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The Gradual Recovery To Pre-pandemic Levels Continues

Listed credit market quarterly update as at 31 December 2022

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Overview

While still a bit lower than the total issuance in pre-COVID 2019, 2022 finished strongly to continue the year-on-year growth from the lows of 2020. SOE issuance and taps as well as Banks and REITs were strong contributors to this late rally. December 2022 had the second strongest monthly term issuance of the year, which was supported mostly by a R7.5 billion Eskom tap issuance. During December 2022, volume issued was dominated by SOE private placements which accounted for around 42% (about R8.0 billion).

The fourth quarter saw the total listed debt market size grow to R976 billion from R961 billion, with banks (including structured finance instruments) and REITS being the major contributors to this increase. SOE total issuance also showed an increase to R273 billion from R272 billion. We expect this value to come down in the coming months, with upcoming maturities in this sector more likely to be funded outside of the debt capital markets. During the fourth quarter, as illustrated below in Figure 1, there was a total net issuance of R11.7 billion.

The MTBS did not provide the expected clarity around the resolution of Eskom's debt problem but did provide some relief for SANRAL and Transnet. Historically, Transnet has been one of the few SOEs able to self-fund with little need or reliance for shareholder capital injections; however, the October 2022 MTBPS allocation to Transnet is evidence of Transnet's ongoing financial and operational problems. Although there was an increase in Additional Tier 1 issuance in the final quarter, we understand the banking sector remaining circumspect in its credit issuance activity as it continues to assess the impact of FLAC (First Loss Absorption Capital) that is to be fully phased in by 2028. FLAC is a bail-in instrument, senior to bank sub-debt, that the South African Reserve Bank (SARB) will use to recapitalise banks at the point of resolution.

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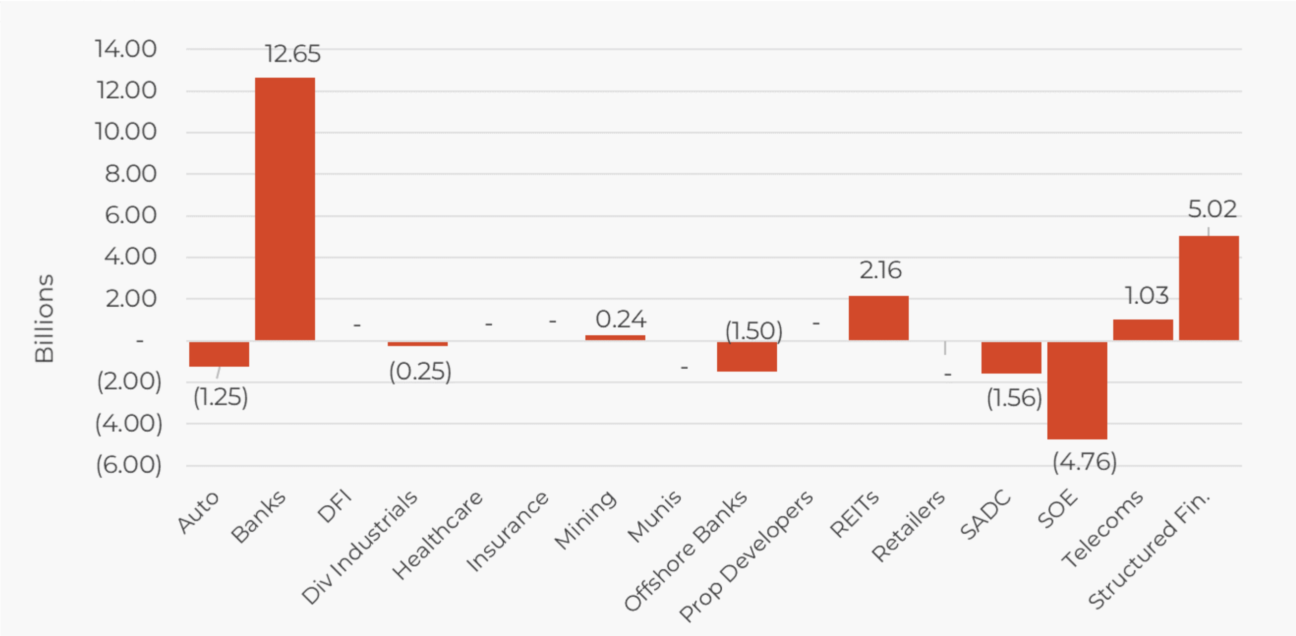
Figure 1: Net issuance/redemption

