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Weekly Credit Brief Feb 4 - Feb 10 2020

Tianqi Lithium, China's largest lithium producer, faces heightened credit risk due to aggressive overseas expansion

by Liu Yuan

Tianqi Lithium Corp (Tianqi Lithium) is the largest lithium producer in China with a market capitalization of over USD 5.9bn and one of the top lithium producers in the world, controlling more than 46% of the global production of lithium. As a critical component in advanced batteries that powers everything from cell phones to electric vehicles, lithium has seen its demand increasing in the recent years amid the technology boom. Over the last few years, Tianqi Lithium had several aggressive overseas expansions to boost its lithium production capacity. In December 2018, it paid more than USD 4bn to purchase near a quarter of shares of Sociedad Químicay Minera (SQM), a Chilean lithium producer, making use of a USD 3.5bn loan from Citic Bank. However, Tianqi Lithium is currently facing increasing pressure to repay the loan in November this year, which still has USD 2.2bn outstanding.

Tracked by the NUS-CRI 1-year Probability of Default (PD), Tianqi Lithium had a sharp increase in PD during the past year after the completion of the acquisition of SQM, with the number rising from around 10 bps in March 2019 to around 70 bps in December 2019 (see Figure 1). While the company's PD was historically lower than the industry median, the gap between them gradually narrowed, and its PD has exceeded the industry level since December 2019. In comparison, another Chinese leading lithium producer Ganfeng Lithium Co Ltd (Ganfeng Lithium), which had a similar PD with Tianqi Lithium before April 2019, keeps its PD at a low level until now.

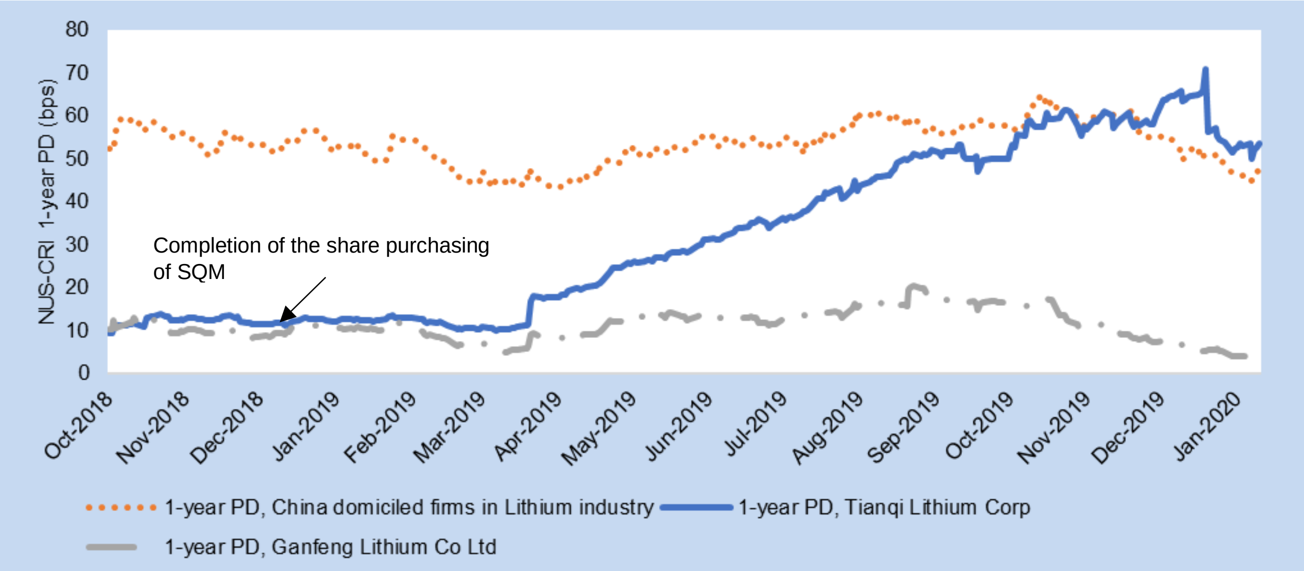

Figure 1: NUS-CRI 1-year PD for Tianqi Lithium Corp, Ganfeng Lithium Co Ltd, and China domiciled firms in the Lithium industry. *Source: NUS-CRI*

During the past two years, the global lithium market has encountered rising supply (see Figure 2a) from the opening of new mines in anticipation of surging sales of electric cars. As shown in Figure 2(b), we could observe a sharp decrease in the delivered pricing of lithium products in China. The weaker price of lithium products squeezed Tianqi's gross profit margin and brought down its investment gain in associate companies as well.

