WHAT’S NEXT FOR ASIA’S CAPITAL MARKETS?
May 2020
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High market volatility and competition from other asset classes have long dampened the growth of equity fund assets in China. Equity fund and mixed fund assets account for about 22% of China’s total fund assets, which is less than half of the global level, according to the most recent data published by the Asset Management Association of China (Amac) and the International Investment Funds Association.2

However, as the Chinese economy restructures and market conditions shift, the popularity of equity investment is poised to rise, says Shi Bo, deputy general manager and chief equity investment officer of Shenzhen-based Southern Asset Management, one of China’s largest fund companies. By the end of 2019, Southern Asset Management had assets under management of over $150bn, serving more than 100m investors both in China and abroad.

The company is dedicated to providing investors with sustained value. By the end of 2019, both the three year and five year overall rate of returns of the company’s actively managed equity funds ranked among the top quartile of peer funds, according to Haitong Securities’ data.3

“Equity fund assets have great growth potentials because historic figures have shown that the stock market could generate satisfying long-term returns,” Shi says.

**Changing environment**

Shi’s confidence is backed by recent market momentum. According to Amac, equity fund assets logged a robust growth rate of 46% in 2019, and a 5% increase in share of total fund assets compared with 2018. Behind the stellar performance are a 22% rise in the Shanghai Composite Index and a 44% jump in the Shenzhen Component Index last year. But Shi believes that bullish sentiment aside, there are more fundamental reasons supporting the trend.

“The first is that the economic cycle driven largely by property development is near its end, and investors will soon realise that the return on equity of public companies is becoming more attractive than buying and holding real estate,” Shi says, adding that the dividend yield of blue-chip companies is also rising gradually. According to CSI Index Co, even as the Chinese economy continued to slow down, A-share companies paid investors a total of $145.4bn in dividend in 2019, 8% more than in 2018.

The second reason is that investors are more committed to the idea of long-term investment. As investors shift funds away from real estate and money market funds, the average holding period of equity fund shares are increasing, Shi says. Institutional investors, led by China’s social security fund, are also leaning towards longer-term results when evaluating fund managers’ performance, with some even abolishing the assessment of single-year result. In December 2019, 10 fund rating firms, including Morningstar’s...
China branch, announced in a joint open letter that they would stop awarding funds based on their annual performance. Instead, they pledged to help lead investors’ attention to longer-term yield of the funds.

Last but not least, promoting equity investment and the idea of value investing have been prioritised by Chinese policy makers. Last September, the China Securities Regulatory Commission rolled out new rules to simplify the registration process for qualified equity funds in support of their growth. In a meeting this January, the regulator reiterated the importance of increasing the share of equity fund assets and expanding the source of mid-to-long term funds.

“Regulators, investors and fund managers...you can feel that everyone’s mind-set is changing,” Shi says.

Harnessing the power of research
To capture this gigantic opportunity, Southern Asset Management has been bringing out new equity funds focused on sectors such as advanced manufacturing, healthcare and consumption. When China’s Star board kicked off last April, the company was among the first seven managers that received approval to launch Star-related themed funds, successfully fulfilling its quota of $140m. The fund was oversubscribed by more than 23 times. Until mid-January, the fund was leading its peers in investment returns as well.

“We believe funds with a clear sector focus have more potential,” says Shi, who started managing funds in 2004. “Sector funds allow managers to deep dive into certain industries just like many of the primary market investors do. Only when managers study and become real experts of the sector, can they achieve a fine balance between investment returns and fund size.”

Shi adds: “We are also rolling out more funds with lock-up periods from one to three years. These funds will help investors curb their impulsion to speculate, and once they realise that lock-up periods can be beneficial for them, they may voluntarily lengthen their investment perspective.”

At Southern Asset Management, fund managers and researchers are divided into different groups based on investment styles and the sectors they cover, which facilitates communication and synergies within the teams, adds Shi. At the same time, Shi also encourages brainstorming and debate between different groups of managers, which help them give each other new perspectives and ideas.

“As one of the oldest fund companies in China, research is in our DNA,” Shi says. “And we have a great culture of apprenticeship, which ensures that our rich knowledge and experience are passed on to the fresh blood.”

Competition is motivation
Southern Asset Management is not the only fund company trying to take advantage of the momentum.

The Chinese market is known for extremely fierce competition. And after China decided to lift the limits on foreign shareholding of fund companies this year, global fund houses such as BlackRock and Fidelity are also keen to join the action.

Some analysts expect wholly foreign-owned enterprise funds to soon start encroaching on domestic firms’ territory when it comes to investing, fundraising and, perhaps more importantly, talent acquisition.

“My prediction is that in three years, foreign fund companies could generate a profound impact on our industry,” but in a good way, Shi says. He elaborates that globally established fund houses could bring in leading investment philosophies such as ESG investing, which may help make market participants more rational and long-term focused.

Shi believes that the entrance of global challengers will only accelerate the growth of equity fund assets in China.

“Competition is a good thing for us; for what we do, no one but the market can decide who the real leader is. The pressure will help us bring out our ‘A’ game.” Shi says.

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2 Cut-off dates of Amac and IIFA data are end of December 2019 and end of September 2019, respectively.
How Asia’s capital markets have endured

Covid-19 has fundamentally altered the way people work, communicate and live. It has also tested the resilience of Asia’s capital markets, writes Matthew Thomas.

After China revealed the first cases of “pneumonia of an unknown cause” at the end of 2019, the capital markets — and, indeed, leaders of many of the world’s largest countries — reacted with little more than a shrug. Asia’s capital markets started 2020 at a breakneck pace. In January, bankers worked on G3 bonds in Asia ex-Japan worth $51.9bn, around 53% higher than the previous year, according to Dealogic. There were $26.7bn of IPOs, follow-ons and convertibles in the region during the same month, more than double the amount they had managed at the start of 2019. That strong start is just a distant memory.

The coronavirus has now spread around the world, infecting well over three million people and causing 239,227 deaths by May 2. Stock markets have collapsed. Asia ex-Japan G3 bond issuance in March was down more than 70% from the previous year, according to Dealogic. There were $26.7bn of IPOs, follow-ons and convertibles in the region during the same month, more than double the amount they had managed at the start of 2019. That strong start is just a distant memory.

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Banks have reacted in a variety of ways to the spread of the pandemic. Some have split teams between two or more locations, relying on disaster recovery sites that feel ill-designed for a pandemic. Others have told almost all of their staff to work from home. GlobalCapital reporters, for our part, have spent much of the last two months communicating only over video calls.

The coronavirus has raised important questions for senior capital markets bankers in Asia. There are short-term questions about pricing, deal volumes and likely revenues and longer-term questions about working practices, risk management and asset allocation. There are also more optimistic questions, particularly — what can the capital markets do to help?

Not all of these questions have clear answers. But the recent performance of Asia’s capital markets, and the efforts being made to develop Covid-19 response bonds in the region, offer glimmers of hope in a world that has been overcome by doom.

Volumes hit
The impact of the coronavirus on Asia’s bond market has been clear. Asia ex-Japan G3 bond issuance fell to $779bn in March, a more than 70% fall on 2019. It rebounded to $35.9bn in April, but that was still an 11% year-on-year fall.

The high yield market looks even worse. Although there was $16.9bn of G3 high yield bond issuance in Asia ex-Japan in January, by March supply had fallen to $1.09bn, a drop of 82% from the previous year. It got worse. Last April, there was $10.8bn of high yield issuance. This year, April passed without a single high yield deal being sold.

There was at least some good news. Although issuers chose to stay away from the bond market through much of March, they have since pulled off some remarkable successes. Malaysian oil company Petronas raised $6bn in the middle of April, generating a peak order book of $37bn. The Republic of the Philippines sold one of its largest-ever deals, raising $2.35bn from 10 and 25 year bonds. Asia’s equity markets have fewer landmark successes to point to, but they have also suffered less. Between January and March, there was $50.1bn of ECM issuance in Asia ex-Japan, according to Dealogic, a fall of around 6% on 2019. But in April, the market came back with a bang. The $24.5bn of issuance makes it the busiest April in the history of Asia’s capital markets.

“There is an unprecedented rate of company formation in Asia at the moment,” says Jan Metzger, Citi’s head of banking, capital markets and advisory in Asia Pacific. “It’s not like during the dotcom boom when a lot of these companies were not real. Real companies are being created and they need access to the capital markets.”

“Our bankers are busy speaking to these companies, advising them and — believe it or not — baking off for their IPOs. These companies are not hiding down a rabbit hole. They are inviting bankers to pitch. There are some changes in terms of how we go about that, particularly the move to pitching over video calls. But companies are still eager to raise capital.”

How many of these deals will actually hit the market? Bankers are even more reluctant than usual to make long-term predictions — and for good reason. Although it is common to hear comparisons between the current crisis and

Jan Metzger, Citi

“\"When the floodgates open, there is going to be a rush of liquidity but then it’s going to shut again\"”

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the global financial crisis of 2007-2008, there is one clear difference: we’re still in the middle of this one. No-one knows when the coronavirus will start to abate, nor how bad the long-term economic impact will be.

The International Monetary Fund thinks the global economy will contract by 3% this year. But it has also warned about the “extreme uncertainty” of its forecast. What path will the virus take as it spreads? How will governments respond? How will supply chains be interrupted? How will spending behaviour change? How should we account for the impact of extreme commodity price volatility? These are among the many uncertainties the IMF has pinpointed.

This makes it hard for capital markets bankers to talk with any certainty about the future. But most agree that in the short term, at least, their markets will suffer.

“We’re not forecasting any strong recovery in primary volumes in Asia until after the summer,” says Henrik Raber, global head of credit markets at Standard Chartered, in Singapore. “We need better clarity on the economic environment. Debt issuance is not just driven by working capital or capital expenditure, but also M&A and event-driven transactions. Those deals are all on hold at the moment.”

Bankers across the capital markets talk about the surprising resilience of their markets in this crisis. InnoCare Pharma’s HK$2.2bn ($289m) IPO, the first meaningful listing to be done following a virtual roadshow, offered a template for others to follow. The Indonesian sovereign’s $4.3bn triple-tranche deal in April, and Kookmin Bank’s $500m bond soon after — both for Covid-19 response bonds — have opened a new market for Asian issuers (see box). But although the recent deal flow offers some good news, the road ahead is still rocky.

“I was surprised at how fast the market reopened but I predict it will shut again,” says the Hong Kong-based Metzger. “It’s like a dam. When the floodgates open, there is going to be a rush of liquidity but then it’s going to shut again. The supply builds up every time the market shuts.”

This all means bankers and their clients need to be realistic about the short-term impact of the coronavirus on Asia’s capital markets. Deal flow is likely to be sporadic. Pricing expectations will rise. Revenues will fall.

Bankers have dealt with struggling primary issuance markets in the past. But the coronavirus could also have a longer-term impact.

Home comfort and chaos
There are two main ways the coronavirus could alter Asia’s capital markets. First, it could lead to lasting changes to the way people work. InnoCare’s virtually-marketed IPO is now just one of a handful to hit the market. Bankers across Asia now have become used to pitching their clients over video calls, often from the comfort — and occasional chaos — of their own homes.

“Investors would rather have access than not have access and they don’t really want to meet in person,” says Raber. “I was surprised at how fast the market reopened but I predict it will shut again,” says the Hong Kong-based Metzger. “It’s like a dam. When the floodgates open, there is going to be a rush of liquidity but then it’s going to shut again. The supply builds up every time the market shuts.”

