Credit Brief on Singapore SMEs
Q2 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 increased to 19.88bps at the end of Q2 2018, in-line with a slower GDP growth of 3.8% during the quarter. The SBF-DP SME Index[1], a forward looking measure of SME sentiment worsen from 51.8 to 51.5, suggesting a less optimistic outlook for Singapore SMEs between July 2018 and December 2018.

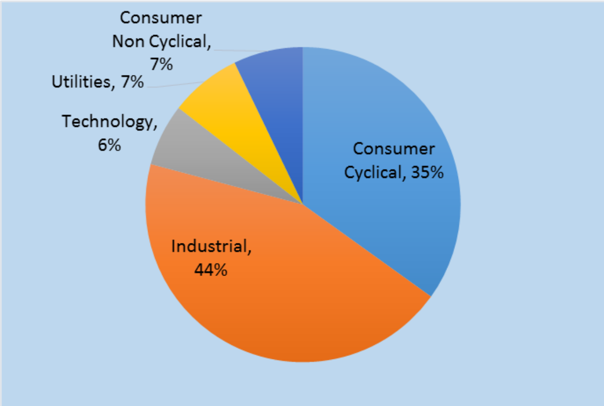
- CRI 1-year PDs for Singapore SMEs in Q2 2018 increased to its highest since the start of the year.
- The Energy and Utilities sectors had the highest credit risk in Q2, while Consumer (non-cyclical) and Financial had the lowest credit risk among all industries.
- The Utilities sector witnessed the largest increase in default risk while Technology saw the smallest increase in default risk.
- The aggregate credit quality of Medium-sized, Small and Micro firms deteriorated during the quarter. The aggregate default risk for Micro Utilities firms increased the most by 51.89bps while the Micro Technology sector witnessed the largest improvement of 3.78bps across any size and industry group.
- The overall multiple of medium term PD (1-year) to short term PD (1-month) decreased to 12.56x from 13.60x 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.
- 79% 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 all the 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:

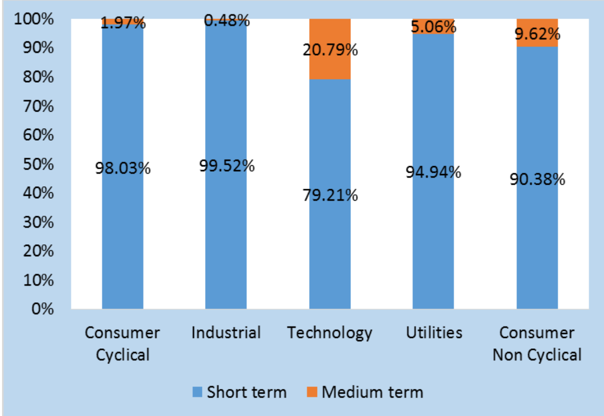
[1] SBF-DP SME Index is a six-month forward-looking business sentiment index by Singapore Business Federation and DP Information Group
[2] This report contains all loans funded through Validus

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



Source: Validus Capital, all figures are updated as of June 30, 2018

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

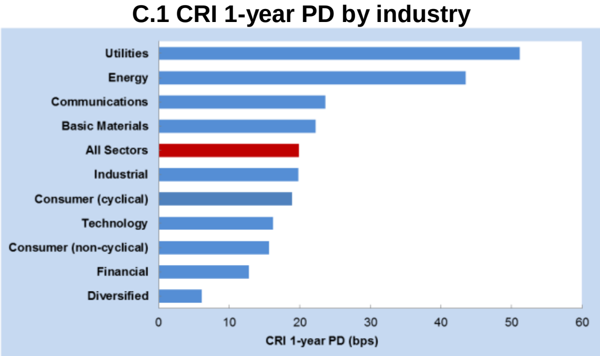


Source: Validus Capital, all figures are updated as of June 30, 2018

C. Credit Risk for Singapore Industries

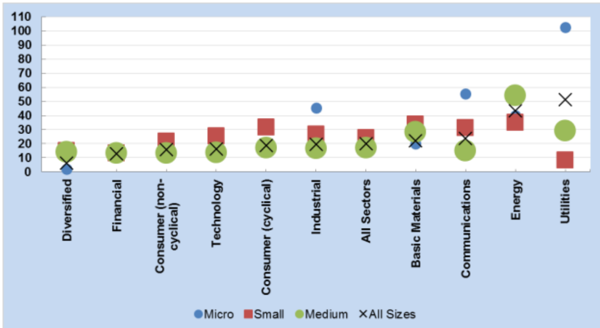
The CRI 1-year PD assesses the credit risk in the future one year. The comparison of PD trends and PD multipliers across industries gives a clear picture of the relative credit performance of each sector. The relative credit performance by firm size within each industry is also provided. By definition[3], 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 June 30, 2018

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



Source: CRI, all figures are updated as of June 30, 2018

The Utilities sector had the highest CRI 1-year PD among all Singapore SMEs, followed by the Energy and Communications sectors in Q2 2018. In contrast, the Technology, Consumer (non-cyclical) and Financial sectors delivered robust performances.

