redeem the paper."

Bradesco is listed on the Brazilian exchange in São Paulo but the shares are very illiquid in trading. The company also has ADRs listed on the New York Stock Exchange.

The exchangeable does not convert into ADRs and is not referenced on the ADRs, but specifically on the São Paulo stock.

Banco Espirito Santo holds a 6.5% stake in the Brazilian bank, and is not trying to divest the stake, according to the banker involved in the transaction. Bradesco's largest shareholder is Spanish banking group BBVA.