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Weekly Credit Brief Jan 12 - Jan 18

Noble Group downgraded as large debt payments are on the horizon

by Justin Hsiao

The default risk of Noble Group Ltd (Noble), the largest commodity trader in Asia, rose to an all-time high as a prolonged commodity down-cycle further squeezed its already-low margins and weighed on the imbalance between the company's cash flow and liabilities. Last year, Noble announced an 84% drop in Q3 net profit because of losses in its metal-and-mining segment. Its share dived 62% last year and was the worst performer in Singapore's STI index in 2015. The shares lost more than 25% this year, becoming the second-worst performer in the STI index in 2016.

Figure 1 shows that the RMI-CRI 1-year Probability of Default (PD) for Noble has a worsening trend from the beginning of last year and peaked at a record 239.7bps on Jan 14, 2016, higher than the PD of 142.9bps it had during the global financial crisis. In tandem with the rising PD, the price of Noble's 1-year credit default swap (CDS), the protection of the company's notes against non-payment, increased during the same period, reaching 2,953bps on Jan 14, 2016, the highest in Asia according to the data provider CMA.

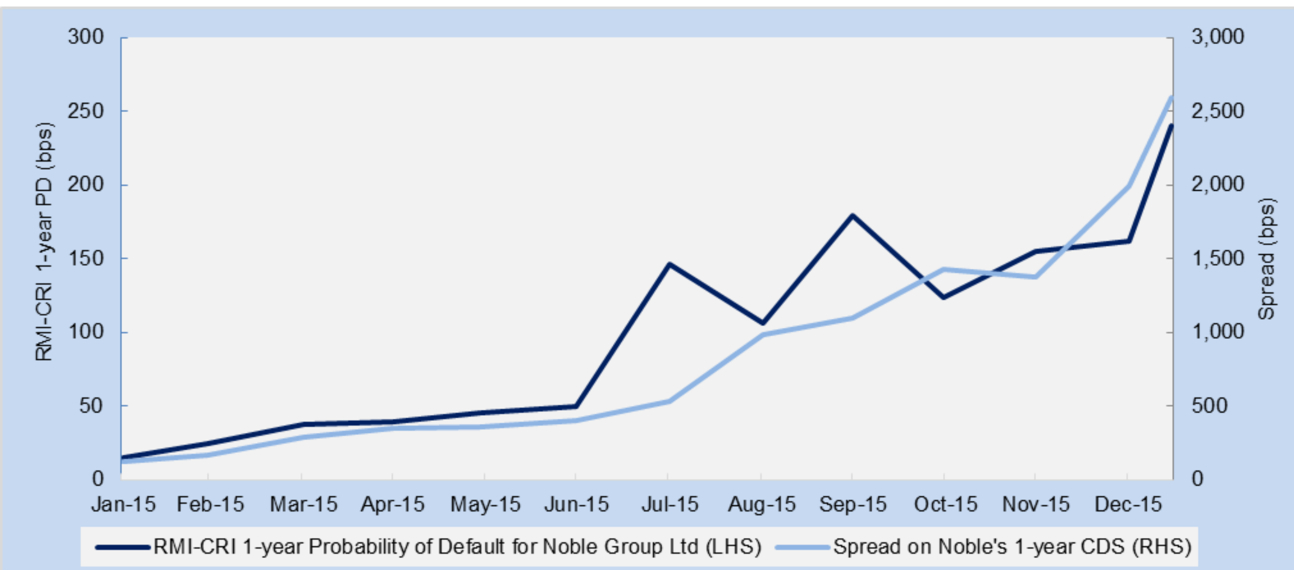

Figure 1: RMI-CRI 1-year PD and spread of 1-year USD-denominated CDS for Noble. *Source: RMI-CRI, Bloomberg*

In the past month, Noble's note has been downgraded to junk by two out of the three main credit rating agencies, highlighting concerns about its ability to repay debt obligations. The company faces a maturity wall this year, which is almost three times higher than the cash position held by the firm on Sep 30, 2015, shown in the left panel of Figure 2. Noble's short-term debt was at a higher level than the historical average of around USD 1.5bn prior to 2015.

To put Noble's liquidity profile into context, at the end of Sep 2015, the firm's liquidity position was about USD 1.9bn, comprising readily available cash and unutilized committed facilities. On top of that, it secured a USD 1.1bn borrowing base facility in Oct 2015 and had a readily marketable inventory of USD 1.7bn, which could be used to repay debt if necessary. On the other side of the equation, Noble has debts maturing in the next 12 months of USD 3bn: USD 458mn senior notes due in Aug 2016 and a USD 2.5bn short-term bank debt due in May 2016. Noble, therefore, should have sufficient liquidity to cover its short-term commitments in the next 12 months (see the right panel of Figure 2).

