Chilton Investment Services
Weekly Update
December 4th, 2017

Visit our website!

www.chiltoninvestmentservices.com

Please feel free to reach out to us. We look forward to your phone call.

Timothy W.A. Horan
CIO-Fixed Income
646-443-7748
thoran@chiltontrust.com

Gregg Manjerovic, CFA
Taxable Portfolio Manager
646-443-7768
gmanjerovic@chiltontrust.com

Stephen Stowe, CFA
Head of Credit Research
646-443-7866
sstowe@chiltontrust.com

Laura Ridolfi
Associate Portfolio Manager
646-443-7792
lridolfi@chiltontrust.com

Eamon Marley
Credit Research Analyst
646-443-7745
emarley@chiltontrust.com

Francesca Genovesi
Credit Research Analyst
646-443-7776
fgenovesi@chiltontrust.com

Asia EM: India, Indonesia and Malaysia Offer China Alternative

In our update dated October 2nd, we outlined our high level views on Asia followed by an October 30th publication stating our cautious view on China. This piece completes our introduction to Asian emerging market credit with a look at India, Indonesia and Malaysia. **While valuations are largely in-line with the broader corporate market following strong year-to-date performance, each offers the benefit of insulation from the Chinese economy – India and Indonesia by virtue of limited external trade linkages; Malaysia due to its strong balance sheet and economic fundamentals**. We approve 6 corporate names in these countries as well as bonds issued by the respective sovereigns.

India - overweight

- State Bank of India (SBI) – overweight; largest Indian domestic bank; state-controlled; spreads should narrow as loan quality improves
- Industrial Credit and Investment Corporation of India (ICICI) – overweight; largest Indian private sector bank; spreads should narrow as loan quality improves
- Bharti Airtel Ltd. (BHARTI) – underweight; leading Indian wireless carrier; cautious view on spreads until market pricing stabilizes

Indonesia – overweight

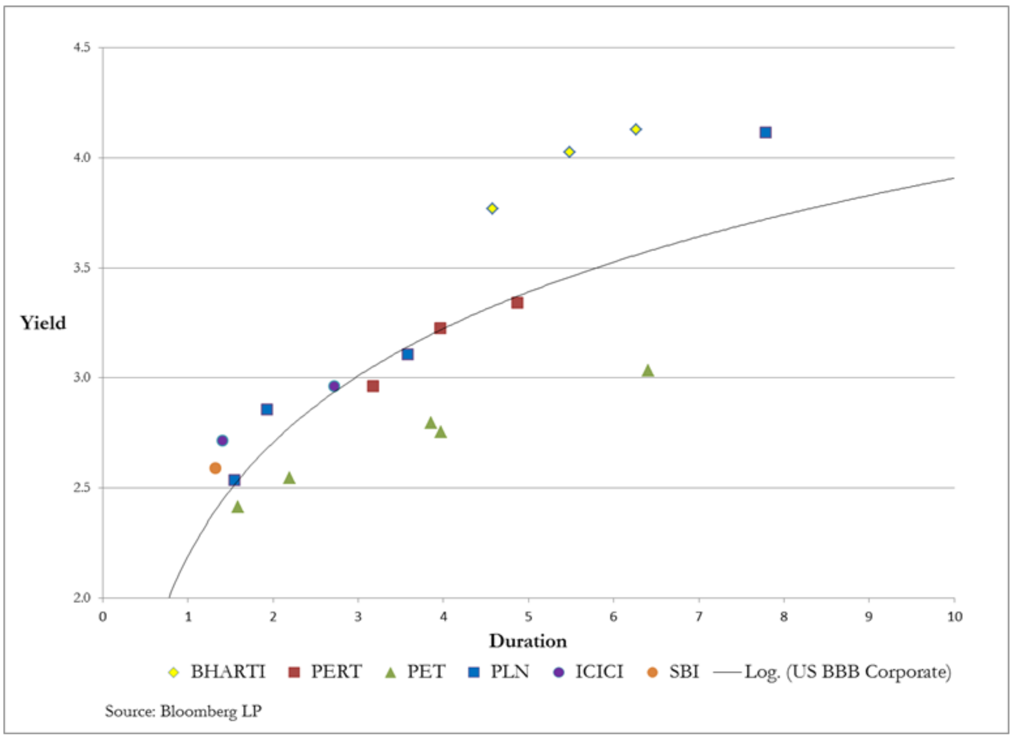
- Pertamina Persero PT (PERT) – overweight; state-owned oil & gas company; relatively higher yields on a leverage-adjusted basis than PLN
- Perusahaan Listrik Negara (PLN) – neutral; state-owned electric utility

