Credit Brief on Singapore SMEs
Q1 2018

Jointly by Credit Research Initiative Team and Validus Capital Pte. Ltd.

This brief is a jointly published quarterly article, between Validus and Credit Research Initiative at National University of Singapore (NUS-CRI), providing insights on industry-level Credit Risk of Singapore SMEs and provides a summary of how loans generated through the Validus' platform incorporates the learnings from the industry-level Credit Analysis. The Credit Risk of the industries is measured via the Probability of Default (PD) model developed by the NUS-CRI team (www.rmicri.org).This analysis is conducted across 10 industries (Bloomberg classification) and the loans funded through Validus. (www.validus.sg)

Data note: Analysis in this report is based on the sample of public SMEs. Due to the small sample size in Singapore and similar credit characteristics of public SMEs across Singapore, Australia, Hong Kong and Korea, all CRI sector PDs are calculated as an average of PDs for the public SMEs in the four economies. This methodology is in agreement with Validus Capital Pte. Ltd. and is expected to reflect the Credit Risk profile of Singapore SMEs.

A. Key Highlights on Credit Risk

The NUS-CRI 1-year PD for Singapore SMEs remained at an elevated level of 15.50bps at the end of Q1 2018, despite a strong GDP growth of 4.3% during the quarter. The SBF-DP SME Index[1], a forward looking measure of SME sentiment improved from 51.2 to 51.8, suggesting an improved outlook for Singapore SMEs between March 2018 and September 2018.

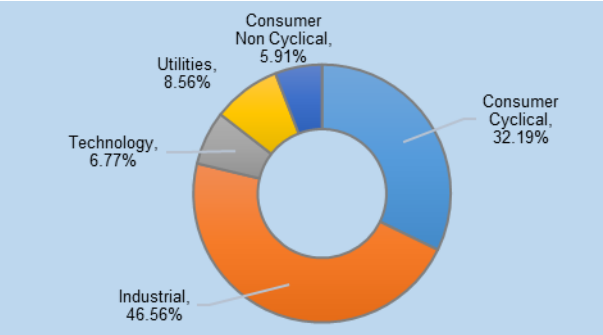
- CRI 1-year PDs for Singapore SMEs decreased in January before rising to the same level as December at the end of Q1 2018.
- The Energy and Utilities sectors had the highest credit risk in Q1, while Consumer (non-cyclical) and Basic Materials had the lowest credit risk among all industries.
- The Utilities sector witnessed the largest drop in default risk.
- The aggregate credit quality of Medium-sized and Small firms improved during the quarter while the aggregate credit quality of Micro firms deteriorated. The aggregate default risk for Micro Communications firms increased by 12.06bps while the Small Basic Materials sector witnessed the largest improvement of 7.39bps across any size and industry group.
- The overall multiple of medium term PD (1-year) to short term PD (1-month) increased to 11.70x from 10.31x in the previous quarter. This is an indicator denoting the extent of the behaviour of medium term PD compared to the short term PD which is further used as a benchmark for industry-level PD multiple. Any industry level PD multiple that is higher than the overall multiple indicates that medium term loans for those industry sectors are more risky than short term loans and vice versa.

B. Loans originated through Validus Platform

- Loans funded[2] through Validus include firms in Consumer Cyclical, Consumer Cyclical, Industrial, Technology and Utilities.
- 78% of loans originated from Validus platform are to companies within the Industrial and Consumer Cyclical sectors. The loans are mostly short term in nature for these two industries. NUS-CRI insights do not indicate any adverse risk on these two industry sectors.
- Profile of loans originated through Validus platform are displayed in the charts below:

