

THE ASIA HIGH YIELD BOND ROUNDTABLE

February 2021



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Asia high yield bonds poised for revival

GlobalCapital and HSBC hosted a virtual roundtable in mid-January to discuss the blowout start to high yield bond issuance in 2021. Leading market experts highlighted how Asia's debt markets have shifted — and how borrowers are positioning themselves for the rest of the year.

The new year started with a bang for Asia's high yield dollar bond market, with borrowers and banks putting out deals at a rapid pace. While the deal spree is reminiscent of January 2020 when the high yield market started strong before facing the brunt of volatility stemming from the Covid-19 pandemic, progress on vaccines has given market participants more reason to be optimistic.

Nevertheless, bond issuers, investors and bankers alike are approaching 2021 with a sense of caution. The market seems poised for growth after 2020's lower volumes, but hurdles remain. Will high yield issuance keep up the pace set in January? Will the market see new borrowers and get diversity from sectors and regions outside of China real estate? How will the growth of green and social bond impact high yield borrowing? GlobalCapital sat down with a panel of market experts in January to find out.

Participants in the roundtable were:

Azhan Azmi, group chief financial officer, Serba Dinamik

Kenny Chan, chief financial officer, Zhenro Properties Group

Annalisa Di Chiara, senior vice president, Moody's Investors Service

Jonathan Drew, managing director, sustainable finance, real assets and structured finance, global banking, Asia Pacific, HSBC

Daniel Kim, managing director, debt capital markets, HSBC

Neeraj Seth, managing director, head of Asia credit, BlackRock

Kailash Vaswani, president, corporate finance, ReNew Power

Moderator: **Morgan Davis**, bond editor, GlobalCapital Asia

GlobalCapital: This year set a new record for start of the year issuance in Asia's offshore bond market. High yield issuers in particular led the charge during the first week back from the holidays. Is that issuance volume going to continue? Or will we see a year like 2020 that was characterised by large investment grade transactions?

Daniel Kim, HSBC: In 2020, we were roughly down around 35% vis-à-vis the previous year in terms of high yield issuance. There were quite a bit of redemptions in 2019 and a lot of issuers prefunded ahead of 2020, hence we saw a record breaking year in 2019. 2020 was a little bit slower, although we did start off with a bang which slowed down on the back of Covid. In 2021, we've started off very busy, and it's probably one of the busiest starts for capital markets. From our calculations on redemptions, we expect to see an uptick of about 35% in terms of bonds maturing this year in the Asian high yield space versus 2020. Our expectation is that the market, as long as it remains open and it's conducive for primary issuance, should make 2021 a very busy year, in line with 2019.

Annalisa Di Chiara, Moody's Investors Service: Our expectation is that there is quite a backfill of upcoming maturities. Across our high yield Asia portfolio, there are rated debt maturities of about \$20bn to \$25bn in 2021. Plus, we're still going to see issuers take advantage of lower rates for longer. Some are going to be doing liability exercises; some of those maturities that are coming through in 2022 or 2023. The other thing is that we're probably going to start to see some M&A activity, and that will probably



Annalisa Di Chiara
Moody's Investors Service

bring in some additional issuance.

I will say we are still seeing some credit differentiation, so it's not everybody that can access the market. We're particularly seeing that in China, and we can differentiate between property issuers within China. We know that some are still going to be able to retain and maintain access but there is going to be some pullback, and I think

investors are still going to be as selective as they can be during this time.

In terms of issuance going forward into 2021, our expectation is it's going to reach 2020 levels. Does it jump higher than 2020? I think I'd probably like to take another quarter to look because last year, at least from a rating perspective, even though we had \$37bn issuance, the majority of it was done within the first quarter.

GlobalCapital: Green issuance seems to be taking off in a big way this year. What are your expectations for growth in that part of the market?

Jonathan Drew, HSBC: It's pretty interesting when we compare how we started last year with how we started this year from a green perspective. Last year, overall market volumes were very high but in the

early few weeks it was almost as if many issuers were rushing to market and didn't want to pause to label their bonds in a green or sustainable format. Of course, this year, overall volumes are again very high, and sustainable label deals are very high. We had more than \$12bn [I think it was \$17bn actually] in the first week of the year in sustainable format, including representation within high yield. The green portion of high yield was about 20% last year, so we had about \$10bn of green high yield through 2020 which was slightly up on the \$8.5bn of green high yield in 2019. There's a message here that the sustainable theme is growing across the markets. There is an increasing focus on sustainability and ESG [environmental, social and governance] themes and risk. Covid has been something no one can avoid that has driven issuers to recognize there's increased importance of distinguishing their issuance by emphasizing those sustainability issues, and therefore going to market in green or sustainable format.



