Credit Brief on Singapore SMEs Q2 2020

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. In this report, the PDs for each quarter were computed using model parameters that were calibrated on July 8, 2020, using all available data up to June 30, 2020.

A. Key Highlights on Credit Risk

The NUS-CRI 1-year PD for Singapore SMEs increased to 35.31bps at the end of Q2 2020 amid a yearly GDP contraction of 12.6% in this quarter.

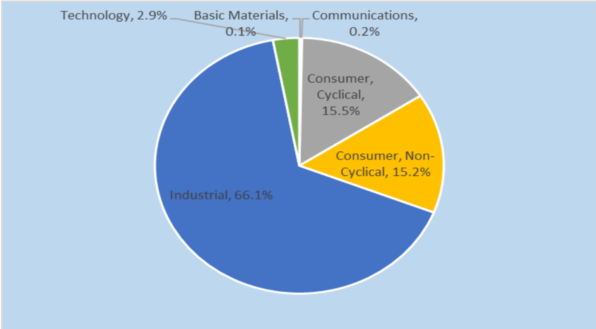
- CRI 1-year PDs for Singapore SMEs decreased in Q2 2020 from the start of the year.
- Continuing from Q1 2020, the Energy and Utilities sectors had the highest credit risk in Q2 2020, while Consumer (non-cyclical) and Financials sectors had the lowest credit risk among all industries.
- While all industries witnessed a general improvement in credit quality, Energy saw the biggest decrease in default risk.
- The aggregate credit quality of Medium-sized, Small and Micro firms improved during the quarter. The aggregate default risk for Micro Industrial firms increased the most by 3.31bps while the Small Energy sector witnessed the greatest improvement of 31.28bps across any size and industry group.
- The overall multiple of medium term PD (1-year) to short term PD (1-month) increased to 10.01x from 8.41x 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 riskier than short term loans and vice versa.

B. Loans originated through Validus Platform

- Loans funded[1] through Validus include firms in Consumer Cyclical, Consumer Cyclical, Industrial, Technology and Utilities.
- 82% 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:

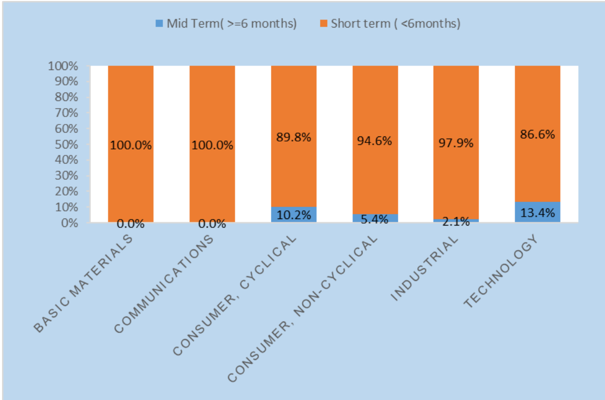
[1] This report contains all loans funded through Validus

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



Source: Validus Capital, all figures are updated as of June 30, 2020

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

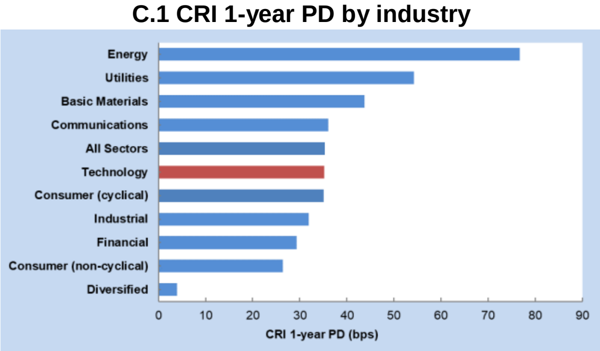


Source: Validus Capital, all figures are updated as of June 30, 2020

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[2], 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

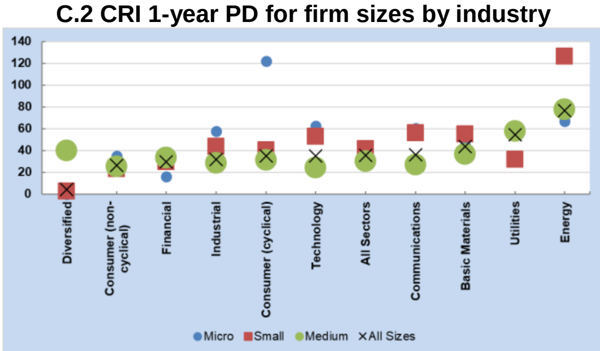


Source: CRI, all figures are updated as of June 30, 2020

The Energy industry had the highest CRI 1-year PD among all Singapore SMEs, followed by the Utilities and Basic Materials sector in Q2 2020. In contrast, the Consumer (non-cyclical), Financial and Industrial sectors delivered robust performances.