Asia embraces Covid response bonds
CAPITAL MARKET innovation may have helped cause the last crisis — but it can soften the blow of this one. Capital markets bankers like nothing more than a new debt instrument. During the financial crisis, their obsession with innovation led to sharp criticism. Subprime mortgage securitisation was partially blamed for starting the global financial crisis. But as the coronavirus spreads around the world, and as the need to find solutions grows, bankers are proving that their innovations can also help the world recover from a crisis.

Chinese issuers took the lead first, selling Rmb332bn ($47bn) of domestic coronavirus-linked bonds in the first quarter. The market has since gone global. The Asian Development Bank, the European Investment Bank and the World Bank are among the supranational issuers to have sold explicit Covid-19 response bonds, which bankers are defining as part of the growing social bond market. There was $25bn of international bond issuance linked to Covid-19 by April 24, according to GlobalCapital data. That includes an Indonesian rupiah deal from the Inter-American Development Bank. In early April, the Republic of Indonesia raised $4.3bn from a dollar bond designed to soften the damage of the pandemic, becoming the first Asian issuer to sell a public dollar bond linked to Covid-19. Later the same month, Kookmin Bank raised $500m from a five year issue that will be used to finance small-and-medium sized enterprises impacted by the coronavirus. Bankers are working on more deals from Asian borrowers, although they warn that the rise in these bonds will not lead to a net increase in volumes. This is evident from the Philippines’ recent sovereign bond. The country’s funding officials had considered billing their deal as a Covid-19 response bond but the need for broader funding — and a welcome loan from the Asian Development Bank — encouraged them to stick to a vanilla deal. Perhaps that is for the best. Covid response bonds will have the most impact when they meet a clear funding need.

One of the complaints that bankers have had about the social bond market in the past is that the definition of ‘social’ varies so widely between countries with differing levels of economic development. Global warming meant green bonds served a common cause in a way that social bonds never did. Who would make that same argument now? The coronavirus has given the social bond market a clear purpose — and given capital market bankers a chance to help.
person either, so they are happy with this arrangement as long as this virus continues,” says Selina Cheung, a managing director on UBS’s ECM team in Hong Kong.

But could the arrangement last even after the virus retreats? There are advantages to virtual roadshows. The reduced carbon footprint is good news at a time when banks are increasingly concerned about environmental impact. The cost saving is likely to be significant. But some senior bankers say video conferencing actually allows them to reach a wider, higher quality audience.

Global fund managers previously expected a face-to-face meeting with the management of any company they were considering investing in. Those face-to-face meetings didn’t just take an hour or two; they also required hours on planes that could otherwise be used talking to other investors. Now bankers have an excuse to maximise the number of meetings their clients can have — without offending investors who would otherwise expect special treatment.

The coronavirus could lead to wider changes for the banking industry. Months of working from home has shown bank bosses and employees what is possible. Will working from home now become more common? Senior bankers told GlobalCapital Asia the most lasting changes would be among back office staff and those in legal or risk functions — essentially anyone who is not expected to continually be in front of clients. But for those in the capital markets, things are likely to go back to normal, or close to it.

“The fact that everyone is working from home means it is much more manageable,” says Standard Chartered’s Raber. “People expect to do video calls now. But it’s not as efficient as working in the office, so we do need to move back to normality. That’s probably going to happen in waves, rather everyone going back in one day.”

Fundamental change
The other way the coronavirus might have a long-term impact on Asia’s capital markets is by fundamentally changing the risk-return picture across the debt and equity markets.

After seven years of near-zero interest rates following the financial crisis, the world had finally returned to the old normal. But after two emergency rate cuts that once again pushed the US Federal funds rate to between 0% and 0.25%, and a swathe of quantitative easing measures announced by global central banks, the cost of money is now back to what it was after the financial crisis.

That looks unlikely to change any time soon. Although the Fed shocked the market with two emergency rate cuts to ease the burden of the crisis, it is unthinkable that it would do the same in the other direction. That makes a strong argument for investors to allocate their money to equities. The stock market has fallen dramatically but a quick recovery is possible. Interest rates — and bond yields — will take time to return to what they were after the crisis.

“The age of fixed income is over,” says a head of private banking in Taipei. “We’re telling our clients to shift aggressively to equity right now. This is a once-in-a-lifetime opportunity.”

This is debatable. Although low rates will make the bond market less attractive to investors, they will make bonds more appealing to issuers. Investors may also take time to get back their optimism, a necessary ingredient for buying shares. A rival private banker, based in Kuala Lumpur, said the market was too unpredictable at the moment to know how investment allocations will change.

But one thing is clear: the huge movements in global markets means investors will be forced to reconsider where they put their money. A combination of steady high yield issuance, low default rates and relatively stable interest rates has been a boon for Asian bond investors. But as rates plunge and defaults rise, investors may have second thoughts.

This may all be moot if the coronavirus gets worse. Those “extreme uncertainties” the IMF warned about should give anyone making predictions pause for thought. But there is reason to be optimistic. The world has shown remarkable resilience during the coronavirus — and that resilience has extended to Asia’s capital markets.

Additional reporting by Jonathan Breen
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India’s capital markets hit pause

India is facing yet another upheaval as the Covid-19 pandemic makes its way through the country. Capital markets activity has all but come to a halt. There are few bright spots, but bankers are focusing on innovation and thinking long term.

By Rashmi Kumar

When the Indian government announced a surprise lockdown of the country on March 24, it got a mixed reaction from its 1.3bn people. Millions of migrant labourers were stranded in cities with no source of income. Companies had to pause manufacturing. In the financial sector, the impact was apparent in different ways for different institutions.

For state-owned banks, most realised they have limited means for remote work, having never truly adopted a strong enough digital platform to support working from home. Privately-owned banks, as well as international banks, which had made efforts to build robust digital networks, were able to keep their businesses running remotely with minimal disruption. Non-banking financial companies (NBFCs) — which unlike banks are not considered essential services — came under pressure.

In that kind of environment, taking stock of business became a priority for corporations.

“There are a lot of unknowns so everybody is scrambling to make sense of the uncertainties,” says Mumbai-based Ashu Khullar, Citi India’s chief executive and regional head for south Asia. “Everyone is focusing on the basics: how do you take care of your liquidity needs given cash is critical?”

This means that Citi is trying to come up with “clever ideas” for companies to diversify away from their traditional reliance on bank loans, for instance.

“We show them options, including going offshore as the markets can be liquid,” he says. “We need some of the strongest corporate and semi-sovereign names to go and open up bond markets for Indian players.”

Risk averse

That kind of action is yet to be seen since the Covid-19 outbreak in India began.

The country’s borrowers had a strong start to the year in the international bond market, bringing 13 public dollar deals in January and February worth about $7.25bn, nearly double what was raised during the same period in 2019, according to Dealogic.

But the flow stopped rapidly. Just one issuer, Lodha Developers International, raised dollars in early March. Since then, no borrower has come to the offshore market, as of early May, shows Dealogic.

In the domestic market, the Reserve Bank of India has taken big steps to shore up confidence, including pumping in liquidity, discouraging banks from parking their funds with the central bank and offering three-month moratoriums on term loan repayments.

While these are helpful, market participants in Mumbai say it has not been enough to propel more lending from banks or lead to an uptick in the credit markets.

Saswata Guha, a Mumbai-based director for financial institutions at Fitch Ratings, tells GlobalCapital Asia that bond yields in India did settle from their previous highs as a result of the RBI’s actions. But he adds that banks are still trying to conserve whatever limited capital they have, given the uncertainty around the virus and the lockdown duration.

“The banks are being risk averse — as one would expect in such a situation — and simply trying to avoid putting more good money behind bad money, because at this stage, it is hard to guess where this whole thing will end,” he says.

It is a similar story in the equity capital markets. ECM volumes stood at about $8bn from 18 trades in the first two months of 2020, followed by volumes of $1.7bn in March through 11 deals, shows Dealogic. However, the March numbers were driven by a chunky $1.4bn IPO from SBI Cards & Payments Services and a $293m block in HDFC Life Insurance Co.

In mid-April, a roughly $100m sell-down in Metropolis Healthcare was priced, but no transactions have hit the market since, shows Dealogic.

There are indications of a revival, however.

Reliance Industries, a conglomerate controlled by billionaire businessman Mukesh Ambani, launched a rights issue of Rs31.2bn ($7bn) at the end of April, a deal set to be the largest rights offering from an Indian company, say bankers.

Privately-owned Kotak Mahindra Bank said in April that it was looking to raise about $1bn-equivalent from a primary capital raise. Yes Bank issued a request for proposals to firms in March for a planned fundraising. RBL Bank and IndusInd Bank are also understood to be planning new transactions, while AU Small Finance Bank got approval on May 2 to raise Rs25bn from a possible qualified institutional placement (QIP).

Citi’s Khullar says Indian banks are looking to raise equity capital to get ahead of the curve.

“It is not only to cushion their balance sheet for potential adverse events in a crisis like this, but also to give themselves the ammunition to be proactive and get on the offensive.”

Guha, however, is a bit more sceptical, especially about state-owned banks that may start to think of tapping the capital markets to shore up their balance sheets.
“Relative valuations have witnessed a sharp fall across banks but in certain cases, the drop has been quite spectacular,” he says. “We believe there is a very limited chance of state banks going out and raising money on their own, which means that they ultimately have to depend on the government, which has a tight fiscal purse.”

**NBFC woes continue**

The shares prices of Indian banks have taken a hammering amid the pandemic. From the beginning of March until the end of April, the Nifty Bank index, for instance, which tracks the 12 most liquid and large capitalised banking stocks in India, fell by about 26%.

An ECM head at a private sector bank in Mumbai says stock price movements show clear distinctions between huge and small banks in the country.

“The large ones, like HDFC Bank, Kotak and ICICI Bank, are not in a precarious condition yet,” he says. “Their stocks have been affected but funding and liquidity are strong.

“With the other smaller banks, like Yes, IndusInd Bank and RBL Bank, it is a perception issue. If they have more slippages, more exposures to medium and small enterprises, or more consumer loans, some of them can turn delinquent. Asset quality and growth are concerns for small banks and NBFCs, but people are looking to buy larger banks at these levels.”

The NBFC sector has already been under pressure, since Infrastructure Leasing & Financial Services, a sprawling infrastructure development and finance company, defaulted in September 2018.

Its downfall brought the financial woes of other NBFCs to light, leading to a liquidity crunch in the sector.

That is now only set to get worse. Kunal Kumar Kundu, India economist at Société Générale, points to the difficulties in credit evaluation as NBFCs lend a lot to micro, small and medium enterprises (MSME), which do not often have sufficient credit information.

“A lot of NBFCs will be in trouble [as a result],” adds Bangalore-based Kundu. “This could impact banks and their loans.”

This means that non-performing loan ratios, which had started to recover among Indian banks in the past year, will be feeling the heat again.

Slippage levels at banks are expected to be high in 2020 and loan recoveries will get delayed, leading to a rise in NPLs again, says Deepali Seth-Chhabria, India bank analyst at S&P Global Ratings.

Since the Covid-19 outbreak in India, S&P revised its outlook on Axis Bank and ICICI Bank to negative from stable in mid-April.

NBFCs such as Shriram Transport Finance and Hero FinCorp have been downgraded, while the outlooks on Bajaj Finance, Manappuram Finance, Muthoot Finance and Power Finance Corp have been revised to negative by S&P.

Moody’s has placed the ratings of Hero FinCorp and India Infoline Finance under review for downgrade, while changing the outlook for Muthoot to negative from stable.

Of these NBFCs, only Hero FinCorp and Bajaj Finance have not sold dollar bonds in the past, shows Dealogic. But Bajaj Finance raised a dual-currency loan of about $571m in January, denominated in dollars and Japanese yen.