However, the rating agencies emphasized that any further deterioration of the liquidity position will have a negative impact on rating actions. A further downgrade could be particularly earthshaking for Noble because USD 11bn of its USD 15.5bn banking facilities are uncommitted, indicating that lenders are not obligated to provide financing. Such facilities are commonly contingent on a company's ability to maintain or improve its credit rating. Moreover, the downgrade will constrain the access of Noble to the capital markets, especially vicious to a commodity trader like Noble, which relies heavily on debt to finance its operations – buying and selling large volumes of coal, oil and other commodities across the globe.

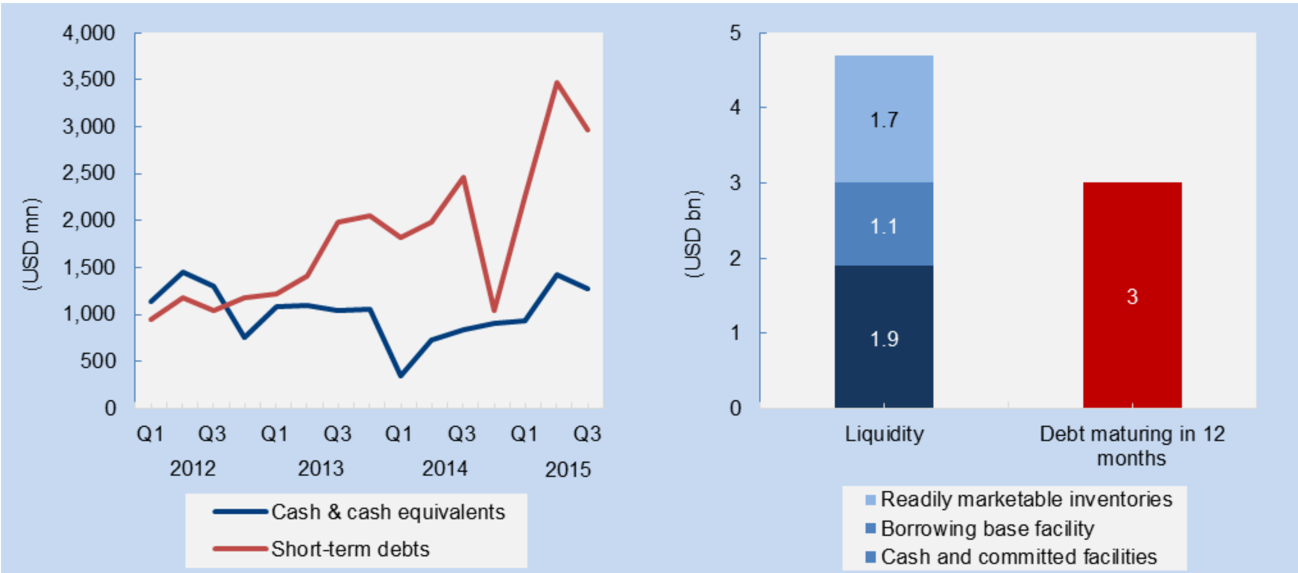

Figure 2. Trends of cash holding and short-term debts (left panel) and access to liquidity as of Sep 2015 (right panel) for Noble.
Source: Company's filing, Bloomberg

Noble's low level of profitability, its anemic ability to repay debt from core operations and high gearing are other factors that worsen the company's credit profile (see Table 1). As the slowing demand from China sent commodity prices plummeting, the operating margin of Noble became thinner - dropping from 1.43% in Q1 2015 to 0.73% in Q3 2015. The interest coverage ratio also demonstrated the weakening ability of Noble to repay its debts from its operating income. The ratio went below 2x in the latest quarter. In addition, Noble's leverage increased significantly in 2015: net debt to EBITDA ratio was 9.34x, almost twice as much compared to the 4.82x ratio at the end of 2014.

