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Singapore Capital Markets: Update

Change in reporting standards – changing for the better or worse?

- We applaud the strengthening of continuous disclosure requirements; though see the move towards lower frequency in financial reporting as net-negative to bond investors, especially if the nature and depth of information do not expand from current market norms.
- 47 out of 72 of the SGD-bond issuers under our current coverage have their primary listing on the Singapore Stock Exchange ("SGX"). By issuer count, we expect more than 90% of these issuers to have the option to move to semi-annual reporting. Amongst the remaining 27 SGD-bond issuers under our coverage, a number are listed in markets with semi-annual reporting. In addition, we cover 8 AUD-bond issuers which report semi-annually.
- OCBC Credit Research tends to be conservative in assigning issuer profile ratings if disclosure is lacking and where we are unable to credibly monitor an issuer's credit profile trajectory.
- Among the selection criteria for our coverage universe is the availability and sufficiency of on-going information. We see the availability of timely, transparent and reliable information as one indicator of issuers with stronger Environmental, Social and Governance ("ESG") standards.
- Over time, we expect the availability of information and accountability to investor (or lack of thereof) to be a differentiator in credit selection. Overall, we expect wider spread dispersion between high grade issuers which tend to have robust disclosure vis-à-vis issuers lower on the credit curve which sometimes adhere only to the minimum standards, particularly issuers with heightened liquidity risk.
- A proposed list of voluntary disclosures which may be helpful to bond investors and an illustration of financial reporting disclosures in other markets is set out.

Background

On 9th January 2020, Singapore Exchange Regulation ("SGX RegCo") announced that quarterly reporting requirements would only be applicable for companies with higher risks while continuous disclosure requirements would be strengthened for all listed companies. This marks a significant shift from the current market capitalization based approach where only companies with a market cap of SGD75mn and above would need to report financials on a quarterly basis. This shift was mooted in 2017 and the changes would come into effect on 7 February 2020.

(1) <u>Risk-based approach to frequency of financial reporting rather than market cap size</u>

Rationale: (1) Market cap approach deemed as too arbitrary and not meaningful in targeting companies that should be doing more frequent reporting (2) In line with other capital markets including Hong Kong, Australia, the UK and other countries in the European Union.

Risk based approach in practice: Companies would have to report its financials on a quarterly basis if it has received a disclaimer of opinion, adverse opinion or qualified opinion from auditors in its latest financial statements, if auditors have expressed a material uncertainty relating to going concern on its latest financial statements or SGX RegCo has regulatory concerns with the company. Reportedly, the SGX would release a list of around 100 companies that would still need to report on a quarterly basis. As at 23 January 2020, there are 714 companies listed on the SGX (including those whose securities have been suspended and halted from trading).

OCBC Credit Research comments: We agree with the rationale that using a market cap approach is arbitrary as mere size alone does not indicate whether a company is considered to be high-risk. Currently, there is no outright "identification tag" as to what is a high-risk company is and this is left to market forces. Taking a sample of SGD bond issuers which had faced financial stress, we observe significantly lower volume traded pre and post debt restructuring where such companies had resumed trading, indicating a lack of investor participation and thin liquidity among companies deemed as “high risk”.

While moving to a risk-based regime is sound in theory, in our view, a move to outright identify companies who are high-risk is likely to lead to deterioration in investor interest in those companies, culminating in a dual-tier market of “good names” versus “riskier names” in the market. While the SGX RegCo has come up with some reasonable parameters linked to auditor’s opinions, in effect rather than the market deciding which companies is riskier; we would see higher regulatory intervention in this matter.

As of writing, OCBC Credit Research officially covers 72 SGD bond issuers; of which 47 have their primary listing on the Singapore Stock Exchange (“SGX”) (one has a secondary listing on the SGX). By issuer count, we expect more than 90% of the SGD issuers under our coverage to have the option to move to semi-annual reporting.

(2) <u>Six months versus three months for all other companies</u>

Rationale: More targeted approach for compliance, international trend of moving away from quarterly reporting and companies must be allowed to consider and implement longer-term strategies.