Jonathan Drew
HSBC

Unfortunately, climate change is just getting worse as we put more emissions into the atmosphere. The average temperature only goes one way and the impacts just get worse so I think we will see the markets continue to respond to that like we've seen in 2020. We've seen outperformance of ESG strategies, whether it's the performance of the stock of some of the issuers on this panel, who have been outperforming in their sector, particularly in the energy space. And more broadly we've seen ESG focussed portfolios outperforming. Given the drive from public policy and financial market regulation, I think it's going to grow.

Kailash Vaswani, ReNew Power: We are expecting issuance will be on the higher side in 2021. It's a great time for us because of the surge in liquidity globally. The spreads have come down and are now more reflective of the nature of our business, which is more driven by contracted cash flows. And it's the green theme also, which is really playing out in a big way. If 2020 was higher than 2019 in terms of green bond issuances, clearly 2021 will be setting a new record. And we will find ourselves at the forefront of all this action.

As far as spreads are concerned, there was massive euphoria post-[Joe] Biden win in late 2020. I think that may not have been sustainable. We've already seen US Treasury rates inch back to a more stable level. Given the overall positive theme on the vaccine development, volatility is going to be much lower in the current year. For issuers to plan their issuances, for businesses such as ourselves which are very dependent on capital, there couldn't be a better time than this.

GlobalCapital: As an issuer from Asia high yield's largest sector, what are you anticipating for 2021, Kenny?

Kenny Chan, Zhenro Properties Group: We had a very successful issuance at the start of January. To be honest, if you look at our refinancing needs, they are really minimal. We only have an offshore bond that will mature in eight months, and the size is about

\$230m. But if you look at the whole property sector in China, I think it will probably be a good year — even with the three red lines policy. We don't see the central government trying to pull down too much of the market. And if you look at our transaction, we had very good feedback from investors, and the offshore banking support is still very stable. I think the China property sector will still outperform when you compare with other business segments within China.

GlobalCapital: Are investors expecting more from high yield borrowers in Asia?

Neeraj Seth, BlackRock: Overall, we are positive on the high yield market in Asia. We do expect supply to be robust and demand to be strong. If you take a step back and think about the world we are living in right now, especially in the post-Covid world, you see a lot more debt in the system pretty much everywhere. But you see a lot more low yielding debt, and one of the challenges that is going to face a number of investors globally and not just in Asia is to find yield and income. That's where Asia high yield actually fits pretty well in terms of providing that yield and still have very positive fundamental and a macro backdrop, and a relatively modest expectation from a default rate perspective.

Overall, when I bring it all back together, I do expect supply to be robust, more in line with or maybe slightly higher than the net level of 2019 or 2020. We expect default rates to stay stable. The other two things which are relevant are that we expect the bifurcation to stay to some extent in the market. You don't see that same uniform recovery since March of last year. We've seen high quality names recovering much faster. And the last point, which Jonathan touched on, is sustainability. I think it's going to be a critical focus for a number of borrowers in the region to get their head around and figure out how they actually meet the sustainability requirements that investors are going to actually ask.

GlobalCapital: Let's dive into that bifurcation and some of the differences in the market. We have here today three different issuers from three different countries with three very different businesses. At BlackRock, where do you see the most interesting investments? Are there any particular sectors or countries that you think have performed well in the wake of Covid?

Seth, Blackrock: Looking through the region, you will have seen recovery to be not very uniform across the countries and sectors. From a country perspective, we have seen more of a recovery in North Asia compared to South and Southeast Asia, which is quite visible in the data. We have seen growth and the overall economic activity rebound. From a risk adjusted return perspective, I would say you still see value in a number of areas. Needless to say, there's always a bottom up fundamental analysis on a security level and one would try to bring that at a sector level.

China as a country and then Chinese real estate from a sector level still seem to be relatively well positioned. In India, some of the renewable power names are in demand, although I would say the spreads have got tight. So we do see a number of spots where there is value. What you would need to think of is how you build a portfolio with some of the most stable carry names with a much longer horizon of your holding view, versus some of the names which might be

slightly higher risk, with more in the middle of the spectrum where you have potential for spread compression over the course of next 12 months. I think you have a few of these spots where on a risk adjusted basis you see attractiveness at this point.