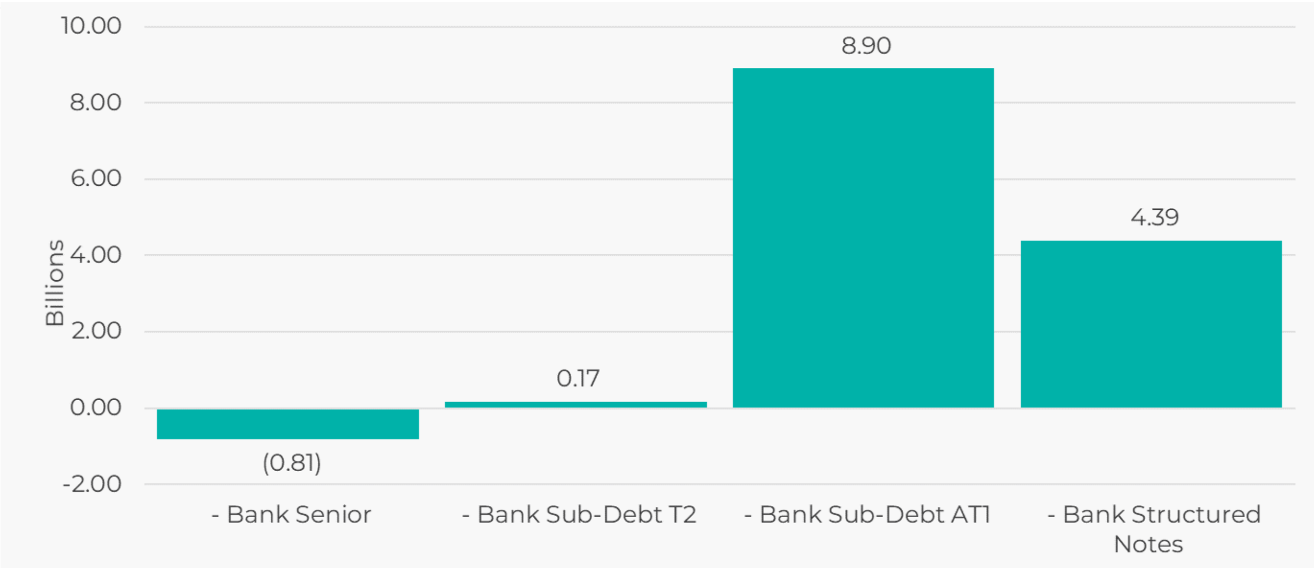


Source: JSE, Futuregrowth

Primary Market

Total market gross issuance in Q4:2022 was R56 billion (up from R52 billion in Q3:2022), with banks continuing to be major issuers (including increases in structured credit issues). AT1 issuances continued to see strong support with ABSA's AGT05 3.22 times oversubscribed and clearing at 358 basis points (bps); FRB's FRB34 cleared at 340bps and was 2.5 times oversubscribed; and with Standard Bank's instrument clearing at 350bps and 2.25 times oversubscribed. Despite the Bank issuance of around R8 billion of senior unsecured debt during the period, the net issuance was negative for the final quarter of 2022.

