STEVE LAMBERT
EXECUTIVE GENERAL MANAGER, CORPORATE FINANCE
NATIONAL AUSTRALIA BANK

Nuance the watchword for Australian-market renaissance

In a wide-ranging state-of-the-market perspective, **Steve Lambert**, executive general manager, corporate finance at **National Australia Bank** (NAB) in Sydney, attributes Australian transaction breakthroughs in 2017 to long-term positive trends on the demand side. The supply equation is more challenging, he says – but there are still areas to watch for the period ahead including in infrastructure, sustainable debt and speciality debt finance.

There is no doubt that 2017 has been an extremely positive year for the development of the Australian debt capital market. We have seen record issuance volume in key credit sectors like corporate bonds and securitisation, and outright volume in the primary market has been accompanied by a raft of novel, innovative or otherwise interesting individual transactions.

My view is that this positive outcome, while assisted by benign funding markets globally, is more than anything the product of long-term trends on the demand side that NAB has identified and has been working to foster. For the last three years I've felt that every year in our business something new has switched on. We've been putting the electricity through the system for a while but it is only periodically that a new light turns on.

Look at the domestic corporate market. The debate 10 years ago was when – if ever – we were going to get a corporate bond market that is relevant to borrowers, consistent and has reliable deal flow. We're now at the stage where we can legitimately say we have a functional, consistent corporate market in Australia. Credit issuance overall is still dominated by financials, but this isn't of itself a problem when corporates have a solid bid in 7-10 year tenor.

Some key transactions from 2017 help demonstrate how far the market has come and, more pertinently, illustrate the way the underlying trends we have been looking at have sparked deal activity.

I honestly believe the deal NAB led for Australian Catholic University was one of the best of the year. This was a bond linked to the United Nations Sustainable Development Goals (SDGs), which highlights the nuance and sophistication we are starting to see in our sustainable-debt market. I expect we will see more SDG-linked issuance in the future.

The gender-equality bond NAB itself issued at the start of the year was another excellent deal. It was a world first, it started a really good debate and I know there are plenty of other borrowers wondering why they're not doing this type of issuance.

Outside the sustainability space, 2017 has seen the growth of the Australian dollar bond market as a regional environment – predominantly for international banks' additional-capital transactions, but with good support from investors in Australia and Asia. It has also been the best year yet for unrated local issuance, including benchmark-sized deals from Seek and NEXTDC.

UNDERLYING DEMAND

The word I keep coming back to when I think about the state of the Australian market is 'nuance'. The market is bigger and reflects the demand patterns of a more varied group of investors, which means a much wider range of deals

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have the potential to be done when conditions coalesce. The two key trends on the demand side are the relevance of our market to Asian investors and the noninstitutional sector in Australia.

The Asian bid keeps getting stronger and the integration of Australia into the Asian capital markets, which we first started talking about 12-15 years ago is really gathering momentum.

What's interesting is that Asian demand has remained vibrant even as Australia's headline yield advantage – over the US, at least – has eroded. In part this is because of the growing familiarity of Australia for various groups of Asian investors – it has become something close to a core market. In some cases there is a shortage of investable opportunities, with acceptable yield, in home markets.

One thing I find interesting is that while we were right about the trend for noninstitutional demand to grow we were in some ways wrong about the means by which it would. We thought an ageing population would inevitably increase its proportional allocation to income assets, but we still aren't really seeing this happen – the incentives to be in property and equity are just too great.

Instead, it's simply an accumulation of assets. Australia has a lot of wealth. Sometimes we use the fact that Australia is the fourth-largest market for investable funds as a throw-away line, but it really is a phenomenally large number. The totality of the super funds is much larger than the banking system now.

Another observation that has really come through in 2017 is that it has become more apparent that the noninstitutional bid is for a lot more than just high-yield paper. For instance, we saw real interest in seven- and 10-year infrastructure debt. My sense is that noninstitutional investors can see infrastructure projects and want to be involved. Perhaps infrastructure is actually one of the ways bonds become mainstream.

But what this says is that we still aren't seeing a big expansion in funding overall. In effect, a greater proportion of corporate debt is being taken to the bond market – but the whole has not grown any bigger.

There is still sensitivity around where future growth is coming from. Business models are being disrupted and companies are worried about this. While the Australian economy is doing okay overall, growth is not consistent and some industries and states are much less confident than others. Retail is very difficult and there is concern over housing and construction. There is certainly more positivity in the resources sector.

Meanwhile, we have a specific challenge on the green investment side in that we don't have the same impetus from the government that one might find in other countries. Put it this way: I would rather be a French bank being very good at green than an Australian bank being very good at green. We're still trying to lead, we just have to accept that when we do a world-first deal another jurisdiction might have done 12 before we get to the second.

