



CHANDLER  
ASSET  
MANAGEMENT

# California Municipal Treasurers Association

## Tips on How to Perform Credit Analysis

April 26, 2017



# CMTA: Tips on Performing Credit Analysis

**SECTION 1**

**Diversification of Credit Exposure**

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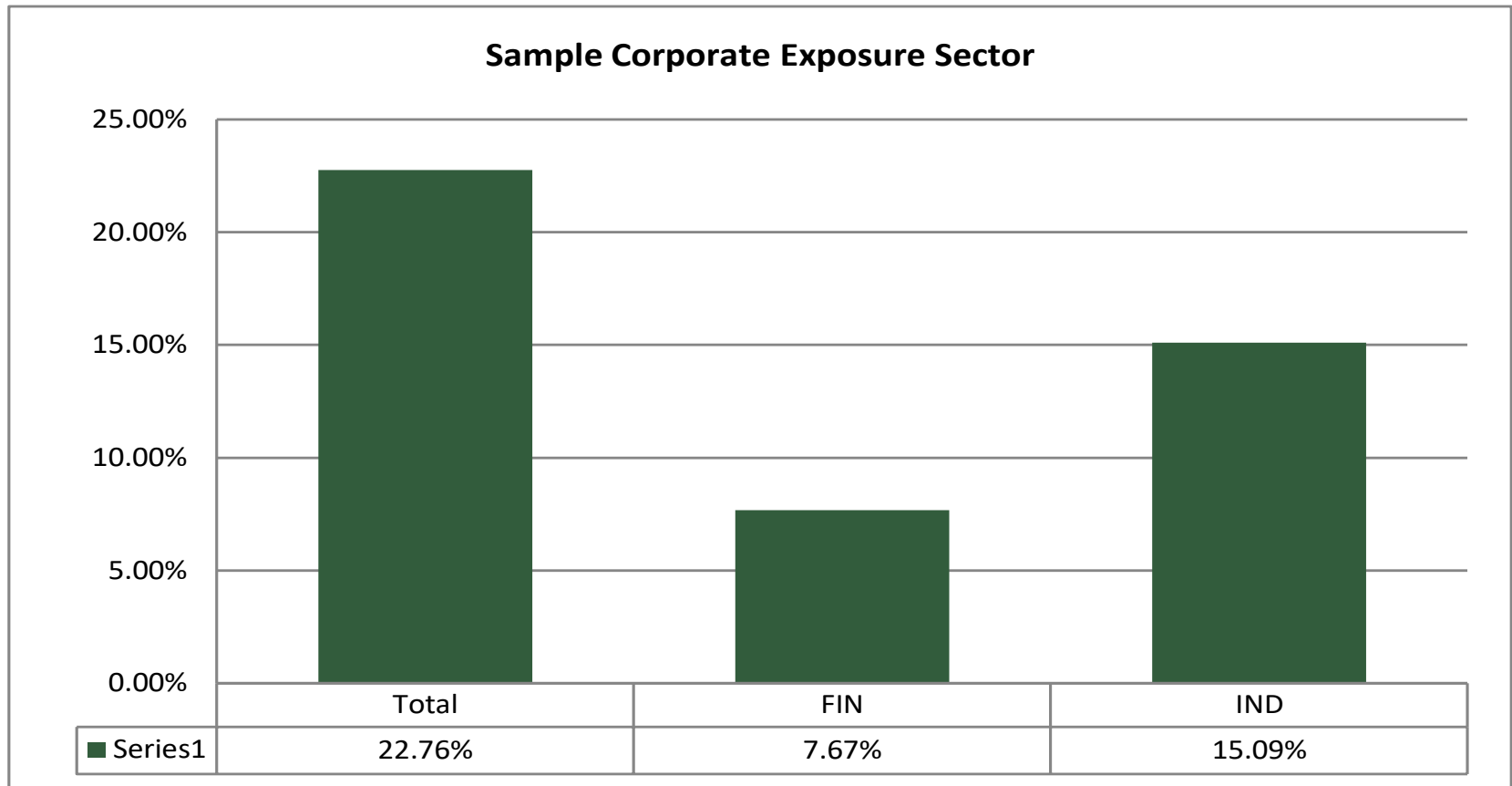
**SECTION 4**

