Diamond miners facing heightened credit risk amid the COVID-19 pandemic

by Liu Yuan

World's diamond miners are currently confronting unprecedented challenges under the coronavirus pandemic. The coronavirus has affected the diamond mining sector through disrupting mining operations and the whole global supply chain. In March, the lockdown of India rendered the global diamond supply chain frozen, since the South Asian country serves as a critical part of the chain. Purchasing mainly from Russia and Canada, it processes and cuts more than 90% of the world's rough diamonds, and then sells polished diamonds and jewellery to customers (mainly in the US and China). Until manufacturing reopens there, there will be no demand for rough diamonds from cutters. The world's second largest diamond miner De Beers Group cancelled its sales event in Botswana, the African centre of diamond mining, and announced to cut diamond production by 20% this year in line with weak diamond demand. Last week, unable to sell their stones, Dominion Diamond Corp, a large diamond miner in Canada, filed for insolvency protection in Canadian provincial court despite its consistent cost cutting. Some smaller diamond miners such as Petra Diamonds Ltd are facing increasing risk of default. The London-listed miner was seeking strategic options on its USD 650mn debt due in 2022 with the help of the investment bank Rothschild & Co.

Tracked by NUS-CRI Aggregate (median) 1-year Probability of Default (Agg PD), globally listed diamond miners' credit profile remained stable in January and February this year, when the coronavirus spread was mainly limited within China. Start from late February, the rapid spread of coronavirus in the globe made the Agg PD of globally listed miners surged sharply from around 40bps to 90bps in late March. While the Agg PD has somewhat stabilized since the beginning of April, the Agg PD still remains at around 80bps, a level far higher than that in the pre-pandemic period. In comparison with globally listed miners, diamond miners have a consistently higher Agg PD and a sharper increase in Agg PD in March. Besides, the gap between their Agg PD widened since the global coronavirus pandemic (see Figure 1).

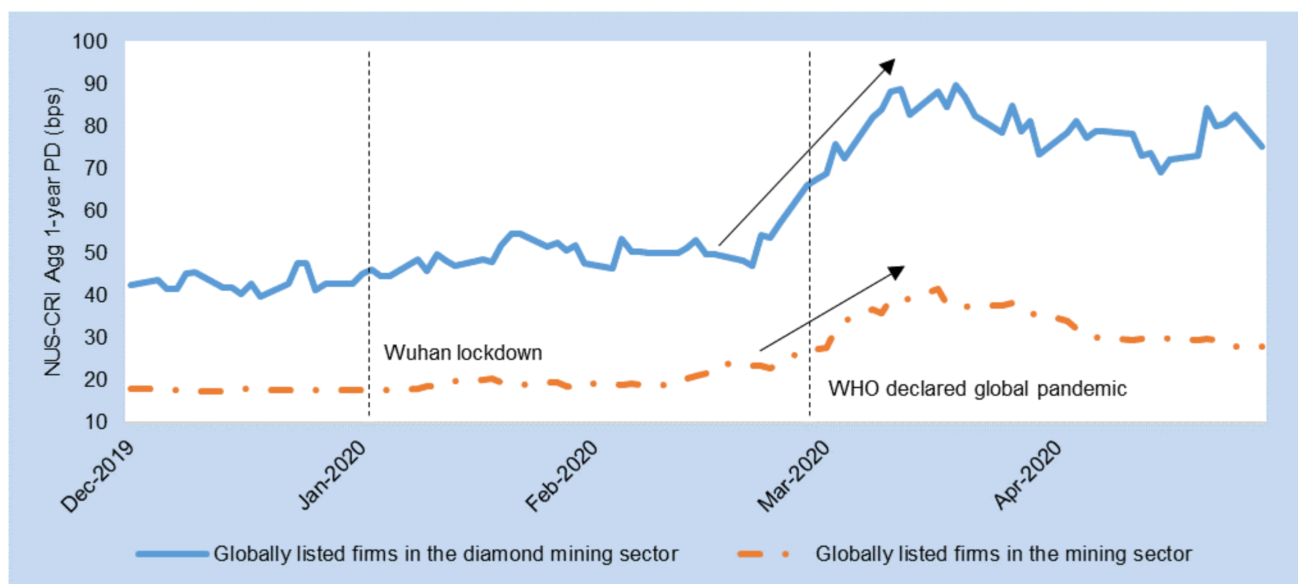

Figure 1: NUS-CRI Aggregate 1-year PD for globally listed firms in the diamond mining sector from Dec 2019. *Source: NUS-CRI.*

Rough diamond price is one of the main factors causing the deteriorating credit profile of diamond miners. As of May 2, 2020, Zimnisky Global Rough Diamond Price Index, which aims to track the price change of natural rough diamonds, was relatively stable in January and February, when a sudden drop occurred from mid-February to the end of March, 2020 due to the outbreak of the global pandemic. During that period, the index value fell sharply to 52-week

low, 125.62, down about 12% from the value in mid-February. A slight increase in the index value showed after the drop but it is still far behind that of pre-pandemic period.