**Funding toolkit**

There are still some ways for NBFCs to raise funds, however, in these choppy markets.

Citi’s Khullar says his team is focusing on “non-conventional financing tools” that can give clients long-term money at competitive rates.

“It’s not about going to commercial banks, it’s not only about doing a Eurobond or a domestic bond,” he says. “There is non-traditional capital available for long tenors for good companies, including NBFCs, which otherwise won’t be able to raise long tenor money.

For instance, Cholamandalam Finance Co, part of the Murugappa Group in Chennai, signed a $200m credit facility with Development Finance Corp in the US, a deal arranged and co-lent by Citi last month.

The proceeds will be used for on-lending to small and medium enterprises in low income areas that lack access to financing options, and those impacted by Covid-19.

Similarly, Citi and Japan International Cooperation Agency (Jica) signed a $100m co-financing agreement with PNB Housing Finance in April.

The deal is split between a $75m five year bullet loan from Jica and a $25m-equivalent two year rupee loan from Citi. The Jica portion will go towards on-lending to affordable housing project loans.

“A lot of NBFCs will be in trouble. This could impact banks and their loans”

Kunal Kumar Kundu, Société Générale

These are just a few opportunities issuers can find. On the capital markets front, not many expect public deals to flow imminently. But active conversations are taking place.

“We are doing some pitches on Zoom and holding calls with both issuers and private equity firms,” says the ECM head. “These are more long-term business development focused conversations.”

He adds that when deals materialise, QIPs will come first, followed by IPOs. There may be some opportunities for block trades too, he says.

But the overall situation is bleak, with economists heavily slashing their growth expectations for India because of Covid-19. India is on track for its lowest GDP growth in nearly three decades this financial year.

The government has room for more stimulus measures to boost both the economy and credit growth — which could in turn bring back some life to the country’s capital markets.

This will not be an immediate panacea, however, but can help in the longer run.

“The stimulus will not help prevent a contraction in economic growth,” warns SocGen’s Kundu. “But the stimulus, both fiscal and monetary together, will ensure that when the bottom is reached, and the economy is ready for a turnaround, there’s enough grease in the machine to keep on moving — rather than rust in the machine which you first need to clear before the machine starts working.”

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China has come a long way in opening up its financial markets to international investors over the past couple of years.

From relaxing restrictions on foreign ownership of securities joint ventures, fund managers, futures companies and life insurance firms, to granting more access to its domestic bond and equity markets, the country’s regulators have been removing one roadblock after another.

This loosening up was much needed as China’s government looks to transform the country.

“Most of the opening up measures fell under China’s efforts in replacing an economy which was very much export driven with one that is domestic consumption driven, and attract capital to offset the reductions in trade surplus,” says CG Lai, chief executive at BNP Paribas China in Shanghai.

“It’s important for them to build this market to be sustainable in attracting offshore flows.”

The domestic bond, equity and loan markets will need to be a lot friendlier to cater to the needs of local companies, in particular private companies, along with having a more friendly legal bankruptcy and insolvency framework, Lai adds.

“If the private companies can thrive, it will be more appealing for investors to bring more money in,” he says.

After two decades of insisting on minority foreign ownership in securities joint ventures, fund managers, futures companies and life insurance firms, China broke its tight control in 2018. It decided to allow a 51% controlling stake, while promising to remove all caps completely by 2021, before bringing the deadline forward to 2020.

The phase one trade agreement reached between Washington and Beijing in January, after two years of tariffs and tit-for-tat retaliations, also gave Chinese regulators further impetus to open up.

For example, the foreign ownership cap for fund managers and securities joint ventures was scrapped on April 1, while a similar change for futures companies took effect on January 1.

Not so fast

China is, of course, not as willing to make equally big concessions in other areas of finance.

Lillian Li, senior credit officer, credit strategy and research, at ratings agency Moody’s in Shanghai, says China may not be as open-minded about relaxations in more strategically important sectors, such as banking and distressed asset management.

However, there have been some new developments in those areas too — albeit at a slower pace.

Although foreign banks can set up shop onshore, China has restricted foreign investment in domestic banks for over two decades. But that changed in 2018.

In August that year, the China Banking and Insurance Regulatory Commission scrapped the 20% foreign shareholding limit by individual investors in domestic banks, together with the collective foreign ownership cap of 25%.

This came after the banking industry became a ‘permitted’ category for foreign investment from being a ‘restricted’ group before.

The country also pushed open the distressed bank debt market to US firms as part of the US-China phase one trade deal. Shortly after, Oaktree Capital became the first foreign asset manager to establish a wholly-owned Chinese unit.

Oaktree previously invested in China through a joint venture with China Cinda Asset Management.

In the debt market, there was some good news for foreign banks gunning for a share of China’s Rmb103tr ($14.6tr) bond market.

The National Association of Financial Market Institutional
Investors (Nafmii), the regulator of China’s interbank bond market, decided to accept applications from foreign banks for ‘type A’ underwriting licences last year. This licence allows the banks to act as lead underwriters for all types of deals from non-financial issuers in the interbank market — a role that was previously exclusive to domestic banks.

The first two licences were given to BNP Paribas and Deutsche Bank in September 2019. The other applicants were Citi, HSBC, JP Morgan and Standard Chartered. BNPPP, together with HSBC and StanChart, had until then held the type B licence. This limits banks’ lead underwriting scope to just Panda bonds — or remnibni bonds issued in China by offshore non-financial issuers. Deutsche, Citi and JPM held a more junior licence, called the underwriting licence, which allows them to participate as an underwriter, but not the lead underwriter, on deals in the interbank market.

Not there yet

Having a licence is just the first of many steps that foreign banks have to take to compete for a bigger share of China’s ultra-competitive underwriting market.

“Underwriting licences tend to be given out to only a few players periodically, and it isn’t an easy process to get one,” says Clifford Lee, DBS Bank’s global head of fixed income, in Singapore. “While being able to have a licence is definitely an improvement, we are not there yet in terms of having foreign banks actively engaging local issuers or bringing foreign issuers to the onshore market.”

For example, foreign banks are yet to lead underwrite a domestic deal on a sole basis. Their involvement is mainly on Panda bonds as well as securitization deals, a big chunk of which are for auto loan asset-backed securities from foreign originators.

One big roadblock to a bigger underwriting presence could be the fact that even if foreign banks have one of the top licences, they still need to seek the regulators’ blessing every time they want to bring a deal to the market, says a senior debt banker at a foreign firm.

But BNPP’s Lai says the market access issue is increasingly less of a concern for foreign institutions.

“The challenge for them is not about the licencing, but about how to get their foot on the ground and start making money,” he says. “Even with a licence, there are still many restrictions and complexities on us preventing us from making the businesses profitable.

“Not being able to make money can be more frustrating than not being allowed into the market,” he adds.

The restrictions on foreign institutions have made it difficult for them to compete with the domestic players, says Augusto King, head of capital markets group at MUFG Securities Asia in Hong Kong.

“Chinese regulators don’t need to be too worried, because even if they decide to open the market up further like Japan, Malaysia and Thailand, it will not disrupt the market and disadvantage local banks and securities companies because we simply cannot compete head-on with them,” King says.

He cites the example of MUFG’s home market Japan, which, despite its longer history of opening up, is still dominated by the Japanese banks when it comes to domestic bond underwriting.

“What we could do in the China market is to service our multinational clients that have operations in China, and that’s how we see ourselves competing, even with a licence,” he says.

MUFG, together with Mizuho, was given the underwriting licence in September last year.

For now, issuers are not looking at China’s bond market for funding arbitrage, given restrictions on repatriating the proceeds offshore.

“The attractiveness of the Panda bond market is really having that capability for our international clients to raise medium-term funding for their operations in China and to expand their businesses in China,” King adds.

“And opening up more foreign bank participation means that we can then bring more clients to China, if they know they can secure that long-term funding which the bank market cannot provide them.”

Given the ample liquidity onshore, more local currency funding is expected, says DBS’s Lee.

“When there is liquidity, bringing in more foreign issuers is an imminent possibility with just a change of regulations,” he adds.

“A clearer and broader set of guidelines on the types of foreign issuers allowed onshore and the easing up of regulations in bringing the bond proceeds offshore can help this market grow even faster.”

Onshore bankers tell GlobalCapital that they are, for now, not concerned about the increasing presence of foreign firms. Even with the supportive policies, it would likely take years, if not decades, before international banks can develop their own domestic client base and build a competitive local franchise in a market that has been functioning well without them, they say.

Far from a credit play

Bringing foreign issuers into China is one concern. Another longstanding concern for the country remains how to draw sustainable foreign capital inflows.
 Reform will continue after Covid-19

China’s story remains an attractive one, despite all the challenges facing international banks and investors over access. But the country’s fast pace of reform was dealt a blow this year, when the Covid-19 outbreak hit the country hard.

Declared a pandemic, the coronavirus was first reported in China in December 2019. It rapidly spread through the country early this year, before taking a toll on other Asian countries, and then the rest of the world.

The disease has forced China to refocus on growth protection, with opening up inevitably taking a back seat.

But market participants speaking to GlobalCapital believe the impact from the coronavirus will be short lived. As soon as productivity increases and growth stabilises, Beijing will refocus its efforts on broadening access to its financial markets to those overseas.

“It seems as though the commitment to further opening up the financial markets is still there and there are still very good economic reasons why China would want to do so,” says Michael Taylor, managing director, credit strategy and research, at Moody’s in Singapore. “While there might be bit of a temporary interruption, we expect to see this trend continuing over the longer term.” 

Chris Pigott, head of Hong Kong ETF services at Brown Brothers Harriman, says he expects China to accelerate its opening up agenda, “just like it has done during challenging times in the past”.

“China will look for opportunity to continue to drive forward the regulatory agenda around opening up the capital markets,” he says.

The policymakers also appear to be conveying a similar message.

As the pandemic came more under control in March, various Chinese officials, including premier Li Keqiang, reiterated the government’s intent to further open up despite external and internal challenges.

China is a huge market that will only get bigger. It offers an opportunity that no one can afford to miss, says Clifford Lee. DBS Bank’s global head of fixed income.

“It is after all the opening up of a gargantuan market to where it is most needed — the credit market. “The Bond Connect and the removal of QFII/RQFII quota limits have made it easier for investors to go in and out of the onshore market,” says DBS’s Lee.

“It is a necessary infrastructure improvement and a step in the right direction, but there are a few more steps for us to get through.”

“The larger issue at hand, he adds, is that foreign investors’ involvement in the onshore market is primarily in government bonds, policy bank bonds and some negotiable certificates of deposit (NCDs).

Premier Li Keqiang says China remains committed to opening its capital markets further

Premier Li Keqiang says China remains committed to opening its capital markets further believe there is the political will to get it done — it may just take longer than what the market would like.”

That confidence from foreign firms — that China will carry on with financial market reform — is key.

But while China can open up its financial markets to the world, and the investment scope for international fund managers to include Chinese assets in their portfolios, that doesn’t necessarily mean the money will come in, reckons Chi Lo, a senior economist at BNP Paribas Asset Management.

“It boils down to foreign confidence in China’s growth outlook, which then boils down to their confidence on whether Beijing is steering the policies towards the direction that will lead to sustainable economic environment,” he says.

“Investors who come into China and increase their exposure in China must be looking into an improvement picture. If someone doesn’t have that confidence, then I don’t think the Chinese market is for them.” GC
“It’s still more of a rates play than a credit one, [and] there remain challenges for it to become a credit play,” says Lee.

