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S&P Global
China Ratings

Will the Recovering Private Enterprise Bonds Become Next Asset Worth Buying?

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Key Takeaways

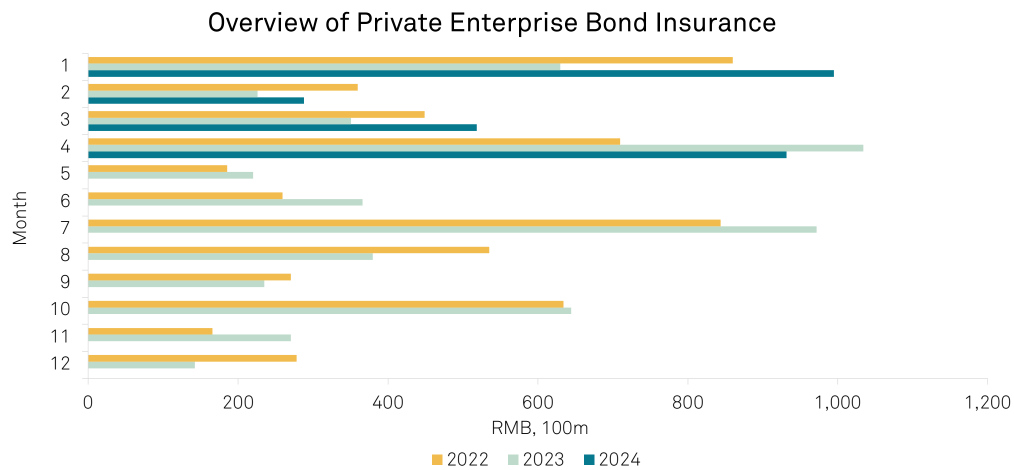
- The issuance volume and net financing of private enterprise bonds have been on the upward trajectory since 2024, with consistent net funds inflow through bond financing for private companies in asset-heavy industries such as technology hardware and semiconductors, auto OEM, and metal & mining downstream.
- Weaker private issuers' short maturity strategies lead to the inversion between issuance rates and maturities for their bonds. Short-term bonds issued by them may become the new choice amid asset shortage.
- Some private enterprises, despite their modest credit quality, have fair leverage levels and mild liquidity pressure over the next year, and their bond spreads are significantly higher than the average for issuers with same creditworthiness on the secondary market. We see certain investment value in these private enterprises.

Against the backdrop of loose liquidity conditions and a series of debt-relieving measures, public bonds issued by LGFVs and state-owned enterprises, which represent a substantial portion of the bond market, have seen a rapid decrease in credit cost, leaving the asset shortage unabated across the market. Backed by favorable policies, private enterprise bond issuance has seen a growing trend. Will private enterprise bonds become the next undervalued asset to bet on? We offer in this report an overview of private enterprises' bond issuance and their credit quality since 2024 in a bid to provide investors with some useful information.

Private Enterprises' Bond Issuance and Net Financing on Upswing from January to April 2024

