
Worsening Economy Increases Risk Of Default

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An interview with Hayk Papyan, Director General of Cascade Investments Company, the underwriter of Cascade Credit, ARARATBANK and ArmRusgasprom bonds

What financial instruments does Cascade Investments offer its clients and generally the financial market of Armenia today in the conditions of so big variety of instruments in the international financial market? What local instruments the foreign investors take interest in?

We can buy or sell any registered securities in any country with regulated market. Cascade Investments offers its clients both shares and bonds. It has recently begun offering also certain classical hedging instruments, in particular, futures contracts, the so-called tradable securities. For instance, one can purchase several tons of products to resale them later as easily as he would buy ordinary shares listed at the stock exchange. This allows local producers and importers to reduce their financial risks depending on fluctuation of the prices of these products. For instance, we had clients, for whom we purchased and resold wheat, rice and gold in foreign markets. Derivative instruments are very popular now and our clients have taken an interest in them. We are working to create the market of commodity and futures contracts for such tradable assets as grain, sugar, butter, and oil products. This market in Armenia is still in embryo, but it may have the key part in the market price making and risk insurance in future, including in the banking business. We constantly depend on the global prices. There are many novelties in the financial markets at present. The list of instruments is constantly enlarged and such variety confuses investors. The year 2008 proved very unlucky for the shares market. Many traditional investors suffered inevitable short-term losses. Generally, in case of necessary instruments and a risk-taking opportunity, it is possible to gain irrespective of any trends if your market forecasts are generally realistic.

This is what makes the securities market attractive.

It has become rather effective buying stock indexes and other appropriately composed securities. The most popular ones are the so-called Mutual Funds and ETF (Exchange-Traded Funds). Securities in these funds are classified into groups depending on capitalization, sectors etc. The principles of index calculation are various. I think that the key advantage of is of more diversified investment, less risky and with more sustainable but lower profitability for long-term outlook. These instruments are first of all convenient for their size. Spending for instance 100 dollars, you are able to acquire 'by a small share' in several hundreds of companies. Second, your forecasting becomes rather easier for you. If you are sure that old people in Europe will spend more=2 0on their health, you can invest in the group of all the major providers of medical service in and pharmaceuticals Western Europe. You are sure that fresh water is a rare resource across the world, you can invest in the fund of producers and distributors of drinking waters etc.

Foreign investors mainly display interest in Armenian shares since the market is new and we are likely to become witnesses of its growth within the coming years. Securities listed at the stock exchange are more attractive, of course, since stock exchange requires regular reports by a company and an investor does not expect unpleasant surprises. Cascade Investments offers specific shares to its clients, particularly, the shares

that will grow in price within the nearest future, as we think. However, buying even not a large package of shares, one should understand that there is risk to become a long-term investor against one's will. Buying such instrument is reasonable when the investor has the so-called long money. The current situation in the global market had a negative impact also on the local capital market. In this connection, foreign investors have some concerns about investing in Armenian securities. In addition, many of them have faced liquidity problems.

What is the key characteristic of the Armenian market of corporate debt obligations? What makes local issuers be so active? Will dram bonds be attractive to foreign investors in conditions of further devaluation expectations?

We have a certain number of accredited issuers. The instrument - corporate bonds - has become more popular among investors and many legal entities and individuals obtain it. The major advantage of bonds comparing to bank deposits is their liquidity. Earlier foreign investors had bonds in terms of Armenian dram. Now Armenian debt securities are no longer attractive due to the sharp devaluation of the Armenian dram. However, bonds in euro and dollars are highly in demand by local clients. If an investor is sure that euro, dollar, yen or Kuwait currency will grow, it is indeed quite favorable to invest in terms of these currencies. Stability of national currency is of great importance for investors. In addition, one can gain on the securities with fixed income such as corporate bonds, treasury bonds. Incomes grow also because of changing the national currency rate. If you are a dollar investor and you have bought Armenian bonds for instance with 10% yield, the annual profitability of these bonds and change of the national currency of this country will ensure your profit. The second important problem of this instrument is the issue volume. If it is not large, the efficiency of investing in debt obligations is low. It is simply absurd for a foreign institutional investor to buy bonds worth less than \$10,000. It is inexpedient. If the total issue of bonds is not significant, it is not attractive to major investors.

What makes local issuers passive in IPO?

Securities are issued for various purposes. When developing a project that will be funded through an issue of securities, a company thinks the issue of corporate bonds or shares more effective. The greatest part of our companies is not ready to deal with a big number of issuers.

Our corporations have no traditions of long-term planning for some natural reasons. Small domestic market and insignificant export potential limit the number of prospective projects of large-scale capital investments. Shares are issued mostly to fund such initiatives. There is practically no experience of IPO and few agree to launch it. This procedure implies amendments to the enterprise structure. If several major emerging companies in our country successfully launch IPO, many others will follow them. A similar situation was in the short history of corporate bonds market development. The companies that purposefully and aggressively chose the strategy of business development, especially in the conditions of stiffened competition, can achieve their goals by launching IPO. The first company to do it, will, undoubtedly, have success.

Should issuers focus on securities? Isn't it easier to raise funds from the banking sector?

Everything depends on what the issuer needs money for. Generally, banks or any other creditors rarely fund long-term, large-scale and risky projects. And it is right. Generally, the long-term, large-scale and risky project is

more profitable. Such projects have always been funded by a stock capital i.e. through issue or sale of shares. A good company will always find an investor for the risky but profitable project.

This phenomenon has originated already in the middle age and will continue in future. So we are not an exception. In the case of bonds, everything depends on specific issuers and their financial situation. Issue of corporate bonds is prior to major companies and banks. First, banks are not always able to issue a big credit. Second, in case of a bank credit unlike the issue of corporate bonds, a borrower deals with one creditor, whereas it is risky for an issuer and creditor to depend on one partner. I admit that for small and medium-sized enterprises the issue of bonds requires serious expenses unlike the bank credit. Nevertheless, everything depends on the status and the financial state of a company etc. There is no advice or recommendation for all occasions. It is important to understand the tasks an issuers sets and the level of the risk he is ready to bear painlessly. This will allow better exploit the current opportunities in the market.

What is the corporate bonds market outlook in conditions of global economic crisis?

Alongside with the global crisis, there are many other factors that may negatively affect the market of corporate bonds .. We have already considered the negative influence of inflation processes.

If business environment and economy of the country, on the whole, are worsening, the risk of default is growing. If the global financial crisis affects business environment, and economy in general, the profitability of bonds will increase or their price will fall due to the instable market.

This will, first of all, damage the owners of bonds and will hinder debt market development. However, I think that the crisis will not have such significant impact on our economy, for Armenia is not enough integrated in the global economy. The general situation in the domestic market is negative. There will be some difficulties. General worsening of economy may lead to worsening of the activity of isolated companies and the risk of default of specific issuers may grow as well.
