

CFA Trending Topics

June 26, 2018

Strong momentum in the convertibles market

Key takeaways:

- The convertibles market is on pace for \$58bn of new issuance in 2018, the highest levels seen since before the financial crisis.
- The biggest driver of the increase in volume is issuance from the technology sector.
- Companies have been synthetically raising conversion premia via “call spreads” more frequently this year than in prior years – a signal of market confidence.
 - 39% of issuers purchased a call spread in 2018 vs 28% in 2017.
 - Companies have been raising conversion premia to 100% above the current stock price, despite the stock market near all-time highs.

The U.S. convertible market has seen \$28bn worth of equity-linked issuance securities year to date with the market on pace to hit \$58bn by year end. The new issuances have been dominated by the technology sector, which raised \$14bn year to date ... of which the four largest raised \$4.2bn (Twitter, Akamai, Atlassian and Square). The current boom in equity-linked securities has been driven by a search for dry-powder capital to pre-fund corporate balance sheets for forthcoming M&A transactions, in contrast to earlier years where issuance volume was mainly driven by actual acquisition announcements. Further, the average premia for call spreads was 93% in 2018, compared to 74% from 2009-2017. Though this 2018 trend in part is driven by the tech sector – a more frequent user of call spreads – the general trend toward 100% conversion premia is a bullish indicator, since this could be seen as a signal that stock price appreciation, for example up to 100%, is potentially in the line of sight for management teams.

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