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Weekly Credit Brief Aug 08 - Aug 14

Tesla fuels Model 3 production with first time high yield bond offering

By Dexter Tan

Last week, Tesla Inc. placed its largest non-convertible bond issuance to date with a total value of USD 1.8bn, offering to pay investors a coupon rate of 5.3% till maturity. The issue was oversubscribed by more than four times as orders for the callable note climbed to USD 8bn. Tesla's surging stock has propelled the company's value to USD 60.7bn to become the most valuable US automaker. The RMI-CRI 1-year Probability of Default (PD) for Tesla remained lower than the 1-year PDs for Ford Motor and Fiat Chrysler, two of the leading US automobile manufacturers.

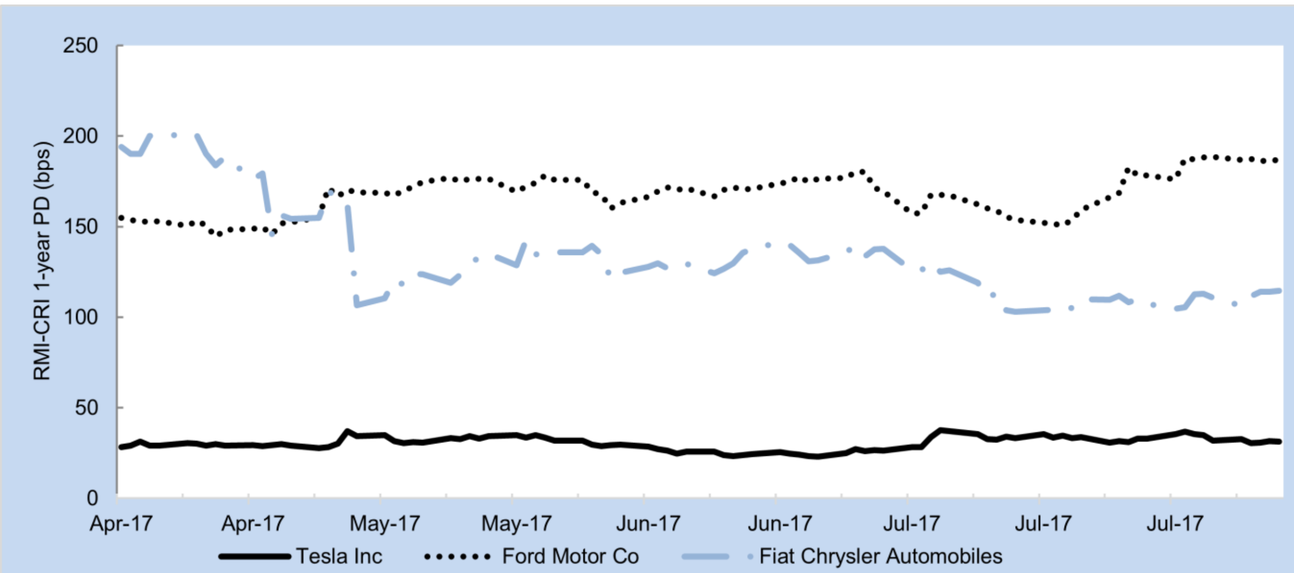

Figure 1: RMI-CRI 1-year PDs for Tesla, Fiat Chrysler and Ford. *Source: RMI-CRI*

The bond sale will help finance the production of Model 3, Tesla's next vehicle introduction which is a cheaper sedan designed for the mass market. The company received 455,000 pre-orders for the vehicle and the first 30 units have been delivered to customers on Jul 28. Tesla's management projected demand for the Model 3 to surpass 500,000 a year but this will test the limit of its Fremont facility. To cope with the increased demand, Tesla will invest USD 2bn in capital expenditure during 2H17 to expand manufacturing equipment, retail locations, service centers and Supercharger locations.

Tesla's 2025 USD 1.8bn bond received junk ratings by S&P and Moody's, citing the company's heavy debt load and uncertain delivery schedule of the new vehicle. Moody's particularly expects Tesla to face large cash requirements through 2018 and remain cash flow negative till 2019. But the firm's USD 3bn cash pile, USD 1.2bn credit lines and USD 1.8bn bond sale may provide sufficient liquidity till 2018.