GlobalCapital: Kenny, China high yield property has been particularly busy since the start of the year. What do you think is supporting that part of the market?

Chan, Zhenro Properties:

If you look at China real estate's performance in the last 12 months, it was very successful. Last year so many of the sales centres were forced to shut down but even since last April, we were able to commence business, and the overall momentum was very overwhelming. We were even able to have very healthy growth. The overall solid demand in the domestic market gives us very good support. The strong liquidity both onshore and offshore gives us a strong funding support. You can look at other business sectors, like the export and import business or retail, and they are not doing very well. But for China real estate, it is a very solid business for investors, and it is a very good investment opportunity for homebuyers. That gave us a very strong rebound since May last year.

This year, I think the Chinese government is still encouraging developers to do more market consolidation. This kind of market consolidation gives us more market share, and that happens to secure financial resources onshore and offshore. For 2021 onward I think that the top 30 or top 50 developers would enjoy this kind of market. I don't see the central bank or the central government having more cooling measures. That's why you see the first week of January. Overall, the China property developers outperform the whole sector. I think that the top 20 or top 30 developers in China will have more than 50% of the market share in the next 12 months, which is very healthy.

Kim, HSBC: The markets are pretty bifurcated. I believe the issuers who are able to come to the market are the well-known, frequent issuers that have issued throughout the years. Investors are very well informed of the companies and companies have been transparent with the investment communities via their respective investor relations teams. The issuers who have looked at more private style club transactions, not widely distributed to the wider investor base but really more reliant on relationship banks, are probably the entities that will have a harder time in terms of tapping the offshore markets when we talk about just the China property space.

When it comes to issuers from other areas, there's always that com-



Kenny Chan
Zhenro Properties Group

parison of where offshore dollar funding rates are vis-à-vis their onshore rates. If you look at the secondary levels of some of the issues from the Southeast Asia region, it's taken a little longer for those to have come back to where previous levels were. The offshore USD markets have been a little bit more expensive for them, versus domestic markets.

GlobalCapital: Will we see more issuance outside of China property this year?

Di Chiara, Moody's: I think one of the things that we see from an issuance perspective is that we don't [anticipate] a lot of new issuers. We just rated Grab earlier this year, but that's probably been a first new issuer out of South and Southeast Asia for I would say 15 to 18 months. It may be different from the other rating agencies. I think one of the struggles, and this question goes back to Neeraj in terms of looking for investments and yield, is that we've got a market and we've got investors that are very knowledgeable about China property, because that is where the depth of the market is. Everything outside of that? There's not a lot of depth right now.

If we talk about India, if we talk about Indonesia, Indonesia has some manufacturing, India's obviously got auto, oil and gas and others, but there aren't many opportunities for investors to diversify outside of China property. When are we going to see some new issuers come to market? Even though we're off to a gangbuster year, it's really questionable in my eyes as to when are we going to see more depth because that's really the only way that this market can continue to grow. About 75% of the issuance last year came out of China property. This year, it's already China property. It would be nice to get some diversity.

Seth, BlackRock: I think it's a very valid point and I think this is something which a lot of investors would welcome. But taking a step back, there's a reason why you don't see as much of the issuance from other countries, especially in the high yield part. It is a combination of regulations, competition from the banks in terms of the cost of debt and also the cost of hedging if you are trying to swap it back.

In terms of regulations now, India is a classic one. If you look through the last 10 years, I think many years ago, India and China were pretty close in terms of the index. Now India has a little over 6% which means China has 51% of the overall Asian current index. So there's something that happened over the last 10 years, where you had significant growth issuance from China but not as much from India, and obviously the relative cost of debt between the banking system and the capital markets plays a role. The cost of hedging for rupee has always been high. And to make things complex, you do have regulatory constraints. For example in India, under the external commercial borrowing regulations, you have a cap that the regulator has put at Libor plus 450bp. Now when you think about high yield market, you're saying less than a 5% coupon in today's world. It automatically takes away a lot of the mid-size players, because the market clearing price will be higher than that. I don't think that's changing. I don't expect a major shift in terms of the issuance patterns away from China real estate or even China high yield in general.

Kim, HSBC: HSBC has a very broad customer base across Asia Pacific and my team, along with our rat-



Daniel Kim
HSBC

ings team, is knocking on the doors of many of these clients pitching rating exercises in the high yield bond markets. But in the end, the real issue is the all-in cost as these companies are getting much cheaper financing either through the domestic bond market or the domestic loan market. As Neeraj mentioned, the cross-currency market is not liquid and very expensive.

