Outlook for the Corporate Credit Market

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Standard Bank

Agenda

1. The Global Economy
2. The South African Economy
3. The SA Corporate Credit Market
4. The Global Corporate Credit Market

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Section 1:
The Global Economy

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Where is the global economy?

- Worst recession since 1930's
- 3.1% global growth 2010 (SARB)
- Strong rebound unlikely
- Growth prospects flat to moderate in 2010 hopefully picking up thereafter
- Excessive levels of volatility in financial markets & concerns about systemic failure have reduced
- To date the developed economies of the US, UK and selected Western European countries have been the worst hit
- Many developing economies have proven more robust, particularly the Far East

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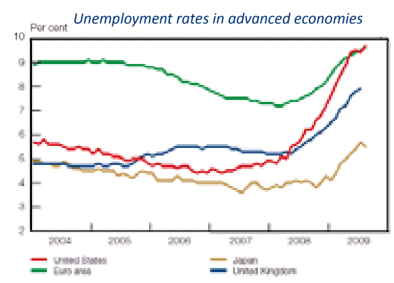
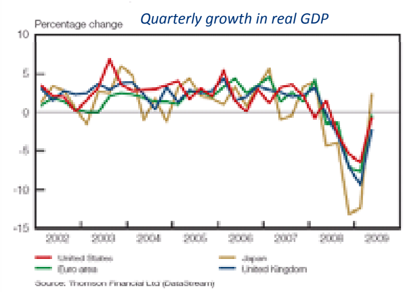
What happens when the stimulus and easing monetary policy stop?

Will unemployment worsen again?



Source: Bloomberg

Will returning global GDP growth be sustainable?



Source: Thomson Financial Limited

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Section 2:
The South African Economy

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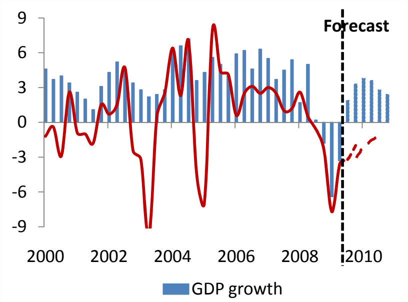
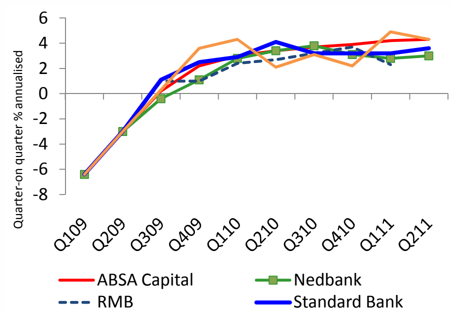
SA economic recovery has commenced

Recession reached advanced phase



Source: SARB, Standard Bank Group

GDP growth trajectory: market view



Source: SARB, Standard Bank Group

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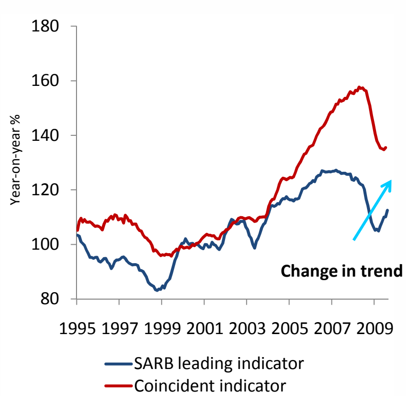
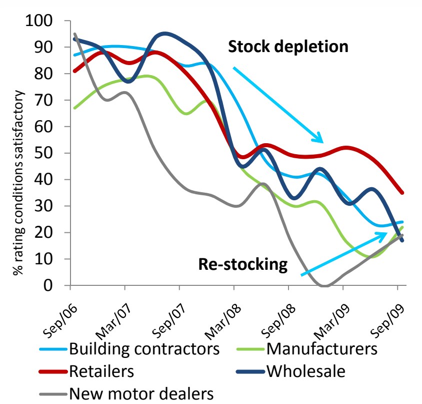
SA economic recovery has commenced cont.

Business cycle indicators turning



Source: SARB, Standard Bank Group

Business confidence on the mend



Source: SARB, Standard Bank Group

Source: Reuters Econometer, September

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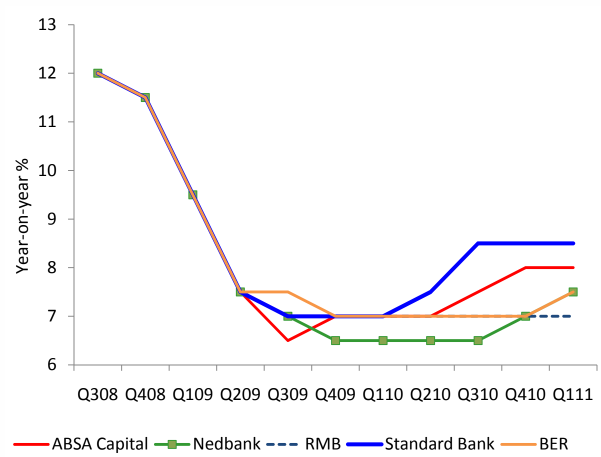
Repo rate trajectory market view – good news and bad news



