Credit Brief on Singapore SMEs
Q3 2019

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 October 09, 2019, using all available data up to September 30, 2019.

A. Key Highlights on Credit Risk

The NUS-CRI 1-year PD for Singapore SMEs increased to 30.54bps at the end of Q3 2019 as yearly GDP growth remains sluggish at 0.1% in this quarter amid the prolonged uncertainties caused by the ongoing US-China trade tensions. The SBF-DP SME Index[1], a forward looking measure of SME sentiment worsen from 50.8 to 50.6, suggesting a less optimistic outlook for Singapore SMEs between October 2019 and March 2020.

- CRI 1-year PDs for Singapore SMEs in Q3 2019 increased to its highest since the start of the year.
- The Utilities and Energy sectors had the highest credit risk in Q3, while Consumer (non-cyclical) and Financial had the lowest credit risk among all industries.
- The Energy sector witnessed the largest increase in default risk while Basic Materials 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 Small Energy firms increased the most by 14.56bps while the Micro Utilities sector witnessed the largest improvement of 11.43bps across any size and industry group.
- The overall multiple of medium term PD (1-year) to short term PD (1-month) increased to 12.84x from 12.34x 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 Non-Cyclical, Industrial, Technology, Basic materials, Communications and Utilities.
- 80% of loans originated from Validus platform are to companies within the Industrial and Consumer Non-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:

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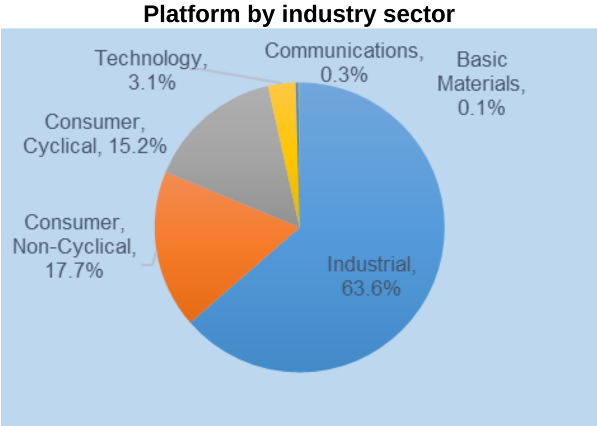
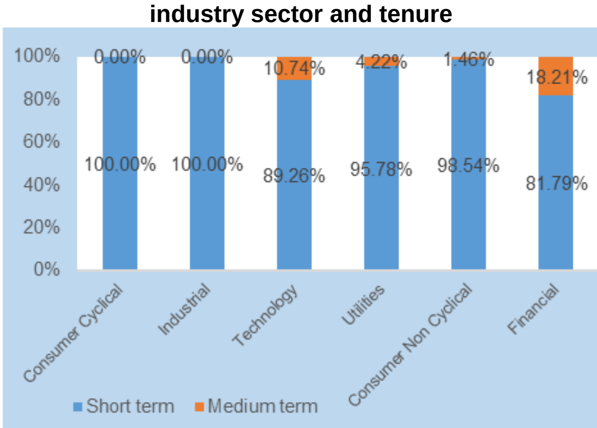
[1] SBF-DP SME Index is a six-month forward-looking business sentiment index by Singapore Business Federation and DP Information Group
[2] This report contains all loans funded through Validus

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



Source: Validus Capital, all figures are updated as of September 30, 2019

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

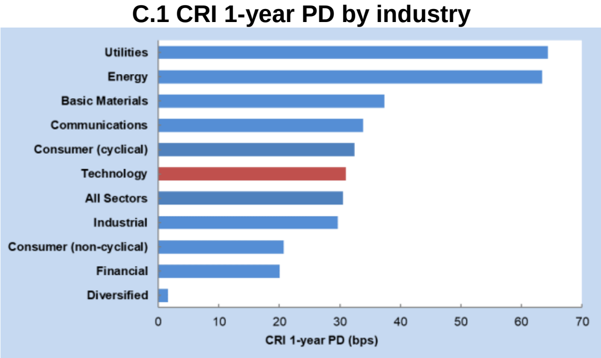


Source: Validus Capital, all figures are updated as of September 30, 2019

C. Credit Risk for Singapore Industries

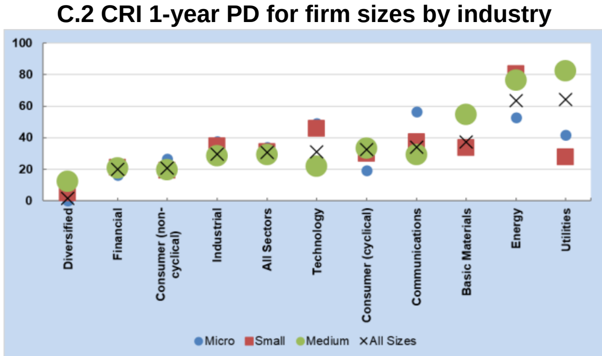
The CRI 1-year PD assesses the credit risk in the future one year. The comparison of PD trends and PD multipliers across industries gives a clear picture of the relative credit performance of each sector. The relative credit performance by firm size within each industry is also provided. By definition[3], 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 September 30, 2019

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



Source: CRI, all figures are updated as of September 30, 2019

The Utilities sector had the highest CRI 1-year PD among all Singapore SMEs, followed by the Energy and Basic Materials sector in Q3 2019. In contrast, the Industrial, Consumer (non-cyclical) and Financial sectors delivered robust performances.