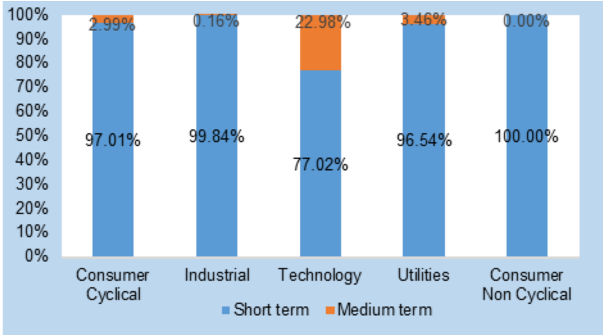
[1] SBF-DP SME Index is a six-month forward-looking business sentiment index by Singapore Business Federation and DP Information Group
[2] This report contains all loans funded through Validus

B.1 % of total loans funded through Validus Platform by industry sector



Source: Validus Capital, all figures are updated as of March 31, 2018

B.2 % of loans funded through Validus Platform by industry sector and tenure

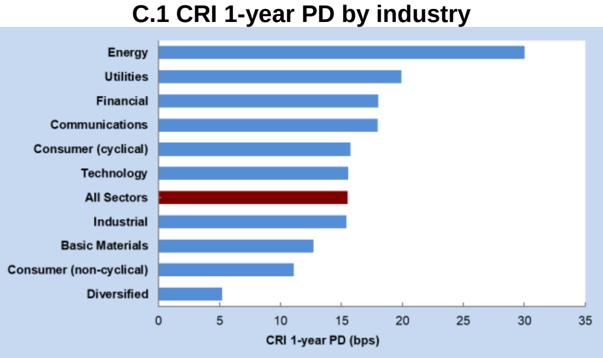


Source: Validus Capital, all figures are updated as of March 31, 2018

C. Credit Risk for Singapore Industries

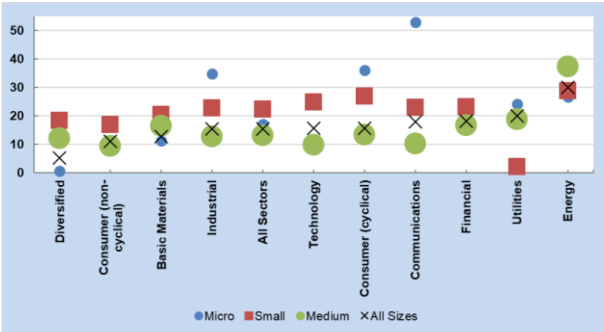
The CRI 1-year PD assesses the credit risk in the future one year. The comparison of PD trends and PD multipliers across industries gives a clear picture of the relative credit performance of each sector. The relative credit performance by firm size within each industry is also provided. By definition[3], firms with annual turnover equal to or below USD 2mn are considered Micro Firms, between USD 2-10mn are considered Small Firms, while larger than USD 10mn and equal to or below USD 100mn are considered Medium Firms.

C.1 CRI 1-year PD by industry



Source: CRI, all figures are updated as of March 31, 2018

C.2 CRI 1-year PD for firm sizes by industry



Source: CRI, all figures are updated as of March 31, 2018

The Energy sector had the highest CRI 1-year PD among all Singapore SMEs, followed by the Utilities and Financial sectors in Q1 2018. In contrast, the Consumer (non-cyclical), Basic Materials and Industrial sectors delivered robust performances.

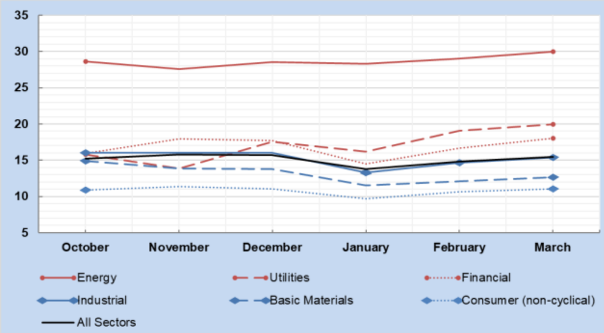
- The aggregate CRI 1-year PD of all sectors fell slightly in Q1 2018 by 0.21bps from the last quarter. The credit performance of most sectors improved in Q1 2018 except for the Energy, Financial, Technology, and Utilities sectors.
- The Energy sector remained to be the most risky sector in Q1 2018. The CRI 1-year PD for the Utilities sector increased significantly over the recent months, and has now become the second most risky sector in this quarter.
- The Consumer (non-cyclical) sector remained as the least risky sector for four consecutive quarters.

