REPUBLIC OF LEBANON
MINISTRY OF FINANCE

UNDP

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# DEBT TRANSACTIONS CONCLUDED IN MARCH-APRIL 2006

## A BRIEF NOTE

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# DEBT TRANSACTIONS CONCLUDED IN MARCH-APRIL 06:
FIVE-YEAR LL, EUROBOND EXCHANGE (Eurobonds Maturing in 2006) AND EUROBOND NEW ISSUANCE (€ 2012, USD 2014, AND USD 2021)

*A Brief Note*

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# DEBT TRANSACTIONS CONCLUDED IN MARCH-APRIL 06: FIVE-YEAR LL, EUROBOND EXCHANGE (Eurobonds Maturing in 2006) AND EUROBOND NEW ISSUANCE (€ 2012, USD 2014, AND USD 2021)

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## I. Five-Year LL Bond Issuance – March 2006

### 1. Background and Objectives

The Ministry of Finance has been working in close coordination with the Central Bank on modernizing the debt markets, and on enhancing public debt management. In this context, the Ministry of Finance has issued, for the first time, a new longer-dated bond – 5 years in Lebanese Pounds (LL) - as a new benchmark instrument, following the successful launch and active participation of the market in the 3-year Treasury Notes introduced in November 2003.

The principal objectives of issuing new 5 year bonds were to:

- Lengthen the average time to maturity of Lebanon's existing portfolio of LL denominated debt (which averaged 19 months as of December 2005)
- Create a yield curve in LL through the creation of a market for medium term notes
- Promote the development of a liquid and active LL debt market

One of the goals of the Ministry of Finance is to gradually revise the issuance strategy to provide for deep and liquid series of longer-dated Treasury bonds. The new 5 year bonds will constitute benchmarks that the Ministry of Finance may wish to re-open, based on the level of demand witnessed in the market. The calendar of issuance will be set on a yearly basis, with the initial objective of effecting four issues during the first year.

### 2. Transaction Summary

On January 5th, 2006, the Ministry of Finance sent out Requests for Proposals to a number of financial institutions to submit offers to lead manage the proposed bond. The institutions were selected on the basis of their asset size, and their activity in the secondary market. As per the stipulated deadline, the Ministry of Finance received offers by Monday January 16th. On February 27, the Ministry awarded the mandate to co-manage the issue to two local banks, BLOM Bank and Byblos Bank. The deal was launched on March 24, and closed on March 30.

The issuance of the new bond(s) was performed in accordance with best international practice, with a formal structure for the definition of the required documentation, settlement conventions, and coupon periods.

A medium term note program has been established to govern the issuance of the new series of bonds. The lead managers conducted the allocation process in a fully transparent manner. The bonds have been listed on the Beirut Stock Exchange and cleared through Midclear, which currently provides clearing and custodial services related to other capital market instruments, including government Eurobonds.

The success of the transaction can be measured by the size, which was increased by over thirty percent due to the high demand. The transaction's success is also indicated by the favorable yield that has been achieved. The size of the issue was 400 billion LL, and was more than 1.5 times oversubscribed. The bonds were issued at an annual interest rate of 9.375%. Below is a summary of the issue terms.

**Table 1: Summary of Issue Terms of First 5-Year LL Bond Issuance**

| | |
|---|---|
| **Issuer:..........................** | The Lebanese Republic. |
| **Lead Managers:..........** | BLOM BANK and BYBLOS BANK. |
| **Description: ..............** | Series 1 under the Lebanese Medium-Term Note Program. |
| **Size:.............................** | LBP 400 billion |
| **Interest rate: ..............** | 9.375 per cent per annum |
| **Issue date: ..................** | March 30, 2006 |
| **Maturity: ....................** | 5 years |
| **Coupon Payment Date:** | September 30 and March 30 |
| **Re-offer Yield:...........** | 9.4 |

**Box 1: Legal provisions related to the Five Year LL Bond Issuance**

**1. The cross default provision** for the bonds states that any default by the Republic in the payment of principal or interest on any Lebanese Pounds denominated Treasury Bills having a maturity of five years or longer shall authorize the holder of any Note issued under the program with a maturity of five years or more to declare such Note to be due and payable.

**2. The negative pledge provision** stated that so long as any Notes with a maturity of five years and more remain outstanding, the Republic will not create or permit to subsist, on any of its present or future assets or revenues, any pledge to secure any Lebanese Pound denominated Treasury Bills with a maturity of five years or longer issued by the Republic.

The Series 1 Notes are transferable in accordance with the rules and procedures of Midclear. The Program Agreement and the Notes are governed by the laws of Lebanon, and the jurisdiction of the Civil Courts of Beirut. The Series 1 Notes were admitted to trading and listing on the Beirut Stock Exchange.

### 3. Coupon Rate and Maturity

The interest rate on the 5-year bonds compares very favorably to that of the two and three-year Treasury Bills, as evidenced in the table below.