Actually, even before the coronavirus came along, the price of natural rough diamonds had seen a decreasing trend since it peaked in Q2 2011. The natural rough diamond market has long been struggling with weaker demand from customers, as well as an oversupply of smaller rough diamond stones. In addition, the natural diamond market has been grappling with the rise of lab-grown diamonds, which are chemically identical to natural stones. In recent years, diamond miners felt the pinch amid US-China trade tension and protests in Hong Kong, and the closure of US retail outlets. At the beginning of 2020, De Beers Group reported that its underlying earnings fell 87% in 2019 to USD 47mn, the worst level since miner Anglo American PLC bought it eight years ago. Analysing the financial performance of the global listed miners in the past two years, we notice that the sector's median quick ratio dropped from 1.01 in 1H 2018 to 0.52 in 2H 2019. During the same period, current ratio dropped from 1.8 to 1.51. Hence, before the coronavirus outbreak, unfavourable markets conditions and deteriorating liquidity performance of diamond miners had caused them to be ill-prepared for the coming pandemic crisis.

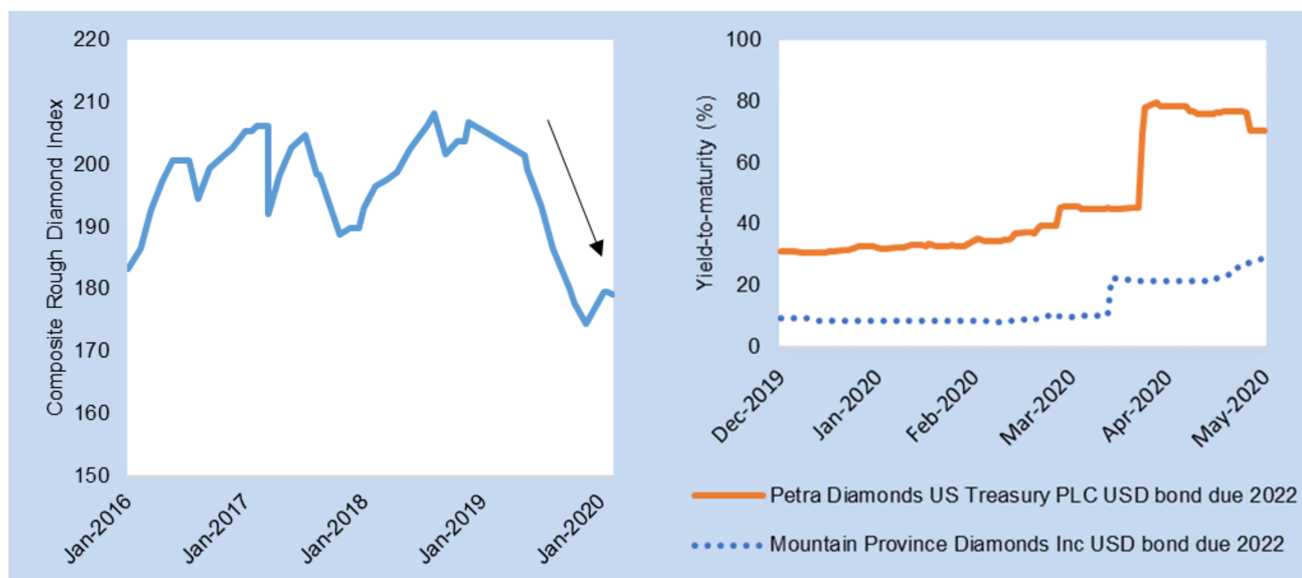

Figure 2a: Overall Rough Diamond Index from Jan 2016 to Feb 2020. Figure 2b: Yield-to-maturity of a selection of bonds issued by diamond miners. *Source: polishedprices, Bloomberg.*

The worsening credit profile of diamond miners can also be manifested in the bond market during the global pandemic. For some of the most detrimentally affected miners, such as Petra Diamonds Ltd and Mountain Province Diamonds Inc, the Yield-to-maturity (YTM) for their USD bonds due 2022 issued by Petra Diamonds US Treasury PLC, a wholly subsidiary of Petra Diamonds Ltd, and Mountain Province Diamonds Inc itself, has increased more than twofold ever since the spread of COVID-19 around the world (see Figure 2b).