	Q4 2014	Q1 2015	Q2 2015	Q3 2015
Operating margin (%)	-0.49	1.43	0.96	0.73
EBIT to interest expense	2.08	2.05	2.82	1.99
Net debt/EBITDA	4.82	7.08	7.81	9.34

Table 1. Credit metrics of Noble. *Source: Bloomberg*

Noble has implemented some measures to mitigate the negative impact caused by the low-price commodity environment. In Dec 2015, Noble agreed to sell its remaining 49% stake in Noble Agri Ltd, the company's agricultural arm, to China's Cofco for USD 750mn in a bid to improve its liquidity health. The firm also managed to reduce its operating costs and capital expenditures. In the short term, Noble might not have imminent liquidity issues; however, as global commodity prices keep dipping into the new lows, the company's credit quality continues to be under pressure.

Credit News

HSBC to BNP would cut securities arms in failure plans

Jan 16. The US Federal Reserve and the Federal Deposit Insurance Corporation released the excerpts of living wills, a requirement under the Dodd-Frank Act, from about 125 financial firms on Jan 15. The living will details a firm's proposal to wind itself down, were it to collapse, and aims at avoiding a repeat of the 2008 financial crisis. Most banks, including HSBC Holdings and BNP Paribas, plan to leave their subsidiaries operating while the parent companies go to the bankruptcy court. (Bloomberg)

Goldman in USD 5.1bn mortgage-backed securities settlement

Jan 14. Goldman Sachs has reached a USD 5.1bn settlement with the US government and other agencies for mis-selling mortgage-backed securities in the run-up to the 2008 financial crisis. The settlement, which will wipe out most of the bank's profits for the fourth quarter, comprised a USD 2.4bn civil monetary penalty to the Department of Justice and USD 875mn in cash payments to various other agencies. A total of USD 1.8bn would also be set aside for various relief programs to support the housing sector. (FT)

Russia prepares stress test as oil slides below USD 30

Jan 13. While US WTI crude briefly stumbled below USD 30 for the first time in 12 years, Russia's Urals blend is already below that mark trading at USD 27.14 a barrel. Given the new reality, the Kremlin has ordered stress tests with USD 25, USD 35 and USD 45 oil. The most recent collapse in energy prices from November means the Russian budget will lose 300 billion rubles (about USD 4bn) in oil revenue in the first two months of 2016, according to the newspaper's ministerial source. The updated macroeconomic forecast will be presented by Economic Development Minister Aleksey Ulyukaev later this month. In the meantime, the government has decided to cut spending by 10%. (RT)

Developing countries face 'new reality' of lower growth, says IMF

Jan 12. The head of IMF warns that emerging economies are facing a "new reality" that is significantly slowing the pace of economic convergence with the rich world and risks leading to further financial market volatility. The change would also reverberate in rich economies. A 1% slowdown in emerging markets would cause already weak growth in advanced countries to slow by about 0.2 percentage points, according to Christine Lagarde. The US Federal Reserve's shift towards ending its ultra-aggressive easing policies has the potential to trigger further exchange rate ructions. (FT)

S&P says corporate credit conditions worsening at fastest pace since crisis

Jan 12. According to S&P, the health of indebted companies globally has deteriorated at its fastest pace since the financial system was wrecked by crisis in 2009. Just 6% of companies are on a positive watch, while the outlook is worsening for 17% of the companies rated by S&P, the greatest difference between positive and negative since the global financial crisis began in 2008. Problematic borrowers are so far concentrated in the oil and gas and metals and mining industries, while investors around the world are also paying attention to the slowdown in the Chinese economy and the heighted borrowing cost following the rate hike by Fed. (FT)

Arch Coal files for bankruptcy, hit by mining downturn (Reuters)

Saudi debt risk on par with junk-rated Portugal as oil slides (Bloomberg)

Singapore's next bond default looms amid Pacific Andes skirmish (Straits Times)

Regulatory Updates

ECB quizzes banks about high levels of bad loans

Jan 17. The European Central Bank, which supervises the top 129 banks in the euro zone, is scrutinizing the high level of non-performing loans in a number of banks in the region. A task force has been created to investigate problematic banks and propose remedial actions. According to the International Monetary Fund's most recent estimate, the stock of bad loans in the euro area totaled 9.2% of euro area gross domestic product. (Reuters)

Reporting rule adds USD 3tn of leases to balance sheets globally

Jan 13. A new financial reporting standard introduced by the International Accounting Standards Board and the US Financial Accounting Standards Board will compel companies globally to add close to USD 3tn of leasing commitments to their balance sheets. The new rule is aimed at providing much-needed transparency on the lease assets and liabilities of companies and it is expected to cause the most impact in the retail, hotel and airline sectors. (FT)

RBI tells banks to hike provisions to tackle stressed assets (Livemint)

PBOC said to impose reserve rule on offshore bank Yuan funds (Bloomberg)

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