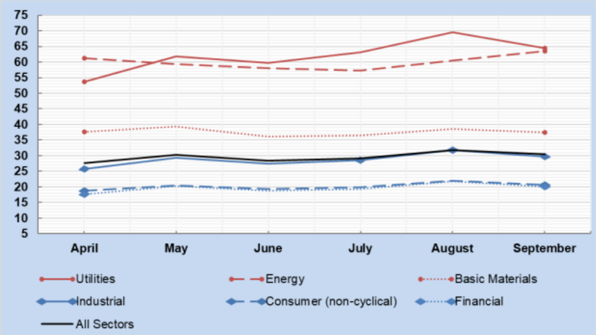
- The aggregate CRI 1-year PD of all sectors increased in Q3 2019 by 2.1bps from the last quarter. The credit performance of all sectors deteriorated in Q3 2019.
- The Utilities sector remained to be the most risky sector in Q3 2019.
- The Financial sector remained to be the least risky sector in Q3 2019.

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, Energy, and Communications.

- Micro firms in the Financial sector had better credit performances than All Sizes in the same sector. Micro Financial firms had the CRI 1-year PD of 16.18bps, 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.
- Medium Utilities firms carried the highest credit risk among every other firm of any size or sector. The CRI 1-year PD for Medium Utilities firms is 82.3bps.

[3] Defined by Validus Capital Pte. Ltd.

C.3 CRI 1-year PD trend by industry

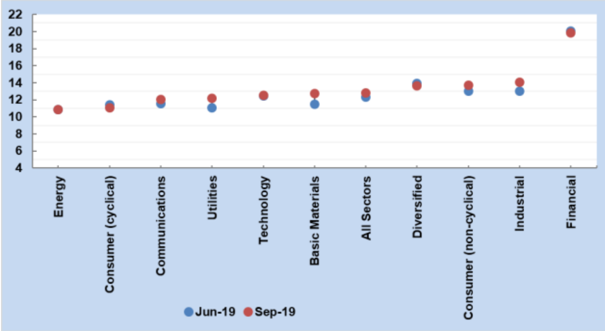


Source: CRI, all figures are updated as of September 30, 2019

The credit performances for all Singapore SMEs worsened in Q3 2019.

- Among the three most risky sectors, the Utilities sector's CRI 1-year PD deteriorated by 4.68bps during Q3 2019. PDs for the Energy and Basic Materials sectors deteriorated by 5.44bps and 1.19bps, respectively.
- Comparing the trends within the three least risky sectors, the CRI 1-year PDs for the Industrial and Consumer (non-cyclical) sectors increased by 2.24bps and increased by 1.39bps, respectively. The Financial sector was the best credit performer this quarter even though its CRI 1-year PD increased by 1.33bps during Q3 2019.

C.4 CRI PD multiple by industry



Source: CRI, all figures are updated as of September 30, 2019

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 all sectors except for the Consumer (cyclical) and Financial sectors. A decrease in the multiplier indicates that credit risk has worsened in the short term faster than the medium term.
- The Consumer (cyclical) sector recorded the largest decrease in PD multiple. The CRI PD multiple for the sector decreased to 11.07X in September 2019 from 11.39X in June 2019.

D. Conclusion

Overall, the NUS-CRI 1-year PD increased during Q3, from 28.40bps in June to 30.54bps in September. The weaker credit profile of Singapore SMEs is line with the sluggish GDP growth at 0.1% in Q3 2019 based on advance estimates from the Ministry of Trade and Industry (MTI). According to the survey conducted by the Singapore Business Federation and DP Information Group, Singapore SMEs show greater caution amid trade tensions. The manufacturing sector has a more pessimistic outlook compared to the other sectors due to being hit by the declining global demand. Except the construction sector, all sectors are expecting a decrease in growth outlook. To tackle the headwinds, SMEs are urged to adjust their internal strategies to protect themselves against sustained challenges in their business environment. The Singapore government has also reassured the SMEs that they are ready to step in to boost the economy, if needed. Despite the more pessimistic outlook, SMEs in Singapore could take advantage of the downturn to improve their capabilities so they can be ready for the upturn.