Panda bonds are eating away at dim sum bonds' popularity

The year the panda ate the dimsum

From Singapore to Hong Kong, the dominance of dim sum bonds seems less assured as panda bonds start to amass momentum due to lower funding costs and increasing support from the Chinese government.

Only a couple of years ago, issuers and investors were feasting on dim sum bonds like there was no tomorrow, but there is a new star in the debt market world: panda bonds, which are yuan-denominated bonds sold by foreigners on the mainland. Analysts in Hong Kong and Singapore note that whilst the dim sum market has grown rapidly and even reached record proceeds in 2014, panda bonds are starting to amass momentum, and may soon overtake dim sum bonds in popularity.

In Hong Kong, issuers and investors are starting to turn away from dim sum bonds and are now flocking to panda bonds due to the latter's lower funding costs and increasing support from the Chinese government. "In the long run it is likely that the panda bond will win out," says **Keith Pogson**, senior partner, financial services, Asia Pacific at EY. "Depth and pricing will likely be key reasons as well as the present uncertainty as to conversion rights for currency."

Whilst the dim sum market has grown rapidly and even reached record proceeds in 2014, panda bonds are starting to amass momentum.

With the move to internationalise the use of renminbi, panda bonds are receiving quite a push from Beijing. Loose monetary conditions meant to spur on the economy have kept onshore funding costs lower, and made panda bonds increasingly more attractive to foreigners that want to raise funds in the mainland.

The debut of China's panda bonds, an equity boom, and the yuan devaluation have helped slow down the demand and issuance for dim sum bonds, says **Elaine Tan,** senior analyst, deals intelligence at Thomson Reuters.

Dim sum bonds began gaining traction in 2010 after the loosening of restrictions and the issuance of international institutions, until reaching a peak record level in 2014 when total proceeds raised amounted to RMB337.7b (US$54.9b). But total dim sum bond proceeds so far this year amounted to RMB85.6b (US$13.0b), down 38.8% from the same period last year. "Although dim sum bonds started to pick up again during the second quarter of this year, potential headwinds include currency concerns and increasing interest in China's onshore bond market," says Tan.

In contrast, panda bonds issuance increased in 2016 year-to-date and reached RMB17.6 b (US$2.7b), a large jump from RMB5.0b (US$777.8m) issued in 2015.

Issuers and investors might be losing their appetite for dim sum bonds, but they have a growing taste for panda bonds, especially with incoming measures to increase the latter's adoption. Pogson says Chinese authorities have been showing interest in necessary reforms to spur on the take-up of panda bonds, including the relaxation of filing requirements to support multiple formats of accounting, which has been one of the key problem areas of issuing panda bonds.

The increase in defaults have also dented interest in dim sum bonds but analysts believe there is still a healthy pool of investors keen to snack on dim sum bonds.

"PRC issuers are hungry for capital and the whispers of looming defaults certainly spook some investors, but there are a lot of investors out there still looking for yield and dim sum is one familiar way to participate," says **Thomas Kollar**, partner at Mayer Brown JSM. "For the right issuers, dim sum will always be an option," he adds. "It will be interesting to see the interplay between the fast-developing onshore panda market and the offshore dim sum market over the course of the next year."

Whilst the rivalry between dim sum bonds and panda bonds dominates headlines, Hong Kong's local currency remains a viable source for issuers seeking to meet regulatory capital requirements, says Tan. In fact, total issuance of HK$ bonds continued to grow at a record pace with proceeds amounting to HK$137.6b (US$17.7b), an 89.5% increase from the same period last year. The Financials and Government sectors accounted for majority of the issuance with 95% market share. Overseas issuers, excluding China, tapped the HK$ bond market and accounted for 26.7% of the market share. Kollar says the recent uptick in activity is due to issuers seeking to take advantage of favourable yields either to raise new funds or re-finance existing debt.