Figure 2: Bank net issuance/redemption (by instrument)



Source: JSE, Futuregrowth

SOEs finished the year strongly, issuing nearly R10 billion via new issues and taps, bringing their total for the year to just under R20 billion. The quarter saw a return to the debt capital markets of the Airports Company South Africa, which on an overall basis was 2.4 times oversubscribed. The AIRF02 (255bps) and AIRF03 (287bps) were both issued under guidance of 260bps to 275bps and 290bps to 305bps, respectively. Furthermore, Airports Company South Africa was able to tap the AIR05 (7.5yr) at 150bps with guidance given at 150bps to 165bps. Eskom was also able to tap the EL037 by R7.5 billion at 225bps; while continuing to redeem the ES23 due on 25 January 2023 by R2.5 billion; leaving R19.2 billion still to be redeemed. At the moment it appears likely that the funding for the balance of this redemption will come from outside the debt capital markets, with perhaps some taps on existing notes via private placements.

The fourth quarter saw only Hyprop and Equites coming to market via auction in the REIT sector. This was Hyprop's first auction in years after a hiatus from the DCM. Hyprop managed to raise R785 million against R1.135 billion in bids received. Although the auction was oversubscribed, it was only limited to six bidders, with banks allocated 32% of the auction against 22% of bids. Equites had a broader distribution of bidders, with a total of 21 bidders and 18 successful bidders. A total of R2.34 billion in bids was received and R1.25 billion was issued (target issue size was R1 billion). The strong participation in the Equites auction speaks to the resilience of the logistics property sector which has continued to outperform under difficult economic conditions. Equites issued a 1-year note which cleared at 108bps (2bps below the lower end of guidance) and a 3- and 5-year note which both cleared within guidance.

There were no auto issuances during Q4 2022. However, spreads for the sector have gradually been widening. This follows on from the lows of COVID-19 when spreads compressed significantly as investors fled for safety. With the market normalising for the most part, autos spreads have followed suit and widened in line. Toyota Financial Services will have an auction in late January, with guidance currently 10bps wider than guidance in 2022. This is expected to set the tone for the year.

Thekwini (the SA Home Loans securitisation) entered the market with their latest securitisation offering in Q3 and tapped it in Q4. This was a well-supported auction with the various tranches of notes clearing within or below guidance. Securitisations enjoyed strong participation throughout the year as investors continued to chase high quality assets.

Secondary Market

November saw the highest traded volumes in the secondary market for the year at 12.3 billion, largely as a result of good primary market activity (Oct: 10.5 billion and Dec: 5.8 billion).

Investors seemed to be sellers of shorter-dated paper trying to term out with the more popular tenor changing to 5yr, with average spreads in the 5yr ending the year tighter at around 143bps. All sectors experienced some tightening except for Munis which widened by about 182bps to 220bps, on average.

The most traded credit continues to be the bank AT1 instruments, as the primary market was not able to meet demand for these instruments. In the corporate sector, autos and diversified industrial counters as well as MTN are the most traded instruments. Demand for REITS also continues, but sellers are few and far between.

Munis remain out of favour with most investors and the bulk of the trading in the SOE sector was largely as a result of switches from short-dated instruments into longer-dated instruments in names such as Eskom, SANRAL and DBSA. SANRAL and Eskom issue local debt with explicit government guarantees.