There are numerous problems. One is a lack of trust in onshore ratings. The other is that the way hedges and swaps can be done onshore remain varied from how they can be done offshore, Lee says. “These parts of the infrastructure will continue to be a work-in-progress,” he adds. “It takes time for investors to go down the credit curve and the market needs more participants to help expedite this, [and] allowing more foreign financial institutions to operate in China can help bring this about sooner.”

Another concern is the type of investors buying Chinese bonds. Institutional investor participation, for one, is still minimal, despite the regulators’ efforts.

Chi Lo, a senior economist at BNP Paribas Asset Management in Hong Kong, says official institutions remain the biggest buyers of onshore bonds held by foreign investors. “Throughout the trade war and the virus outbreak, foreign inflows into the Chinese bond market have not stopped at all. It shows that the world is still buying the Chinese story, despite the negative narratives,” he says.

“It is also because, unlike the equities market, the majority of the capital inflows to Chinese bonds are still coming from central banks and official institutions.”

Chinese bonds offer compelling yields compared to the US and other developed markets, but Lo says Chinese government bonds are still preferred in the short term. “I wouldn’t be looking at credit at this point, because there will be more defaults coming out of this slowing economy, especially with the coronavirus,” he adds.

What’s holding back other international investors from jumping into the mainland’s debt market?

Better discipline
One of the problems for credit investors has been the lack of trust in onshore ratings.

Domestic rating agencies have long been criticised for not providing some much-needed credit differentiation for foreign investors buying onshore debt. Over 70% of the issuers are rated AA, AA+ or AAA onshore.

Some also believe that a crowded domestic ratings market, where eight major agencies are fighting for the same pie, may have led ratings standards to slip.

Credit investors may take comfort from the fact that S&P Global (China) Ratings, wholly-owned by S&P Global Ratings, obtained an onshore licence in early 2019, before rating its first domestic issuer in July.

Applications from Moody’s and Fitch to start rating onshore deals independently could be given the go-ahead in April.

The hope is that these agencies will introduce more discipline in the domestic ratings market and produce high quality research.

This will, in turn, help not only foreign but also local investors navigate the challenging landscape of investing in Chinese bonds.

“Now that foreign institutions are allowed to rate bonds in the interbank market, the level of global consistency they will be providing should give more comfort to foreign investors,” says Chris Pigott, head of Hong Kong ETF services at Brown Brothers Harriman in Hong Kong.

Still restrictive
The unfortunate reality is that, even when including government bonds, foreign participation makes up just a tiny fraction of the onshore bond market — at just over 2% last year.

In comparison, foreign bond holding stood at 12% for Japan, 24% for Malaysia and 39% for Indonesia. MUFG’s King points to accessibility as the primary reason of the low participation, saying that a lot of investors find investing in China rather complicated.

“You have the Bond Connect which has a different system of settlement, and then there is the quota system — there’s just a lot to get their heads around,” he says, adding that there is a lot of explanation that foreign banks need to provide investors. “It is good to have the platforms, but the process is still considered quite complex compared to what investors can do elsewhere.”

BNPP AM’s Lo says that while all the relaxation measures are loosening foreign ownership of Chinese assets and improving liquidity, “ultimately there’s still control”.

“For example, the Stock Connect is a very free trading mechanism for foreign investors to buy Chinese A-shares, but investors can only do that through Hong Kong,” he says. “And that’s just one restriction.”

In addition to the complicated schemes and operational hurdles, the fact that there is not much secondary liquidity in China’s bond market is denting investor appetite. From the issuers’ perspective, it remains difficult to move the proceeds offshore.

“China is trying, but they are trying in the context of still retaining certain level of control, which does make investors hesitate to come in proactively,” MUFG’s King says, adding that it makes sense for the government to simplify inflows and outflows so there will be more liquidity coming into China.

Despite inflow improvements in recent years, many do not see further loosening on outflows happen in the near term.

“China is very cautious about capital outflow, having lost $1tr of foreign reserves within a year back in 2015, and the renminbi is yet to become an international currency,” says a senior banker onshore.

“In the process for the renminbi to become a key international currency, China is still at a stage where it needs to have enough foreign currency to create confidence in its own currency,” he adds. “I don’t see that changing in the next few years.”
Bond bankers adapt to new reality

The Covid-19 pandemic has forced Asia’s debt issuers to confront a fundamental question: how can they raise money in these turbulent times? Bond bankers are scrambling to find the best solutions for their clients as they position themselves for when the market reopens. Morgan Davis reports.

After a blowout start to the year in January, Asia’s bond market has been in a lull since Covid-19 spread rapidly across the region, before hitting Europe, the US and the rest of the world. By mid-April, the virus had infected more than 2m people globally, according to the World Health Organization.

The toll on people, hospitals, governments and corporations has been hard. Equally hard has been the impact of the pandemic on Asia’s debt market.

New deals have only been possible with a decent premium, or by finding anchor investors. High yield credits in particular have suffered, with debt bankers in Asia uncertain that issuers too low down the credit curve will be able to tap the public bond market anytime soon.

“We’re going through an unprecedented time at the moment,” says Jimmy Choi, DCM head, global, and head of capital markets for Asia at ANZ in Hong Kong.

Even for industry veterans such as himself — Choi has been a capital markets banker for about 20 years — there is no playbook.

While bankers and investors can find similarities in other market crashes, most recently being the global financial crisis, they don’t offer nearly enough insight to how the Asian markets can hold up against a fast-spreading pandemic.

For Choi, that means dealing with clients like this was any other market dislocation. DCM bankers across the street are confronting clients’ liquidity needs head on, looking for options to fill the gaps until the bond market reopens if necessary.

For some issuers, that means considering loans and bridging facilities to tide them over. But for most, that means taking a wait and see approach.

“People just don’t know where the bottom is at,” says Choi, speaking to GlobalCapital Asia in late March. Asian issuers still lack the willingness to venture into the primary market and pay the large new issue premiums that their counterparts in the US are paying, he adds.

Slow uptick

A small revival came at the tail end of March, when the bond market reopened with investment grade rated credits naturally leading the way.

On March 31, Hong Kong’s AIA Group, an insurance company rated A2/A/Aa-, sealed a $1bn deal. A day later, Chinese technology firm Baidu, rated A3/—/A, raised the same.

AIA offered about 25bp in new issue premium, while Baidu coughed up about 15bp.

In early April, the Indonesian sovereign tested the waters for a $4.3bn triple-tranche bond to tackle the Covid-19 pandemic, with Malaysian oil and gas company, Petronas, raising a jumbo $6bn in mid-April.

Despite these high profile transactions, deal flow was only trickling into the market by mid-April as markets continued to remain volatile. But the pipeline is nothing but robust.

“If you look at the pattern of every other crisis, if the market closes, the advice usually is to get your documents ready and as soon as there is a window, issuers will jump at that opportunity and take advantage of the liquidity,” says Choi.

But what advice are banks giving to issuers hesitant to take the plunge into the bond market?

Loans have been an obvious choice for many, given its resilient nature amid turbulence and the low margins that borrowers can often get away with.

ANZ is also discussing potential buybacks with companies, says Choi. “That is something that’s liked by investors, because they welcome the liquidity,” says Roch.

This option is, however, not suitable for all companies given how volatile secondary spreads have been.

Some issuers are also keen to explore local currency options. The Chinese renminbi market, for instance, seems relatively open, with domestic investors still willing to buy deals.
The only thing we can do is provide the best advice we can and get them ready for potential open windows in the market,” says Choi.

**Investors respond**

Those windows appeared in late March and early April, when Asia’s debt markets started to turn a corner.

Given that China faced the worst of the Covid-19 outbreak from the end of January, by about the end of March, companies were slowly resuming operations and people were returning to work.

Asia high yield has held up relatively well when compared to the US and Europe, says Sheldon Chan, associate portfolio manager in T Rowe Price’s Asian credit bond strategy team in Hong Kong. “That’s in part a reflection of how the spread of the Covid-19 virus has progressed from China to the rest of the world.”

In March and April, the virus spread rapidly across Europe and the US, forcing countries into lockdowns.

Chan says there are opportunities to buy good paper in Asia, given valuations have fallen so much.

Some BB rated credits fell up to 30 points, numbers that under normal circumstances would be pricing in a default, he says.

Jamie Grant, head of emerging markets and Asia fixed income at First State Investments in Hong Kong, says his team began looking at the supply chain and the impact of the virus in mid-February, given their experience in dealing with the fallout of the 2008 global financial crisis.

While the Chinese economy is much different today than 12 years ago, Grant and his team are still cautious about declines in China.

This meant that in the weeks before China announced its purchasing managers index (PMI) data on February 29, Grant’s team began to derisk their portfolios, without going underweight.

“People invest in fixed income because they need income,” he says. “We felt we were heading into a significant liquidity crunch and if you sell your bonds, there is a risk you can’t buy them back.”

For the time being, Grant is

**DCM bankers tackle working from home**

The Covid-19 pandemic, and the social distancing measures and the lockdowns it has brought, have forced everyone around the world to adapt rapidly. In capital markets, banks, investors and issuers have been dealing with video calls and delayed conversations as they are largely working from home.

Trading has been difficult, admits Sheldon Chan, associate portfolio manager in T Rowe Price’s Asian credit bond strategy team. With many traders stuck at home, conversations about risk are isolated. “That affects how markets are being priced,” says Chan.

At the same time, many in the finance world say that their jobs are shifting to be more digital anyway, with asset managers and bankers in Hong Kong having first-hand experience of being forced to work from home in the second half of 2019, when protests rocked the city.

Chan says that he has found it important to schedule regular discussions with his team, and keeps in touch constantly through technology including internal chat rooms, emails and phone calls.

Many people say the Covid-19 related isolation offered a surprise “test case” for remote work.

“We’ve gone through a mass trial period of how this can be done,” says Jimmy Choi, DCM head, global, and head of capital markets for Asia at ANZ. Hong Kong’s protests provided the “fire drill,” he says.

“We’re well adapted now,” he says, adding that he does not think there has been any problems getting in touch with people as needed.

Avinash Thakur, head of debt origination for Asia Pacific at Barclays, says that roadshows have been conducted in remote ways for some time.

“The industry will move increasingly toward a less travel required roadshow,” he says. This is especially as there are plenty of advantages to using virtual roadshows.

Cutting down on in-person meetings means quicker turnaround to get into the market when a window opens. Nevertheless, the sooner we get back to normal the better, says Chan. Only time will tell what the new normal would be.
positioned in neutral credits.
Valuations are cheap, but in distressed markets, they can get cheaper still.

The effect of the quantitative easing measures may also be felt for years to come.

Grant adds that his team’s decision to cut risk early and position in neutral credits has been “proven correct” already, but the question is “what happens next”.

**Bond volumes**
Given Chinese firms are the biggest bond issuers in Asia, they naturally reopened the offshore debt market. But they were given a helping hand by the country’s central bank and regulators, which have taken numerous measures since the outbreak to shore up the economy, ease costs for borrowers, and keep its domestic capital markets open.

For instance, in February China rolled out Rmb500bn of quota to be used for re-lending and re-discounting for commercial banks to on-lend from the central bank to small businesses.

The government added another Rmb1tr about a month later, alongside a cut to the reserve requirement ratio (RRR) for small lenders to boost liquidity.

Many anticipate more action to come from the Chinese government, given the country’s GDP growth for the first quarter of 2020 contracted for the first time in decades.

“They’ve moved swiftly and they’ve moved broadly,” says First State’s Grant of China’s stimulus actions. But, “It takes time to see a material impact in the economy.”

Outside of China, things look shakier.

There hasn’t been much reliable data regarding Covid-19 in Southeast Asia and South Asia, leaving investors concerned that they don’t have the full picture over how much the countries are struggling and when they will recover.