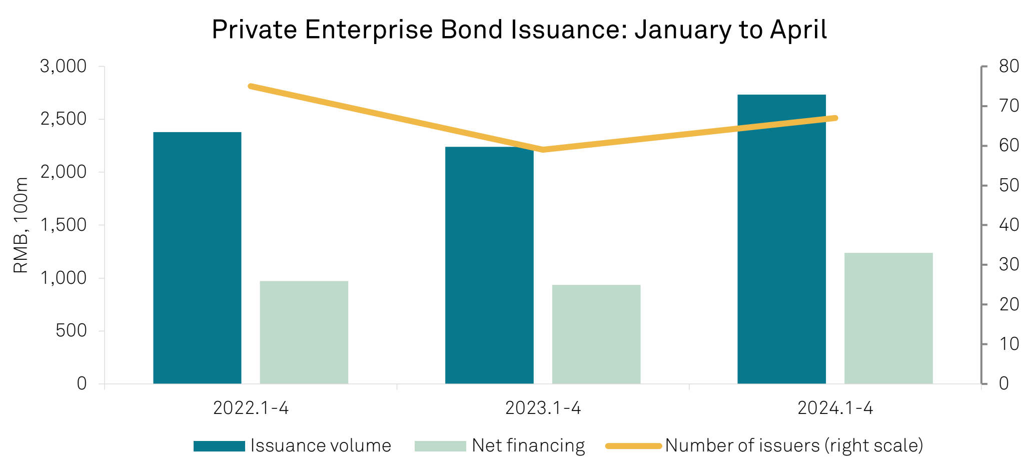
Private enterprises' bond issuance and net financing have showed robust growth year to date. From January to April, private enterprise bond issuance reversed the previous downward trend to deliver a year-on-year growth of 22%, and net financing also recorded a positive turnaround, increasing by 33% YoY. In our view, policy stimulus, decreased financing cost, and rising market demand from some industries may be the major contributors to growth in private sector's bond financing needs.

Chart 1



Note: Bonds include medium term notes (MTNs), corporate bonds, commercial papers, and private placement notes (PPNs).
Source: Wind, S&P Global (China) Ratings.

Chart 2

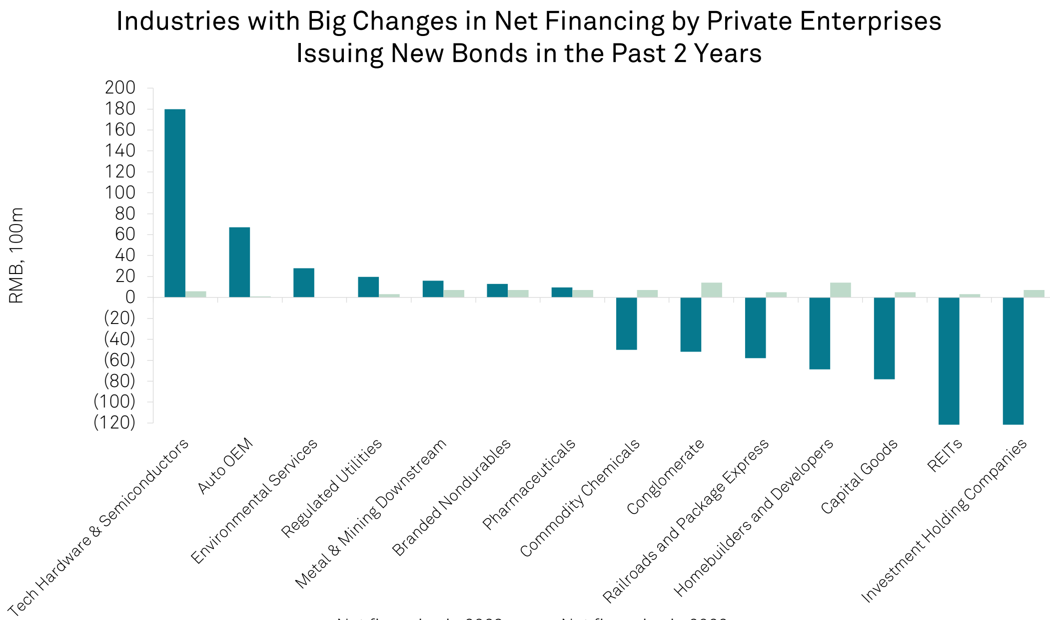


Note: Bonds include MTNs, corporate bonds, commercial papers, and PPNs.
Source: Wind, S&P Global (China) Ratings.

By sector, private companies in asset-heavy industries such as technology hardware and semiconductors, auto OEM, and metal & mining downstream continued to see net funds inflow via bond financing in the first four months of 2024, and nondurable consumer products companies saw remarkable increase in net financing volume YoY under operating pressure.

