

## CCXI & CCXAP – Research & Commentary

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### **Default Rate of the Public Offering Market Is Expected to Rise to 0.7-0.8% in 2021, and Investors Should Pay Attention to Three Credit Risk Types**

Hong Kong, 19 January 2021 -- The Research Institute of China Chengxin International Credit Rating Co., Ltd. ("CCXI") released a report titled "Default Rate of the Public Offering Market Is Expected to Rise to 0.70-0.80% in 2021, and Investors Should Pay Attention to Three Credit Risk Types : Overview of the Credit Risk in the Bond Market in 2020 and Outlook for 2021", which has reviewed the credit risk performance in the bond market in 2020 and forecast the credit risk trends in 2021 under credit differentiation pressure.

According to the report, **given the uncertainty about issuers' subsequent profitability recovery, when the external financing environment is marginally tightened, the pressure of making payment for bonds mature within the year will remain high, so credit risk is likely to increase marginally in 2021 from 2020. The default rate of the public offering market of the year will probably rise to 0.70%-0.80%, up 0.04-0.14 percentage point from last year. In the meantime, tail issuers with low qualification will be still faced with clearing pressure. Therefore, investors should pay attention to the credit risk of state-owned enterprise (SOE) issuers in "weak regions", tail issuers with low qualification in industrial sectors and issuers who renew bonds or choose not to redeem perpetual bonds.**

**Looking back on the credit risk performance in 2020, default risk, which first fell and then rose, decreased from 2019 on the whole.** According to CCXI's statistics, in 2020, a total of 150 bonds defaulted, with a total amount of RMB124.558 billion, down 11% year on year; 49 defaulting issuers were involved, including 32 new ones, down 25% from the same period last year. One of the defaulting issuers was only a subject of default and its amount due was paid by its guarantor. By quarter, in the first and second quarter, as the effect of the easing credit policy was gradually shown, the release of default risk slowed down. However, in the third and fourth quarter, credit risk increased, as the financing environment was gradually tightened and a cluster of defaults by state-owned enterprises happened. The monthly rolling default rate of the public offering market fluctuated downward throughout the year and fell to 0.66% at the end of the year. In terms of the characteristics of subjects of default, most of the new defaulting issuers were private enterprises, but the number of defaulting SOEs achieved a new high, which caused certain impact on the market. The defaulting issuers were still distributed in various industries. Proportions of defaulting issuers in the real estate industry and the auto industry increased. The reasons for default included the impact of the COVID-19 pandemic that started in 2020, the increasing downward pressure on the macro economy, dwindling profitability that was seen in some issuers, limited sources of internal funds, and a marginally tightened external financing environment. Against such backdrop, the default risk of issuers who had poor business performance, were aggressive in business expansion and had governance and management problems was quickly exposed. In the meantime, impacted by the external environment, some SOEs who adopted a heavy-debt business model or had weak profitability faced liquidity risk.

**In terms of credit risk mitigation measures, in 2020, some issuers mitigated default risk through renewal, over-the-counter redemption, issuance of replacement bonds, etc. In particular, deals between issuers and bond holders to renew bonds increased significantly compared to those in 2019.** According to CCXI's statistics, in 2020, a total of 28 issuers renewed 36 bonds, nearly double that in 2019, and the volume was over RMB23 billion. Actually, among the renewed bonds, some bonds had already been renewed several times or had a material default. **Moreover, the phenomena that issuers chose not to exercise their rights of redemption of perpetual bonds also increased in 2020.** During the year, a total of 11 perpetual bonds were not redeemed, which increased year on year, and eight saw their interest rates jump by 100bps to 316bps after their redemption dates.

**In terms of subsequent resolutions of default, there are sixteen defaulting issuers on the public offering market have made substantial progress in resolutions since 2020.** The handling methods include judicial channel, debt restructuring, and repayment by issuers. It is noteworthy that Xiwang Group and its holders reached an agreement on debt settlement in 2020, becoming the first case in China to handle a bond default through judicial settlement procedures and also the debt restructuring program involving the largest volume of defaulting bonds in the Chinese bond market, having great enlightening and referential significance to enriching the mechanism for handling domestic bond defaults and building a high-yield bond market. As at the end of 2020, a total volume of RMB437.752 billion on the bond market defaulted, involving 188 issuers, and only 11% or 46.15 billion default had been repaid. Judging from the payment of public offering default bonds, of 330 public offering default bonds, only 94 bonds were disposed after default, accounting for about 28 percent. The average recovery rate of the principal of the publicly offered defaulting bonds that were handled was 89%. **Overall, the handling methods of bond defaults have become more diversified, but the subsequent handling progress is still slow.**

**Looking into 2021, after taking into full account issuers' profitability recovery, the trends of the market financing environment, and bond payment pressure, CCXI forecasts that credit risk will increase marginally in 2021 compared to that in 2020.** However, market participants don't need to be too worried about credit risk. With strict measures adopted by the regulator to crack down on those who escape and revoke debts, future defaulting issuers will still be mostly tail entities with low qualification whose credit fundamentals deteriorate substantively or who have insufficient solvency. Since most issuers on the bond market have excellent credit qualification and strong risk resistance, **default risk on the bond market will remain controllable on the whole, and the default rate of the public offering market in 2021 is expected to rise to 0.70%-0.80%, up 0.04-0.14 percentage point from last year.**

**In 2021, under the pressure that credit risk will probably increase, tail issuers with low qualification will still be faced with clearing pressure. To determine if an issuer has default risk,** investors should evaluate the issuer from multiple dimensions such as the region and industry it is in and its risk characteristics. Specifically, **in terms of region,** as the degree of economic recovery and financial strength vary from region to region, attention should be paid to the solvency of urban construction investment bond issuers with a relatively low administrative level or less important positioning in the regional strategic development in "weak regions". In the meantime, it's necessary to watch out for the possibility that risks will spread to the bond market because some urban construction investment bond issuers default on non-

standard debts and its external guarantor pays for it. **In terms of industry**, since the degree of profitability recovery, driven by the recovery of the macro economy, varies from industry to industry and some industries, affected by policy or market sentiment, are faced with a stressed financing environment, the solvency of issuers in different industries differs. Investors should pay attention to industries that recover slowly in profitability, have a stressed external financing environment and have greater pressure of making payments for mature bonds. **Moreover, as bond renewals and refusals to redeem perpetual bonds increase, it's necessary to pay close attention to the possibility that exposure of relevant issuers' credit risk will delay.**

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