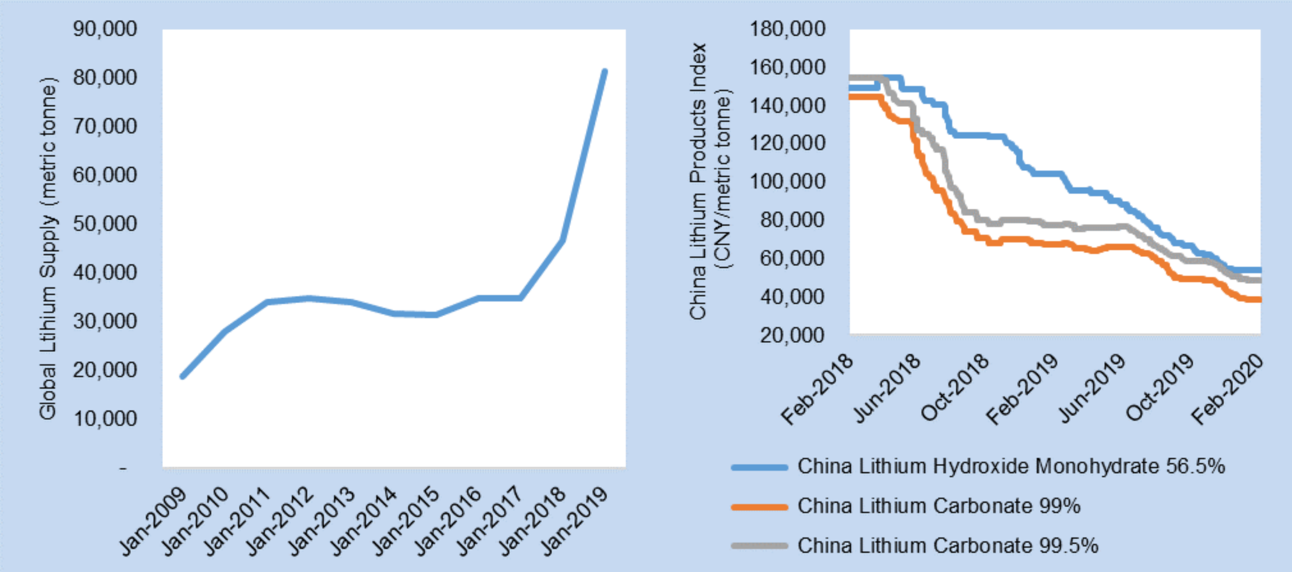

Figure 2a&2b: Global lithium supply (metric tonne) and China Lithium Product Index (CNY/metric tonne). *Source: Asian Metal Inc., Bloomberg NEF*

Tianqi Lithium's worsening credit profile was mainly due to its aggressive overseas expansion, which largely elevated the company's financial burden and exposed it to the uncertainty of foreign regulations. There was a dramatic increase in total debt amount and leverage ratio in 2018 Q4, upon the company's acquisition of SQM. Its total debt amount expanded near 5 times to over USD 4bn, and its net debt to EBIT ratio climbed significantly to 8.28X. Due to its expansions, the company's financial expenses rose more than 500% year-on-year in the third quarter. Besides, Tianqi Lithium reported several impairment losses due to change of foreign tax law and lower than expected profits from the associate companies. The equity investment in SQM was recognized as high as USD 4.3bn in 2018 while SQM was hit by the declining lithium price and reported large decrease in profits. Thus, together with the change of Chile tax law, Tianqi Lithium announced a USD 320mn provision for the impairment of long-term equity investment and a USD 47.58mn tax compensation in SQM, and amended its annual net income forecast in 2019 from CNY 80mn (USD 11.46mn) to negative CNY 2.6bn (USD 370mn), first time negative since 2014.

Looking at the Table 1 below, we could find a deteriorating financial performance for the company in the profitability, liquidity, and leverage aspects from Q2 2018 to Q3 2019, in comparison with the industry median level.