GlobalCapital: Kailash, do you see these themes affecting your issuance or that of other issuers in India?

Vaswani, ReNew Power: From an India perspective, Neeraj is right. The regulations are fairly restrictive for small or mid-sized companies to access the market. We have done a few issuances under those regulations but given the collapse seen in the Libor levels, we are seeing the cap being at around 5%. We tried to do an issuance in the last year that was fairly successful. So while the cap is restrictive, for repeat issuer like ourselves, we don't find that to be a constraining factor. And the good news for us at this point is that spreads have actually come down. Given the entire angle of our business is ESG focused, we are front and centre in terms of green initiatives, sustainability, governance and everything else. And then at the same time we were not as much impacted by Covid.

What we have also seen as the trend from India is that issuance is increasing. And there is diversification happening. We are seeing new sectors come to the market. We did see a lot of non-banking finance corporations access that market, and renewable energy companies have been accessing the markets in this country since 2017 on a regular basis so that continues. In India, the capital market is reasonable for large companies which find favour with the dollar. The hedging costs are on the higher side between the dollar and the rupee and it sort of limits the number of issuers who want to access the dollar market.



Kailash Vaswani
ReNew Power

GlobalCapital: Is this also the case in other parts of Asia?

Azhan Azmi, Serba Dinamik: As you can see, there's not much issuance coming from Malaysia and I think one of the main reasons is that there's still a lot of liquidity in the local market. At the same time, there's a lot of disparity in terms of cost of debt. It is still cheaper to raise domestic funding. However, as a company we also wanted to be recognized in the international market. So back in 2019, we did our first issuance. And again, we came back into the market at the end of 2019. Of course, after the situation in 2020, we have seen that the cost of debt for us to issue in the international market is higher. We have taken this opportunity to do some liability management where we buy back from the international market to actually tap into the lower costs of debt from the domestic market.

Last year, we had the intention of going back into the market, but because of what happened we don't see coming into the dollar market as really beneficial to the company. We were able to raise money from



Azhan Azmi
Serba Dinamik

the domestic market. I will say that Covid did hamper the plan for us to go into the international market. Hopefully 2021 will be a better year, and we hope that we can come back into the market.

GlobalCapital: Green and social bond labels continue to be a theme, and increasingly they are used by high yield borrowers. We've now seen

a number of Chinese property companies sell green bonds. Why is that? How are these bond labels making their way into the high yield market?

Drew, HSBC: I think in a sense the rationale for why there is growth across the market is reasonably straightforward if we look at the key sustainability issues. For something like climate change, there is increasing recognition that we have a very serious problem. We need to put capital to work to decarbonize our system, otherwise we risk pushing temperatures to a level where we perhaps irreversibly destabilize or even lose control of the environmental systems that we depend upon for the whole of the existence of our society; and it is that serious. We've seen governments through policy and financial regulators starting to raise the bar very significantly. We've seen asset owners demanding that money is invested responsibly. If we're either successful or unsuccessful in transitioning, there's going to be big value shifts so there is huge risk.

In 2020 obviously along came Covid and really beyond all reasonable doubt showed these issues aren't something that might arise tomorrow. They're here and now, and in the most dramatic way we saw the impact of those on economic activity. We saw what I might call a forced unscheduled transition to a lower carbon system, which obviously had huge impacts on many sectors. In other ways we have seen what transition can look like. Suggestions to syndicate such as "why can't we do low carbon roadshows for green bonds", suddenly became: well, we do low carbon roadshows for every deal now. We've been forced to do that so we've been forced to change. And then I think we've seen governments respond to that with the need to move capital to address the consequences of lockdowns. And that gave a huge impetus to social labelled issuances.

In 2020, I think in Asia Pacific, social and sustainability issues were more than the total for green. So that was a big shift after 2019, when it was maybe only 10%. We saw governments coming through with sort of build back better or green recovery type programmes recognizing this was an opportunity to shift. Science suggests that climate change is a driver of the increased probability of pandemics taking hold. In addition to other issues, other impacts, it is very difficult for any corporate to turn away from responsibility for dealing with these.

What we've also seen emerge is that in most markets renewable energy is now the financially smart thing to do. The subsidies aren't needed in most markets, so there is now a shift in focus to say well what next? For example energy consumption in the

cement sector, in iron and steel, and of course in oil and gas. We've arrived at a big conversation in 2020 around transition finance. How do we start going beyond a narrow definition of green? What is the right approach to identifying what is good transition and what isn't?