- The aggregate CRI 1-year PD of all sectors decreased in Q2 2020 by 18.43bps from the last quarter. The credit performance of all sectors generally improved in Q2 2020.
- The Energy sector remains the riskiest sector in Q2 2020.
- The Consumer (non-cyclical) sector became the least risky sector in Q2 2020.

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



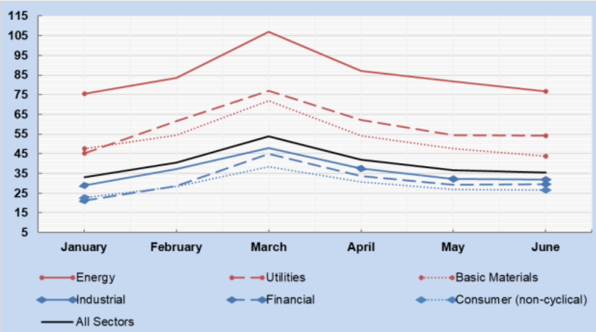
Source: CRI, all figures are updated as of June 30, 2020

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 Consumer (cyclical), Energy and Technology sectors.

- Micro firms in the Financial sector performed better than All Sizes in the same sector. Micro Financial firms had a CRI 1-year PD of 16.20bps, lower than every other firm of any size or sector.
- The Consumer (cyclical) sector displayed the highest variance of the CRI 1-year PDs among all sectors. In contrast, the sector that displayed the lowest variance is the Consumer (non-cyclical) sector.
- Small Energy firms carried the highest credit risk among every other firm of any size or sector. The CRI 1-year PD for Small Energy firms is 126.30bps.

[2] Defined by Validus Capital Pte. Ltd.

C.3 CRI 1-year PD trend by industry

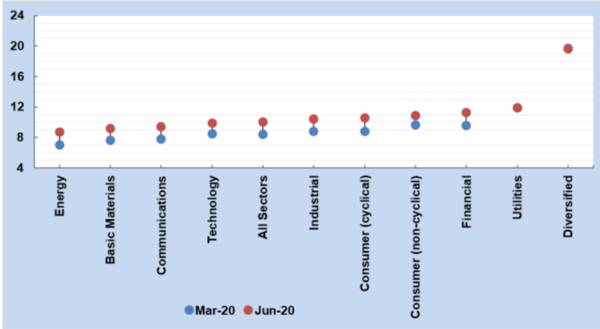


Source: CRI, all figures are updated as of June 30, 2020

The credit performances for all Singapore SMEs deteriorated in Q2 2020.

- Among the three riskiest sectors, the Energy sector's CRI 1-year PD decreased by 30.33bps during Q2 2020. PDs for the Utilities and Basic Materials sectors decreased by 22.78bps and 28.29bps, respectively.
- Comparing the trends with the three least risky sectors, the CRI 1-year PDs for the Industrial and Financial sectors decreased by 16.10bps and 15.69bps, respectively. The Consumer (non-cyclical) sector was the best credit performer in this quarter. Its CRI 1-year PD decreased by 12.08bps during Q2 2020.

C.4 CRI PD multiple by industry



Source: CRI, all figures are updated as of June 30, 2020

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

- The PD multiplier has generally increased for all sectors. An increase in the multiplier indicates that credit risk has improved in the short term faster than the medium term.
- The Consumer (cyclical) sector recorded the largest increase in PD multiple. The CRI PD multiple for the sector decreased from 8.76X in March 2020 to 10.55X in June 2020.

D. Conclusion

Overall, the NUS-CRI 1-year PD decreased during Q2 2020, from 53.74bps in March to 35.31bps in June. The credit profile of Singapore SMEs improved despite the GDP contraction of 12.6% in Q2 2020 based on advance estimates from the Ministry of Trade and Industry (MTI). This difference is reconcilable in view of Singapore opening up from its strict series of containment measures. The stringent yet effective approach towards Covid-19 has availed individuals and firms-alike confidence and optimism. Coupled with prompt and extensive aid from local institutions, a great deal of liquidity and cash flow have been made available to struggling local SMEs across all sectors. The Monetary Authority has taken it upon themselves to ensure that the market is well endowed with both SGD and USD. On Mar 2020, a new MAS USD Facility has been set up to provide over USD 60bn of funding. The central bank also worked with local banks to avail flexibility of debt deferment and lower cost of funding to fuel existing operational costs and/or efforts to digitize. Both of which are vital for uplifting the SME's balance sheets and keeping them competitive in the long run.