The year in review

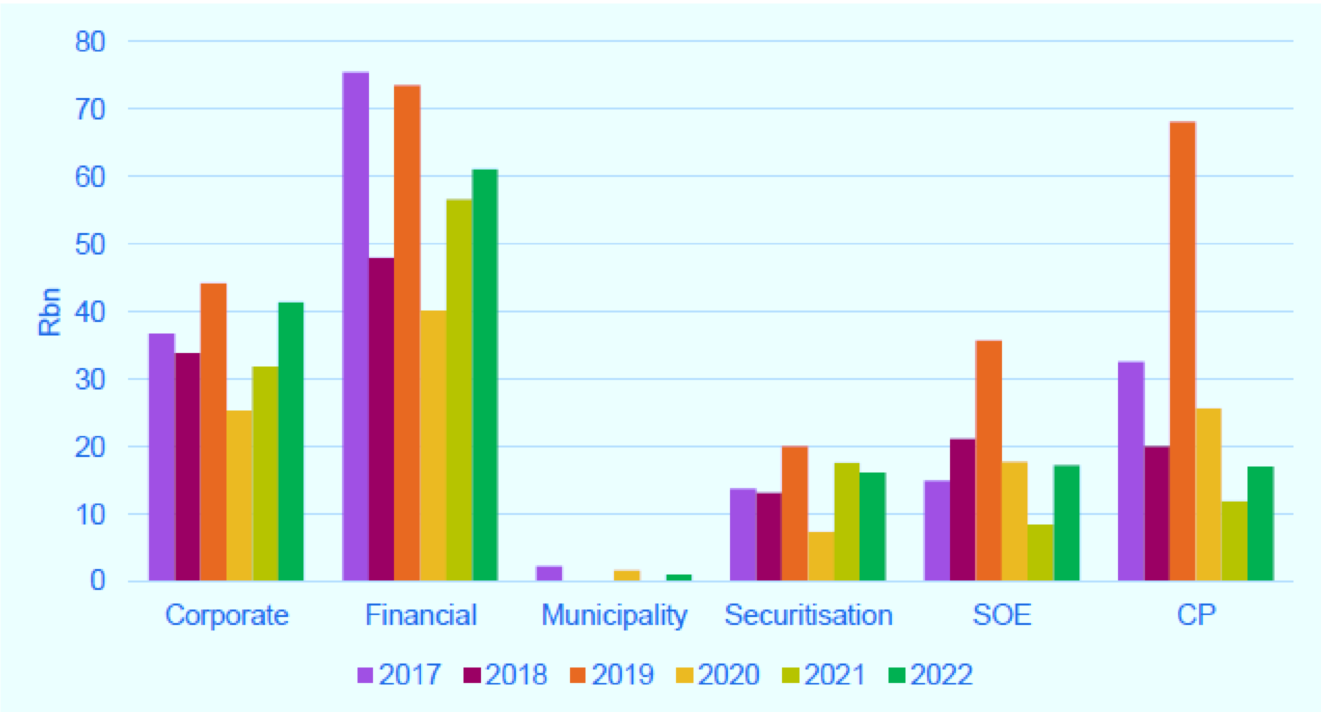
The total Bond issuance for the year totalled R136.9 billion in 2022, up 19% compared to 2021. Bond issuance was, however, 21% lower than in 2019 but is likely to continue its gradual recovery to pre-pandemic levels. The listed bond market grew by R9.9 billion in

2022 after contracting by R3.1 billion in 2021 and R27.9 billion in 2020, due to a reduction in issuance. The growth was primarily driven by an increase in Corporate bonds (property and non-property). Non-property corporates issued R29.4 billion of bonds against R26.6 billion of redemptions in 2022, whilst Property companies issued R12.0 billion of bonds against R7.9 billion of redemptions during 2022. The SA Banks continued to be aggressive bidders in higher-rated corporate auctions during 2022, which has continued the trend of keeping spreads compressed in the higher-rated assets.

Rbn	2017	2018	2019	2020	2021	2022	2022 vs. 2021	2022 vs. 2019
Corporate	36,8	33,9	44,3	25,3	31,9	41,4	30%	-7%
Financial	75,5	48,0	73,6	40,2	56,7	61,2	8%	-17%
Municipality	2,3	-	-	1,7	-	1,0	-	-
Securitisation	13,8	13,2	20,1	7,4	17,7	16,2	-8%	-19%
SOE	15,0	21,2	35,8	17,8	8,4	17,2	105%	-52%
Total (bonds)	**143.4**	**116.3**	**173.8**	**92.4**	**114.7**	**136.9**	**19%**	**-21%**

Source: Standard Bank Research; Auction Feedback; JSE Data as at 31 December 2022