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# Section 1: Diversification and Credit Exposure

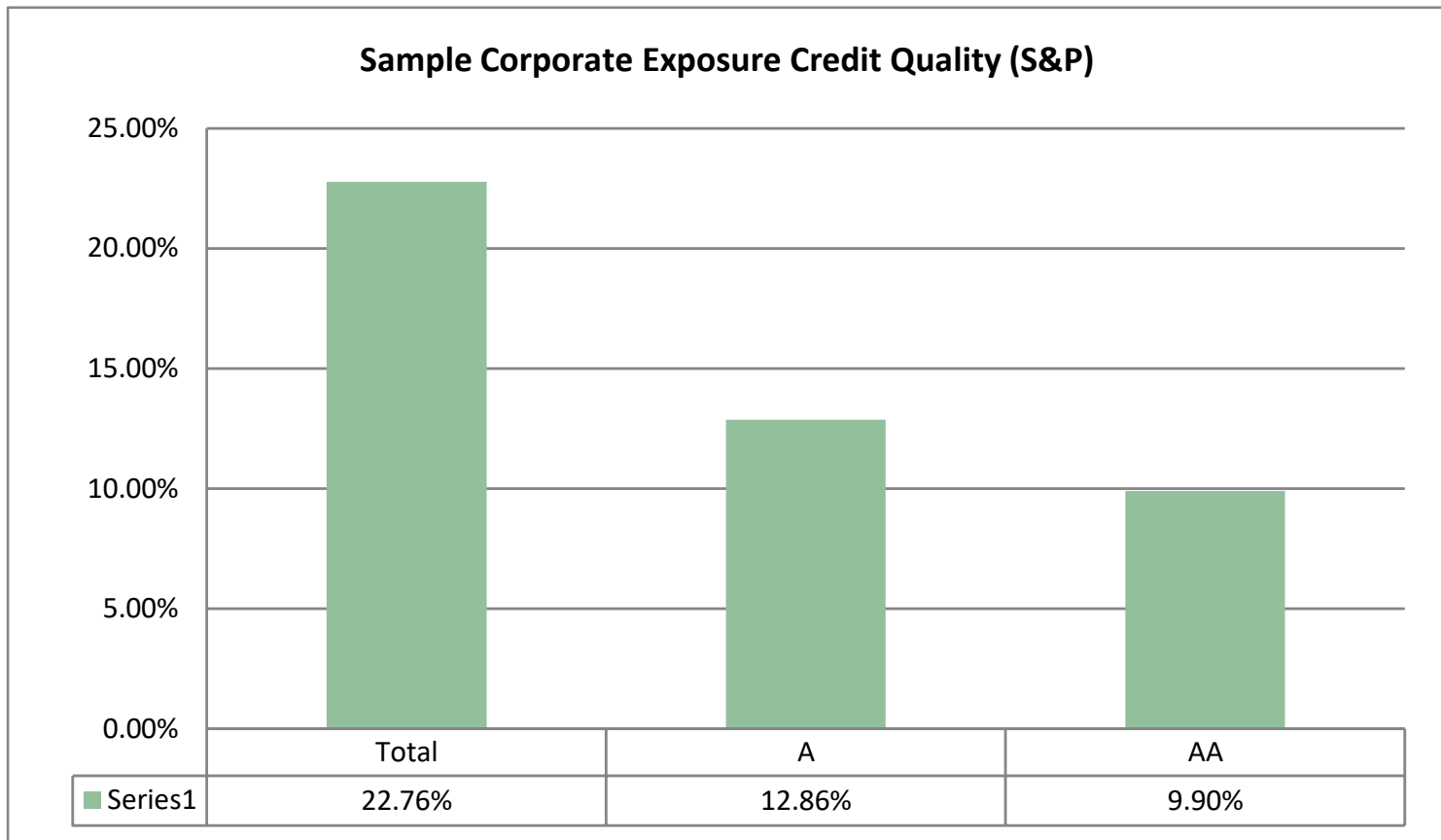
- Chandler recommends a stratified approach - diversifying exposure across multiple elements to ensure a portfolio meets the tenets of safety, liquidity, and return.
- The relative attractiveness of overweighting FIN (financials) or IND (industrials) will depend on a many factors including risk tolerance, economic outlook, and market availability.