Additionally, more so than renminbi, Indian rupees and Indonesian rupiah tend to be more sensitive to global and emerging market stress.

This naturally means that year end bond volumes in Asia will fall well short of 2019’s numbers, say bankers. But what is key is to take a long-term view on Asia’s debt market.

“Offshore Chinese investors have been through a couple of these volatility spouts,” says Choi. Chinese investors, who are comfortable with bonds from their home country, continue to give the market some liquidity.

“It’s been resilient so far,” says Choi.

**Default risks**
Fortunately, many Asian issuers took advantage of the strong market in late 2019 and January 2020 to pre-fund their upcoming maturities.

“A lot of the funding requirements that they have now, the majority of them are not urgent,” says Avinash Thakur, head of debt origination for Asia Pacific at Barclays in Hong Kong.

He says that most of the clients he works with will be able to hold off going to capital markets in the near future.

Thakur adds that his clients are not considering other funding routes yet, but that may come later if the primary bond market remains rocky.

In many ways, refinancing pressure is easier to deal with because it is clear to identify. But Thakur says that the dents in the economic market will take some time to appear.

“There’s an element of panic and some of that is driving the market,” he says. “The real impact on the economy? No one is focused on [that] yet.”

As the market weighs the economic impact, and the potential for companies to be devastated financially, conversations about the possibility of defaults have become commonplace.

Chan admits he was fairly sanguine about defaults from the Asia high yield sector before. But now, as the Covid-19 pandemic takes a toll on corporations, the risk is greater, particularly in areas like Indian commodities and Indonesian coal, but less so with Chinese dollar bonds.

“When we see the policy market action in China, there’s been a lot done to make liquidity available,” says Chan. Small and medium sized enterprises, and private sector corporates, have been able to tap the onshore market for the most part.

Chan believes that China has reason to keep sectors like high yield property stable, which will safeguard the market from mass defaults.

But a rise in defaults this year is only inevitable as the Asian market hasn’t had to contend with a downward credit cycle for an extended period, says ANZ’s Choi. Defaults may impact the primary market, but much still depends on how and when recovery takes place.

Grant, from First State, expects a wave of bankruptcies to happen over the coming months. Because of that, he is focusing on fundamentals, not valuations, when investing.

Some of the highest quality paper in the market is trading at distressed prices because the market is not functioning properly, Grant points out. Investors could be scrambling for yield as rates remain suppressed, even if credit spreads are doubled.

“Now isn’t the time necessarily to go all in,” says Grant.
Asia turns to SRI bonds for pandemic help

As Asian countries slowly pick up the pieces from the aftermath of Covid-19, the bond market has emerged as an important source of funding. When the dust settles, its use for more socially responsible investment (SRI) bonds is only set to rise, writes Morgan Davis.

Green, social and sustainable bonds, like the rest of the debt market, have come under pressure due to the Covid-19 pandemic. Investors have turned risk averse, and eager to unwind their bond positions in some cases.

Sean McNelis, global co-head of DCM at HSBC in Hong Kong, says that the global sell-off has been “extreme,” perhaps even more so than in 2008. “It has required issuers and investors to think again about plans for 2020,” he adds.

That has involved looking at new places and styles of funding, such as through local currency markets, private placements or loans.

But as borrowers get creative, the outbreak of Covid-19 has also inspired a new type of social bond that specifically targets relief from the pandemic.

“It’s been exponential,” says Chaoni Huang, head of sustainable bonds for Asia Pacific at HSBC. She adds that capital market participants are in a unique position to put their money to work, by channeling funds to projects that alleviate the negative impact of Covid-19.

The Indonesian sovereign, for one, took $4.3bn from the international bond market in early April. Part of the proceeds will go towards the country’s relief efforts.

Covid-19 related issuance in Asia, outside of onshore China, is still relatively small. But interest for these types of deals is very much there.

McNelis says that HSBC is looking to do similar virus relief trades for other borrowers, including some in China, South Korea, Australia and other parts of Asia.

He says other issuers will want to follow suit, and multilateral institutions may encourage issuance by providing guarantees.

Chaoni Huang, head of sustainable capital markets, global markets, Asia Pacific, at BNP Paribas in Hong Kong, says: “The virus has really exposed some big questions, like are our healthcare systems sufficiently robust. The capital market needs to do more to plug funding gaps across core global services, including healthcare.”

More likely to use a “sustainability” label, which incorporates both green and social use of proceeds.

Of the $274bn of sustainable bonds sold globally last year, only 5% designated their proceeds for social projects, according to Huang.

The BOC deal was the first offshore social bond from China. But other banks, and even some corporate issuers, can follow the BOC template to put their money to work in ways that they previously didn’t consider a “social” effort.

“Covid-19 raised many people’s awareness of social bonds, which is a newer and smaller stream than green bonds,” says McNelis.

It began in China’s domestic bond market in early February, with a mix of policy banks, hospital builders and pharmaceutical companies becoming the first batch of issuers of Covid-19 relief bonds.

In some cases, the deals were tagged as ‘novel coronavirus prevention bonds’; in other cases, issuers simply earmarked a chunk of their bond proceeds to combat the pandemic. The regulator also introduced a faster registration process for virus-related debt issuance.

The offshore market quickly caught up too. At the end of February, Bank of China sold a landmark Hong Kong dollar and Macau pataca denominated social bond. The proceeds were to help small and medium enterprises (SMEs) that are suffering because of the virus.

South Korea’s Shinhan Bank followed suit with a $50m privately placed Covid-19 relief bond that will also be used in part to help SMEs. The remaining money was earmarked for medical related items.

For the trade’s single investor, the bond provided an opportunity to fight the pandemic through the capital markets.

“Investors, like everybody, would like to try their best to support [the relief efforts],” says Luying Gan, head of sustainable bonds at the Indonesian sovereign.

Social uses of proceeds can be easier to identify for banks, because they provide lending support to such a broad range of sectors, she adds.

It is not as straightforward for corporates, however. Before something like the global pandemic happened, it was difficult to identify social projects for companies.
COVID-19 BONDS

One catch is the designated use of proceeds. For issuers using a portion of a bond to finance something socially related, such as aid for SMEs, but another portion for general corporate purposes or working capital, a social bond label is deceiving and will not hold up with international investors.

“It’s only technically a social bond if all of the proceeds are used for [social] purposes,” says McNelis.

While that may challenge some issuers and keep deal sizes relatively small, McNelis says banks could still sell bonds of $500m or more, as so many parts of Asia’s local economies will be damaged by Covid-19.

One industry source says he is sceptical that traditional environmental, social and governance (ESG) investors will be eager to buy Covid-19 related notes.

“There’s still going to be this kind of hesitancy to embrace that, even with the panic,” he says. “There’s legitimately some opportunity here, and anything that can help fund virus prevention is a good thing, but is this going to be a new asset class?”

Additionally, the source is wary about assuming that virus related social bonds will bring more enthusiasm for social bonds generally in the region. He says it is apparent that China is interested in virus bonds, not social bonds, and he does not think this will spur issuance of social bonds with other uses of proceeds.

McNelis believes that a lot of the Covid-19 related bonds will be kept to domestic markets.

“This is such a significant event for global economies and markets that all clients, regardless of sector, are considering their need to raise funding in the next couple of months,” he adds.

Huang says that banks will be the best candidates to issue Covid-19 relief bonds. SMEs will be some of the worst hurt as a result of the pandemic, and they’ll face cash flow problems in the short term. “They definitely need to see support from the banking sector,” she says.

In some ways, the woes from the pandemic reflect a reversal of the financial crisis, when the banks had to be bailed out by the governments, says the industry source.

“There is a sense of: ‘wait a minute, maybe the banks should be helping the government [this time],’” he says. Banks will have to step up to lend to economies that can’t handle the social weight of lost wages and other burdens. “It’s about finding ways in the capital markets to fund industries that need it right now, and fund governments that need it,” adds the source.

For McNelis, the Covid-19 social bonds are an obvious extension to the ESG principles many companies already consider. As governments around the world turn to the private sector to help restore and support local economies, there may be government support for such initiatives by the private sector.

**Planting seeds of green**

This year was expected to be another record setter for green bond issuance. In 2019, nearly $207bn was raised globally, up from the $148bn of green debt sold in 2018, according to Dealogic. In Asia, the number grew to $48bn in 2019 from $44.1bn in 2018.

Through April 1 this year, just $42.6bn of green notes were sold globally, and $4.5bn of that came from Asia ex-Japan. Now it is unclear how much growth there will be.

The appetite for green issuance has not gone away, but it is on the backburner.

“We’re seeing a very different dynamic than the volatility we saw last year with the China-US trade war,” says Huang. “That volatility makes it difficult [to issue green bonds]” Still, Huang says she is speaking with potential issuers on a regular basis about the potential for green bond sales in the future.

Gan says now is the time for issuers to set up their green bond documents and get ready for a window to execute deals. If they do not already have frameworks in place, the quietening of the capital markets can present the perfect time to focus on activities such as this.

The industry source says that green funding could gain attention after the pandemic dissipates, as people realise the effect of human beings on the world.

“Everyone’s kind of thinking it, but everyone’s afraid to say it on the record, including me,” he says.

He points to lower carbon emissions from China during lockdowns, as well as the various stories of cleaner water and animals returning to natural habitats around the world. “If you do the math, how many lives is that saving?” he asks of the reduced emissions.

“People in the industry are thinking these things,” says the source. He sees this as an opportunity to make changes when things go back to normal.

**Investor enthusiasm blooms**

While investors may have few options to buy in the primary market right now, the pandemic may shine a light on the values of ESG for the buy-side as well.

“Increasingly, we see the ESG considerations fit into the bond discussions,” says Gan.

“All clients, regardless of sector, are considering their need to raise funding in the next couple of months”

Sean McNelis, HSBC

In the past, ESG was more of a consideration for equity investors, she adds. As a result of this shift, investors may even look at a conventional bond through an ESG lens. This means that they will examine how the issuer and the use of proceeds rate.

“They don’t only look at them as a credit, they increasingly factor in ESG considerations too,” says Gan, explaining that for investors, this shows future value.

Huang is optimistic about the potential for SRI bonds. Investors have proven supportive, and are now opening up to ideas like “transitions bonds,” which allow companies to use their proceeds to become more environmentally friendly. This is often helpful for industries that are not traditionally green.

“When the market conditions improve, there’s no reason for sustainable bond [issuers] not to come back and take advantage of the market,” says Huang.
Chinese issuers face volatility and less choice

It should come as little surprise that the Covid-19 pandemic has led to a sharp repricing of Chinese bonds in the onshore and offshore markets. What might be a surprise is that the two markets have gone in different directions. Rebecca Feng reports

Chinese issuers are far and away the biggest source of bond supply in Asia. The country’s bond market grew to $12.1tr by the end of 2019, overtaking Japan as the world’s second-biggest bond market after the US. Chinese issuers also dominate Asia’s offshore bond market. Last year, they sold $216.4bn of bonds, representing nearly 64% of overall issuance in the region, according to Dealogic.

The sheer scale of this issuance means the fate of China’s bond markets is of importance to bankers, investors and issuers elsewhere. But the fact that China was the first country to be hit by the coronavirus — and looks likely to be the first to emerge from the crisis — makes it an even more important case study for those elsewhere. How have China’s bond markets endured the chaos unleashed by Covid-19?

The answer is complicated. Chinese corporations are spoiled for choice when it comes to bond issuance. Those looking to raise renminbi can sell interbank bonds or exchange bonds, tapping two domestic markets with different regulators and slightly different investor bases. They can also tap foreign investors with an offshore renminbi bond. Those looking to the dollar markets face a much easier choice, since the vast majority of deals are in Reg-S format. But even there, the investment grade and high yield markets are increasingly diverging in terms of investor appetite and the approach to execution.

