Credit Research Initiative
National University of Singapore
transforming big data into smart data
NUS National University of Singapore | Asian Institute of Digital Finance
Weekly Credit Brief
Jun 22 - Jun 28 2021

China retailer Suning.com faces bleak credit outlook as debt maturity looms

by Tian Mengxi and Yao Xuan

- **As demonstrated by the NUS-CRI Agg PD, Suning.com's credit health has worsened due to a pandemic-induced retail slump and looming debt maturities**
- **Suning.com's aggressive expansion into non-core operations despite the low profitability in its main retail business has resulted in a weakened credit outlook**

Once known as the king of retail in China, Suning.com Co. Ltd. (Suning.com), has recently come under the spotlight due to concerns over its liquidity and ability to meet its near-term debt obligations. The company, which is one of the largest online-to-offline (O2O) retailers of consumer goods and the 3rd largest B2C e-commerce platform in China by transaction share, has consistently had weak cash flow generating ability since 2011. The pandemic-led decrease in footfall at its brick-and-mortar stores only further strained margins in 2020, culminating in a CNY 5.4bn net loss in FY 2020. Recent development suggesting that the company's controlling shareholder (Zhang Jindong) and its parent company (Suning Appliance Group Co. Ltd.) are in financial distress and are facing trouble in meeting their short-term liabilities, have caused concerns over Suning.com's credit health to arise as well. In Jun-2021, following the news that the controlling shareholder's shares have been frozen, investor's perception of Suning.com's outlook took a downturn, with its share price falling by 10%.

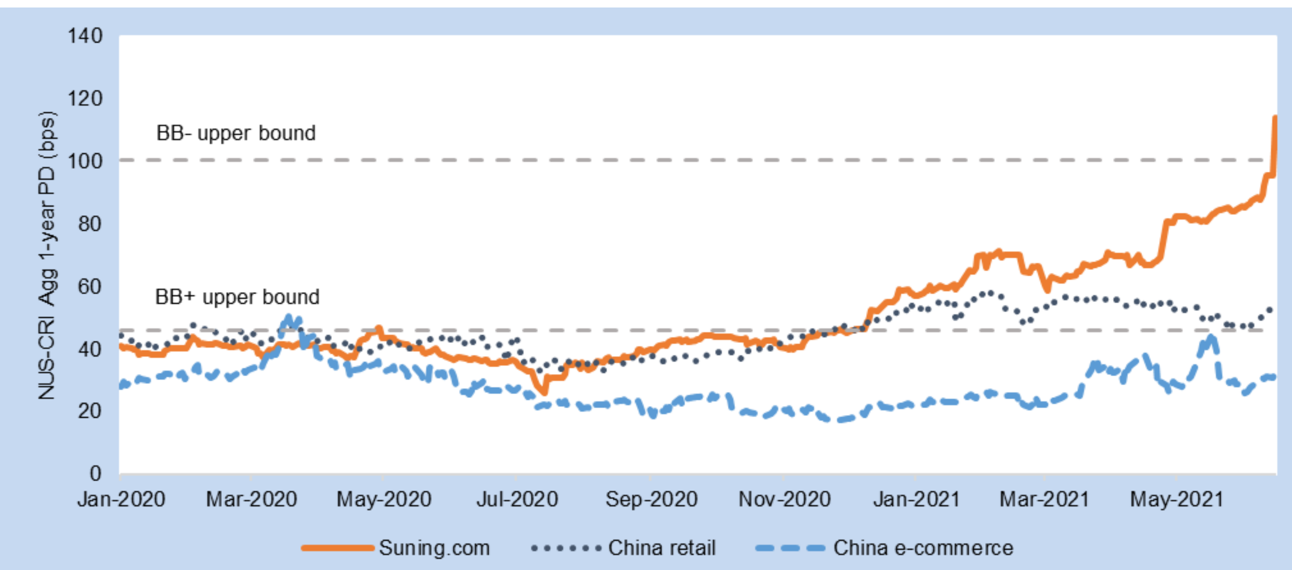

Figure 1: NUS-CRI Aggregate (median) 1-year PD for Suning.com, and all listed China-domiciled corporates in the offline retail and e-commerce industries, with reference to the PDiR2.0 bound. *Source: NUS-CRI*