		2018 Q2	2018 Q3	2018 Q4	2019 Q1	2019 Q2	2019 Q3
Return on Assets (%)	Tianqi Lithium	16.27	13.20	7.04	5.22	3.31	1.87
	Industry	5.31	4.95	4.04	3.06	2.64	2.21
Current Ratio (X)	Tianqi Lithium	2.74	1.90	0.88	0.84	0.72	0.69
	Industry	1.54	1.48	1.38	1.37	1.35	1.41
CFO/Total Liabilities (%)	Tianqi Lithium	48.52	39.06	11.23	8.74	6.55	4.85
	Industry	-0.39	1.84	6.30	7.34	8.13	9.73
Total Debt/Total Asset (%)	Tianqi Lithium	30.63	31.02	68.30	67.45	69.75	69.96
	Industry	27.51	21.05	26.06	21.14	27.23	27.18
Total Debt/Total Equity (%)	Tianqi Lithium	50.68	53.83	255.38	252.28	273.56	282.43
	Industry	54.50	46.37	54.80	41.12	55.11	53.79

Table 1: Financial analysis for Tianqi Lithium and China's lithium industry. *Source: Bloomberg*

In order to repay the debts it borrowed, Tianqi Lithium has been actively expanding its financing channels including equity financing and debt financing. The company raised USD 424mn in a December rights issue on the Shenzhen stock exchange last year to repay the loans it used for overseas expansion. Moreover, Tianqi Lithium was approved for a USD 315mn commercial paper and mid-term notes shelf registration in China interbank bond market. However, the amount it raised was still much less than its obligation - a total of USD 2.2bn is due in November.

Looking forward, we can find that Tianqi Lithium has a deteriorating credit outlook according to its NUS-CRI Forward 1-year PD[1] term structure (see Figure 3). Its Forward 1-year PD curve stays above that for China's lithium industry and the gap between them widens, suggesting a heightened credit risk of Tianqi Lithium in the future. Despite the abovementioned risks, optimism still remains over the overall lithium markets on the back of expected higher electric vehicle uptake in Europe and the still favourable NEV subsidy policies in China. If Tianqi Lithium could employ its competitive production advantage and seize the market opportunities, its credit profile could be improved in the future.

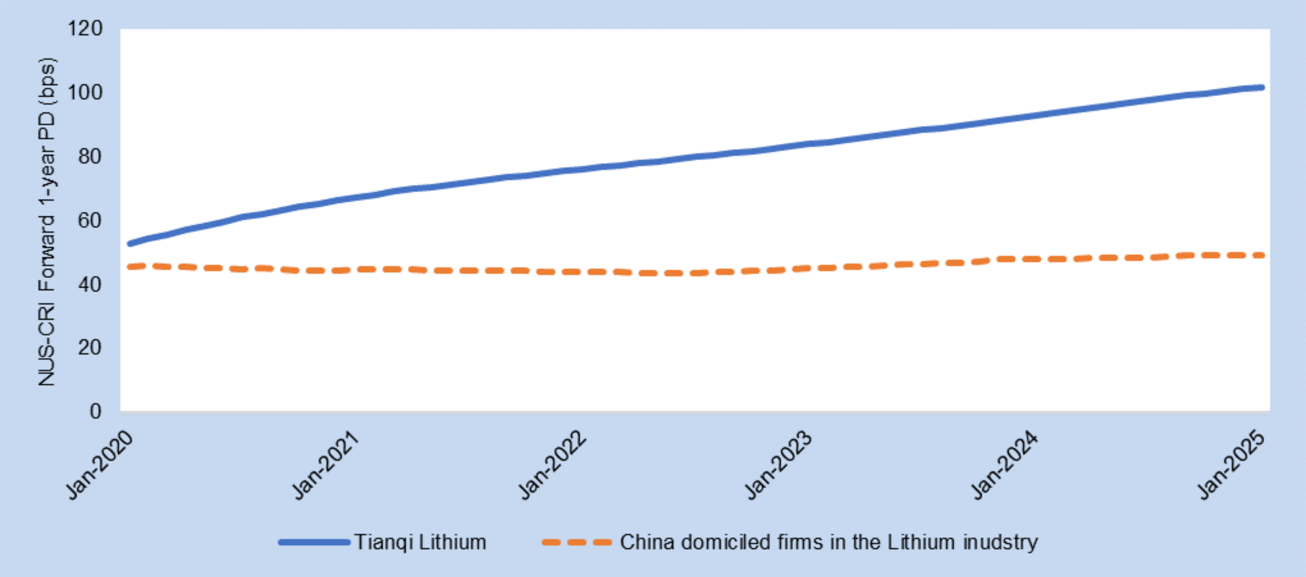

Figure 3: NUS-CRI Forward 1-year PD for Tianqi Lithium and China domicile firms in the lithium industry. *Source: NUS-CRI*