The electric car maker may further raise cash as it continues to expand its distribution network and ramp up vehicle production. After taking 4 quarters to raise its cash level from USD 3.2bn to USD 4bn in 1Q17, Tesla depleted its cash by 25% to USD 3bn in Q2. The 10Q filing also revealed that the firm extended the availability period and maturity date of its December 2018 term loan and revolving aggregation credit facility to improve liquidity.

Tesla has a commendable track record in raising capital. Market observers lauded the auto manufacturer for being opportunistic as it has managed to successfully time its bond offerings to match demand. Its USD 2bn convertible bond offering in 2014 was said to be the largest at that time and the recent 2025 5.3% bond sale was launched to coincide with strong demand for junk bonds. Offering to pay an annualized yield of 5.3% may seem reasonable, as Tesla's outstanding bonds may be too expensive or less attractively priced. (See Table 1)

Issuer	Coupon (%)	Maturity	Bond Type	Amount Outstanding (USD mn)	Collateral Type	Last Ask Yield to Maturity (%)
SolarCity	1.625	11/1/2019	Convertible	566	Sr. Unsecured	3.825
SolarCity	2.75	11/1/2018	Convertible	230	Sr. Unsecured	2.487
SolarCity	0	12/1/2020	Convertible	103	Sr. Unsecured	N.A.
Tesla	1.25	3/1/2021	Convertible	1380	Sr. Unsecured	-3.23
Tesla	2.375	3/15/2022	Convertible	977.5	Sr. Unsecured	-3.05
Tesla	0.25	3/1/2019	Convertible	920	Sr. Unsecured	-8.04

Table 1: List of earlier Tesla related available bonds with outstanding amounts of USD 50mn or more, as of Aug 11. Tesla is free to pay SolarCity's bond although it is prohibited from guaranteeing the subsidiary's debt. *Source: Bloomberg*

Given the high market capitalization, Tesla's 2019 convertible note holders may soon exercise their right to convert their bonds into shares or cash as the recent share price has exceeded the conversion price of USD 359. Bondholders may exchange their notes for cash but the cash strapped situation may result in a negotiation to swap the notes for stock, similar to the June 2017 arrangement with 2018 convertible note holders. The conversion of the 2019 convertible note would dilute the existing ownership interest of shareholders and any sale in the public market of common stock upon conversion can momentarily affect the company's market capitalization.

However, short bouts of market volatility are unlikely to change the positive long term outlook for electric cars. In July, the UK government said it would join France in banning the sale of fossil fuel cars by 2040. Additionally, the International Energy Agency (IEA) wants electric vehicles to account for at least 30 percent of all new car sales by 2030. An IEA report estimated the electric vehicle market grew 60% in 2016, down from the 77% annual growth rate in 2015. Carmakers from Volkswagen to Volvo are racing to launch their versions of electric vehicles, but the infrastructure for such cars has yet to be established. Tesla recognized this potential roadblock and made plans to significantly increase the Supercharger and urban charger network this year, as a first mover strategy also to make competitors use its charging points.

Credit News

China's economic speed bump may reignite bond default wave

Aug 15. China saw a drop in corporate distress with 0.27% issuers defaulting in the first half of 2017. Economists said the improvement was due to the favorable macroeconomic conditions that makes the improvement uncertain to be a trend. Both retail sales and factory output slowed down in July that failed economists' expectation. Analysts expect the defaults could pick up when the pace of economic growth in the second half of 2017 slacken. Meanwhile, the profit growth is also expected to slow down due to the government's persist with the reform program that is affecting downstream industries.(Bloomberg)

Las Vegas Charity files for bankruptcy 20 months after debt sale

Aug 15. 20 months after issuing about USD 22mn of unrated municipal bonds to finance the acquisition of three retail facilities Goodwill Industries of Southern Nevada filed bankruptcy. Goodwill industries runs 50 donation centers and retail stores in Las Vegas. The debt was issued through a Wisconsin agency that specializes in acting as a conduit for risky debt and Invesco Ltd. the largest holder held USD 12.5mn of the bonds as of June 30. The continuous dropping in sales and increase in operation costs led to the decision to filed bankruptcy. In its bankruptcy filing Goodwill Industries' assets and liabilities were listed between USD 10mn and USD 50mn. (Bloomberg)