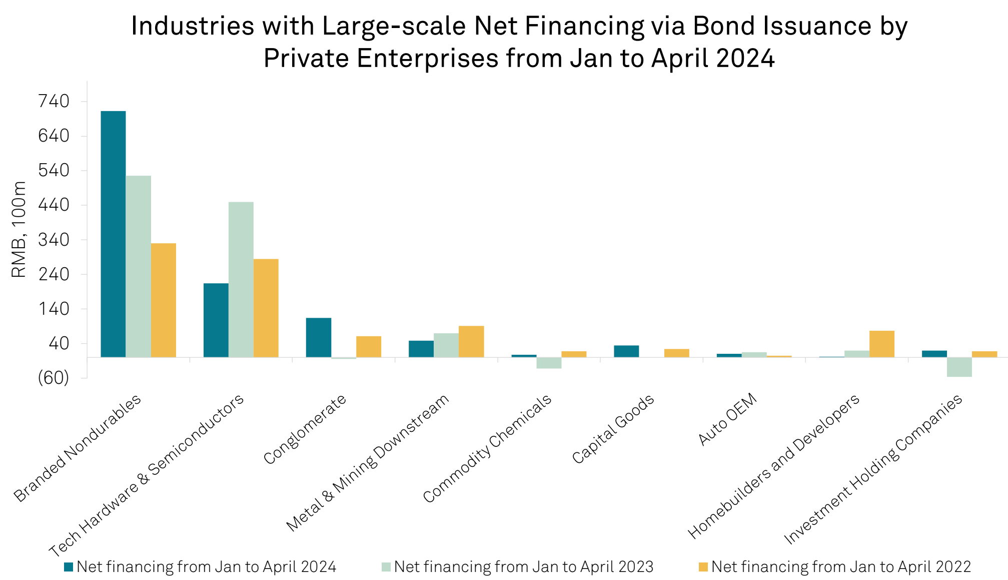
In light of national policies propelling strategic emerging industries, leaders in technology hardware and semiconductors, such as Huawei and ZTE, have maintained large-scale financing, which help build the industry's prominent position in private sector's bond financing. Metal smelters, e.g. China Hongqiao, Nanshan Holdings, and Huayou Cobalt, and auto OEMs such as Geely have continued to see net funds inflow from bond financing. Dairy leaders Mengniu and Yili, due to the industrial attributes, mainly rely on rolling over super & short-term commercial papers to meet funds needs from daily operations and typically maintain a balance between funds inflow and outflow on an annual basis. However, both dairy giants saw increased net bond financing from January to April 2024, driving up nondurable consumer products industry's overall bond financing to 71.3 billion RMB, up by 36% YoY. This may be attributable to higher demand for working capital under a decline in dairy product sales within the year.

Chart 3



Note: Net financing in 2022 and 2023 is calculated based on companies issuing new bonds within the year. Bonds include MTNs, corporate bonds, commercial papers, and PPNs.
Source: Wind, S&P Global (China) Ratings.