**Table 2: Coupon Rates for 5-Year LL Bonds and Comparables**

| Bond | Coupon |
|---|---|
| **Two-year Treasury Bills (1)** | 8.5% |
| **Three-Year Treasury Bills (1)** | 9.32% |
| **Five-Year LL Bonds** | 9.375% |

*(1) As of April 27, 2006*

The issuance of the 5 year bond increased the average time to maturity of the outstanding domestic debt from 19 months as of end December 2005 to 21 months as of end March 2005.

## II. Eurobond Exchange

### 1. Background and Objectives

Eurobond principal payments falling due in 2006 amounted to US$ 2.48 billion. An additional amount of coupon payments amounting to US$ 0.98 billion, payment related to the AFD French Loan totaling US$ 66 million, the expected reimbursement on behalf of EDL of US$ 463 million representing gas oil and fuel oil purchases from Sonatrach and KPC and finally the estimated repayments for Concessional loans, brought the total value of foreign currency payments due in 2006 to around US$ 4.6 billion.

**Table 3: 2006 Eurobond Issues by the Lebanese Republic**

| Issue date | Mat. Date | Currency | Coupon Rate | Outstanding Amount (in original cur) | Outstanding Amount (USD) |
|---|---|---|---|---|---|
| 23-Apr-01 | 24-Apr-06 | USD | 9.875% | 1,110,000,000 | 1,110,000,000 |
| 15-May-02 | 15-May-06 | USD | 10.500% | 320,950,000 | 320,950,000 |
| 27-Jun-02 | 27-Jun-06 | USD | 10.500% | 104,700,000 | 104,700,000 |
| 02-Aug-02 | 02-Aug-06 | USD | 10.500% | 640,573,000 | 640,573,000 |
| 06-Oct-99 | 06-Oct-06 | Euro | 8.875% | 263,600,000 | 314,632,960 |
| **Total (expressed in USD)** | | | | | **2,490,855,960** |

Approximately US$ 2.2 billion of the foreign currency payments were scheduled to fall due in the first half of the year with Eurobond principal payments accounting for US$ 1.5 billion of this amount and Eurobond coupon payments accounting for US$ 348 million. The first Eurobond was to mature in April and was for a face value of US$ 1.11 billion.

In the objective of conducting pro-active debt management operations, the Ministry of Finance approached the capital markets with a reactivation of the voluntary exchange transaction of Eurobonds maturing in 2006. MOF's aim from this debt exchange transaction is to ensure a smooth financing of the high level of maturing bonds in 2006 as well as to extend the redemption profile of maturing Eurobonds in the medium term and to diversify the debt holder base.

## 2. Transaction Summary

On March 9, 2006, the Ministry of Finance appointed BankMed, BNP Paribas and Credit Suisse as joint lead managers in connection with the offer to exchange some or all of the Eurobonds issued by the Republic and maturing in 2006. The transaction was launched on March 30 and settled on April 12.

## 3. Premium and Interest Payments

The secondary market prices of the 2006 Eurobonds in March 2006 revealed that all five bonds were still trading over par. The Ministry of Finance thus had to buy back the bonds at a premium.

**Table 4: Exchange Prices of 2006 Eurobonds**

| Original Notes | Exchange Price |
|---|---|
| US$ 9.875% April 2006 | 100.16 |
| US$ 10.50% May 2006 | 100.46 |
| US$ 10.50% June 2006 | 101.02 |
| US$ 10.50% August 2006 | 101.44 |
| EUR 8.875% October 2006 | 102.37 |

The settlement of the premium and the accrued interest resulting from the exchange transaction were made in cash.

The premium amounted to USD 13.66 million[1]. The premium represents the difference between the exchange price and par for the exchange of each of the original Notes maturing in 2006.

The accrued interest on the original notes amounted to USD 79.63 million. The accrued interest was calculated per 1,000 denominations and according to the basis of 30/360 for the US dollars denominated bonds and Actual/Actual for the Euro denominated bonds.

The table below shows the details of the accrued interest and premium paid on the exchange of original Notes

[1] USD/ EURO = 1.2256. This exchange rate is used in all calculations.

**Table 6: Accrued interest and cash premium paid on the Exchanged Notes**

| Original Notes | Accrued interest in original currency | Cash Premium (in original currency) |
|---|---|---|
| US$ 9.875% April 2006 | 40,923,872.76 | 1,412,385.60 |
| US$ 10.50% May 2006 | 19,056,507.30 | 916,274.00 |
| US$ 10.50% June 2006 | 2,240,401.36 | 739,071.60 |
| US$ 10.50% August 2006 | 8,987,767.22 | 6,249,340.80 |
| EUR 8.875% October 2006 | 6,872,950.32 | 3,544,145.40 |
| **TOTAL (US$)** | **US$ 79,632,037** | **US$ 13,660,777** |

## 4. Maturities of New Issues

The choice for the new Eurobonds was based on the existing maturity profile, which was congested in the period 2007-2011. A suitable choice therefore was issuing an 8 year (2014), a 15 year (2021) in US$, and a 6 year in Euro.