Source: SARB, Standard Bank Group

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Section 3:
The SA Corporate Credit Market

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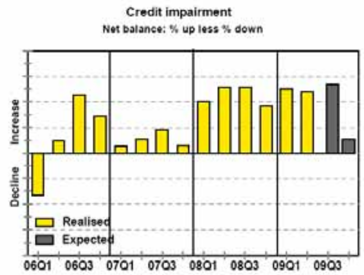
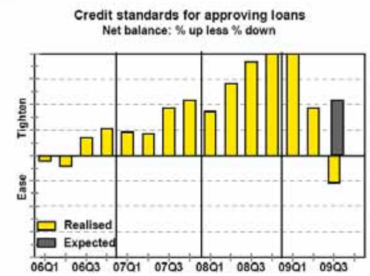
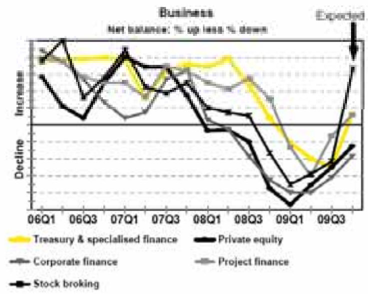
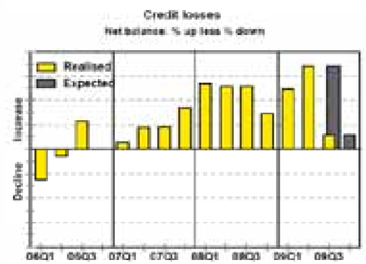
Ernst & Young Q3 2009 corporate lending findings









Source: Ernst & Young Financial Services Index, 3rd quarter 2009

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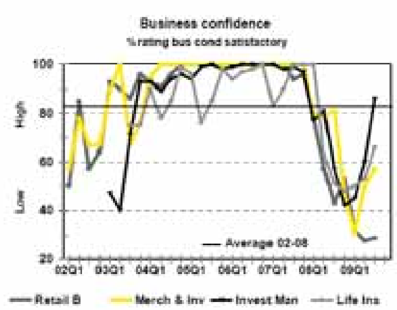
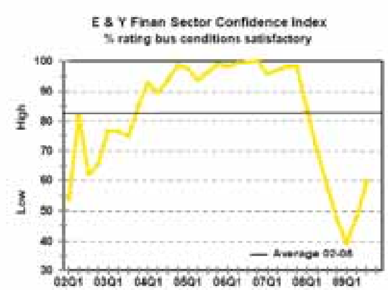
Ernst & Young Q3 2009 corporate lending findings cont.

- Ernst & Young Financial Sector Confidence Index rose to 60 in Q3 (Q2 48), despite basic fundamentals remaining weak
- Not in sync with retail trends or with the Business Confidence Index
- Business Confidence Index dipped to 10 year low in Q3 2009





Source: Ernst & Young Financial Services Index, 3rd quarter 2009

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SA corporate credit market

- The corporate lending sector has proven very resilient to date
- NPLs have increased but are still at very acceptable levels given the global and SA economies
- Average SA NPLs for the major banks at June 2009 were R2.7bn (vs R1.1bn June 2008)

  and average credit loss ratios at June 2009 were 0.68% (vs 0.18% June 2008) *(caveat emptor)*
- Some sectors have been worse hit than others, for example:
  - Motor manufacturing
    However many companies have strong international parents
  - Property and particularly (residential) property developments
    However the size of the listed property market with diversified portfolios & generally low levels of gearing has been a strong positive
  - Mining
    Especially new start ups but hedging has been a key mitigant and commodity prices have been recovering
  - Construction
    Starting to feel the pain as offshore markets have dried up, Gautrain and World Cup kickers come to an end and government infrastructure spending in SA is increasingly under threat

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SA corporate credit market cont.

- Risk appetite was comparatively conservative going into the crisis
- There are some obvious areas of higher risk appetite
  - Private equity deals
    Covenant light funding was a particular negative but hedging offsets arising from foreign currency bond funding a positive
    Limited casualties to date
  - End of cycle BEE deals
    However corporate sponsors and the funding banks have generally been supportive and accommodating
- Low exposure to high risk securities or complex instruments
- Economic pricing, less aggressive tenors and more comprehensive covenants
- Strict regulatory environment
- Positive response to Basel II
  - Advanced approach adopted by all majors
  - Better appreciation of the impact of concentration risk and diversification
  - Improved risk based pricing

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SA corporate credit market cont.