Recently, the Zimnisky Global Rough Diamond Price Index rebounded 1.09% from the previous month. Looking into the future, rough diamond prices may likely find a more reliable price level when the diamond supply chain begins to reopen, which will require the opening of borders, retail outlets and manufacturing and trading hubs globally. However, at the moment, uncertainty continues to prevail. As indicated in the NUS-CRI Aggregate Forward 1-year PD[1], which reflects the credit risk of a sector in the future period at an aggregate level, while the Forward PD curve for the globally listed diamond miners shows a slightly downward tendency in the next two years, it should be noted that Forward PD still remains above 50bps, which is above the Agg PD in the beginning of this year.

[1] The Forward PD estimates the credit risk of a company in a future period, which can be interpreted similar to a forward interest rate. For example, the 12-month Forward 1-year PD is the probability that the firm defaults during the period from 12 months onwards to 1 year plus 12 months, conditional on the firm's survival in the next 12 months.

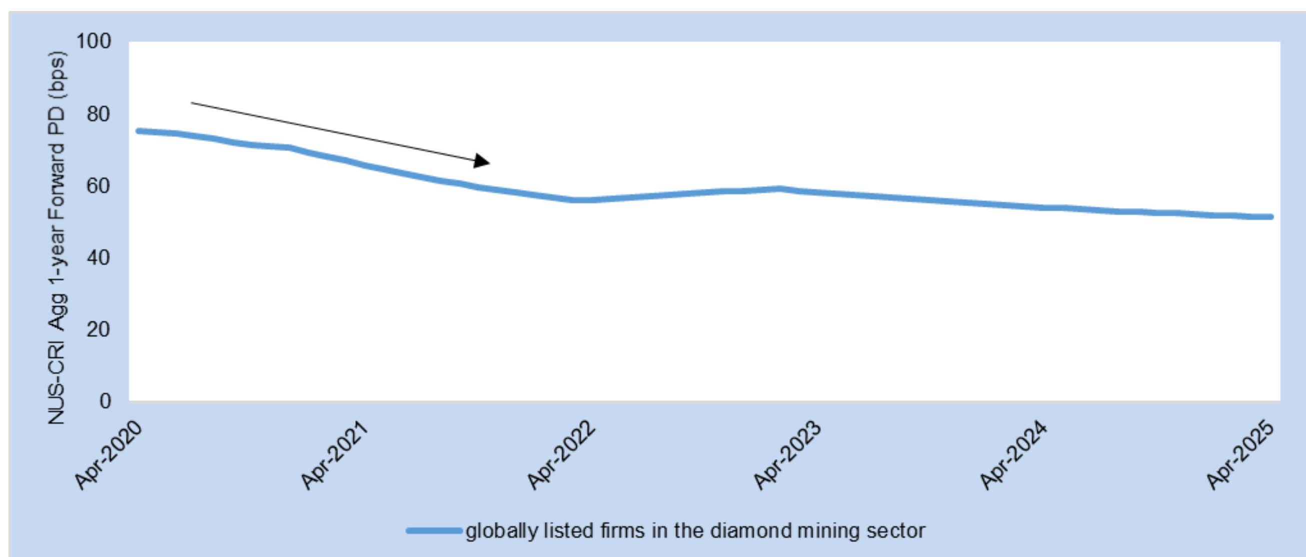

Figure 3: NUS-CRI Aggregate 1-year Forward PD for globally listed firms in the diamond mining sector based on information on Apr 2020. *Source: NUS-CRI.*

Credit News

Indian bank bad debt could double in coronavirus crisis

May 4. At the end of September 2019, Indian banks had about USD 123bn of bad debt, which was equivalent to about 9.1% of their total assets. These non-performing assets could double to 18-20% by the end of 2020. By now, 20-25% of all outstanding loans face default risk. Small- and medium-sized businesses constitute nearly one-fifth of overall credit and may be amongst the worst affected. Furthermore, all 10 of India's largest cities are zones with high virus-risk so that restrictions will remain stringent. These zones contribute significantly to India's economy and account for about 83% of all loans that are made by its banks as of December 2019. (Reuters)

Junk bonds fly off the shelves after Federal Reserve boost

May 1. US companies sold almost USD 32bn of junk bonds in April, marking the biggest month of fundraising by low-rated issuers in three years after the support from the Federal Reserve. The deluge of fundraising has boosted investment banking revenues for Wall Street banks. Global banks together have earned a record USD 14.1bn in debt underwriting fees so far this year, offsetting big losses from other parts of banks' businesses. Analysts said the market has been brought back to life by the US central bank, and assets at two popular ETFs known by their tickers HYG and JNK were lifted by more than USD 6bn collectively after Fed's announcement to buy exchange-traded funds owning high-yield corporate bonds. (FT)

