San Miguel SLB: missed target efficiently digested

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San Miguel Industrias (ticker SMIPET), a Peru-based plastic packaging producer, has one bond outstanding, a Sustainability Linked Bond (SLB) issued in Aug 2021. We assessed the bond in question, SMIPET 3.5% 28s (ISIN US79911QAA22), prior to its Sustainability Performance Targets (SPT) observation date and classified it as '50:50', identifying risks to the target being achieved, primarily driven by lack of data.[1]

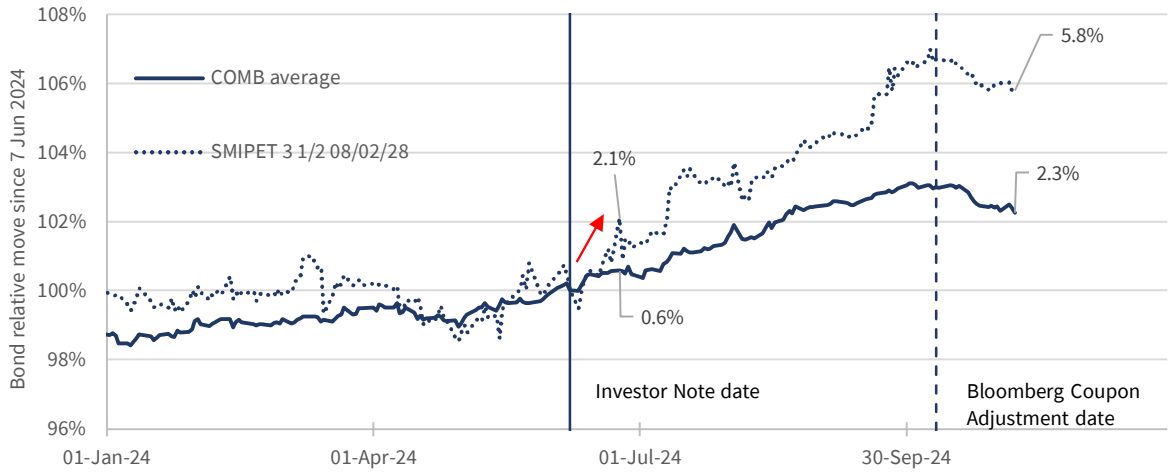
On 7 June 2024 the company disclosed in an investor notice that the target for its first KPI, the percentage of recycled plastic used, was missed. It also communicated that the target for the second KPI, total tons of post-consumer waste managed, was exceeded by an undisclosed margin.[2]

We saw no media reports at the time of this investor notice. The Bloomberg coupon of the bond was only adjusted on 10 Oct 2024, over four months after confirmation was given, possibly indicating this could have been missed by the market.

In fact, the SMIPET SLB price appears to have responded in the two weeks post company disclosure, demonstrating market efficiency.[3] When comparing the bond to a basket of comparable securities, we see significant outperformance since the investor notice, as shown in Figure 1.

The outperformance of this bond shows the value of the SLB hedge for investors, and should promote attractive pricing for issuers that bring ambitious SLB structures to market.

Figure 1. Pricing for SMIPET SLB versus a basket of comparable securities. Source: Bloomberg, accessed 15 Nov 2024.



[1] "SLBs: a summary of 2023 targets", AFII, 15 Nov 2023.
[2] "Investor Notice", San Miguel Industrias, 7 Jun 2024.
[3] This is in contrast to a missed target on an SLB issued by a UK housing trust, where the bond outperformance appears to have been triggered by the Bloomberg coupon adjustment rather than the investor communication as detailed in "London & Quadrant SLB: market update", AFII, 7 Oct 2024.

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The Sustainability Linked Bond (SLB)

San Miguel Industrias PET SA (ticker SMIPET), also referred to as SMI Group, has one bond outstanding, an SLB, which was priced in Jul 2021. The bonds are guaranteed by the parent company, NG PET R&P Latin America SA, and rated by Fitch as BB+.[4]

The Sustainability Performance Targets (SPTs), with observation date of 31 Dec 2023 were:

- Achieve at least 20% recycled plastics (specifically recycled Polyethylene Terephthalate or rPET) content in preforms and thermoforming products across the combined operations of the Companies and their subsidiaries.[5]
- Increase the total tons of post-consumer waste managed by the Companies and their subsidiaries in their combined operations to at least 34,000 tons per annum.[5]

Our earlier analysis assessed the likelihood of the bond meeting its SPTs as '50:50', primarily due to a lack of ongoing data to understand progress against KPIs.[1]

Call option

We note this bond is callable from 2 Aug 2024.[6] The call prices vary with time, and also vary depending on whether the SPTs are achieved. Full details are shown in Table 1.