Towards the end of last year, we had the transition guidelines coming out from ICMA that talk about what makes for a valid transition pathway. We've also had a huge growth, mostly driven by the loan market, of sustainability linked products. These are deals where there's a financial incentive for the borrower in the loan market, and now the issuer in the capital markets with the emergence of the sustainability-linked bonds, to meet specific and relevant and ambitious sustainability linked KPIs (key performance indicators). The loan market has certainly grown very quickly. Increasingly, this will play not just in the high grade but also in the high yield space as well because the issues are very relevant.

We're seeing more specialty funds on the buy side emerging so that's encouraging people to adopt and comply with these principles and therefore the label on market issuance makes sense. And out of Europe, we're now seeing regulation coming in around definitions and the EU taxonomy. Money managers are being required to report against levels of compliance against that taxonomy, and therefore getting that right and communicating that when you take your deal to market is going to be a key way to make sure you're going to get the European bid into your transaction. The story is getting more and more complex as we go across all sectors.

I think the onus is very much on us to help our sell side clients get the right structure and tell the right story and pitch it well. Don't oversell your greenness because that can backfire. As we are increasingly seeing, there's a very loud media and NGO community who are focused on this, so you need to get that balance right. It's an increasingly complex task to get the sustainability messaging right in your fundraising programmes.

Seth, BlackRock: I think the key here is the awareness. The demand of the overall focus is shifting dramatically. If you think in a broader context of ESG, I think it's one of the trends which I would say was already in play. And it really has got accelerated by Covid over the course of the last 12 months, so you do see clear demand coming through from the clients' perspective. When it comes to Asia, you can imagine some of the challenges are not unknown, with regard to data availability and how do you actually measure them. But the fact is if you look at the issuance patterns it's moving in the right direction.

One thing which is quite clear, I would say, there's certainly a lot more focus on social. If you look at the past, it was mainly governance and it has started becoming more environment and now social. And I think this is critical for a number of these businesses to actually have a social licence to be able to operate in these markets. And the other part which is quite



Neeraj Seth
BlackRock

natural I would expect is that as we start to focus on these aspects, the sustainability and the broader ESG, it will start to shift the capital pools in terms of diverting capital in certain industries versus the other. It will start to change the cost of capital, and that itself obviously will have implications in terms of the cost of capital and the return on that investment, so in a way it's a virtuous cycle which has started. I don't see this reversing; it's only going to go in one direction.

GlobalCapital: Kenny, Zhenro is one of the China property companies to have sold green bonds. Why did your company choose to do so?

Chan, Zhenro Properties: The topic of green bonds is not new to us. Hong Kong listed companies are required to file an ESG report on this. And if you look at the China local government policies, in order to build residential projects in the domestic market, you have to fulfil so many local green related requirements. Our headquarter in Shanghai is a green rated building. China has had these kinds of green policies for about five years. But I think the demand for the capital market and these kind of ESG related bonds and the ESG funds suddenly came out last year. We checked with our investors and then we thought that all our existing ESG requirements or green related requirements would fit with green bond requirements. That's why we started doing green bonds.

It wasn't that we started doing green this year or last year; we have been doing this green related stuff for many years. But I think that just the ESG data and the ESG focus within funds started to become more popular last year and gave us a very nice opportunity to diversify our funding channel. That's why we have more investors these days. If you look at our transaction earlier this month, we had over 300 accounts in our order book, and almost half of them are related to ESG.

GlobalCapital: We've covered a few different themes for the start of 2021, but what key phrase would you use to characterize the theme that you will be most closely watching in 2021?

Kim, HSBC: For me, it would be the further development of the high yield markets in Asia. As discussed earlier, I would like to see new issues from different sectors and countries.

Seth, BlackRock: Search for income. I think it's going to get more profound.

Drew, HSBC: The transition to sustainability.

Chan, Zhenro Properties: Market consolidation and substitutability, as they are subtopics in my sector, but I'm still cautiously optimistic.

Azmi, Serba Dinamik: I would like to see recovery, especially in my market and, hopefully, like I say, we can come back and maybe issue in the market as well.

Vaswani, ReNew Power: I'll say clean energy transition globally and record bond issuances, for a better climate.

Di Chiara, Moody's: I'm going to stick with credit differentiation.

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