Malaysia – neutral

- Petroliam Nasional Berhad (PET or "Petronas") – neutral; state-owned oil & gas company

Chart 1 demonstrates that these names are fairly priced with most yielding comparably to the triple-B rated segment of the US investment grade market. BHARTI remains an outlier on the high side while PET trades rich, befitting its position as the strongest credit. In such an environment, our focus is on gradually building positions in names with the strongest relative fundamentals and awaiting an appropriate time to add to positions if yields become attractive. Irrespective of pricing, we believe an allocation to these names makes sense to gain exposure to the regions strong long term fundamentals and capture diversification benefits.

Chart 1: Yields Generally In-line with US triple-B issuers



India

Overweight on India reflecting a large economy with good growth prospects (current GDP growth 6.3%). Limited external vulnerability as just 0.4% of GDP is derived from export sales to China. Prime Minister Modi has proceeded with an ambitious set of fiscal reforms including a surprise announcement in November 2016 that over 85% of the cash currency in circulation would be voided in an effort to reduce the size of the untaxed, cash economy. Perhaps more impactful is the introduction of the new Goods and Services Tax in July 2017, a measure which eliminated roughly 40 prior Federal or local taxes and levies and introduced a computer-based payment network to improve compliance. Future reforms must address the country's banking sector and promote further liberalization of the foreign trade sector.

We approve the two largest Indian banks – the **State Bank of India (SBI)** and **Industrial Credit and Investment Corporation of India (ICICI)**. SBI is 57% owned by the Government of India and is the largest bank in India with assets equal to 34 trillion rupee's. ICICI is a private company and ranks 2nd in total assets at 9.9 trillion rupee's. Both banks are currently working through a high level of non-performing loans, the result of an overleveraged and uncompetitive corporate sector, especially in areas such as iron, steel and power. This balance sheet clean-up is expected to take at least several quarters. Favorably, passage of the Insolvency and Bankruptcy Code in 2016 is expected to help accelerate the historically sluggish bankruptcy court process. Given ICICI's higher retail banking exposure (54% of loan exposure vs. 26% at SBI), credit quality and growth prospects are much stronger than SBI whose largest line of business is corporate lending at 49% of loans. As a result, ICICI's non-performing loans are 4.4% of total loans versus 10% at SBI. However, the government views SBI as "too-big-to-fail" as evidenced in the October 2017 announcement that it was providing 2.1 trillion rupees of recapitalization funds to assist public sector banks struggling to reduce bad loans. ICICI offsets this lack of state support with higher capital levels and a better funding mix than SBI. Therefore we view the two banks as comparably equal credit quality.

India's telecommunication industry has been rocked by the disruptive entry into the market of Reliance Jio Infocomm Ltd. (a.k.a. "Jio"), a well-funded initiative from a leading industrial conglomerate. Jio debuted service in December 2015 and has rocketed to 11% market share by offering free voice and data for limited time periods and steep discounts thereafter. We approve the leading wireless carrier, **Bharti Airtel Ltd. (BHARTI)**, which holds a 24% market share. In addition the company has significant operations in Africa which represent 21% of revenue. Despite the current intense price competition, BHARTI is likely to emerge as one of the domestic leaders and two recent acquisitions will boost domestic wireless market share to around 31%. BHARTI's competitive advantages include a strong spectrum portfolio and the fastest 4G network (though Jio has broader coverage). While top line and average-revenue-per-user (ARPU) have been declining since Jio entered market, industry consolidation and removal of weaker competitors has laid the groundwork for a more stable pricing environment, albeit not until fiscal 2019.