Comparing the NUS-CRI 1-year Probability of Default (PD) for Suning.com with the NUS-CRI Aggregate (median) 1-year Probability of Default (Agg PD) for listed China-domiciled retail and e-commerce companies, it can be seen that Suning.com's recent credit health has indeed worsened, reaching an all-time high of 115bps. As seen in Figure 1, Suning.com's PD has conventionally hovered around the industry median in the retail and e-commerce sectors. However, starting from Dec-2020, the company's credit health diverged from that of its peers, surpassing both the BB+ and BB- upper bounds (PDiR2.0[1]) in Nov-2020 and Jun-2021 respectively.

[1] The Probability of Default implied Rating version 2.0 (PDiR2.0) provides a more familiar interpretation through mapping the NUS-CRI 1-year PDs to the S&P letter grades. The method targets S&P's historical credit rating migration experience exhibited by its global corporate rating pool instead of relying solely on the reported default rates.

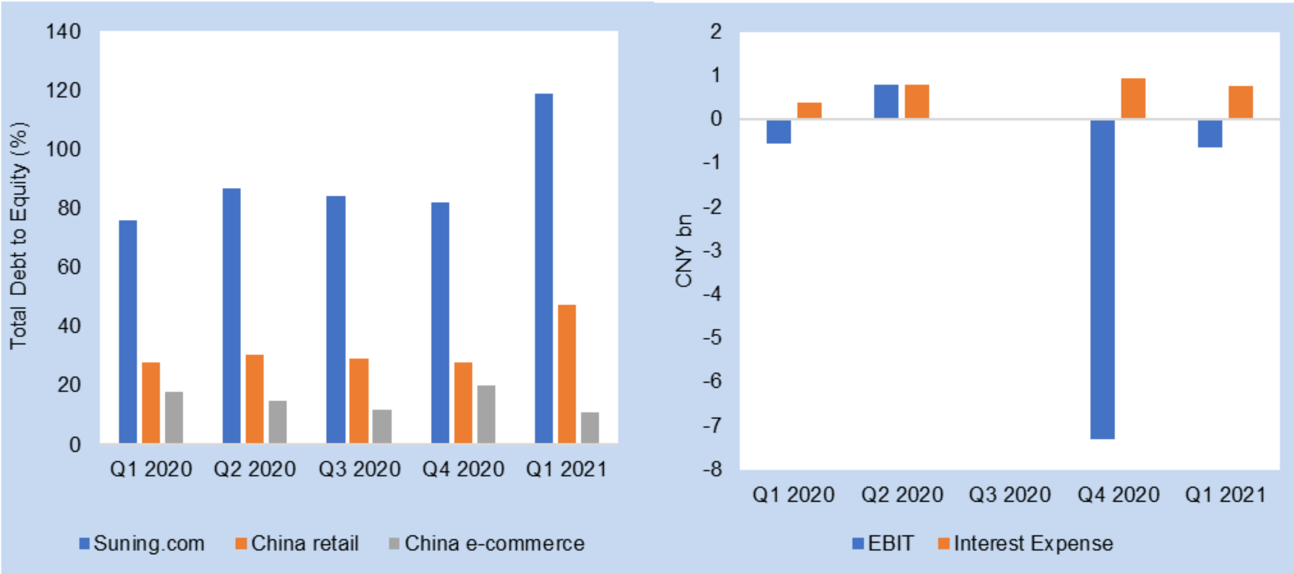

Figure 2a (LHS): Quarterly (median) total debt to equity ratios for Suning.com and all publicly-listed China-domiciled companies in the e-commerce and offline retail industry from Q1 2020 to Q1 2023. Figure 2b (RHS): Quarterly EBIT and interest expense for Suning.com from Q1 2020 to Q1 2021. *Source: Bloomberg*