Table 1. SMIPET SLB call prices and step-up values. Source: bond prospectus, AFII.

Year	SPTs met	SPTs missed	Difference	Max non-discounted value of step-up coupon
2024	101.7500%	101.8750%	0.1250%	1.0000%
2025	100.8750%	100.9375%	0.0625%	0.7500%
2026 onwards	100.0000%	100.0000%	0.0000%	0.5000%

SLBs have been subject to criticism for including call options; because issuers can potentially use redemptions to minimise the payment of step-up coupons.[7] Our earlier analysis found that there was no material difference in the proportion of SLBs that were callable compared to similar bonds, and that most calls in SLBs were out-of-the-money, signifying a low chance of being exercised.[8]

While increasing the call price if the SPTs are not achieved will help dispel the criticism that the call avoids paying the step-up coupon, as Table 1 shows the increase in the call price is significantly lower than the potential step-up coupon payment.

Current market pricing of this bond is around 91%, which makes the call option currently out-of-the-money and therefore unlikely to be exercised. Although, if rates rally as the maturity approaches, it could be that the post-2026 call price at 100% becomes more likely, and at this stage there is no adjustment for the SPT miss.

[4] "Fitch Rates NG PET R&P & San Miguel Industrias Sr Unsecured Notes 'BB+'; Affirm SMI's IDR", 21 Jul 2021.
[5] "Second Party Opinion", ISS ESG, 19 Jul 2021.
[6] This is separate to the make-whole provision whereby the bond can be redeemed at the Treasury Rate + 50bp on a semi-annual basis.
[7] This idea is explored in "Structural Loopholes in Sustainability-Linked Bonds", World Bank Policy Working Paper Series, 2022.
[8] For the full analysis please see "SLBs: no cal(l)amity", AFII, 20 Sep 2023.

The investor notice

On 7 June 2024, SMIPET published an Investor Notice with the performance of its KPIs compared to targets for the SLB.

The target of 34,000 tons of post-consumer waste managed in 2023 was confirmed to have been exceeded, though it did not state by how much, and few details were provided.

However, the company confirmed that it did not meet the rPET target, citing "*(i) an unprecedented growth in SMIPET's volumes of over 60% from 2019 to 2023, and (ii) the worldwide logistic crisis related to COVID-19 causing a delay in delivering machinery purchased by SMI to start its new recycling operations and expand the existing ones.*" [2]

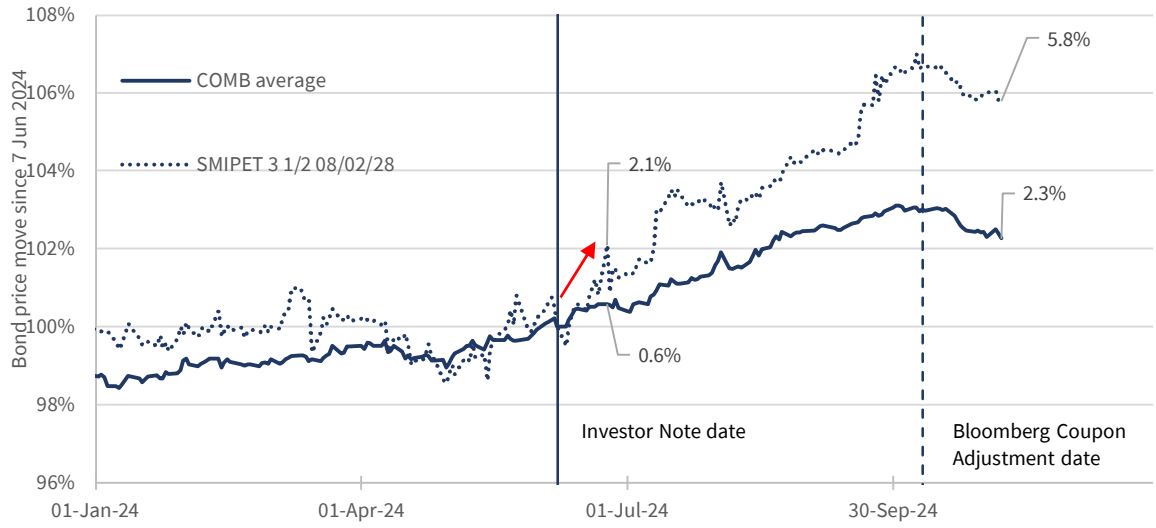
The notice further stated that the bond was to step up from 2 Aug 2024, resulting in an increased coupon of 0.25% from 3.5% to 3.75% for four years until the bond maturity in Aug 2028. This has a non-discounted value of 1% for bond investors.