SMEs with different firm sizes delivered variable CRI 1-year PD performances within each industry. Industries with the highest PD variance of sizes were the Communications, Consumer (cyclical), Utilities, and Industrial.

- Small firms in the Utilities sector had better credit performances than All Sizes in the same sector. Small Utilities firms had the CRI 1-year PD of 2.12bps, lower than every other firm of any size or sector.
- The Communications sector displayed the highest variance of the CRI 1-year PDs among all sectors. On the other hand, the sector that displayed the lowest variance is the Financial sector.
- Micro Communications firms carried the highest credit risk among every other firm of any size or sector. The CRI 1-year PD for Micro Communications firms is 52.85 bps which is 12.06bps higher than previous quarter’s.

[3] Defined by Validus Capital Pte. Ltd.

C.3 CRI 1-year PD trend by industry

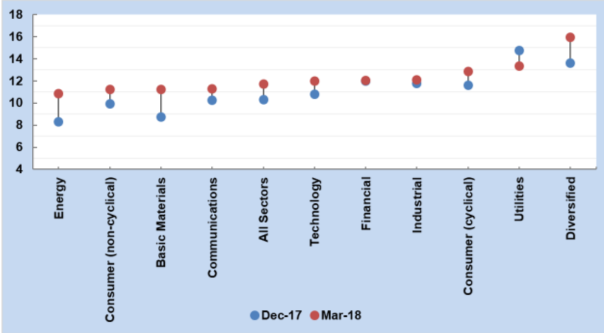


Source: CRI, all figures are updated as of March 31, 2018

The credit performances for nearly all Singapore SMEs worsened in Q1 2018.

- Among the three most risky sectors, the Energy sector's CRI 1-year PD deteriorated by 1.72bps during Q1 2018. PDs for the Utilities and Financial sectors deteriorated by 3.71bps and 3.58bps, respectively.
- Comparing the trends within the three least risky sectors, the CRI 1-year PDs for the Basic Materials and Consumer (non-cyclical) sectors increased by 1.16bps and increased by 1.40bps, respectively. The Technology sector was the best credit performer this quarter, as its CRI 1-year PD increased slightly by 0.3bps during Q1 2018.

C.4 CRI PD multiple by industry



Source: CRI, all figures are updated as of March 31, 2018

The multiples of medium term PD (1-year) to short term PD (1-month) for all industries are shown above.

- The PD multiplier increased for most sectors except Utilities. An increase in the multiplier indicates that credit risk has worsened in the medium term faster than the short term.
- The Energy sector recorded the largest increase in PD multiple. The CRI PD multiple for the sector increased to 10.9X in March 2018 from 8.3X in December 2017.

D. Conclusion

Overall, the NUS-CRI 1-year PD remained at the same level during Q1, declining to as low as 13.77bps in January before rising to 15.50bps in March. However, the credit profiles of Singapore SMEs may improve in Q2 2018 on higher business sentiment and looser fiscal measures. According to the survey conducted by the Singapore Business Federation and DP Information Group, Singapore SMEs could report their strongest sales and profit results in three years during Q2 and Q3. Survey respondents said that funding conditions have improved and respondents gave their highest profitability expectation score since Q2 2015. The optimism about companies' profits may have resulted from lower taxes announced in February during Budget 2018. A surplus in the last fiscal year allowed lawmakers to raise the corporate income tax rebate to 40 percent of tax payable, and extend the corporate tax rebate to fiscal year 2019. The wage credit scheme, which co-funds wage increases for certain employees will be extended to 2020, meaning that companies could seek help for labor expenses in the coming years.