On again, off again
The pandemic has led to a dramatic fall in onshore funding costs for investment grade issuers, making the domestic market an obvious choice to them. Indeed, Chinese investment grade issuers have largely returned home this year. In March, triple-A rated issuers sold Rmb2.83tr ($399bn) of bonds in the domestic market, 14.6% more than the same period last year, Wind data shows.

In contrast, the offshore bond market, an important funding source for China’s high yield issuers, has been patchy since the beginning of March, thanks to prolonged pandemic-triggered volatility.

Some investment grade issuers have braved the market — one notable example being Baidu’s $1bn dual-tranche bond at the beginning of April — but high yield issuers have struggled.

China’s real estate developers, who make up the majority of offshore high yield issuers, cannot take advantage of the funding arbitrage between the onshore and offshore markets. The country’s strict capital controls forbid them to move money from China offshore to pay back dollar debts. The pandemic has meant a sharp rise in their offshore funding costs and sadly there is not much they can do about it.

Chen Yi, head of global capital markets at Haitong International Securities in Hong Kong, says that a company rated single-B by global rating agencies would be expected to pay double-digit yields offshore, but could get away with between 8% and 9% in the onshore bond market.

“IT’s another story for investment grade names,” he says. “It’s a lot cheaper for IG issuers to sell bonds offshore than onshore because the onshore yield curve is flat and there is not much of a spread between high-rated and low-rated names.”

That flat yield curve may finally steepen a bit this year thanks to Covid-19, which has spurred a widespread flight to safety among investors, something that is being reflected in China’s domestic market.

The Covid-19 pandemic has driven yields to historic lows for state-owned enterprises and highly-rated privately-owned enterprises. But as investors rushed to these safer credits, the funding cost for lower-rated issuers — meaning anything below double-A in China’s lopsided rating environment — have not declined as much.

The average three year credit bond yield for triple-A issuers had dropped by 76bp to 2.42% on April 21 from 3.18% on February 3, the day Chinese domestic market reopened after the Lunar New Year, China-bond data shows. In comparison, AA-rated issuers, which are considered as high-yield issuers onshore, have seen their three year yields coming down only by only 43bp in the same period.

That divergence is set to deepen, says Ariel Yang, chief executive at CCX Analytics, the investors’ service sector of China Chengxin International Credit Rating. Yang is based equally in Hong Kong and Beijing.

“Investment grade bonds will
be more popular this year and we expect their funding cost to have a more significant decline,” she says. “However, for most HY issuers, investors will demand more risk premium to partially make up for the decline in Treasury yields. We expect HY issuers to see a very limited decline in funding costs.”

An unintended benefit brought by the pandemic is that China’s onshore investors may be forced to draw a more detailed differentiation among credits that are all rated from AA to triple-A.

Onshore rating agencies, who tell GlobalCapital China their work should be judged by their reports more than the specific rating, still tend to give most deals a double- or triple-A rating. International observers have long called for an end to Greater China macro strategy at NDRC to loosen its grip on development. Since last July, Chinese property developers have only been allowed to sell foreign currency bonds to refinance mid to long-term debt that is due within the next 12 months, part of a policy directive issued by the National Development Regulatory Commission, a powerful bond market regulator.

But the Covid-19 induced economic slowdown will likely force China’s top-heavy rating system. The coronavirus could force at least a small step in that direction.

“As the return on IG bonds and Chinese government bonds keeps going down, funds will have to take more on risk to achieve the targeted returns,” Linan Liu, head of Greater China macro strategy at Deutsche Bank in Hong Kong, tells GlobalCapital China. “Issuers rated AA and AA+ [onshore] may gain some traction this year. The polarisation of credits will continue but the breakdown of each class may go through some adjustments.”

Property rights

There are two key sources of Chinese issuance in the offshore corporate bond market: property companies and local government financing vehicles. They are likely to face very different funding needs this year.

The property market is the obvious starting point. Over 78% of high yield dollar bonds sold by Chinese companies in 2019 were from property firms, according to Dealogic.

Many property issuers, often rated AA+ or triple-A onshore but seen as high yield issuers offshore, have been able to sell three year notes onshore between 3% and 6% so far this year. Wind data shows. In the offshore market, however, it is not uncommon for them to pay anywhere between 8% and 12% for similar tenors, according to Dealogic.

Take Evergrande Group as an example. The B1/B+ rated HY developer had to pay 11.5% for a $1bn three year transaction in mid-January. However, in the same month, the same issuer, rated AAA onshore, walked away with a Rmb4.5bn three year transaction paying only 6.98%, Wind data shows.

This makes the onshore market seem an obvious choice over dollar bonds. But the choice is illusory for many real estate issuers. With refinancing pressure increasing in both markets, developers need to tap both. As the pandemic rages on, there is not much they can do but swallow the rising funding cost offshore.

“Many people ask how real estate issuers make the choice between the onshore market and the offshore market,” says Cristiano Cui, managing director of Modern Land in Hong Kong, one of many HY property issuers offshore. “But for many of us, the practical question to ask is which market you can issue bonds in.”

Since last July, Chinese property developers have only been allowed to sell foreign currency bonds to refinance mid to long-term debt that is due within the next 12 months, part of a policy directive issued by the National Development Regulatory Commission, a powerful bond market regulator.

But the Covid-19 induced economic slowdown will likely force NDRC to loosen its grip on developers’ funding channels, bankers tell GlobalCapital China. Foreign investors will need to take some of the funding burden for property companies in the wake of the coronavirus.

The prolonged issuance from the property sector means it is now a much easier sell to international investors. “Investors have so much data across many cycles over the years,” says David Yim, head of DCM of Greater China and North Asia at Standard Chartered in Hong Kong. “The other sectors only have three to five names for investors to compare.”

The other source of Chinese offshore bond issuance is the country’s local government funding vehicles (LGFVs), most of which are rated investment grade. Unlike some real estate companies who have genuine offshore expansion or refinancing needs, many LGFVs have less clear motivation to issue dollar bonds.

Some LGFVs come to the international market simply because they wanted to be the first in their region to go offshore, say bankers. Others hope to get on the radar of foreign investors to help corporations in their respective regions attract foreign investments.

These deals also tend to appeal to a different investor base: less international, more homegrown. LGFVs often rely on the offshore branches of Chinese banks to drive deals, leaving some of their transactions executed more like club loans than public bonds. The risk-return means they are a good fit for relatively conservative city and rural commercial banks, says Terry Gao, head of Asia Pacific international public finance at Fitch in Hong Kong.

But this is one sector that should be able to sit out the volatility unleashed by the coronavirus. Only $12bn of offshore LGFV bonds are maturing this year compared with almost $30bn in 2019. But since LGFVs are only allowed to sell bonds in the offshore market for refinancing existing deals due within one year, the issuance volume this year is likely to experience a significant drop.
IPOs: the future is virtual

The Covid-19 pandemic has changed the way Asia’s equity capital markets operate, with virtual roadshows and deals finding enough success to outlast the coronavirus, writes Jonathan Breen.

For initial public offerings, roadshows are key as investors get face time with the listing company’s management. These typically include a global tour of multiple cities and hundreds of meetings.

But travel bans, quarantines and general fear caused by the pandemic have dealt a serious blow to the usual rounds of face-to-face meetings.

Making the best of the circumstances has been important. Adapting to changing conditions even more so, with virtual roadshows gaining prominence. They are increasingly recognised not just as a way to navigate a crisis but also for the benefits that shifting more of the IPO process online can bring — with less time and money spent travelling a big selling point.

The idea is not entirely new, Digital communication has been increasingly used in IPOs to reach investors far from the world’s financial hubs. But to do the entire deal without a single face-to-face meeting is novel.

InnoCare Pharma’s Hong Kong IPO in March was the litmus test. It passed with flying colours, raising HK$2.2bn ($289m) from a deal mobbed by institutional and retail investors.

While the firm was able to spend months nurturing investor relationships, the last stages of the IPO were done online out of necessity, including the roadshow, as Covid-19 rolled markets. But it shows what can be done with a simple video call.

“There is no reason you can’t do deals digitally; you don’t need to be there in the room,” says Rob Mumford, an investment manager for emerging markets equities at GAM Investments in Hong Kong. “So whether it be IPOs, or result calls or even how we are meeting with analysts now, it is really effective doing it digitally.”

There are different schools of thought on embracing virtual meetings in the equity capital markets in Asia. But even the most hard-core dissenters tell GlobalCapital Asia that there are clear benefits to going digital, not least when facing a crisis as severe as the coronavirus pandemic.

Soon after the lockdown of Wuhan, the central Chinese city seen as the root of the coronavirus, banks emptied across China and most non-essential businesses were closed, as people began working from home around early February.

**Standstill**

Hong Kong’s bankers were hamstrung when travelling to the mainland by compulsory 14-day quarantines on their return. Within weeks, similar travel restrictions came into force around the world. The IPO market came to a standstill.

In Asia Pacific, Hong Kong was the hardest hit.

From the Wuhan lockdown on January 23 until March 23, when this piece was written, there were 15 IPOs on the HKEX. Seven of these raised more than $20m and just two over $100m, according to Dealogic data. During the same period of 2019, 25 companies floated on the bourse — eight for over $100m and five above $200m.

As primary deal flow slowed, bankers had to come up with creative ways to continue doing business. They turned to virtual roadshows as a way of getting deals done.

It is more than just a solution to a temporary problem, however. Instead, this way of executing deals marks a sea change in the region’s equities market.

While digital is unlikely to replace face-to-face communication entirely, it is set to become a lot more prevalent once the Covid-19 situation comes under control.

“This is like a trial to think about what you really need to travel for and what are some of the things you could do via the internet,” says Selina Cheung, a managing director on UBS’s equity capital markets team in Hong Kong.

“I do think that a lot of future executions, after the mandate has been granted, could probably be done in an online format, aside from due diligence trips,” she adds. “I think that would be a good thing for the environment and for the banking industry as a whole to keep costs down.”

A pick-up in the use of digital communication could also potentially shorten marketing periods, says a Hong Kong-based head of ECM.

“We don’t need the management teams to be flying around anymore, which saves a lot of time,” he says. “We can have shorter deal roadshows and be able to do more meetings in a day.”

“There are still going to be people who request to meet in person, but until then I think all of us, and the issuers and investors, are getting used to what could become the new normal,” he says.

Others see similar benefits, but predict investors that are considering parting with large sums of money will want to meet the recipients at least once face-to-face.

Niccolo Manno, head of Asia ECM syndicate at JP Morgan in Hong Kong, says digital communication is effective in the execution and roadshow where you have a defined number of days to market to investors.

“But in the overall process, there will still be a need for major investors to meet a company’s management in person,” he adds.

Cheung says there is merit to having face-to-face interactions when it comes to pitching clients for mandates, as a way to “build trust”.

A traditional IPO roadshow usu-
ally involves a team primarily made up of the company management and bankers, varying with the size of the deal and type of company.

The usual pit stops include Hong Kong, London, New York, Boston and San Francisco, but video conferences and conference calls are used to contact investors at harder to reach locations, such as the Midwest region of the US.

But the increased need for video conferences and other digital communication could encourage its use beyond just the fringes of the roadshow, says Ringo Choi, Asia Pacific IPO leader at EY in Hong Kong.

“The beauty of video conferencing is it saves time spent traveling,” he says. “If you have a meeting for three hours, sometimes you need to spend double or triple that time to get there or you need to stay overnight so that you can attend the meeting if it is in the morning.”