Lower frequency of financial reporting in practice: Companies are encouraged to consider providing voluntary business updates to shareholders in between half-yearly financial reporting. Major capital markets that do not require quarterly financial reporting include: Australia, France, Germany, the UK and HKSAR (and soon Singapore). Those requiring quarterly financial reporting include the USA, Canada, South Korea, Mainland China, Japan, Indonesia and Malaysia, although Malaysia like the USA are contemplating the issue of dropping quarterly financial reporting. For the UK market, reporting requirements went from semi-annual to quarterly reporting in 2007 before flipping back to semi-annual in 2013.

OCBC Credit Research comments: Based on the literature available on the topic, there had been various for and against arguments over the issue of quarterly reporting. Rather than a sound academic framework underpinning which is best, it appears that exogenous conditions prevail as to which frequency works for a particular capital market. The off cited rationale for semi-annual reporting is that the scrapping of quarterly financials would allow companies to focus on long term strategies rather than meeting analysts and investor’s short term expectation. In our view, it is arguable whether moving to a six-month horizon as opposed to three-months constitutes long term. Furthermore, it is typically earnings guidance which leads to short-termism rather than reporting of financials per se in our view.

(3) <u>Strengthening of continuing disclosures on various matters</u>

Rationale: Strengthening areas where investors are most concern about including interested person transactions (“IPTs”), significant financial assistance, significant transactions and secondary fundraising.

Enhanced continuing disclosures in practice: Specifically, (1) SGX RegCo will have the powers to deem a person or entity as an “interested person” with respect to IPTs (2) Requiring a competent and independent valuer to be appointed for significant asset disposals (3) Requiring additional disclosure for rights issue (4) Extending the need for disclosure and shareholders' approval for the provision to third parties of significant financial assistance which is not part of the company’s ordinary course of business (5) Explicitly making disclosure obligations apply not just to materially price-sensitive information but also trade-sensitive information and (6) Companies have to make immediate announcements where there is a change in in the issuer’s near-term earnings prospects or where there are ongoing developments.

OCBC Credit Research comments: While we do not purport to be experts on corporate governance matters, we see the efforts to strengthen continuing disclosures as commendable as this should overtime enhance minority investor protection (including for bond investors, albeit less directly, via the existence of a strong, sustainable equity buffer). We think implementation would be key given that some of these would require subjective judgment call on the part of SGX RegCo.

How does the change impact bondholder and OCBC Credit Research's Issuer Profile Score ("IPS")

Overtime, we expect the availability of information and accountability to investor (or lack of thereof) to be a differentiator in credit selection. We expect wider spread dispersion between high grade issuers with robust disclosure vis-à-vis issuers lower on the credit curve who adhere to the minimum standards. This spread differential will be most apparent among issuers with heightened liquidity risk in our view.

OCBC Credit Research tends to be conservative on our issuer profiles if disclosure is lacking and where we are unable to credibly monitor an issuer's credit profile trajectory. The lack of transparency may weigh down issuer profiles despite seemingly conservative credit metrics. Increasingly, investors are penalizing issuers with poor Environmental, Social and Governance ("ESG") standards. For example, Westpac Banking Corp ("WSTP") saw an 18% decline in its listed equity price in 4Q2019. While WSTP issues were not stemmed from poor disclosures, it fell within the gamut of poor ESG standards. At OCBC Credit Research, we see the availability of timely, transparent and reliable information as one indicator of issuers with stronger ESG standards.

While we commend the efforts of strengthening continuous disclosures, net-net **we think the lower frequency of financials is net-negative for bond investors**, especially if there is no expansion in terms of what is disclosed from current market norms.

OCBC Credit Research Wish List – Voluntary Disclosures which can be Helpful to Bond Investors

Informational rights are frequently negotiated and demanded (even in private markets) and we think it will serve bond investors interest to demand better terms within the purview of bond documentation. This is especially more so given the number of unlisted issuers and the lack of consistent information even among listed issuers.

While there certainly are SGD bond issuers with highly commendable standards in disclosure, the SGD market more broadly has some way to go before closing the informational gaps with developed bond markets. Below are some suggestions on voluntary disclosures which we think would assist bondholders in making their investment decisions.