Limited exposure in Singapore

In Singapore, dim sum bonds are once again heating up, but it is a trend that not everyone is keen to ride just yet. Despite the higher yields that dim sum bonds offer, more cautious investors have been limiting their exposure due to a fear of defaults and currency depreciation.

"There are conflicting views on whether issuers will return to the dim sum market. There was a tail-off last year and the beginning of this and the reasons for the reductions have not disappeared," says **Vicky Münzer-Jones**, a partner in the Singapore office of Norton Rose Fulbright.

"However, some are starting to believe the rhetoric that China's slowdown is a sensible correction, and, therefore, the prospects for the currency over the typical term of a dim sum bond are not so bad."

She reckons offshore renminbi issues will be attractive for investors who are looking for higher returns compared with other currencies, especially in a market where negative interest rates are not just confined to Japan. It will also be a viable option for those that want to diversify their portfolios. "Investors may be willing to ignore why the higher yields are offered. In this environment, a dim sum bond may seem to be the better option," says Münzer-Jones.

"Some investors sitting on capital which needs to grow are looking at increasingly risky structured investments to get a return which they would have been able to get from reasonably standard investments not that long ago," she adds.

More interest in panda bonds

But based on anecdotal evidence, in Singapore, Münzer-Jones observes that more clients asking about panda bonds than about dim sum bonds.

China's panda bonds market opened last year to great enthusiasm, opening a new funding channel that had been exclusively available to select agencies. Since then overseas-incorporated Chinese companies had been lining up to issue panda bonds due to their lower funding costs compared to dim sum bonds.

Keith Pogson

Elaine Tan

Vicky Münzer-Jones

Thomas Kollar

Over the past months, there has been expectation that China's panda bonds will exceed dim sum bonds for the first time. Warehouse developer and operator Global Logistic Properties (GLP) became one of the first foreign companies to issue panda bonds on the Shanghai Stock Exchange. GLP floated $224m which proved to be popular among institutional investors and ended up three times oversubscribed, with reported plans to issue a larger amount of up to $1.5b.

Key challenges

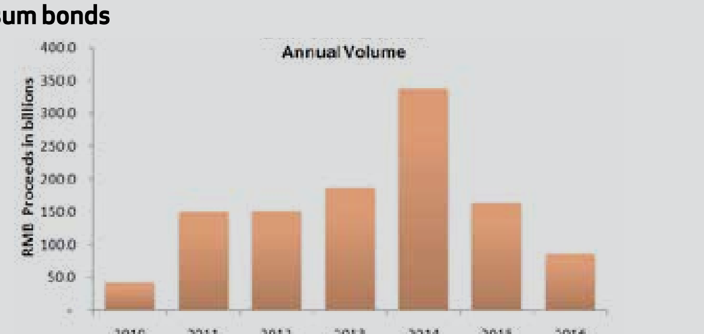
But despite GLP's successful issuance, some foreign issuers have had to deal with a muck of regulatory issues surrounding panda bonds, which has tempered interest. Key challenges for potential issuers include providing past three years of financial statements under Chinese accounting standards (CAS), according to **Jack Chan,** managing partner, financial services, Greater China at EY.

Converting non-CAS accounts into CAS accounts as part of the filing can be a very arduous task, barring any granted exemptions for the issuer. panda bond issuers also must draft circular and disclosure documents in Chinese, requiring careful translation.

But for issuers that decide to push through, the payoffs could be worth it. He reckons panda bonds offer a way for financial and non-financial enterprises to diversify their investor base and gain a foothold in China. They also provide a vehicle for enterprises that want to fund an onshore subsidiary or to expand their operations in China. And for first movers, the issuance grants significant publicity and marketing advantages.

Norton Rose Fulbright Singapore's Münzer-Jones reckons debt capital markets in Singapore and South East Asia will face a bumpy road, but there remains hope that there will be more deals in the region during the last part of the year.

Dim sum bonds



Source: Thomson Reuters