Looking at the company's fundamentals, Suning.com's leverage saw a sudden surge over the past quarter. Its total debt increased more than 48.7%, from CNY 63bn in Q4 2020 to CNY 93.6bn in Q1 2021, and its total debt-to-equity ratio increased from the 80% range in all of 2020 to 119% in Q1 2021. A benchmark of the company's total debt-to-equity ratio against other publicly listed China-domiciled companies in the offline retail and e-commerce sectors highlights Suning.com's comparatively more levered capital structure. As of Q1 2021, the company's debt to equity ratio stood at 119%, more than 10 times compared to the median of 10.8% for the e-commerce sector and higher than the offline retail sector's 47.6% (Figure 2a). Reasons that could account for the high leverage include Suning.com's heavy use of debt to fund its aggressive expansions over the past few years as it attempted to diversify into sectors such as sports, sports streaming, and telecom. Between 2015 and 2019, Suning.com invested a total of CNY 71.6bn in a slate of non-core investments, although many of these investments remained unprofitable and only accelerated Suning.com's rate of cash burn.

To maintain normal operations and sustain its cash levels, the company has relied on the sale of its assets. In 2019, the sale of Suning Convenience Store increased Suning.com's net profits to CNY 3.4bn. In an attempt to raise cash, Suning also sold off apartments built to house their employees this year. However, it remains uncertain how much further the company will be able to stretch the limits of its assets if its profitability is to remain low. Apart from asset sales, Suning.com has also been strategically seeking returns on financial investments. In 2018, Suning.com took advantage of the rise in the price of the Alibaba shares that it had acquired in a partnership with the e-commerce giant. Although these have allowed the company to weather some of its loss-making investments in the past, it is unsustainable in the long run if the company's profitability is to remain low. From Figure 2b, for instance, we see that the company's profitability has been weak over the past year. It suffered a loss of CNY 550mn in Q4 alone, and its net income margins have also hovered around -6.75% to 1.14% in the same time period.

Over the years, Suning's main retail operations have been heavily impacted by the rise of e-commerce companies like TMall, JD.com, and Pinduoduo. These have disrupted the traditional sale of consumer goods through brick-and-mortar stores, eroding the market share of companies like GOME Retail Holdings and Suning.com who started out and gained prominence as offline retailers. Despite spending billions transitioning to e-commerce, Suning.com has not been able to find its foothold in the e-commerce market. Currently, the company only commands a mere 4.6% of the Chinese B2C e-commerce market by transaction share as of Q1 2021, compared to 63% by TMall and 26.5% by JD, a far cry from its previous status as a retail giant in 2011.

On the bright side, Suning.com's YoY cash conversion cycle (CCC) has been decreasing, falling from 12 days in 2017 to -4.8 days in 2020. The negative CCC could reflect an improvement in the management of working capital for the company and improvements in the company's operational efficiency. The shift could have been driven by the recent pandemic-led store shutdowns that have forced Suning.com to shift its focus from non-core operations and acquisitions back to its core offline retail and e-commerce business.

