Credit Research Initiative
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Weekly Credit Brief Jan 24 - Jan 30

Trump takes aim at Mexican companies

By Dexter Tan

Last week, President Trump signed an executive order to build a wall on the Mexican border and suggested a new 20% tax on Mexican imports to finance the construction of the wall. The President also threatened to renegotiate the North American Free Trade Agreement (NAFTA), a three-country accord signed in 1994 blamed for the loss of US manufacturing jobs. One year after NAFTA took effect, Mexico experienced a severe currency crisis that nearly pushed Mexico into default. The recent devaluation of the Mexican Peso to a new record low and the renewed focus on NAFTA suggested that history could repeat itself, but Mexican companies now have stronger credit profiles than in 1995.

Our survey of 92 Mexican domiciled businesses generated a median RMI-CRI 1-year Probability of Default (PD) of 3.32bps on Jan 27, which is 72% lower than the median 1-year PD for 489 Latin American companies. Unlike 22 years ago, more Mexican firms hedge their exposures to foreign currency fluctuations and diversify their revenue streams overseas.

Figure 1 shows the distribution of 1-year PDs against their respective change in market cap since the US Election Day on Nov 8. Mexican firms have lost USD 56bn, or 14% of their total market value since US Election Day and more than 50% of the firms have a less than 5bps likelihood of default within 12 months. The market caps of real estate companies, for example Corp Inmobiliaria Vesta SAB de CV, Corpovael SA de CV and Fibra Shop Portafolios Inmobiliarios SAPI de CV have declined 28.33%, 32.22% and 27.32%, respectively but their 1-year PDs remained below 5.5bps. It appears that sell off in these real estate stocks, accompanied by higher interest rates, rising office vacancies and the prospect of weaker housing demand did not alter the credit quality of these firms significantly.

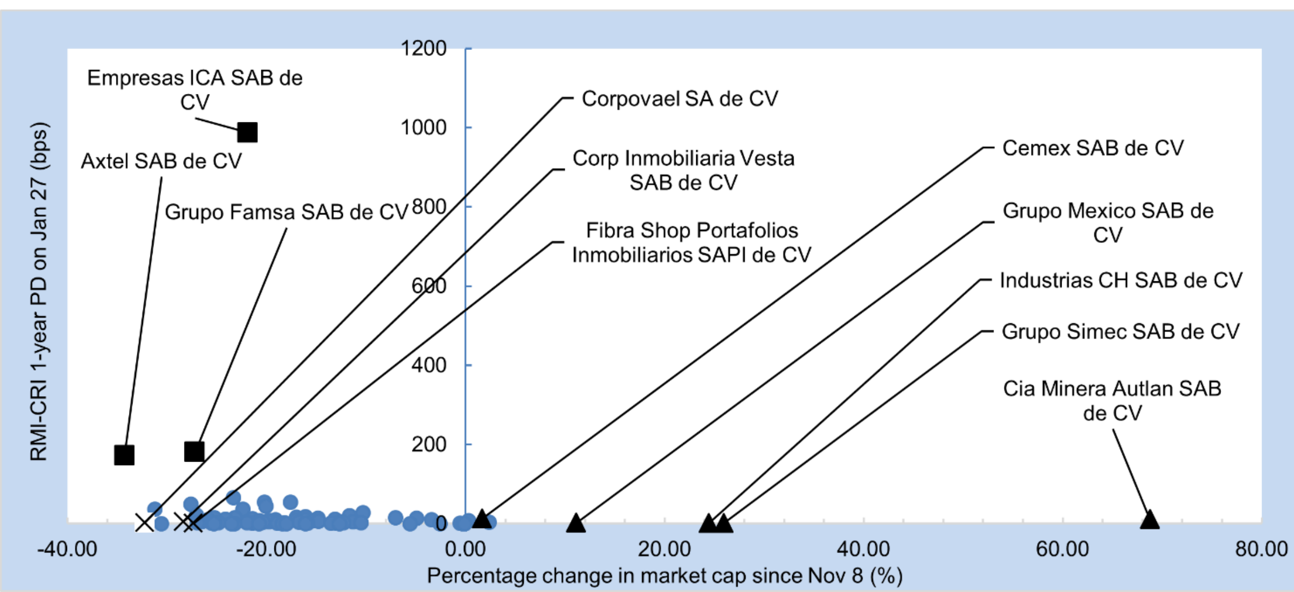

Figure 1: RMI-CRI 1-year PDs for 92 firms vs percentage change in market cap. Note: Illiquid stocks with infrequent trading were not considered in our rated universe. *Source: RMI-CRI, Bloomberg*

As shown in Figure 1, the majority of Mexican 1-year PDs congregate toward the lower left corner of the chart as 75% of the firms have a market cap decline exceeding 22.60%. However, not all companies have low default risks and large drops in market values. Small firms such as Empresas ICA SAB de CV, Grupo Famsa SAB de CV and Axtel SAB de CV have 1-year PDs of 986.71bps, 180.36bps and 171.93bps, respectively. Their market cap differences are – 21.85%, -27.18% and -34.25%, respectively.