Choi adds: “No one has a crystal ball, but my personal view is that the virus will change the eco-system and behaviour. [Video conferencing] saves travel time, reduces the cost of booking a venue and it means you don’t need a private jet, which you might use for a roadshow.”

Bankers use a number of online apps to conduct video calls and conferences. US-based Zoom Video Communications is a particular favourite. Chinese internet company Tencent Holdings saw the warning signs early, rolling out an international version of its own conferencing platform, Tencent Meeting, on March 21. This was a week after a ramp up of travel bans, quarantines and tumult in global markets.

Using any of the modern platforms typically means connecting through a laptop, tablet or TV, with the face of the speakers on the screen.

“For the time being, we are seeing a lot of this going on, including online conferences being done by our competitors and a lot of our investor education non-deal roadshows,” says UBS’s Cheung.

JP Morgan is among the banks to have held virtual conferences in the region this year, with one in Shenzhen, where over 200 institutional and corporate clients attended.

“We adapted a conference to go online and it was well attended,” says Manno at JP Morgan. “It was quite interesting to see both corporates and investors sitting in their living rooms and talking to each other.”

However, there are uncertainties about the use of digital communication and teething problems with the various methods being deployed.

EY’s Choi is even looking into potential legal issues.

“Some sensitive information, such as the working paper for an IPO, cannot be taken outside of China,” he says. “There is a law against it. But the China team might show a page from the working paper to the Hong Kong team or to bankers for analysis or data. So is that a violation of the law?”

Choi’s legal team also flag potential issues with ownership of the video or conference information from a video call. The platform used for the conference call could be in a position to use the information. But the issue is still new and being explored.

Not for all
Not every issuer can enjoy the benefits of using digital techniques equally just yet.

For example, e-commerce firm Alibaba Group Holding switched many of its planned face-to-face meetings into phone calls for its HK$101.2bn secondary offering in Hong Kong in November 2019 after protests gridlocked the central business district.

But it was able to pull that off because of its ubiquitous name. “It is an existing stock, people know it and they know how it trades,” says a senior equity syndicate banker who worked on the transaction.

Being a simple product also helps. For United Hampshire US Real Estate Investment Trust’s (Reit) $324m Singapore listing in March, bankers were able to put video and regular conference calls to use because Reit investment is easy to understand.

But a more complex proposition, say from a Chinese technology company, may be a harder sell.

“If a founder or CEO needs to explain why his company is a great candidate, he’ll want personal exposure,” says Brock Silvers, a veteran China investor and a managing director at Adamas Asset Management in Hong Kong. “If less explanation is required, it may only need FaceTime instead of face time,” he adds, referring to Apple iPhone’s video call function.

But just because a company might need some extra explaining does not mean it can’t also use digital communication to do so, even if it is loss-making like InnoCare Pharma, says Silvers.

“In today’s environment, profit-ability may become even scarcer,” he says. “For those without it, video conferences may be a stumbling block. For those with sufficient track records or promise [like InnoCare Pharma], the lack of face-to-face meetings will not be prohibitive.”

Going a step further than that, Mumford at GAM Investments sees an actual meeting with company management as secondary when considering investing.

“Not meeting face-to-face, pressing palms, is not the major issue,” says Mumford. “When we go into an investment situation, we have a framework through which we look at a company. That is the traditional private equity approach to analysis, which includes looking at the top down picture, company positioning, valuation, management — increasingly in the context of broader [environmental, social and corporate governance] — and key milestones.

“In any [face-to-face] interaction you are fleshing out those points to understand them a little better and get an additional sense of each key factor,” he adds.

How virtual roadshows in IPOs evolve will depend on the duration of the Covid-19 pandemic and its after-shock. But the question is no longer whether digital communication will play a larger role in Asian IPOs — it is how big a role it will play. “There is no reason you can’t do deals digitally, you don’t need to be there in the room”

Rob Mumford, GAM Investments

Rob Mumford, GAM Investments
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Home is where the IPOs are

The Hong Kong IPO market has seen a big shift as Chinese technology companies that once shunned the bourse return for secondary listings. There is plenty working in the exchange’s favour, despite competition. Jonathan Breen reports.

The US stock exchanges of New York and the Nasdaq have long competed with bourses in Hong Kong and China. One of the biggest battles has been in wooing companies operating in the new economy sector, which includes high-growth industries focused on developing cutting-edge technology.

In this battle, the US has traditionally been the winner. Technology companies tend to flock to the US, listing mainly on the Nasdaq through IPOs of American Depository Shares (ADS). But 2020 is set to be a turning point for Hong Kong.

“We will see more companies coming back from the US for dual listings,” says Nicoolo Manno, head of Asia ECM syndicate at JP Morgan. “Larger companies will find it easier. With a more established investment community now in this region and the HKEX’s efforts to improve the listing process for those companies, you will see more companies looking to list here than previously.”

The first US-Hong Kong dual listing came from technology company Alibaba Group Holding in November 2019. It raised HK$101.2bn ($13.1bn) from a secondary offering on the HKEX.

A capital markets lawyer with an international firm in Hong Kong says that there were a lot of discussions over whether a second listing by Alibaba in Hong Kong was a good or bad idea.

“There are certain types of investors that would prefer to invest on the US exchanges and others that would prefer to invest in Hong Kong, and for companies that are substantial, like Alibaba and JD.com, both are,” reckons the lawyer.

Alibaba’s success is paving the way for others to follow suit. E-commerce peer JD.com mandated banks in March for its Hong Kong secondary offering, expected this year.

Chinese travel service provider Trip.com, online gaming company NetEase and search engine Baidu are also said to be in talks with banks for dual-listings in Hong Kong.

“Chinese tech companies, in the past, were able to sell US investors a good story and then they managed to do very good IPOs,” says a Hong Kong-based IPO consultant. “The US is one of the places where you can get a high valuation without a positive cash flow.

“Chinese companies think the US is a good place to go because investors there recognise a company’s future value,” he adds. But that is no longer the case. After a big spike in US IPOs of Chinese companies from 2018, their popularity has gone down after consistently poor aftermarket performance.

The result? IPOs are raising considerably less than their placeholder size — set when listing documents are filed with the US regulator. They are also more ‘friends and family’ deals, where either a large part of the stock was bought by investors close to the issuer or these investors boosted the orderbook sizes with oversized bids.

US out, Hong Kong in

The China-US trade war also inadvertently forced Chinese companies to change tack.

The conflict between the two countries made the prospect of floating in the US harder for mainland-based issuers. The appeal of a listing in Shanghai’s tech-focused Star Market, or the Hong Kong exchange, increased.

“The relationship between the US and China and the impression of Chinese companies will affect their valuation and performance,” says Ringo Choi, Asia Pacific IPO leader at EY. “With the trade argument

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between the US and China and the talk of poor governance of mainland companies, you can easily imagine how difficult it will be for them to go public or convince investors that they are a good investment.”

The Hong Kong-based capital markets lawyer adds that the appetite of Chinese companies to float in the US, and the interest from US investors in Chinese opportunities have gone down directly because of tensions between the two countries.

“This means that only the “most committed companies” from the mainland opt for a US listing now, adds the lawyer. If they are on the fence or uncertain about the right listing venue or market, they end up ditching the US.

What had been one of the US stock markets’ primary attractions, freer regulation, has also increasingly become less important.

This is mainly because the HKEX has taken big steps to become more like a US stock exchange. In 2018, the HKEX introduced a new chapter to its rules that allows dual-class share IPOs and listings by some pre-revenue firms.

Shanghai’s Star Market is also offering issuers increasing flexibility, introducing a registration-based IPO process for companies — a first in China.

“There is less of an incentive now to go to the US,” says a senior equity syndicate banker in Hong Kong.

“There were reasons in the past why people went to the US. Some of them still exist, but the majority of the market is ready in Hong Kong.”

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GlobalCapital | May 2020 | What’s Next For Asia’s Capital Markets?
China’s tech board is a Star attraction

China’s ambitious technology board boasts friendly regulations and a horde of eager investors. But it is still a work in progress. By Rebecca Feng

China’s domestic capital markets are huge, important and increasingly open to foreign investors. But for many years, one thing was lacking: IPOs from China’s most famous technology companies.

When Alibaba Group turned to the US for its $21.8bn listing in 2014, it started a trend that other technology companies followed. By 2018, bankers were questioning whether the onshore market was finally becoming more attractive to Chinese tech companies. Xiaomi Corp’s decision to sell a $6.1bn IPO in Hong Kong answered that question in the negative.

At the time, it was hard to blame them. China’s traditional A-share market is not designed for growth companies. IPO candidates need to tick a number of boxes before being able to go public. The listing requirements, ranging from three consecutive years of profitability to three consecutive years of zero change in substantial shareholders, are fine for companies with long operating histories and relatively stable growth. But how many technology start-ups fit that description?

“Many of China’s outstanding internet companies went to list overseas because they had not been profitable by the time they wanted to go public,” says Wang Xinchen, a fund manager at Harvest Fund Management in Beijing.

There were other problems besides the listing requirements. Even those technology companies that could satisfy the regulators still had no guarantee they would be able to list quickly.

Bankers say the long wait from the China Securities Regulatory Commission (CSRC) is a big problem when pitching onshore listings.

When a company finally manages to overcome all these hurdles, it will face the final obstacle — a price cap.

Chinese regulations mean that listings on the country’s main boards cannot be priced at more than 23 times of earnings, another big problem for companies concentrating more on growth than profitability.

That has been good news for Hong Kong. The bourse got Alibaba’s second listing, technology unicorn Meituan Dianping and even one of mainland’s most famous restaurant chains Haidilao Hotpot, as well as the recent jumbo listing from Xiaomi.

“Because of policies such as the longer approval time and the 23 times earnings cap, the main boards in China may not always be discussed on equal ground with the Hong Kong Stock Exchange,” says Sun Lijun, co-head and a managing director of UBS Securities Global Banking, in Beijing.

Chinese regulators have often fought back. Their previous attempts, such as establishing the National Equities Exchange and Quotations OTC market and the Shenzhen Stock Exchange’s ChiNext in 2006 and 2009, did not have much impact. But in 2018, they went one step further, launching the Star market.

That has been a much bigger success. By April 29, a total of 100 companies had listed on the board and 260 companies had applied to list, according to the Shanghai bourse.

The market has also seen the first red-chip company — that is Chinese companies incorporated outside of the People’s Republic of China; its first pre-profit company; and its first dual-class share structure company.

Chinese characteristics

The board offers clear advantages to technology companies. The first batch of 25 companies to list on the Star board priced at an average price-to-earnings ratio of 49.2 times. Perhaps just as important: their share prices rose to an average of 140% of their IPO prices on the first day of trading.

“China’s stock market is famous for high valuations,” says Louis Lau, a partner of the capital markets advisory Group at KPMG China in Hong Kong. “If you compare the Hong Kong market and the traditional A-share market, there is a persistent valuation gap. For companies listed on the Star market, especially in the initial first two months, the PE ratio could be as high as 100 times.”

Take Haohai Biological Technology as an example. The company has been trading between HK$27 to HK$50 for the past six months in Hong Kong. But its Star IPO was set at Rmb89 ($12.6), roughly HK$97, a share. The company was trading at Rmb77.5 when the market closed on April 14.

“A reason for this difference is that the mainland and Hong Kong capital markets are not yet completely accessible to each other,” says Sun from UBS Securities, the sponsor of Haohai’s Star debut. “If they are, then the price difference will be narrowed. As for why the Star market has higher valuations than the A-share onshore, that’s mainly because of the unique background of the Star market. Chinese investors like new things such as the Star board.”