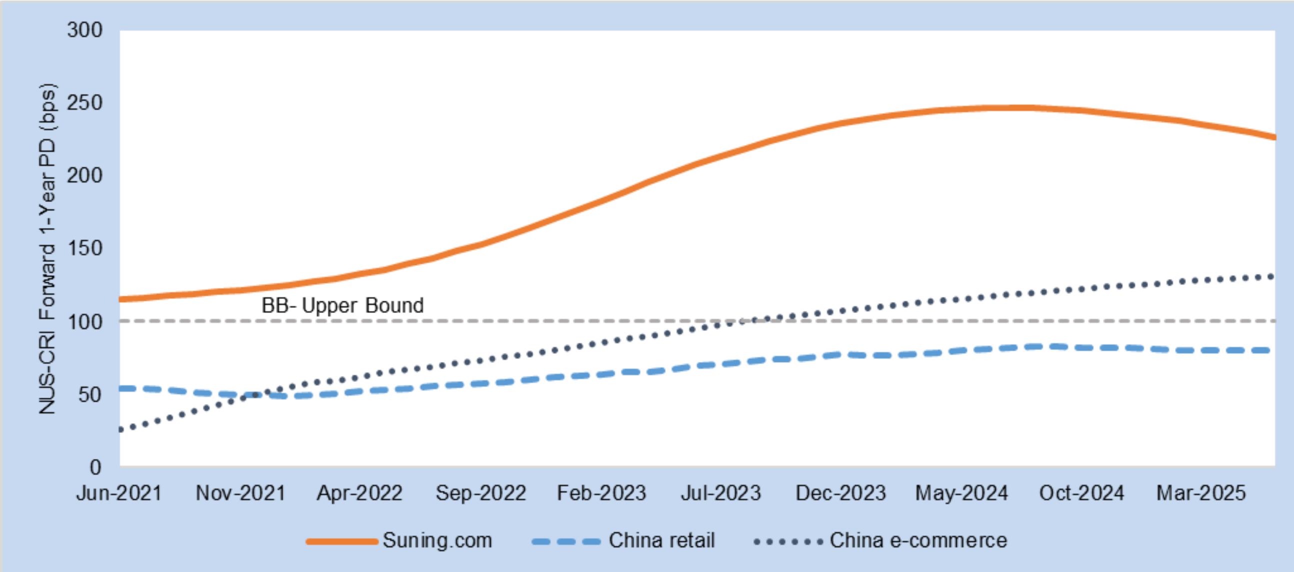

Figure 3: NUS-CRI Agg Forward 1-year PD[2] (median) for Suning.com vs for all listed China-domiciled corporates in the offline retail and e-commerce industries. *Source: NUS-CRI*

Looking forward, the Chinese offline retail sector looks well poised for a strong recovery, with double-digit industry growth possible if large-scale vaccination campaigns can be actualized. This would relieve the revenue pressures that Suning.com has been facing over the past year. For now, the most urgent issue Suning.com is facing is the billions of dollars of debt due within a year. With the fast-approaching debt maturities and a heavy debt load, it remains to be seen how the company will be able to fulfill its obligations in the years to come. The NUS-CRI Forward 1-year PD above (Figure 3) indicates that Suning.com's medium-term outlook could further deteriorate and could reach highs of around 250bps. However, a solution may just be around the corner as a consortium led by Alibaba Group and the Jiangsu provincial government is said to be nearing a deal to buy a stake in the retail business. With a possible change in the controlling shareholder of the company ahead, the future outlook of the company thus rests heavily on the new shareholders' approach to managing the debt that Suning.com has accrued so far.

[2] The Forward PD estimates the credit risk of a company in a future period, which can be interpreted similar to a forward interest rate. For example, the 6-month Forward 1-year PD is the probability that the firm defaults between the 6th month to the 18th month, conditional on the firm's survival in the first 6 months.

Credit News

Pressure builds to resolve fate of Chinese bad debt manager Huarong

June 28. Huarong Asset Management's failure to release its 2020 financial reports and the uncertainty surrounding its CNY 1.7tn assets has triggered fluctuations in its USD 22bn dollar-denominated bonds. In the past, Huarong was the most aggressive among China's asset managers, with its assets ballooning sevenfold between 2012 and 2018. The company also established its banking, brokerage, insurance, and leasing arms, alongside a drive into property development. As Huarong's dollar debts trade at distressed levels, the urgent question for investors and regulators is where its reckless growth has left its balance sheet. The USD 100bn of Chinese corporate debt due this year added to the urgency of resolving Huarong's future. While Huarong is likely to play a crucial role in China, especially if domestic credit conditions tighten further, the next move lies with the Chinese government. (FT)

Investors pile USD 54bn in to ESG bond funds in fiery start to 2021

June 26. In the first five months of 2021, investors poured USD 54bn into bond funds specializing in Environmental, Social, and Governance (ESG) issues, compared to the USD 68bn for all of 2020. This is amidst increasing concerns over potential "greenwashing", and fears that bond funds are not as sustainable as they claim to be. As such, fund managers are finding it difficult to discern their ESG credentials. The demand for ESG bond funds is catalyzed by the combination of regulation and the new cohort of investors, like millennials and younger investors, who focused on seeing their money do good while generating returns. This escalating demand has evoked a rush of new fund launches, with companies and governments disclosing social and green bonds to tap into the trend. There were 122 new ESG bond funds launched last year, with 44 new offerings in the first quarter of 2021 (FT)