Indonesia

We hold an overweight on Indonesia given a reform-minded administration which seeks to diversify the commodity-reliant economy. With a large, growing domestic population and limited export exposure to China (1.9% of GDP), the country offers an attractive diversification option within Asian emerging markets. Macroeconomic fundamentals are currently sound with below-trend inflation providing support for recent central bank rate cuts. A rally in commodity prices has improved the current account deficit and combined private and public sector leverage is the lowest in our Asian emerging market names at 68% of GDP (~250% for China).

The national oil and gas company – **Pertamina Persero PT (PERT)** - represents one of the largest two Indonesian corporate issuers. Owned entirely by the Government of Indonesia, PERT enjoys a dominant position in domestic downstream activities, owning roughly 90% of domestic refining capacity and retail infrastructure. Historically enjoying the benefits of government fuel subsidies, the subsidy rate was slashed in FY15, driving the overall level of government support to 8% of FY16 revenues from 26% in FY14. However, sales growth is expected to remain strong given the country's strong demographic and socioeconomic trends. Indonesia's nationalistic economic policy has dampened foreign investment, leading to multiple years of flat-to-declining domestic oil and gas production. Current policy seeks to place PERT at the forefront of domestic exploration and production most notably via the upcoming, government-encouraged operational takeover of the Mahakam natural gas field when a current agreement with Total SA-led joint venture expires at the end of 2017. This project and a mandate to expend the country's refining infrastructure represents an opportunity and challenge for PERT as the company has historically struggled to develop new oil and gas resources. While leverage is expected to increase, the company's current credit profile is decent, reflecting the positive impact of recent commodity price increases which should help it absorb a planned ~40% ramp up in capital investment this year.

Similar to PERT, the national electric utility **Perusahaan Listrik Negara (PLN)** has been tasked with an aggressive infrastructure mandate, specifically to increase the country's electrification rate to 97% from current 93%. The project was initiated in 2015 and includes adding 35 gigawatts of new domestic power generation of which PLN is responsible for 11 gigawatts, a roughly 20% increase from its current generation portfolio. The remaining 70% of the planned new capacity is expected to be built by private power companies. Initially expected to be completed in 2019, reversals and delays on several major projects have likely delayed completion of the 35 gigawatt program to an unspecified future date. PLN is fully state-owned and has an integrated operating model, controlling ~80% of domestic generation capacity and 100% of transmission / distribution infrastructure. Leverage at PLN is already high at 5.0x and is expected to rise modestly over the medium term. There have been modest power market reforms in recent years though the government continues to maintain tight regulatory control over tariffs and purchase agreements. Somewhat offsetting this restrictive regulation, the government provides an annual subsidy to PLN which is currently equal to 23% of sales. Rumors of reducing this subsidy arise periodically but nothing has materialized thus far.

Malaysia

Malaysia represents one of our strongest emerging Asian names, although its open, export-oriented economy makes it vulnerable to global financial market cycles. China exports represent 9.1% of GDP and external debt is 68% of GDP. However, the economy is highly developed and very diversified with both technology and commodity exports representing key sectors. External finances are reflective of an open economy with favorable terms of trade and the current account is consistently in surplus. GDP growth is 6.2%, a good rate for a nation with a relatively high per capita income of $13,958. Current policy initiatives include education and productivity reforms, and reducing the government budget deficit towards a target of -3%, a very achievable goal.

We approve **Petroliam Nasional Berhad (PET or "Petronas")** as a government-owned integrated energy firm with exclusive legal jurisdiction over oil and gas operations in Malaysia. The company has good geographic diversity with a presence in over 70 countries though most reserves (~66%) are in Malaysia. The company is well positioned for the ongoing shift toward cleaner fuels as proved reserves are ~60% natural gas and the company has a strong position in the booming liquefied natural gas (LNG) industry, accounting for 12% of global trade. PET has an excellent balance sheet with negative net leverage for at least the last 10 years. Recent investments have focused on increasing the company's refining and petrochemical assets and LNG capacity.

	on a number of assumptions; as such, CIS does not guarantee their accuracy. CIS, in its sole discretion, may modify this document at any time and without notice to the recipient. This presentation is confidential and may not be shared by the recipient with any third parties without the express prior consent of CIS.