Credit News
China's hurting banks brace for worst-case economic scenario **Feb 10.** Analysts now expect that the spreading coronavirus could send China's first-quarter growth to as little as 3.8%, lower than last year's envisaged worst-case economic growth rate in China's annual banking stress tests. Economic growth is plummeting this quarter albeit huge cash injections from the central bank. Chinese banking industry has already suffered record loan defaults amid the weak economic expansion and it is now taking a big hit by the outbreak of the virus on top of an unresolved trade dispute with the US. (Bloomberg)
Asian junk debt's weak fundamentals harder to ignore after virus **Feb 7.** After the sell-off on the coronavirus concerns, money managers are more scrutiny towards Asian junk bonds. It turns out that some important fundamentals of junk debt had been weakening before the epidemic. As economic growth outlooks worsened in 2019, inflation rose in places and central banks in emerging markets eased less aggressively. The upgrade-to-downgrade ratio for Asian high-yield issuers slumped in the fourth quarter last year. The outbreak of the new virus put further pressure on borrowers by

[1] The Forward PD estimates the conditional credit risk a company faces in its future and works similarly to a forward interest rate. For instance, the 3-month Forward 1-year PD is the probability that the firm defaults during the period from 3 months onwards to 1 year plus 3 months, conditional on the firm surviving the next 3 months.

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China's USD 1.5tn pile of bad debt lures foreign funds

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China epidemic threatens a broader wave of defaults in 2020

Feb 5. The coronavirus outbreak that began in China has exacerbated the outlook of default in the China bond market. With millions of citizens quarantined within China and businesses in affected provinces, especially Hubei, put on a standstill, this resulted in low liquidity and negative borrowing sentiments of Chinese lenders. The Chinese government has since implemented liquidity policies to ease the economic slowdown. However, it is unlikely that this will trickle down to the weaker borrowers. There is a possibility that if financial-rescue bills mount up, the nation's banks will see an increase of CNY 5.6tn of new bad loans as estimated by S&P Global Ratings. Hence, the creditworthiness of the small and poorly operated companies will deteriorate, making the anticipated defaults in 2020 on par with the record high of CNY 137.6bn seen in 2019. (Bloomberg)

China may ease shadow-bank crackdown to bolster slowing economy

Feb 5. In light of the coronavirus outbreak and record high defaults in the past two years, China will slacken the crackdown on shadow-bank and diverge their attention to solving the immediate health crisis for now. Policy makers are extending the grace period to shadow-banking curbs as well as lowering borrowing rates to cushion against the worsening economic outlook caused by the epidemic. Since 2017 to date, Fitch Ratings has estimated a decline of CNY 11.5tn in shadow loans and this has caused an increase in interest rates and a strain on borrowers bringing about the highest number of defaults in 2018 and 2019. (Bloomberg)

Coronavirus strikes World Bank's 2017 catastrophe bonds (FT)

Rush to green sparks concern of bubble in ESG assets (Bloomberg)

Global junk bond issuance hits monthly record (FT)

Regulatory Updates

Fed includes 'heightened stress' in leveraged loans in 2020 bank stress tests

Feb 7. The Federal Reserve (Fed) announced on Thursday that large banks with significant trading operations will have their finances tested in 2020 against a scenario that includes "heightened stress" in leveraged loans. Furthermore, those banks will also be tested against a hypothetical counterparty default as part of its 2020 round of stress tests. The focus on leveraged lending in the upcoming round of stress tests comes after regulators and some in the industry have raised concern for years amid the rapid growth in the corporate debt market, particularly in loans to already heavily-indebted firms. In total, there are 34 banks with more than USD 100bn in assets that will face this year's stress test and the Fed has approved capital plans for all tested banks after the 2019 cycle. (Reuters)

India unveils steps for bad loan-laden banks to boost credit

Feb 6. India's central bank unveiled steps to encourage banks to lend more amid the 58-year slow credit growth in the struggling economy. Besides exempting banks from setting aside the mandatory cash reserve ratio of 4% of fresh loans for automobiles, residential housing and small businesses until July 31, the central bank also extended relaxation of rules on the classification of loans. To further bring down banks' funding costs and lending rates, banks are allowed to borrow from the central bank for one and three years at 5.15%. (Bloomberg)

Turkey stiffens manipulation penalties in banking overhaul (Bloomberg)

With little policy room, Africa central banks fret over debt (Bloomberg)

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