Chart 4

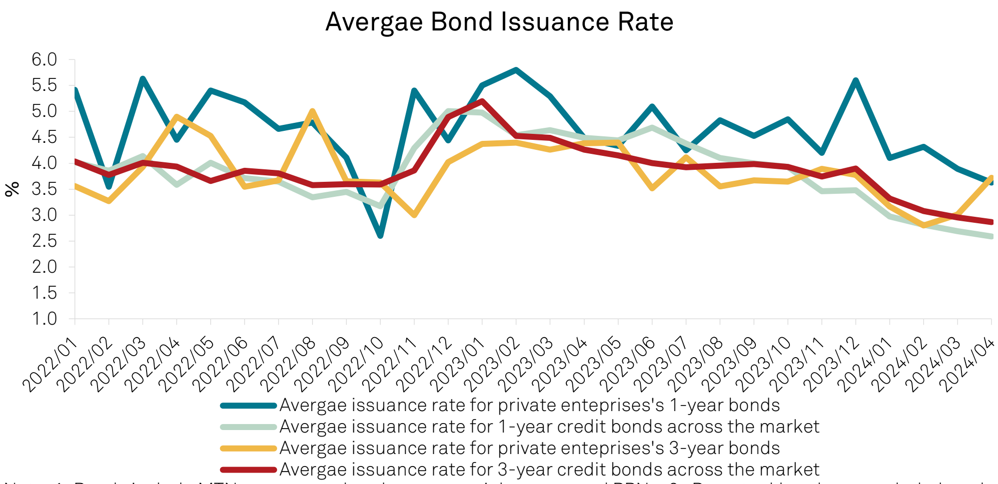


Note: Net financing is calculated based on companies issuing new bonds within the year. Bonds include MTNs, corporate bonds, commercial papers, and PPNs.
Source: Wind, S&P Global (China) Ratings.

Short-maturity Private Enterprise Bonds May Become the New Choice Under Asset Shortage

Due to investors' preference for SOE bonds and numerous defaults across the private sector amid the default wave over the past few years, private enterprises face deteriorating financing conditions. Companies with weaker credit quality can only raise funds through issuing short-term bonds, while those issuing 3-year-or-longer-term bonds enjoy better credit profiles. This has caused the average issuance rate for private enterprises' short-term bonds to stay significantly higher than that for the bonds with same maturity across the market. In addition, maturities and interest rates of private enterprise bonds are considerably inverted.

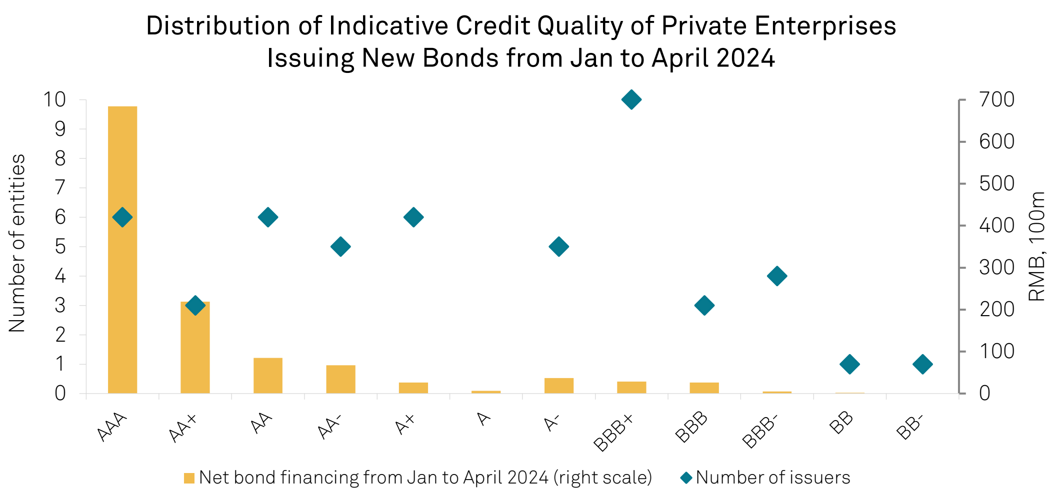
Chart 5



Note: 1. Bonds include MTNs, corporate bonds, commercial papers, and PPNs. 2. Perpetual bonds are excluded, and pre-vesting maturities are adopted for option-embedded bonds.
Source: Wind, S&P Global (China) Ratings.

We have conducted an assessment based on public information and discover that among private enterprises issuing new bonds in 2024, issuers with indicative credit quality of "AA" category or above only account for 33% of overall sampled entities, indicating that a large proportion of issuers have relatively weaker credit quality.