In contrast to the three firms mentioned above, there is no underlying common theme explaining the decline in market values. Empresas ICA was Mexico's largest corporate default and the ongoing restructurings at the firm resulted in much volatility in the company's stock price. Grupo Famsa and Axtel SAB have significant exposures to the Mexican Peso devaluation, and the currency's weakness has decreased the equity values of the companies.

At the other end of the spectrum are Mexican corporates with low 1-year PDs and large market cap gains. Steel producers, material suppliers and construction firms - Cemex SAB de CV, Grupo Mexico SAB de CV, Industrias CH SAB de CV, Grupo Simec SAB de CV and Cia Minera Autlan SAB de CV benefited from rising steel prices as well as President Trump's promise to boost infrastructure project spending. Strong Chinese demand together with China's campaign to cut excess capacity fueled a rally in steel prices and lifted the equity values of a number of Mexican steel makers. Shares of Cemex rallied ahead of the wall construction announcement last week and remained high despite the clarification by the US administration that US companies would build the wall.

The creditworthiness of Mexican companies may not have a strong relationship with market cap changes but a plot of the RMI-CRI 1-year PDs against their debt capital structures shows a possible linear relationship between the two variables. As shown in Figure 2, firms with a low/high default risk have a low/high debt composition on their balance sheets. The amount of debt together with the changes in market cap affect the RMI-CRI Distance-To-Default (DTD), which is a key determinant of 1-year PDs. It may be difficult to quantify which input variable has a larger impact on RMI-CRI DTD, but results from Figures 1 and 2 suggest that the 1-year PDs for Mexican firms could be more sensitive to capital structure changes, compared to short-term fluctuations in the stock market.

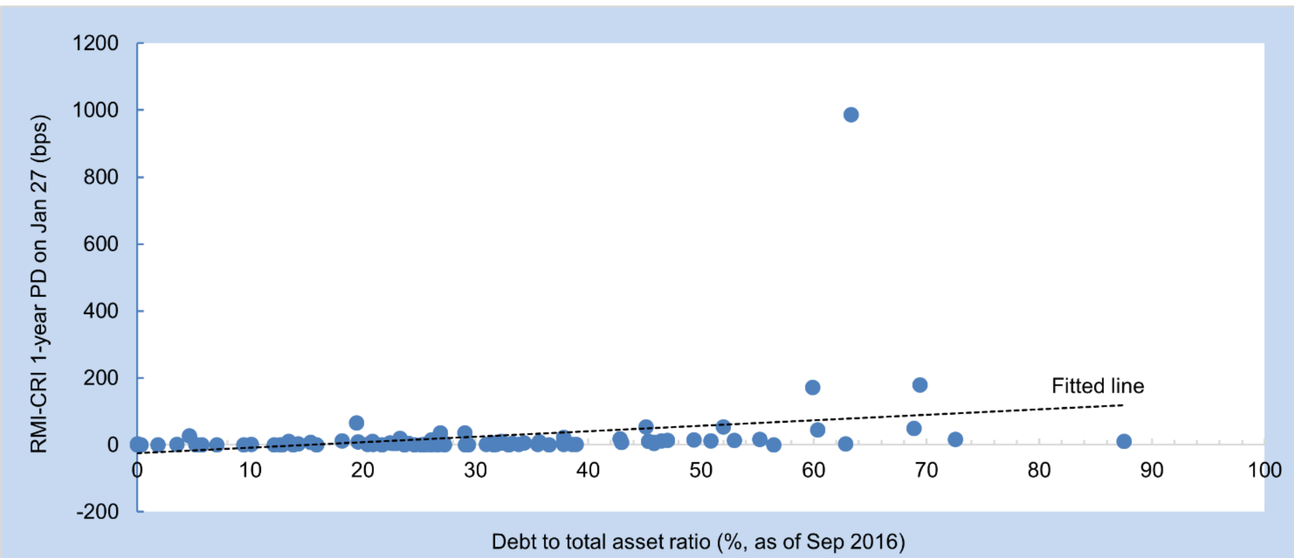

Figure 2: RMI-CRI 1-year PDs vs debt to total asset ratio. *Source: RMI-CRI, Bloomberg*

Mexican firms have been resilient to market prices; however, a few factors could pose a substantial threat to the credit quality of Mexican firms. The US could place NAFTA on the negotiating table formally, raise trade barriers with its neighbors and affecting its economies adversely. Foreign investment into Canada and Mexico might fall as more companies might set up factories in America directly. While there are few details on how trade protectionism against Mexico could play out, Fitch estimates that only a fifth of Mexican corporates would have no impact from changes in NAFTA.