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The important thing to remember is that 'Asia' isn't just one country – and, unlike when I started my career, it is much more than Japan. Banks still dominate in parts of the region but even in this context we are talking about multiple banks from different countries. Then there are insurance companies, funds, private banks and high net-worth individuals, all of which have their own investment styles.

At home, we're really starting to see the noninstitutional sector making its presence felt in the debt market. Every year it is stronger and every year it is buying more. It's the same story: it's becoming more nuanced and it's not just one channel. We are not just talking about self-managed super, though this is important, but also wealth outside self-managed super.

SUPPLY SIDE

It is worth noting that while the bond markets have had a very positive year for issuance volume, the underlying loan market has not. Volume in syndicated loans is down. I don't see this as a bad thing *per se*, because we just talk about funding or financing overall. It could be in loan form or a debt form, depending on the client.

DEVELOPMENT OPPORTUNITIES

Looking to 2018, I still see some good opportunities in the securitisation market, which has had a great year in 2017 and I think will maintain its momentum. I think there is still a lot more to be done in infrastructure. And, despite the challenges, I see further progress in green and social debt.

The desire for social-style bonds in some form, including SDG-related,

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will grow. Theoretical demand is already greater than supply – though I say theoretical because we are still waiting to see how repeatable the demand is. What I do believe is that the doors are largely open and the challenges we face, while significant, are more around things like scale. I think the Australian market for true impact investing, for instance, needs a wholesale catalyst in some form.

It's actually a fascinating situation because we're at a stage where we can still discuss what the right model is for getting funds deployed, and indeed whether multiple models might work. The great thing for NAB is that we have something of a 'sandbox', where we can test and experiment. Of course the final goal is to get things out into the market.

In my mind, the green and the broader environmental finance piece is in a lot of ways still at the experimentation phase. Look at it this way: we're two years old, which certainly isn't too old to play. But at some stage we have to drink some milk and kick the football with the big kids.

On infrastructure, my sense is that perhaps the bond market got ahead of itself in its expectations of infrastructure as a major supply driver earlier this decade. But this doesn't mean the supply won't come.

The example we talk about internally is what we saw in our loan books from the mid-90s with privatised electricity assets in Victoria. In the early days, they might have been carrying 20 per cent capital-markets debt and 80 per cent bank debt. Within 10 years it was 80-20 the other way. The point is, it takes a while for the capital-markets supply to come through – even for existing assets.

Going back to the market-development theme, I'm confident that the process by which a privatised asset brings its debt funding to the bond market will be quicker nowadays. The new owners will get their cheques from the banks and start working on their first capital-markets issue more or less straight away – it won't take 10 years to get there. Ausgrid issued two bond-market transactions, in the US and Australia, in its first year as a privately owned entity.

Another positive factor in infrastructure is that many of the players in global infrastructure are Australians. I go to New York or London and hear the same accent a lot. At some point most Australians want to come home, so we can be the beneficiary of this pool of talent with global expertise.

We are also looking out for more innovation in the broader energy space. NAB did a transaction recently around corporate power-purchasing agreements, for instance, and this sort of more bespoke arrangement is quite interesting. Companies use a variety of techniques in their supply chains and I think there are potentially some interesting debt-market consequences from this.

Something we haven't seen in the Australian market, but that we are looking at closely, is Islamic finance. Actually there is a tie-in here with social investing, and NAB is in a good place given its strong background in this area and as a banker to the faith and healthcare sectors.

We have worked on some funding around a mosque in Western Sydney in the aged-care arena. There is a population of ageing people who came to Australia and have poor or deteriorating command of English. As people get older they typically want to be with others who speak their language. There weren't enough facilities catering for aged people in this specific community, so it makes sense to build an aged-care facility under the auspices of a mosque to cater for its community.

We worked on this deal in a way that is Sharia-compliant. To me this ties in with impact investing, financial exclusion, innovation and relates to our healthcare business. At some point, hopefully in 2018, we will have done enough of this type of financing that an aggregation could be interesting.

MARKET SHAPE

The most important thing about what I have referred to as nuance is that it is not just how to sell more product but about how to solve problems – trite as it might sound. What this means to me is a renaissance in a relationship style of banking, which I think you can see in the way some of our banking relationships crop up in outcomes across the business.

As you get close to a client you can, or should, start to think more about how they would benefit from being put in touch with someone else you deal with because it will be interesting and will help their business. We are thinking a lot about this role for a business bank – of helping make connections and really extracting value from people who know people.

We are definitely hearing more about the European banks coming back to Australia and the Asian banks certainly have a footprint now. But I think this is good for the market. The last thing you want is absolute reliance on a small group of banks.

The really exciting aspect for the next few years is the way our market is becoming so much more nuanced, varied and complex. If we keep a good handle on the subtleties I think we should be able to keep doing interesting things, delivering on our goals and actually having some fun at the same time. •