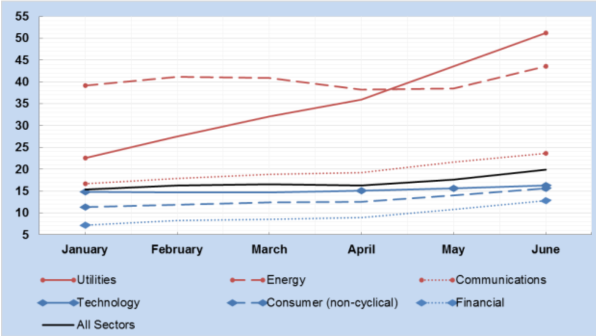
- The aggregate CRI 1-year PD of all sectors increased in Q2 2018 by 3.35bps from the last quarter. The credit performance for all sectors deteriorated in Q2 2018.
- The Utilities sector was the most risky sector in Q2 2018. The CRI 1-year PD for the Utilities sector increased significantly over the recent months, and has now become the most risky sector in this quarter.
- Despite the increase in CRI 1-year PD, the Financial sector is the least risky sector.

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 Utilities, Communications 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 8.12bps, lower than every other firm of any size or sector.
- The Utilities 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 Utilities and Micro Communications firms carried the highest and second highest credit risk respectively among every other firm of any size or sector. The CRI 1-year PD for Micro Utilities firms is 102.63bps which is 51.89bps higher than previous quarter’s.

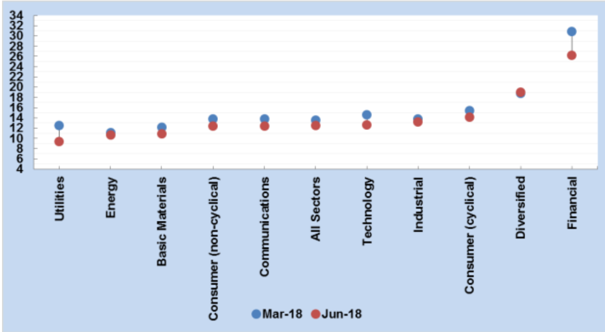
[3] Defined by Validus Capital Pte. Ltd.

C.3 CRI 1-year PD trend by industry



Source: CRI, all figures are updated as of June 30, 2018

C.4 CRI PD multiple by industry



Source: CRI, all figures are updated as of June 30, 2018

The credit performances for all Singapore SMEs worsened in Q2 2018.

- Among the three most risky sectors, the Utilities sector's CRI 1-year PD deteriorated by 19.12bps during Q2 2018. PDs for the Energy and Communications sectors deteriorated by 2.65bps and 4.87bps, respectively.
- Comparing the trends within the three least risky sectors, the CRI 1-year PDs for the Technology and Consumer (non-cyclical) sectors increased by 1.61bps and increased by 3.24bps, respectively. The Financial sector was the best credit performer this quarter even though its CRI 1-year PD increased by 4.19bps during Q2 2018.

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

- The PD multiplier decreased for all sectors. A decrease in the multiplier indicates that credit risk has worsened in the short term faster than the medium term.
- The Financial sector recorded the largest decrease in PD multiple. The CRI PD multiple for the sector decreased to 26.22X in June 2018 from 30.85X in March 2018.

D. Conclusion

Overall, the NUS-CRI 1-year PD increased during Q2, from 16.53bps in March to 19.88bps in June. The weaker credit profile of Singapore SMEs is line with the slower GDP growth in Q2 2018 based on advance estimates from the Ministry of Trade and Industry. According to the survey conducted by the Singapore Business Federation and DP Information Group, Singapore SMEs remain upbeat about their prospects for the second half of 2018 but is more cautious due to the ongoing trade war between US and China. Survey respondents expect the outlook for turnover and profits to remain stable with the Business Services sector being the most optimistic. One reason for the better optimism amongst Singapore SMEs is the support by Enterprise Singapore and other government agencies. Some of the programs available are the Productivity Solutions Grant which provide subsidies for SMEs to adopt IT solutions and equipment or the SME Digital Tech Hub for digital needs such as data analytics and cybersecurity. However, SMEs in Singapore would also require more support on global trade opportunities so as to drive productivity and expand their market. SMEs are also looking for more information on trade opportunities and hoping that there can be new or improved trade agreements given that competition was cited as the biggest barrier to international trade.