Credit News

China's COSCO shipping flags RMB 9.9bn loss for 2016

Jan 26. COSCO Shipping Holdings expected to post a net loss of RMB 9.9bn for 2016 due to a weak freight market and the impact of asset disposal despite a slight recovery of freight rates in the fourth quarter. Its full-year loss has been COSCO Shipping's weakest annual performance since 2011 after the firm restructured its business in 2015 by selling its dry bulk business and other divisions at a loss to its parents as part of a wide-ranging merger of China Ocean Shipping Group and China Shipping Group. The merger aimed to resist the prolonged shipping market downturn. (Business Times)

Oceanus in debt restructuring deal with key creditors

Jan 25. Homegrown premium seafood supply chain manager Oceanus Group has entered into a binding term sheet with its key creditors relating to a proposed debt restructuring. The firm will convert 76.4% of its total outstanding debt to equity, a move that substantially improves its balance sheet. Oceanus's key creditors have agreed to transfer approximately SGD 31.87mn of the outstanding debt to a consortium consisting of new value investors and Oceanus management. To meet ongoing capital needs, the new investors will inject new funds up to SGD 6mn. A further SGD 29.57mn of outstanding debt will be converted to new shares at SGD 0.00395 each, while the remaining SGD 20mn will not be repayable until Dec 31, 2018. (Business Times)

A USD 90bn debt wave shows cracks in US property boom

Jan 24. A USD 90bn wave of maturing commercial mortgages, leftover debt from the 2007 lending boom, is laying bare the weak links in the US real estate market. Factors, such as rising interest rates, regulatory constraints and choosier lenders, have all increased the odds that borrowers will come short when it is time to refinance. The delinquency rate for commercial mortgages that have been packaged into bonds is forecast to climb by as much as 2.4 percentage points to 5.75% in 2017, reversing several years of declines, as property owners struggle with maturing loans. According to S&P analysts, about 13% of real estate loans coming due will ultimately default, up from 8% over the past two years. (Bloomberg)

Trump budget pick seeks entitlement cuts as urgent step on debt

Jan 24. Mick Mulvaney, President Donald Trump's pick for budget director, said at senate confirmation hearings that the government must resolve the USD 20tn national debt soon. He also mentioned he would convince Trump of the need for a change in the entitlement programs for the Medicare and Social Security trust funds so that the funds would not go bankrupt. However, he underscored that he would not advocate cutting benefits to current beneficiaries, a promise that will mitigate the impact. (Bloomberg)

China's army of global homebuyers Is suddenly short on cash (Bloomberg)

Keppel T&T posts 93.1% drop in Q4 earnings (Straits Times)

Regulatory Updates

Bank of England's Carney sees risks as fintech booms

Jan 26. Bank of England Governor Mark Carney said that the fast-growing fintech sector could hold big systemic risks for the banking sector and the broader economy, an issue that needs to be addressed by bank regulators around the world. As the fintech could add concerns to the stability of bank funding and credit quality, Carney suggested that authorities focus more intensely on regulation and prudential requirements and ensure a more disciplined management of operational and cyber risks. The Financial Stability Board (FSB) is assessing how suitable existing rules are for addressing fintech risks and would report its findings to G20 in July this year. (Reuters)

Savers cashing final-salary pensions 'at risk of scams'

Jan 24. The Financial Conduct Authority (FCA) said that its supervisory work revealed that recommendations made by some financial advisers did not meet its expectations. Specifically, advisers were not conducting proper checks on where the funds of their clients, who are cashing in their final-salary pensions, go. The FCA reminded retirement fund advisers that pension transfer benefits are usually irreversible and it was important that firms advising on such transfers ensure clients are aware of the implications. Advisors did not meet the FCA's expectations to observe the 'critical yield' – a test regularly used by advisers to pinpoint the investment returns needed to match the benefits offered by the existing scheme. In a separate statement, the FCA urged pension scheme operators to ensure that their due diligence processes were robust. (FT)

Banks' AI plans threaten thousands of jobs (FT)

Bank rescues defended in Sweden as issuers find out at what cost (Bloomberg)

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