The argument for the 8 year was the low level of maturities in 2014. The bond promised to appeal to investors looking for a shorter maturity and diversification among a short/medium term bond and a longer dated one. The argument for the 15 year was that (1) 2021 maturities were little as per the redemption profile, and (2) it appealed to international investors who have traditionally shown more appetite for a longer-term bond. The argument for the Euro portion was the local appetite for Euro-denominated bonds. Maturities higher than the chosen 7-year would have pushed up the coupon rate. Bullet maturities were chosen because they appeal more to investors, as they are the market standard for bonds.

## 5. Pricing and Success Ratios

The yields for the new issues were determined based on the secondary market prices of existing comparable maturities, the yields for comparables in other emerging markets, in addition to the sovereign rating of the Lebanese Republic. The bonds were issued at a time when interest rates on US Treasuries were going up.

**Table 7: Yields for the New Bond Issues**

| New Notes | Coupons |
|---|---|
| US$ April 2014 | 7.375% |
| US$ April 2021 | 8.250% |
| € April 2012 | 5.875% |

The participation rate in the exchange transaction reached an average of 71 percent, mainly driven by the 80 percent success ratio for the exchange of the April 06 Note. The participation rate in each of the original notes offered for exchange is detailed in Table 5.

**Table 5: Exchange details**

| Original Notes | Outstanding Amount (in original cur) | Amounts exchanged (in original cur) | Participation rate (%) |
|---|---|---|---|
| US$ 9.875% April 2006 | 1,110,000,000 | 882,741,000 | 79.5 % |
| US$ 10.50% May 2006 | 320,950,000 | 199,190,000 | 62.1% |
| US$ 10.50% June 2006 | 104,700,000 | 72,458,000 | 69.2% |
| US$ 10.50% August 2006 | 640,573,000 | 433,582,000 | 67.7% |
| EUR 8.875% October 2006 | 263,600,000 | 149,542,000 | 56.7% |
| **TOTAL (US$)** | **US$ 2,499,291,160** | **US$ 1,771,249,675** | **70.9%** |

## 6. Cancellation of New Cash Portions

The initial subscriptions to the transaction were as per the table below. However, following certain actions taken by LibanCell in relation to their arbitration award, the Ministry of Finance was forced to cancel the issuances of an aggregate amount of USD 846.8 million of additional Eurobonds for cash on April 12, 2006.

**Table 8: Original Size of the Issue**

| Series | New Notes | Coupons | Total new issue size | Amount of additional notes issued for cash | Amount issued via exchange |
|---|---|---|---|---|---|
| 41 | US$ April 2014 | 7.375% | $750,000,000 | $73,098,000 | $676,902,000 |
| 42 | US$ April 2021 | 8.250% | $1,500,000,000 | $588,531,000 | $911,469,000 |
| 43 | € April 2012 | 5.875% | 300,000,000 € | 150,458,000 € | 149,542,000 € |

# III. Eurobond Issuance

## 1. Background

Following the cancellation of new issues for cash and in order to complete the transaction, the Ministry of Finance decided to issue a second tranche for the US$ 15-year and the Euro 6-year.

## 2. Transaction Summary

On April 13, 2006, the Ministry of Finance assigned BankMed, Bank Audi - Audi Saradar Group, Byblos Bank and Fransabank to manage a new Eurobond issue. The deal was launched on April 17, 2006, and closed on April 24, 2006. The Ministry of Finance successfully issued € 175 million and US$ 750 million, as a reopening of two of the Eurobonds issued in the context of the exchange transaction, as per the table below.

**Table 9: New Eurobond Issuance**

| Series | Size | Maturity | Coupon | Issue Price |
|---|---|---|---|---|
| 42 | US$ 750 million | 12 April 2021 | 8.25 percent | 100.00, plus accrued interest from April 12, 2006 |
| 43 | € 175 million | 12 April 2012 | 5.875 percent | 100.00, plus accrued interest from April 12, 2006 |

Settlement occurred on April 25, 2006. The second tranche of the US$ 15-year bond has been consolidated to form a single series with the U.S. $911,469,000 8.250 per cent Notes due 2021, which were issued on April 12, 2006. The second tranche of the Euro 6-year bond has been consolidated to form a single series with the Euro 149,542,000 5.875 per cent Notes due 2012, which were also issued on April 12, 2006.

As a result of the exchange transaction and the new issue the aggregate principal amounts of the new Eurobond series are as follows:

**Table 10: Total New Eurobond Size After Exchange and New Cash**

| Series | Size | Maturity | Coupon |
|---|---|---|---|
| 41 | USD 676,902,000 | 14 April, 2014 | 7.375 percent |
| 42 | USD 1,661,469,000 | 12 April 2021 | 8.25 percent |
| 43 | EURO 324,542,000 | 12 April 2012 | 5.875 percent |