U.S. Junk bond coupon sets record low in race to rock bottom

June 26. Average US junk-bond yields stand at 3.89%, just five basis points from their all-time low. Investors on a hunt for higher yields are the driving force behind the rally in high yield debt. Even amidst investor concerns that rising inflation would undercut the value of bonds; a record amount of junk debt was sold in May to investors for all trances of junk debt. Companies have also taken advantage of low yields and increasing oil prices by increasing debt issuance, with a total of USD 8.6bn of junk-rated debt sold over the previous week. (Bloomberg)

A USD 27bn pile of debt looms over India's new bad bank

June 28. India's bad bank, expected to launch this month, will be handling USD 27 bn worth of distressed debt. In doing so, the bank hopes to accelerate decision-making and improve bargaining power during the resolution of stressed assets. However, tackling one of the worst bad-loan piles in the world will require the effective implementation of bankruptcy reforms. Fall in creditor recovery rates, delays in closing cases, and higher liquidations have weakened investor confidence in the country's bankruptcy reform capabilities. In an effort to alleviate hurdles in bankruptcy reform implementation, the government and judiciary will have to primarily manage fundamental problems such as the number of judges and lack of digital infrastructure. (Bloomberg)

Brazil's hawkish turn ends bond-market rush into inflation haven

June 25. The bond market has increased confidence that Brazil's central bank can control inflation. Even though it is uncertain when the rate hikes will occur, the hawkish tone spurred confidence that the central bank will not allow inflation to spiral out of control. The potentially increased pace of interest-rate hikes gathered steam after the Federal Reserve quickened its pace for contractionary monetary policy, with the Fed set to begin discussions to decrease bond purchases that have kept long-term rates low. The Fed signals could potentially put pressure on emerging-market countries to increase interest rates in a bid to prevent an outflow of investors. Brazil was the only major economy in Latin America that reduced monetary stimulus, followed by Mexico. (Bloomberg)

US banks gear up for buyback bonanza after passing stress tests (FT)

ESG investors clamor for Tokyo city bonds, slashing yield (Bloomberg)

DBS launches digital bond issuance platform (Straits Times)

Regulatory Updates

Fed's Rosengren says 2022 rate hike in play as job market heals

June 26. According to Boston Fed's President Rosengren, the Fed may contemplate raising the interest rate as soon as late 2022, when the labor market reaches full employment and inflation meet its target. Federal Open Market Committee (FOMC) is likely to make significant further progress on jobs and inflation, required to taper the bond purchases before next year. The FOMC expects the US economy to grow by 7% this year, providing further support for labor market recovery. The current inflation is largely transitory, reflecting the reopening of the economy after the pandemic and temporary supply issues. Financial-stability issues, said Rosengren, must be contemplated when the Fed sets monetary policy as concerns rise over the efficacy of regulatory measures in preventing future crises. (Bloomberg)

Libor fears persist for loan market with six months to deadline

June 26. Just six months before the deadline to ditch Libor for all new deals, there remain serious concerns to ensure a smooth transition to a new reference rate. In a survey conducted by Barclays, more than 78% of respondents are worried about a mismatch between assets and liabilities driven by a lack of consensus regarding the replacement rate and its pricing effects. For bankers and borrowers with existing securities using Libor, one reprieve is to remain with the discredited benchmark for an additional 18 months. Bond issuance is forecasted to be subdued this week at USD 10-15bn in the US. In Europe, 2021 new bonds sales are about the break EUR 1tn. The bond sales in Asia, excluding Japan, have gained momentum from their lowest weekly volume since last month, backed by a USD 2tn deal by the Export-Import Bank of Korea. (Bloomberg)

Korea set to lead Asia's rate-hike cycle as Lee flags 2021 move (Bloomberg)

Latin America rate hike pressure grows as Chile signals liftoff (Bloomberg)

Published weekly by Credit Research Initiative – NUS | Disclaimer
Contributing Editors: Raghav Mathur, Anthony Prayugo