

# **Bond Case Briefs**

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## **Reynolds American's Merger and a Massive Fine Could Snare Tobacco Muni Bonds.**

A stream of news out of the tobacco industry has failed to derail prices on municipal bonds backed by cigarette makers. But muni bond analysts warn that investors could get caught in the middle as the big players in the tobacco industry shift.

Reynolds American Inc. was whacked with \$23.6 billion in damages after a Florida jury decided that the company acted negligently in marketing its tobacco products. The company had been sued by a widow who claimed the company failed to inform her husband about the cancer-causing nature of tobacco.

The news came less than a week after Reynolds said it would buy out rival Lorillard Inc. in a deal worth \$27.4 billion.

### **Tobacco bond pricing**

What that news means for some \$100 billion in tobacco bonds isn't yet clear, but the debt hasn't changed noticeably in price, traders say. Ohio tobacco settlement bonds maturing in 2047 traded at 78 cents on the dollar Monday, up from 76 cents on Friday, prior to the settlement announcement, according to the Municipal Securities Rulemaking Board.

Tobacco debt has rebounded strongly this year amid a broader rally in high yield bonds. The S&P Municipal Bond Tobacco index has gained over 10% so far this year.

"There are very few places left to go and find behind 7% [yields] in munis, and this is one of the places," said Adam Buchanan, vice president of sales and trading at Ziegler Capital Markets.

But the long-term trend for the risky sector of the municipal bond market is negative, as cigarette consumption continues to plummet. Many of the bonds trade at distressed levels.

### **Verdict impact**

Tobacco bonds are repaid by a consortium of cigarette companies as part of a settlement agreement over health problems caused by cigarettes. Payments come from a fee that is charged to the tobacco companies per cigarette.

While the lawsuit payout wouldn't directly affect that stream of payment, past lawsuits have had a negative impact on tobacco bond prices, according to Dick Larkin, senior vice president and director of credit analysis for Herbert J. Sims & Co. He sees the Reynolds settlement as one more blow to an already-struggling market.

"The tobacco bond market right now is probably about as bad as it's ever been. Will [the lawsuit] make it worse? I don't know, but it certainly won't make it better," Larkin said.

The payout in the trial may change, as Reynolds has vowed to fight the decision.

#### Merger announcement

The Reynolds buyout of Lorillard, however, may have a broader negative impact on tobacco bond prices, Buchanan noted. When the merged companies sell off some of their brands — which is part of the initial deal — it could negatively impact the amount of payments dedicated to repaying bonds under the settlement, he said. Nonetheless, the way in which those spun off brands will be treated in the settlement agreement is not yet known.

“When you have an unclear message, it takes its toll on markets,” Buchanan said.

Another potentially negative impact: the joint companies will be able to afford more legal fees, which means that continued litigation between bondholders and tobacco companies may grow fiercer.

Strategists at Municipal Market Advisors write in a Monday report: “The combined legal resources of the two behemoths may prove credit negative for MSA bondholders as adjustments to annual payments are dragged out and nitpicked.”

Bloomberg

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– Ben Eisen