Figure 3: Recent bond issuance per sector

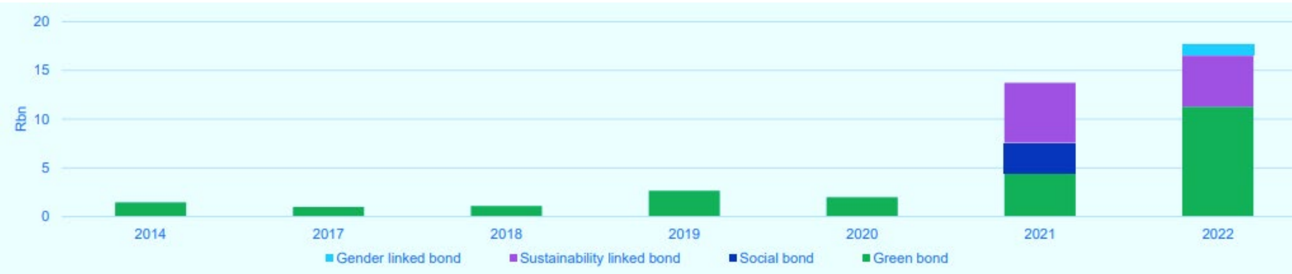


Source: Standard Bank Research; Auction Feedback; JSE Data as at 31 December 2022

The Big 5 SA banks issued R29.6 billion of senior paper against R33.7 billion of redemptions in 2022. When compared to other years, there was relatively weak senior bank issuance, with spreads mostly widening around 5 – 10bps over the year. Bank AT1 auctions were very well supported during the year with record bids received and spread levels reaching record lows in several auctions held in Q4:22, due to very aggressive bidding (in our view) as a result of the search for yield, given that certain auctions were cleared at around 7 – 20bps below pricing guidance.

Concerning green, social and sustainability-linked issuance in 2022, there was a 28% increase to R17.65 billion from 13.73 billion in 2021.

Figure 4: Recent Sustainable, Green and Social Bond Issuance



Source: Standard Bank Research; Auction Feedback; JSE Data as at 31 December 2022

Credit market forward view

Maturities of R76 billion are expected during Q1:2023, with Banks and Structured Finance making up over R30 billion. The SOE sector's upcoming R29 billion maturities are made up mainly of Eskom (R19 billion) and DBSA (R7.7 billion). While DBSA came to market on 30 January 2023 and raised R1 billion in a well-supported auction, it is expected that Eskom will raise funding for its imminent maturity either in the offshore market or the domestic bank loan market (i.e. outside the debt capital market). Transnet started the year with a global bond issue in late-January 2023. In our view, Transnet's credit risk has worsened since their last issuance under the GMTN programme in 2011. The continued unavailability of locomotives, persisting security incidents and recent floods in Kwa-Zulu Natal have contributed to the subdued financial performance and a breach in the cash interest cover covenant. Furthermore, the South African sovereign risk has migrated from an A3 rating, when Transnet tapped the GMTN, to Ba2 (based on Moody's Ratings), and the country risk overlay has also contributed to the increased cost of funding. Whilst the dollar coupon rate for this issue increased, the effective costs of funding will be lower than what Transnet would pay if funding was raised locally. In essence, Transnet is adjusting its funding costs and making use of all available funding lines. We understand that the funding will be used to refinance a bridge to a bond arranged last year during volatile market conditions.

The rest of the roughly R13.4 billion maturities are across 17 issuers and 30 instruments. Although we do expect further REIT issuances during the year, our view is that further

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spread compression during the year is unlikely. Concerning the Bank issuance, we expect senior Bank spreads to remain at current levels, but Bank capital instruments (At1 and Tier2) are likely to continue their spread compression during the year. Our view is that the diversified industrials spreads are expected to remain stagnant at the 2022 levels with marginal tightening to take into account the higher expected demand to continue to exceed supply for certain higher rated counterparties.

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