# Section 1: Diversification and Credit Exposure

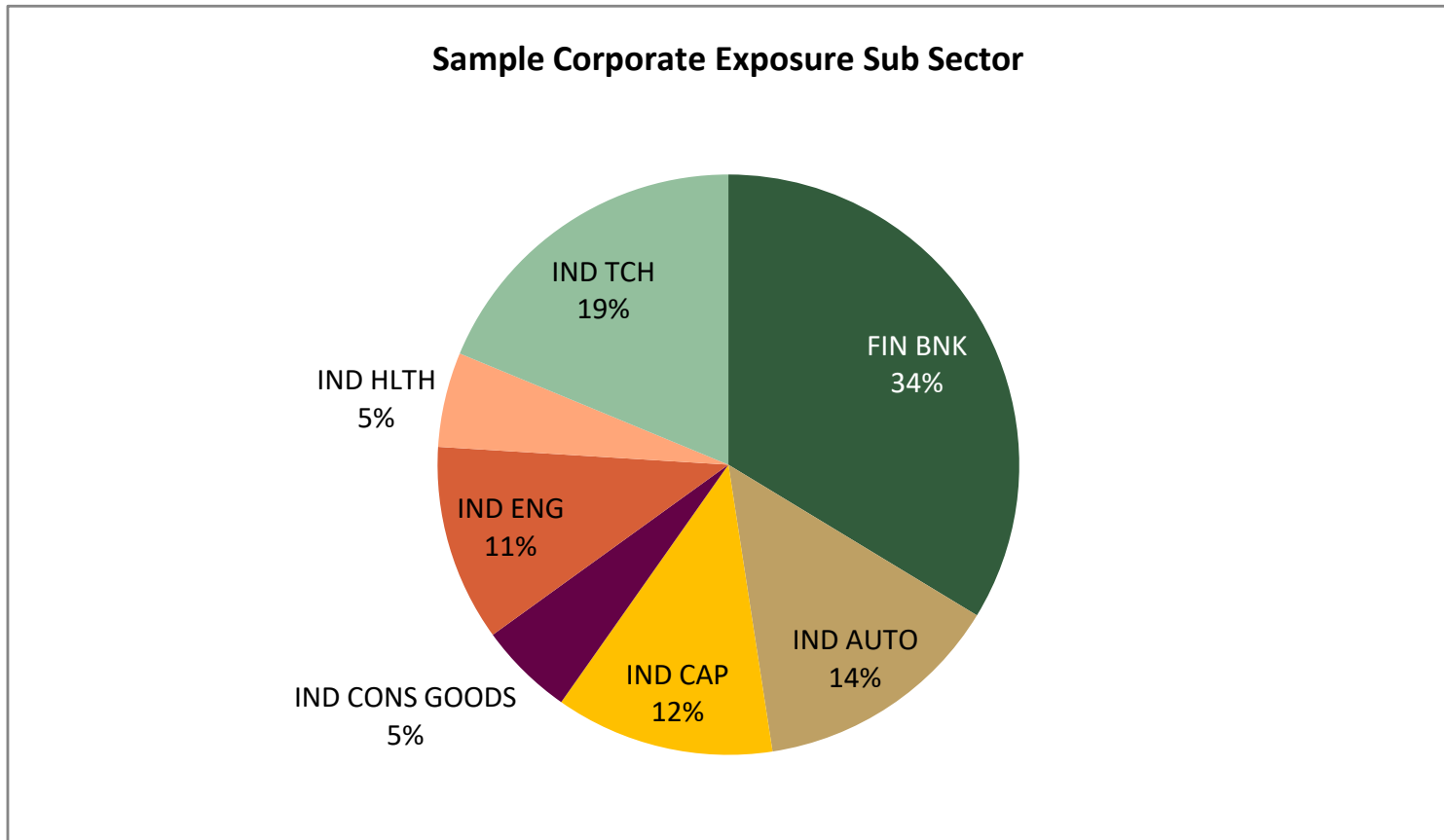
- California Government Code requires an 'A' or better rating from one Nationally Recognized Statistical Rating Organization (NRSRO) to be an eligible Corporate investment.
- In practice Chandler advocates a portfolio diversified by credit quality with a modest bias for 'A' rated names with a stable to improving credit profile and attractive relative value.