Bond investors batter bloodied Pemex with no relief in sight

May 1. Since Petroleos Mexicanos (Pemex) lost its investment grade rating, bondholders are pricing in a higher probability of default for the company compared to its other competitors. The spread between Pemex bonds and that of its closest peer, Petroleo Brasileiro has also widened sharply. Although the President of Mexico, Lopez Obrador, has promised to revive Pemex, the company remains saddled with more than USD 100bn financial debt. Its financial balance also deteriorated with a USD 23.6bn loss reported in the first quarter. Despite Pemex's repeated assurance that they had the backing of the government, investors are unconvinced and since June last year as many as 75% of active investors have let go of billions of bonds. It is expected that once Pemex drops out in April this year, passive investors are bound to follow suit. However, some are confident that Pemex is too big to fail and the government will bail them out given that the President has hitched his fortunes to Pemex. It just needs some time before the government acts. (Reuters)

Hard-hit energy companies' bonds rise after Fed expands loan program

May 1. The Federal Reserve announced to expand its Main Street Lending Facility to larger and riskier companies that are affected by the coronavirus pandemic. As a consequence, the corporate bonds' prices of hard-hit oil and gas companies rose after the announcement. The central bank plans to widen its lending to firms with 15,000 employees and USD 5bn revenue, which is an adjustment from the initial 5,000 employees and USD 2bn revenue limits. This project aims at helping companies that were financially stable before the crisis and have since been hit. Energy companies were particularly hit hard as fuel demand has dropped by about 30% all over the world. These companies also make up for more than half of all fallen angels – companies that were downgraded from investment grade to a junk rating. (Reuters)

Banks seek to limit revolver usage as companies race for cash

May 1. Banks are seeking to limit companies from accessing credit lines as the global pandemic continues to weigh on banks' balance sheets. Since the coronavirus pandemic took hold, companies including Hilton Worldwide and Ford Motor Co have drawn more than USD 201bn in revolver capacity to ensure access to liquidity facing the supply chain disruptions and closed retail operations. More anti-hoarding provisions are seen because lenders are more concerned that companies will hold cash to use later, potentially to stave off bankruptcies. Investors are also looking at credit agreements for revolvers to determine borrowing capacity and whether there are anti-hoarding provisions. (Reuters)

Distressed debt deals may rise to 2009 levels in crisis-hit gulf (Bloomberg)

Norwegian Air gets bondholder deal on USD 1.2bn debt-for-equity swap (Reuters)

Delta taps debt markets for USD 5bn to replace lost cash flows (FT)

Regulatory Updates

Fed won't use stimulus aid to push Libor replacement

May 3. The Federal Reserve has scrapped plans to use a USD 600bn aid program for small and midsize business to promote the replacement for Libor. The U.K.'s Financial Conduct Authority and regulator announced that there is no plan to delay the expiration of Libor in December 2021, but regulators now face more resistance from lenders who don't want to add complexity to stimulus efforts amid a global economic upheaval. Even before the coronavirus pandemic, doubts were growing about the financial system's ability to make the switch from Libor to SOFR. The American Bankers Association warned that an abrupt transition to SOFR would deter participation in the Main Street Lending Program, undermining the program's effectiveness amid the coronavirus pandemic. (WSJ)

ECB launches fresh push to lend to banks at ultra-low rates

May 1. The European Central Bank (ECB) will launch a round of targeted longer-term refinancing operations (TLTROs) that allows banks to borrow loans at rates as low as -1% from June onwards. This scheme is expected to bolster the European's banking system access to funds and prevent credit from drying up. These loans require banks to hit certain lending targets before they get the lowest rate, thus incentivizing lending. Concurrently, the ECB also announced that a new series of non-targeted pandemic emergency longer-term refinancing operations (PELTROs) will be launched from this month to a year later for banks to borrow at -0.25%. The ECB's move follows slowing growth projections and declining consumer sentiments in the Eurozone, especially since the first-quarter financial data shows its economy has shrunk its fastest rate on record and growth projections for this year range from -5% to -12%. The ECB has shown full commitment to

its pandemic emergency purchase program (PEPP) and has used EUR 100bn out of its allocated EUR 750bn so far. (FT)

UK starts state-backed loans for smallest firms (Reuters)

ECB's stealth rate cut lures banks to fund virus-hit economy (Bloomberg)

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