Extensive restructuring experience from the last downturn

- Proactive identification of problems and a positive approach to solutions - as has been the case with many other market participants, for example fund managers and institutional investors

  Examples include:
  - Metorex
  - Supergroup
  - Sentula
  - with more pending….

In addition:

- Many of the more unsavoury liquidators are out of the game or have fled
- Company directors are far more aware of their responsibilities etc
- But where are the recovery funds and appropriate government sponsored support?
- Fraud especially in the broader sense has become increasingly more evident
- Do we fully appreciate and/or understand the implications of the new business rescue provisions in the new S.A Companies Act? Good news and not such good news

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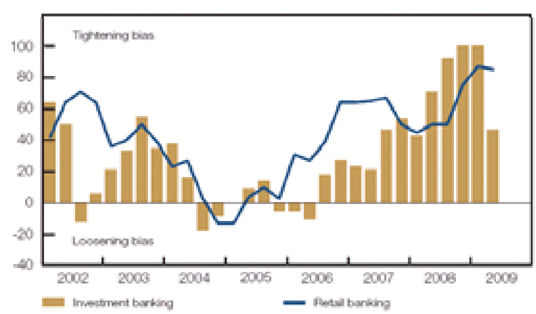
Corporate lending risk appetite is improving

‘Net balance' is the difference between the percentage of bank survey respondents who tightened lending standards and those who eased them during a specific quarter



Source: Bureau for Economic Research & Ernst & Young

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Section 4: The Global Corporate Credit Market

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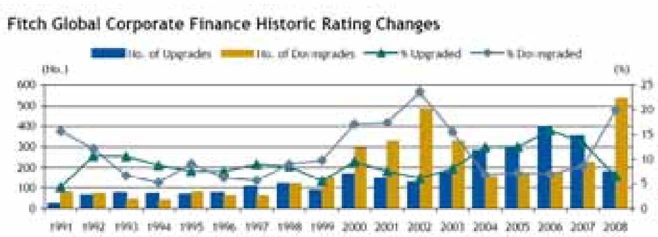
Selected 2008 Fitch findings in respect of corporate credit

- Global corporate credit quality deteriorated at an alarming rate in 2008
- Downgrades: upgrades = 3:1 (vs 0.6:1 in 2007)
- 37 global issuer defaults vs 3 in 2007 (Fitch)



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Source: Fitch Ratings

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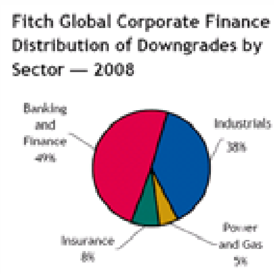
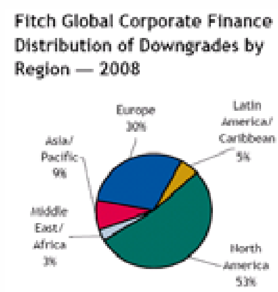
Global corporate credit market

- Investment grade issuers: 19.2% increase in downgrades (vs 8.7% 2007)
- Speculative grade issuers: 21.9% increase in downgrades (vs 8.2% 2007)





Source: Fitch Ratings

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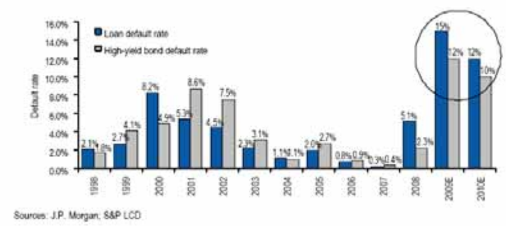
JPMorgan has revised its corporate default rate forecast for non-investment grade companies

From



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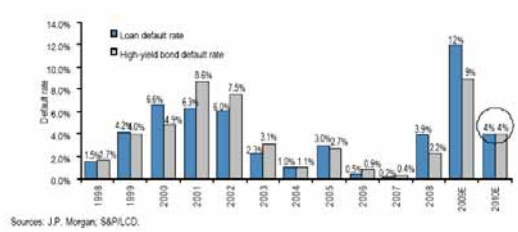

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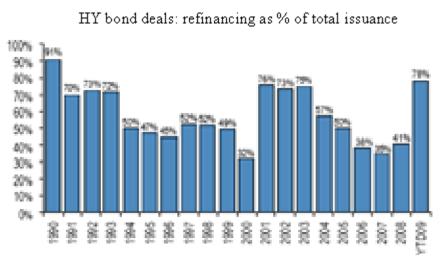
Which has been primarily driven by…

- Opening of the High Yield Bond market
  New bonds to fund existing debt



- "Amend and extend"
  Stressed firms are avoiding bankruptcy by rolling existing loans into longer maturities