Chart 6



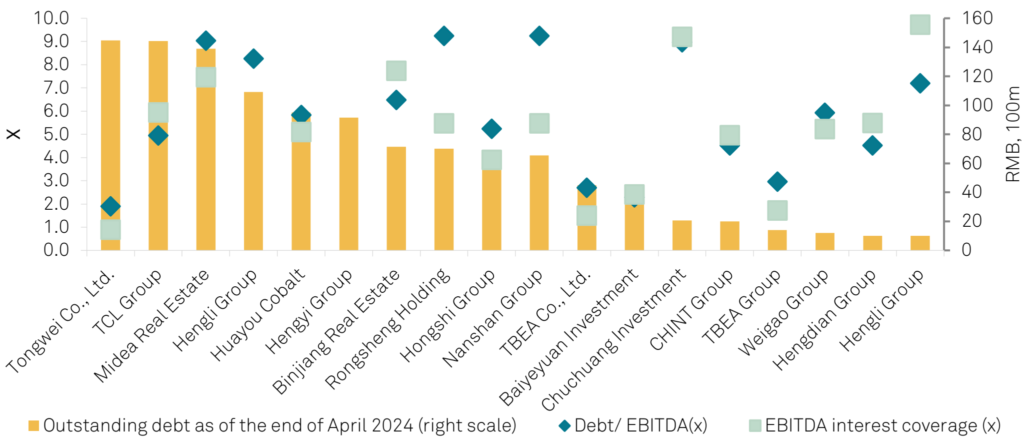
Note: Indicative credit ratings are our testing results based on public information.
Source: Wind, S&P Global (China) Ratings.

Private Enterprises' Potential Investment Value Underpinned by Three Characteristics: Fair Leverage, Mild Liquidity Pressure, and Higher Spreads Relative to Issuers with Same Credit Quality on Secondary Market

Although some private companies see modest creditworthiness in general, they maintain fair leverage levels and mild liquidity pressure over the next year, thus showing certain investment value. These companies include TCL Group, Huayou Cobalt, Baiyeyuan Investment, and TBEA.

Chart 7

Private Enterprises with Moderate Debt Burden and Mild Liquidity Pressure Over the Next Year

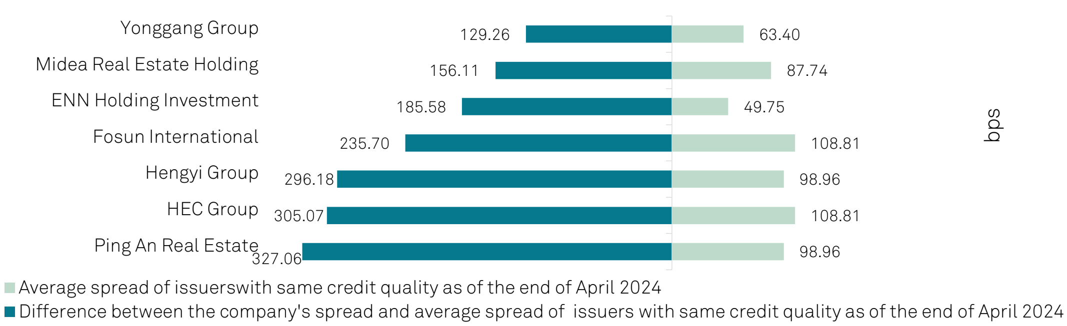


Note: Financial metrics based on Wind data as of the end of 2023.
Source: Wind, S&P Global (China) Ratings.

Some private enterprises have credit spreads that are noticeably higher than the average for issuers with same creditworthiness. Nonetheless, these private enterprises' credit quality, despite widely distributed and greatly diverged, should stand better than that of the overall secondary bond market, thus illustrating these companies' potential to become valuable investment targets.

Chart 8

Companies with Significantly Higher Spreads Compared to the Average of Issuers with Same Credit Quality from March to April 2024



Note: The company's spread is the average of differences between yield to exercise for all the company's bonds and yield to maturity for CDB bonds with same maturities, based on ChinaBond valuation. Indicative credit ratings are our testing results based on public information and our corporate methodology.
Source: Wind, S&P Global (China) Ratings.

This report does not constitute a rating action.

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