# Section 1: Diversification and Credit Exposure

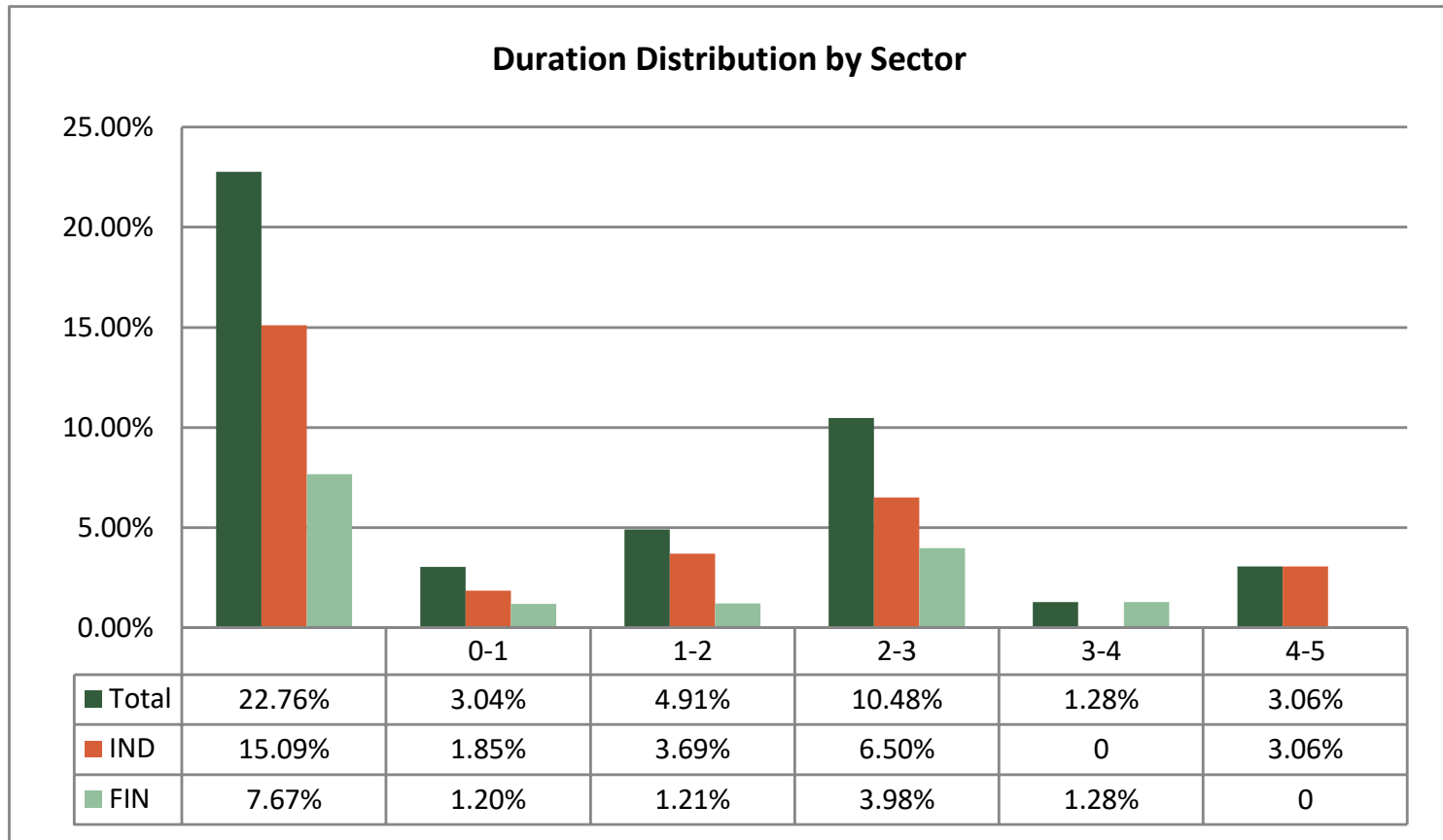
- Sector diversification is an important element to remain cognizant of to reduce risk and enhance return potential consistent with safety, liquidity, and return.
- The below sub sector allocation is the 22.76% Corporate exposure sliced up in a more granular form. Notable sector allocations missing include Financial Services, Media, and Retail.





