Emerging Market Corporates

Popular Misconceptions Dispelled By The Facts

Weaker currencies and lower commodity prices are not always negative for EM corporates.

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It is no longer appropriate to label emerging market debt as a singular asset class but it is not easy to come up with a better term for such a great diversity of countries and opportunities. In the EM corporate space, regional dynamics highlight materially different trends even within the same industry sector thus requiring a highly efficient analytical approach and more so, the analyst resources close to the action.

We believe there is no "secret ingredient" to EM corporate investing other than having deep analytical capabilities, a focus on the fundamentals, and maintaining a close and constant dialogue with the issuers, while assessing whether dollar revenue streams are matching dollar liabilities etc. Without these capabilities, investors are at risk of investing blindly and being too influenced by misconceptions formed by headlines rather than the facts.

The traditional investor focus on EM sensitivity to commodities is a prime example of how markets have changed. Sharp commodity price falls explain only part of the EM story and many forget EM companies have managed through low price levels in previous cycles.

As oil prices fell below US $100 last year in almost a straight line, they triggered a sharp risk aversion across global markets with a profound impact on EM debt and currencies, in particular. The EM currency basket dropped by about 22%[1] against the US dollar over the last 12 months, with wide divergence in FX performance. Commodity-currencies, the likes of the Brazilian real, Colombian peso and Russian rouble fell by almost 40% over the same time. Half of that weakness happened over the last three months as commodities continued to march lower, now driven by what we believe are overblown investors' concerns that the Chinese government is losing control over its economy.

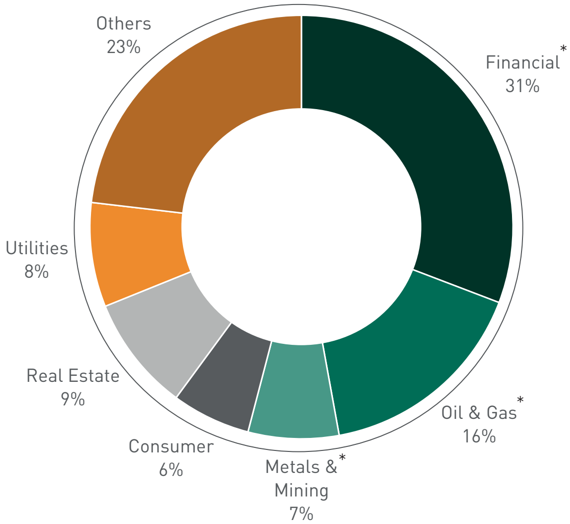
Other currencies, notably the Philippine peso, Indian rupee, Thai baht and some Eastern European currencies fared much better, even though still down. There are also tightly managed and pegged currencies that make up almost one third of the countries in the EM corporate universe and these hardly budged, even though speculation is growing that some of the pegs maybe let go, triggered by the recent partial adjustment of China's foreign exchange mechanism. While this may be the case for some, with the Kazakh tenge and some smaller Asian country currency regimes already having re-adjusted, the rest, notably the Gulf pegs, will likely stay unchanged given these countries' resources and willingness to maintain currency stability.

EM corporates were naturally affected by the broad currency dips, but not always negatively. Generally, where central banks have allowed currency adjustments, countries have typically boosted commodity producers' dollar revenue streams and increased the competitiveness of their local cost bases. The impact on net importers of commodities is not so straightforward as currency weakness may offset the benefits of lower commodity prices. We believe each individual company's financial performance needs analysis on its own merit.

The metals & mining sector that accounts for about 7% of the mainstream corporate index is a case in point: its recent review by PineBridge's ten-strong team of EM corporate analysts concluded that the Asian regional outlook signals a mixed picture while Latin America

[1] Source: FX component of the JP Morgan GBI-EM Global Diversified Index, 22 September 2015

FIGURE 1 EM Corporates Industry Breakdown



Source: JP Morgan, 31 August 2015
*Green-shaded sectors are naturally less exposed to currency risk.

generally indicates a negative trajectory. Meanwhile Europe, the Middle East and the African region mainly have a positive bias (figure 2). The conflicting regional circumstances show it is senseless to generalize across a US $1.7 trillion asset class spread across 50 different countries as compelling opportunities can be easily overlooked. More so, the international US dollar corporate bond market consists of a highly diverse group of substantial companies, most have foreign currency revenue streams, are listed, rated and highly transparent.

Over the last year geopolitical disorder has added a layer of disarray across EMs and grasping the potential impact of this is no easy task. An analysis of the underlying credit fundamentals often provides clear evidence of the true picture. Russia is much maligned, yet Russian mining and metals USD bond issuers are in robust financial health, having an average net debt to EBITDA level of only 1.8x and cash covering short-term debt by an impressive 1.68x.[2] Debt levels fell sharply as the rouble depreciated 35% against the US dollar in the last quarter of 2014. Profit margins were maintained, yet their bonds still trade at semi-distressed levels at 80-90% of their original issue price. With all the noise around commodity prices this year, metals & mining sector returns were down by about 1% year to date while Russian names have been top performers generating around 20% returns in the same period.

Although currency weakness remains a risk to EM, we believe it is not as widespread as many commentators assert. Issuance from the banking sector accounts for about a third of the total EM corporate universe and for these entities the currency exposure is either hedged or matched as required by the many of the local regulators. Meanwhile commodity producers, which form another quarter of USD issuers, typically hold a natural hedge for FX debt in the form of dollar revenues (figure 1). So again, the devil is in the detail. Overall for the asset class, debt servicing is manageable, defaults are low and commodity producers have high cash balances.

FIGURE 2 The Devil Is In The Detail: A sample of metals & mining corporates metrics[3]

	FX Revenues	FX Debt	Total Debt	Short Term Debt/Total Debt	Short Term Debt	Cash	Capex	Free Cash Flow	Net Debt
Company 1	100%	66%	1,752	2.2%	39	1,377	421	567	0.31X
Company 2	35%	90%	2,907	16.3%	474	1,552	577	1,049	0.57X
Company 3	59%	81%	3,036	29.0%	880	1,384	595	962	0.68X
Company 4	59%	100%	6,368	15.3%	974	996	510	911	2.48X
Company 5	60%	73%	4,207	9.8%	412	533	388	822	2.11X
Company 6	26%	66%	3,048	18.4%	561	144	294	198	3.70X

[2]Data as of 30/06/2015 – this number is conservative and strips out Polyus Gold which had a Cash/ST Debt ratio of 36.2X as at 30/06/2015.
[3]Source: PineBridge Investments, companies data based on Q2 2015 earnings.

About PineBridge Investments

PineBridge Investments provides investment solutions that span the full spectrum of asset classes and geographies around the globe. We manage more than US $77 billion in assets, and more than US $38 billion in Fixed Income investments. Our investment professionals focus on delivering compelling results for our clients, and the global interconnectivity among our teams allow us to remain at the forefront of opportunity.

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