They have continued to like the market even as prices have surged. It is still common for a Star IPO to be more than 1,000 times sub-
data shows. That has led to a different problem for regulators — having previously worried there was not enough supply of tech IPOs, should they now be concerned about too much demand?

Regulators have tried to tweak the rules to protect retail investors. Only those with more than Rmb500,000 in their trading accounts and at least two years of securities trading experience can directly invest in the Star market. But that threshold is probably not high enough. A source at the CSRC admits that the regulator somewhat underestimated the amount of wealth of Chinese retail investors.

Nor is it just China’s hungry retail investor base driving the rise in prices. China’s institutional investors may also have a “domestic bias”, says Harvest Fund’s Wang.

But a mix of the government’s regulatory changes, exhaustion from the strong start to the market and fears about the Covid-19 coronavirus have stemmed the optimism of the market slightly — albeit only slightly.

Star board IPOs have recently been priced at PE ratios of between 40 and 60 times, still a big boost from the 20-30 PE valuations they would get in Hong Kong, says KPMG’s Lau. For now, that pricing gap looks likely to remain.

“If the companies listed on the Star market are actually high-growth companies [as they should be], then their price-earnings ratio will automatically decline as they become stable-growth companies in the future,” says UBS Securities’ Sun. “However, I don’t think the valuation premium from the offshore market will be eliminated in the short-term.”

Heavy disclosure burden
There have been some teething problems, particularly the shift from an approval-based IPO system to a fully “registration-based” system.

The time required for a company to obtain approval from the CSRC to list on the Star market — usually a few months — is already dramatically shorter than the time needed to list on the main board. But there is still room for improvement.

Under Star market regulations, companies file their applications with the Shanghai Stock Exchange (SSE) and have to answer questions from the listing committee. Their applications are then turned over to the CSRC, which will give the final verdict. An onshore fund manager says that companies often face three rounds of enquiries form the regulator, accumulating as much as 900 pages of documents — a page count that does not include IPO prospectuses.

“This is done with good intentions since the regulators want to protect investors,” says the fund manager. “However, in the long-term, regulators will not have the ability or the capacity to keep this up. Perhaps the regulators can instead roll out harsher punishments for insufficient or untruthful disclosures and improve the exit mechanisms.”

There are other areas of potential improvement, say market participants. A senior manager at a large fund tells GlobalCapital China that the current timeline for price discovery gives investors very little time to do careful research on companies before having to arrive at a valuation.

There are also questions for the securities house joint ventures of foreign banks, who appear to be getting little benefit from the rapid growth of the market. So far, only UBS Securities has sponsored a Star market IPO.

The heart of their woes is a quirky co-invest requirement. Sponsors are required to buy in 2%-5% of total shares depending on the IPO size. Their holdings will also face a two-year lock-up period, the longest among all shareholders except for the company’s owners.

Hong Kong adjusts
The growth of the Star board is not just of interest to investors and issuers. Foreign exchanges are also taking notice, particularly Hong Kong. But executives at the Hong Kong stock exchange should not panic just yet. Although the Star board may have some impact on future supply, Hong Kong’s deep pool of liquidity and strong legal framework means it is unlikely to be replaced any time soon.

The HKEX has also been shifting its focus from mainland companies to international ones, says KPMG China’s Lau. The exchange announced a three year strategic plan in February 2019, revealing its intention to expand beyond a once-reliable supply of Chinese IPOs to a broader universe of potential companies. That has already paid dividends: the exchange’s biggest listing last year was the HK$39.2bn ($5bn) IPO of Budweiser’s Asian business.

Of course, the Star board and the Hong Kong stock exchange both face the same big source of instability: the Covid-19 pandemic and the uncertain outlook for the global economy, financial markets and stock prices. The near-term damage on companies’ revenues is likely to be significant. But Sun thinks that, although timelines might be delayed, the desire to list will only be stronger than ever.

After all, companies still need financing — and Star board investors still appear hungry to provide it.
Slow but steady loan market faces up to Covid hurdles

The relatively slow pace of the loan market means it has an ability to endure temporary moments of bad news without too much impact. The coronavirus brings a whole new set of challenges, writes Pan Yue.

It has been impossible to turn on the news over the last few months without hearing of more travel restrictions being imposed as the coronavirus spreads around the world. In China, those restrictions have been applied internally, limiting the ability of citizens to go from one province to another. There are alarming consequences for the global economy, but the impact at a more local level should not be overlooked — roadshows and site visits for syndicated loans have been cancelled, forcing many deals to be delayed.

By May 4, some 92 loans in Asia ex-Japan worth $60bn had been launched or closed in US dollars, Hong Kong dollars or euros, the three main currencies of Asia’s offshore loan market. That represents a big drop from 182 deals worth $86bn during the same period last year, according to Dealogic.

Bankers are divided over how quickly the market will recover. Some believe that a rapid rebound can be expected one or two months after the virus is brought under some control, as companies that have outstanding debt maturing soon will need to return to the market for refinancing. But others think difficulties around originating and developing new clients because of travel bans will result in a continued slowdown of activity in the second half of the year.

“Our main clients are Chinese companies, but we can’t meet those who are based in mainland China, so we are focusing on Hong Kong clients at the moment,” says a senior banker from a big Chinese lender. “Origination has been slowing down, and the progress of discussion with clients is also quite slow.”

Bankers are adapting quickly to meet their budgets for the year. For example, Chinese banks, which tend to focus almost entirely on their domestic clients, are trying to find business from bilateral and club deals. Some are making up for the reduced deal flow by committing more to the loans they are comfortable with.

“We don’t have much in the pipeline to launch into syndication soon, but we are working on a few club deals,” says a Hong Kong-based banker from another big Chinese lender.

Taiwanese banks are proving cautious about the impact of the coronavirus on Chinese companies’ financials. They are further shifting their focus to southeast Asian countries, continuing a trend that started before the coronavirus. Many Hong Kong-based Taiwanese bankers say they are unlikely to get any internal approvals for deals that are not from their existing clients. As a result, they are now buying southeast Asian state-owned companies’ deals from the secondary market.

Some Asian bankers are trying to rely on chunky refinancing deals from large corporates, which are likely to make their regular returns to the loan market. Unlike the bond market, which faces many uncertainties, the loan market is comparatively stable. With strong bank liquidity, bankers expect some companies to tap the loan market for bond refinancing.

ESG boost

Other bankers are hoping to see a boost for deals that fit the environmental, social and governance (ESG) category.

Deal volume of green and sustainability-linked loans in Asia ex-Japan hit $14bn last year compared to $9bn the year before, although the deal count dropped slightly from 27 to 23, according to Dealogic.

Chinese, Hong Kong and Singaporean companies have been more active than others in the sector, partly because of encouragement from their governments. For example, Singapore has set up a $2bn investment programme to support green finance and help achieve its goal of becoming a global sustainable finance hub. Stock exchanges in Hong Kong, Singapore and China now require companies to include ESG reporting.

Southeast Asian borrowers will increasingly get in on the act. Otoritas Jasa Keuangan, Indonesia’s financial services authority, launched a sustainable finance roadmap in 2014 but deal flow has only started to take off in the last few years. Last July, DBS provided an export financing sustainability-linked loan to Sumatera Timber-Indo Industry, a premium wooden door manufacturer.

“For Vietnam and Indonesia, there are a lot of proactive discussions around green financing.”

Chris Bishop, Allen & Overy
The upside to lower prices

Few bankers, if any, will emerge from the coronavirus unaffected. But leveraged finance bankers have reason to believe they will be able to generate new deals from the chaos—even if they lose a few old ones along the way. Pan Yue reports.

The impact of the coronavirus has been undeniable on Asia’s debt markets. G3 bond issuance in Asia ex-Japan was $43.8bn in March and April, down more than 35% year-on-year, according to Dealogic. Loans volumes, despite usually being slow to react to bad news, have also fallen, hitting $41.7bn in March and April compared to $46bn during the same period last year. The number of deals fell dramatically, from 105 to 54.

Most loans bankers have little reason for cheer at this point. Their clients rely on a customer base that has spent much of the last two months locked up at home.

The Asian Development Bank predicts the region’s developing economies will grow by just 2.2% this year, down from an earlier prediction of 5.5%. Although loan refinancings will still get done, new deals are likely to suffer.

The one exception to this is leveraged and acquisition finance. It might seem surprising to hear any optimism from leveraged finance bankers right now. After all, companies are likely to want to hoard cash at the moment, not spend it on expensive acquisitions. But there are a few reasons for the positivity.

First, there is already a decent pipeline of deals. Blackstone is in talks with Soho China to take the Hong Kong-listed Chinese property developer private. Singapore-based Canadian International School, which is owned by Southern Capital Group, is also up for sale.

China’s video game developer Leyou Technologies Holdings is in talks with potential buyers, including CVC Capital Partners. The crisis means that new acquisitions might fall through, but bankers at least have existing deals to keep them busy.

“We have a strong M&A financing pipeline but there’s increased caution from both sponsors and lenders,” says Andrew Ashman, head of loan syndicate, Asia Pacific, at Barclays in Singapore. “Investors are focusing on resilient sectors given the current situation — industries with exposure to travel or credits with complex global supply chains are particularly sensitive.”

Adnan Meraj, co-head Asia Pacific syndicated and leveraged finance at Bank of America in Hong Kong, says: “I am of the view the market should end up with higher volume at year end…there are various ongoing sell-side situations, which is encouraging, and bank lenders are not pulling back on the back of strong liquidity.”

Dry powder support

The new deals that do come are likely to get a boost from the rise of Asian private equity funds, who can help soften the blow of a global market fall.

“The local sponsors and Asian sponsors [have started] to bid for Asian assets, and we’ll definitely see that trend continue in Australia and southeast Asia,” says Siddhartha Hari, head of loans and structured credit, North Asia, at Deutsche Bank in Hong Kong. “We haven’t seen that many in China but will start to see more in the next six to nine months.”

The second factor: depressed equity prices will make some deals more attractive.

This is most obvious for take-privates. For example, Nasdaq-listed China Biologic Products Holdings is in talks with banks for a loan of over $1bn to finance its take-private. In February, Hong Kong-listed Wheelock and Co announced its HK$48bn ($6bn) privatisation plan led by its founder Douglas Woo. These deals should, at the very least, offer bankers some respite.

“Many PE funds have a big pipeline of deals which will be impacted,” says James Horsburgh, head of leveraged and acquisition finance, Asia Pacific, at HSBC in Hong Kong. “Deal volumes this year are likely to be driven by sector consolidation, or ownership structure and management succession, or companies which are listed but trading below the book value of assets or at a low multiple.”

However, bankers are divided on whether there will be a meaningful increase in take-private deals. Although lower equity prices mean privatisation should look more attractive to management, these deals also tend to be slow to put together. That exposes them more to market risk, says Ashman.

“One further bit of good news for leveraged finance bankers in Asia: funds in the region have much more money to put to work this year. The amount of ‘dry powder’ — uninvested funds — at Asia-focused private equity funds hit $376bn by the end of last year, according to Preqin.

“Part of the reason for a lack of large sponsor driven deals is due to the competition from strategic buyers,” says Siong Ooi, co-head of debt capital markets, loans and bonds, at MUFG Bank in Singapore. “Strategic buyers are able to integrate acquisitions into the existing business and potentially generate more synergies, meaning that corporates can be more attractive to a competitive place for certain types of assets.

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“Part of the reason for the sector is all relative, of course. Leveraged finance bankers in Asia could not be mistaken for bulls. But in a wider market landscape that sees only bad news, leveraged loans bankers can at least point to a few reasons for optimism. (“Given the amount of dry powder, private equity funds will be more active for sure” — Siong Ooi, MUFG)
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