# Section 1: Diversification and Credit Exposure

- Evaluating the term structure of the Corporate exposure in a portfolio can help identify areas to consider when looking to increase or decrease exposure.
- In the below example the sample portfolio could use additional IND exposure in the 3-4 year duration range and FIN exposure in the 4-5 year duration range and FIN exposure overall.





## Section 2: Fundamental Analysis

- Chandler subscribes to Egan-Jones rating service to assist with our initial analysis of Corporate names to consider adding to our approved list as well as to monitor existing names we follow.
- Sample Credit 1 is a Corporate name in the banking sector that meets the rating requirements of California Government Code.
- Notably the fundamental trends in the name appear to be on the upswing with an higher Tier I Capital Ratio on a y/y basis and an Efficiency Ratio (expenses as a percent of revenue) also improving over the same time frame.

EJR Ratios		Ratios for 4 Rolling Quarters					
Sample Credit 1	Ind Ratio	Trend	Dec-16	Sep-16	Jun-16	Mar-16	Dec-15
Shareholders' Equity/Assets (%)	A	improving	11.9	10.8	10.6	10.5	9.9
Tier 1 Capital Ratio (%)	AA	improving	11.8	11.8	10.9	11.3	11.0
Loan Loss Coverage (%)	AA	improving	164.1	141.0	55.6	56.3	54.9
Earn Assets/T Assets (%)	AA	improving	68.0	64.6	62.6	61.8	59.0
Efficiency Ratio (%)	BBB	improving	69.0	69.7	71.4	72.1	73.2
Non Perf Loans/T Loans (%)	AA	improving	0.2	0.2	0.4	0.5	0.4
Implied Sen. Rating			A+	A+	A	A	A

Source: Egan-Jones



## Section 2: Fundamental Analysis

- Sample Credit 2 is also a Corporate name in the banking sector that meets the rating requirements of California Government Code.
- Although the Tier I Capital Ratio is more robust than Sample Credit 1, the majority of the other metrics in the name is not as robust; in the majority of elements cited fundamentals are not improving.
- The subtle divergent trends in the respective names will likely take time impact the trading levels but as an investor it is crucial to be aware of the fundamental trends in a specific security.

EJR Ratios		Ratios for 4 Rolling Quarters					
Sample Credit 2	Ind Ratio	Trend	Dec-16	Sep-16	Jun-16	Mar-16	Dec-15
Shareholders' Equity/Assets (%)	BB	stable	8.7	8.7	8.7	8.8	8.6
Tier 1 Capital Ratio (%)	AA	stable	14.1	15.0	14.7	14.4	14.3
Loan Loss Coverage (%)			NMF	NMF	NMF	NMF	NMF
Earn Assets/T Assets (%)	AA	stable	81.7	81.1	82.2	80.9	82.9
Efficiency Ratio (%)	BBB	negative	75.0	72.4	73.4	73.4	72.3
Non Perf Loans/T Loans (%)	AA		0.0	0.0	0.0	0.0	0.0
Implied Sen. Rating			A	A	A	A	A

Source: Egan-Jones





# Section 3: Relative Value - Option Adjusted Spreads

- At issuance, both Corporate names cleared the market with similar spreads.
  - Sample Credit 1 cleared the market in January of 2017 when the overall Option Adjusted Spread (OAS) of 75 when the aggregate credit market was valued with an OAS of 116.
  - Sample Credit 2 cleared the market in May 2016 at a slightly lower spread but the overall market has a much wider relative valuation with an OAS of 143.
- In Chandler view the clearing levels imply Sample Credit 1 is viewed by investors as a higher risk name and in theory would have traded at a wider level in May 2016 compared to Sample Credit 2.
- Based on the earlier Fundamental analysis of the respective sample credits their appears to be an opportunity to increase exposure to the name with the improving fundamentals, and obtain a higher spread, relative to the name with less attractive Fundamental trends.