(1) Business Information

Quarterly trading update with key headline financial (sales, gross profit) and key operating numbers specific to issuers (eg: housing sales % for property developers, list of property assets for asset owners, unit sales and geography of sales for manufacturers)

(2) Debt Information

Debt maturity profile for the next 5 years
Debt funding split by currencies and by type of debt
Key credit ratios
Disclosure of the issuer's key financial policies including key financial ratio targets
Fixed to floating debt ratio
Financing costs overtime

Descriptions of significant debt arrangements
Availability of committed and uncommitted credit facilities
Three to five year capital expenditure plan, split into discretionary/growth and mandatory/maintenance expenditure

(3) Depository of Information

Trust Deeds accessible by both existing bondholders and prospective bond investors
Information Memorandum and Pricing Supplements and/or Principal Terms and Conditions to be made publicly available
Yearly certificate confirming covenants are met to be publicly available
Yearly audited financials for unlisted issuers to be publicly available within a reasonable timeframe

(4) Investor Outreach

Analyst and investor briefings to be extended to debt holders and/or availability of transcripts to be publicly available

(5) Risk-based approach

While we agree with the idea that companies with higher risk should continue to report on a quarterly basis, we think the bulk of this approach would need to be dependent on SGX RegCo's assessment rather than any dependence on auditors who are focused more on the quality of the financials rather than its implications. Instances where there is sole reliance on auditors may be too low a bar for investors. We think quarterly reporting is more important for companies lower on our Issuer Profile Ratings (5 to 7) as it allows investors to better judge the evolving liquidity situations of these companies.

Disclosures in other markets

Table 1: Illustration of disclosures in other key capital markets

	US	UK	Hong Kong	Singapore
Frequency	Quarterly	Semi-annual	Semi-annual	Quarterly
Report type	• Annual report, less detailed than 10-K, presented more as a marketing document for shareholders • 10-K, annually • 10-Q, quarterly • 10-Qs broadly follow a similar format to 10-K except 10-Ks contain audited reports	• Annual report • Interim results • Preliminary annual report	• Annual report • Interim Report in substantially the same format as annual report • Preliminary annual report and preliminary interim report	• Annual report • Quarterly financials • Sustainability report • Annual report substantially more detailed than quarterly financials
Key content	• Description of Business • Risk Factors • Legal proceedings • Management Discussion and Analysis of Financial Conditions and Results of Operations ("MD&A") • Market Risk • Detailed financial statements with notes • Controls and Procedures	• Strategic report (covers business overview) • Director's and corporate governance report • Detailed financial statements with notes • Explanation of industry jargon • Reconciliation of IFRS to management numbers	• Description of business • Corporate structure chart • MD&A • Report of directors including business overview, business outlook, legal proceedings, connected transactions • Corporate Governance Report • Detailed financial statements with notes	• Description of business • Business and sector overview • Asset portfolio • Corporate Governance Report • Detailed financial statements with notes
Recent significant developments	Since 2018, the SEC is exploring moving to semi-annual, a move which has bipartisan support	Nil	New ESG reporting requirements effective from July 2020 which includes disclosures on climate change and social issues	Moving towards a risk-based approach on quarterly reporting and strengthening continuing disclosure
Other disclosures	• Recordings of quarterly conference calls post release of financial results and transcript of prepared remarks for conference calls • Investor presentations • Supplemental financial information based on non-GAAP measures • Corporate Governance information	• Quarterly trading update call and transcript • Quarterly sales and revenue results call • Earnings call recording, webcast and transcript • Investor presentations • Solvency and financial condition report • Interview with CEO	• Monthly report on production and sales volume	• Earnings call transcript semi-annually • Investor presentations

Source: OCBC Credit Research, company financials and information as at 23 January 2020

Note: (1) Based on actual companies in the respective stock market with a market cap of ~SGD10bn; chosen randomly

Explanation of Issuer Profile Rating / Issuer Profile Score

Positive ("Pos") – The issuer's credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

Neutral ("N") – The issuer's credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

Negative ("Neg") – The issuer's credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings into a 7 point Issuer Profile Score scale.

IPR	Positive		Neutral			Negative	
IPS	1	2	3	4	5	6	7

Please note that Bond Recommendations are dependent on a bond's price, underlying risk free rates and an implied credit spread that reflects the strength of the issuer's credit profile. Bond Recommendations may not be relied upon if one or more of these factors change.

Explanation of Bond Recommendation

Overweight ("OW") – The performance of the issuer's specific bond is expected to outperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Neutral ("N") – The performance of the issuer's specific bond is expected to perform in line with the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Underweight ("UW") – The performance of the issuer's specific bond is expected to underperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

Withdrawal ("WD") – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

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