Market response

In previous analyses when issuers have missed SLB targets, there have been other bonds to compare the performance to.[9] In this situation, because SMIPET has only one bond outstanding, we have constructed a portfolio of comparable securities using Bloomberg COMB analytics.[10]

We observed the market response throughout 2024, across the announcement date of 7 June 2024, and the date of 10 October 2024, on which the coupon was updated on Bloomberg.[11] We compared performance to the portfolio of peer securities, using relative price movement since 7 June. The results are shown in Figure 2.

Figure 2. Pricing for SMIPET SLB versus a basket of comparable securities. Source: Bloomberg, accessed 15 Nov 2024.



[9] For another example please see "Enel SLBs: fortes fortuna juvat", AFII, 26 Apr 2024.
[10] These analytics identify peer securities using the Bloomberg Fixed Income Classification System, and a similar duration. This provided 18 peer securities, two of which were issued within 2024 and so couldn't be used for a full comparison. The remaining 16 are included as a list in the Appendix.
[11] Confirmed by the Fixed Income Corporate Actions team at Bloomberg.

As can be seen in Figure 2, the bond ultimately outperformed the COMB average by 3.5%, significantly more than the value of the step-up coupon.

Even in the two weeks from 7 June to 24 June the move was quite pronounced; the SMIPET bond moved +2.1% compared to +0.6% for the basket of comparable securities, a move which is more commensurate with the size of the increased coupon.

The impetus for bond outperformance appears to have been the investor notice rather than the Bloomberg coupon adjustment. This is contrary to our observation for London & Quadrant Housing trust where the SLB began to outperform only once Bloomberg had adjusted the coupon. This suggests the market has been more efficient in digesting the coupon step-up.[3]

Conclusion

SMIPET announced in Jun 2024 that it missed one SPT on its outstanding SLB, resulting in a 25bp step-up to be applied for the remaining four years of the bond.

Immediate outperformance of this bond, compared to a basket of peers, suggests that the miss was recognised and digested quickly by the market.

The bond outperformance also provided a hedge for investors, further validating the option pricing approach to SLBs.[12] This supports the credibility of SLBs as financial instruments and promotes tighter issuance spreads for ambitious issuers.[13]

[12] For AFII's pricing approach please see "Sustainability Linked Bond Handbook", AFII, 12 May 2024.
[13] For details of Enel's return to the market after an SPT miss please see "Enel returns to the SLB market: per angusta ad augusta", AFII, 21 Jun 2024.

Appendix

Table 2. Peer securities used in market analysis generated using COMB analytics. Source: Bloomberg.

ISIN	Issuer	Description
XS2495855640	BANCO DE CREDITO DEL PER	BCP 5.05 06/27/27
US204448AA22	CIA DE MINAS BUENAVENTUR	BUENAV 5 1/2 07/23/26
US445640AB18	HUNT OIL CO OF PERU	HNTOIL 6 3/8 06/01/28
US45780UAB08	INRETAIL SHOPPIN	INRSHM 5 3/4 04/03/28
US45866EAA55	INTERCORP FIN SER INC	IFSPE 4 1/8 10/19/27
US45790TAB17	INRETAIL CONSUMER	INRCON 3 1/4 03/22/28
US68559BAA52	ORAZUL ENERGY PERU SA	ORSAPE 5 5/8 04/28/27
US48344FAA84	KALLPA GENERACION SA	KALLPA 4 7/8 05/24/26
US31446YAB83	FENIX POWER PERU SA	FENIPE 4.317 09/20/27
US89388AAA07	TRANSPORT DE GAS PERU	TGPERU 4 1/4 04/30/28
US156830AA95	KALLPA GENERACION SA	KALLPA 4 1/8 08/16/27
US05968DAC48	BANCO INTERNAC DEL PERU	BINTPE 3 1/4 10/04/26
PEP12100D276	BANCO INTERAMERICANO DE	BIFCPE 5.9 10/26/27
PEP12100D284	BANCO INTERAMERICANO DE	BIFCPE 5.7 11/23/27
US134638AE50	CAMPOSOL SA	CSOLNO 6 02/03/27
US45721RAC79	INKIA ENERGY LTD	INKENE 5 7/8 11/09/27

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