Issuer	Maturity	Issue Date	Amt Issued (mm)	Spread @Issue	Index OAS on issue date*	Security OAS 3/31/17	Index OAS on 3/31/17*
Sample Credit 1	02/07/22	01/31/17	\$1,250	75	116	65	112
Sample Credit 2	05/19/21	05/16/16	\$750	70	143	61	112
<i>*Bloomberg Barclays Credit Index</i>							



## Section 4: Synching up the Info. Presented / Questions

- Can anyone in the audience identify either Sample Credit 1 or 2?
- Specific to the banking sector, does anyone in the audience have an opinion on how fundamental trends are likely to evolve in light of:
  - Regulatory outlook under President Trump?
  - Revenue and earnings outlook for the banking sector as the Federal Reserve moves further away from the zero interest rate policy?
- Does anyone in the audience keep track of investment grade new issuance trends?
  - The primary market is a very important source of information for investors to ponder when considering purchasing a Corporate name in the secondary market.
  - Issuance trends are cyclical and somewhat predictable throughout the calendar year.



# Section 4: Synching up the Info. Presented / Questions

EJR Ratios		Ratios for 4 Rolling Quarters					
Bank of New York Mellon (1/26/17)	Ind Ratio	Trend	Dec-16	Sep-16	Jun-16	Mar-16	Dec-15
Shareholders' Equity/Assets (%)	A	improving	11.9	10.8	10.6	10.5	9.9
Tier 1 Captial Ratio (%)	AA	improving	11.8	11.8	10.9	11.3	11.0
Loan Loss Coverage (%)	AA	improving	164.1	141.0	55.6	56.3	54.9
Earn Assets/T Assets (%)	AA	improving	68.0	64.6	62.6	61.8	59.0
Efficiency Ratio (%)	BBB	improving	69.0	69.7	71.4	72.1	73.2
Non Perf Loans/T Loans (%)	AA	improving	0.2	0.2	0.4	0.5	0.4
Implied Sen. Rating			A+	A+	A	A	A
State Street Corporation (3/03/17)	Ind Ratio	Trend	Dec-16	Sep-16	Jun-16	Mar-16	Dec-15
Shareholders' Equity/Assets (%)	BB	stable	8.7	8.7	8.7	8.8	8.6
Tier 1 Captial Ratio (%)	AA	stable	14.1	15.0	14.7	14.4	14.3
Loan Loss Coverage (%)			NMF	NMF	NMF	NMF	NMF
Earn Assets/T Assets (%)	AA	stable	81.7	81.1	82.2	80.9	82.9
Efficiency Ratio (%)	BBB	negative	75.0	72.4	73.4	73.4	72.3
Non Perf Loans/T Loans (%)	AA		0.0	0.0	0.0	0.0	0.0
Implied Sen. Rating			A	A	A	A	A
Industry Ratios	AA	A	BBB	BB	B	CCC	
Shareholders' Equity/Assets (%)	15.0	12.0	10.0	8.0	5.0	2.0	
Tier 1 Captial Ratio (%)	10.0	8.0	6.0	4.0	2.0	0.5	
Loan Loss Coverage (%)	150.0	85.0	70.0	40.0	20.0	10.0	
Earn Assets/T Assets (%)	70.0	60.0	50.0	40.0	25.0	15.0	
Efficiency Ratio (%)	55.0	60.0	70.0	80.0	85.0	90.0	
Non Perf Loans/T Loans (%)	0.5	1.0	1.5	3.0	5.0	8.0	

Source: Egan-Jones



# Section 4: Synching up the Info. Presented / Questions

Issuer	Ticker	Coupon	Maturity	Issue Date	Amt Issued (mm)	Spread @Issue	Index OAS on issue date*	Security OAS 3/31/17	Index OAS on 3/31/17*
Bank of NY Mellon Corp	BK	2.600	02/07/22	01/31/17	\$1,250	75	116	65	112
State Street Corp	STT	1.950	05/19/21	05/16/16	\$750	70	143	61	112

\*Bloomberg Barclays Credit Index