TT International asks for more time to report financial results

Aug 15. TT International had requested for an extension to announce its unaudited financial statements in midst of its ongoing debt restructuring. The extension will be for a period of six months till 14 February 2018. The moratorium is to provide enough time for TT International to pursue a total solution for the group. Trading of the company's shares was voluntarily suspended on 4 August 2017 after its subsidiary, Big Box, received a letter of demand from OCBC Bank for the repayment of SGD 111.3mn under a loan facility granted for construction of the Big Box building. The company was looking to extend the due date of repayment on 14 August 2017 and had been negotiating with lenders to obtain funding of up to SGD 380mn to refinance the loan facility and other payment obligations. (Straits Times)

Ezion posts USD 2.6mn loss for Q2; suspends trading as it talks to lenders, creditors

Aug 14. Liftboat operator Ezion reported a net loss of USD 2.6mn in Q2 2017, a reverse of the net profit of USD 8.1mn a year ago. The company had applied for trading suspension while it engages in discussions with stakeholders and creditors on its financing and capitalization structure. Revenue of Ezion fell 19.5% in the second quarter primarily due to declining charter rates and a drop in the utilization rate of the group's service fleet. Ezion also suffered unrealized foreign exchange losses of USD 5.8mn due to a strengthening SGD. The company is looking into the possibility of a debt restructuring for its total liabilities of USD 1.61bn as the depressed charter rates is likely to continue for a year, while collection of receivables remains slow. Additional capital expenditure is expected to be incurred to modify and upgrade Ezion's existing fleet in order to service secured contracts. (Straits Times)

Venezuela debt reaches flashpoint in political crisis

Aug 11. Venezuelan bond yields remain elevated and prices depressed after President Maduro staged a power grab last week, pressing ahead with the formation of a constituent assembly that will rewrite the country's constitution after a widely discredited election. In response to the new leader's obduracy and the jailing of opposition politicians, the US has imposed fresh sanctions. The national debt has also emerged as a flashpoint in the crisis. Goldman Sachs received criticism that it helped support the autocratic government from the country's opposition, by purchasing the Venezuelan bonds from the state oil company PDVSA. Now Credit Suisse has been banned from trading in a sovereign issue due in 2036 and PDVSA's bond maturing in 2022, and would further prohibit trading in any bonds issued after June 1 from any Venezuelan entity. (FT)

UAE's JBF RAK PET output stalls amid debt restructuring (Reuters)

Shipbuilder Nam Cheong posts massive Q2 net loss of USD 652mn (Straits Times)

Marco Polo Marine plunges further into the red with Q3 net loss of USD 304mn (Straits Times)

Regulatory Updates

Australia's central bank renews alert on mounting household debt

Aug 15. Australian's central bank has just released minutes of August rate meeting. The Reserve Bank of Australia (RBA) highlighted the risks associated with high household debt, strong labor market, and healthy GDP growth fueled by low rates and expected growth in non-mining business investment. RBA switched its emphasis from the job market to mounting household debts as another key concern alongside the residential property market. Although uncertainties remain, the RBA is confident that the Australia's economy will strengthen and is poised to benefit from the tailwind of a much improved global backdrop. (Bloomberg)

Denmark says its lenders could be hit too hard by new Basel

Aug 11. Denmark asked the Basel Committee to take into consideration specifics of the Danish mortgage system for the proposals would hit its mortgage sector unfairly by ignoring the low risk of Danish mortgage bonds. The USD 400bn Danish mortgage bond market has not had a default in its 220-year history. If the most likely recommendations from Basel committee is adopted Denmark's biggest mortgage and credit institutions will need to raise capital requirements by additional 27% to 39%. The government said it would continue its work in its dialogue with the European Union to ensure that Danish institutes are not to be hit as hard by the new requirements as the preliminary estimates could indicate. (Reuters)

SEC says bond liquidity fears overdone (Reuters)

MAS, CAD warn about investment schemes based on digital coins and tokens (Straits Times)

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