Source: JPMorgan

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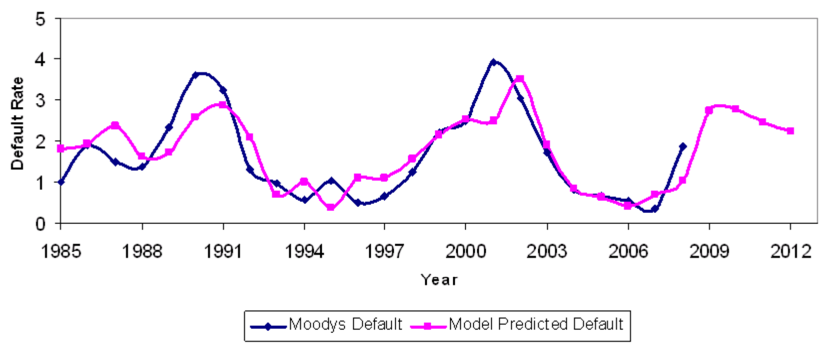
Moody's global outlook for corporate defaults and Standard Bank's model predicted defaults



Source: Standard Bank Proprietary Internal Research

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Global corporate credit market cont.

- To date the developed economies of the US, UK and selected Western European countries have been the worst hit
- The general perception is that NPLs in SA and other Emerging Markets (EMs) are lagging developed economies by up to 9 months
- NPLs in EMs have varied considerably
  - BRICs other than Russia have proven robust
  - Results have been mixed in the Far East, with China spectacular
  - Eastern Europe has generally been hard hit
  - EMEA has been varied
  - Africa outside SA has been relatively robust
  - South America has also been varied, with Brazil the shining star
  - SA is proving to be robust

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Global corporate credit market cont.

- Country risk has proved to be a very significant factor
  - Politics
  - Economic fundamentals

  Good examples are:
  - Ukraine (both)
  - Argentina (politics)
  - Dubai (economics)

  In country defaults, trading loans and the like are often treated more favourably than other lending
- The strength of each country's regulatory regime has been important
- There have been some clear surprises, for example many developed economy regulators and banks have mostly fared worse with low regulatory capital requirements, under/unregulated products and very aggressive risk appetites etc
- In developed markets the holding of security is less common and gearing levels tend to be higher

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Global corporate credit market cont.

- Multi bank syndications are more common in developed markets, typically with participants from different geographies with different styles
- Participation by hedge funds and vulture/distressed debt funds are significant in most markets - their approach can be very aggressive and usually causes complications when they have bought at a discount
- Bonds have been frequently and aggressively used in developed markets, especially for funding private equity and similar deals, with such bonds often being covenant light, while the senior and/or secured lending tranches may penalise the holders when they exercise early termination and other rights
- In EMs Government special requirements and conditions are not uncommon, for example to ensure local equity participation as a condition of obtaining and/or retaining licenses and the like
- Legal risks typically differ materially from country to country, for example:
  - Business restructure law and insolvency law
  - Does an ISDA work in Argentina and a derivative in China (unless it is clearly in the interest of the client)?

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Global corporate credit market cont.

- Banks with "new" Government shareholders (such as RBS in the UK) are being encouraged to exit foreign exposures
- Do "client-bank relationships" still have as much value when there is a lending problem?
- Participation in IFC, government export agency and similar lending is meant to limit defaults and/or mitigate losses – but does it, and at what cost?
- Picking your syndication partners can be key, for example:
  - In Angola, big French oil banks and Chinese banks are a 'yes'
  - In Congo Brazaville oil lending on the coast (at Point Noir) with a government linked French oil company & a squad of French Foreign Legion just down the road is also good

Sharia'h lending can be a complication…is it treated as equity or debt?

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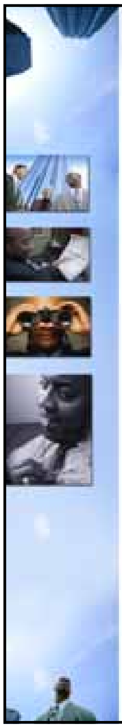

Global corporate credit market cont.

- Typically it is much harder to manage a problem loan when you do not have local presence and hence have less knowledge with (long term) country relevance
- US$-denominated borrowing is common in EMs but the ability of a lender or borrower to hedge a foreign currency EM loan is often limited or very expensive
- Primary and secondary EM and high yield debt distribution markets can evaporate very quickly in distressed circumstances
- Changing OFAC and related requirements can be a problem, for example in Iran and Sudan

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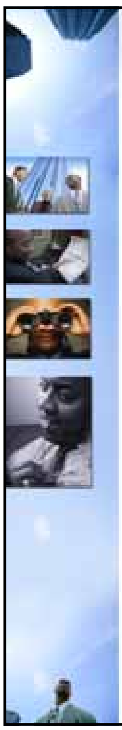

Questions

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