



Uncertainty of Sistema's credit outlook mounts on lawsuit

by [Melissa Wong](#)

Sistema PJSC FC, a Russian conglomerate, mainly operates in the telecommunications industry and owns several subsidiaries. Although the firm has been performing well and paying out high dividends since 2015, it suffered a technical default in July 2017 due to an asset freeze as part of the lawsuit with Rosneft.

Sistema had achieved all of its [key targets and milestones](#) in 2016, such as repaying debts and paying out high dividends. Total debts of the firm fell from RUB 67.96bn in 2015 to RUB 58.44bn in 2016. In addition, Sistema reported positive earnings for the Year of 2016, a result that boosted the market confidence and made investors optimistic about the outlook for 2017. Sistema also [pledged](#) to further deleverage and increase its dividend payout. However, the uncertainty has loomed large over Sistema since May 2017, when it received a legal claim filed by Rosneft for the recovery of RUB 106.6bn in damages (later increased to [RUB 170.6bn](#) due to currency depreciation), accusing the group of stripping assets from Bashneft, an oil producer now owned by Rosneft but previously held by Sistema. Sistema [refuted](#) the legal claims, stating that the reorganization complied with Russian laws and was in line with its business model, which aims to develop Bashneft into one of the best oil companies, to create significant value for its stakeholders, and to prepare it for the future IPO. Facing the headwind, Sistema's market capitalization has plunged, in tandem with the RMI-CRI 1-year PD surge to 100.42bps on Jul 21. (See Figure 1)

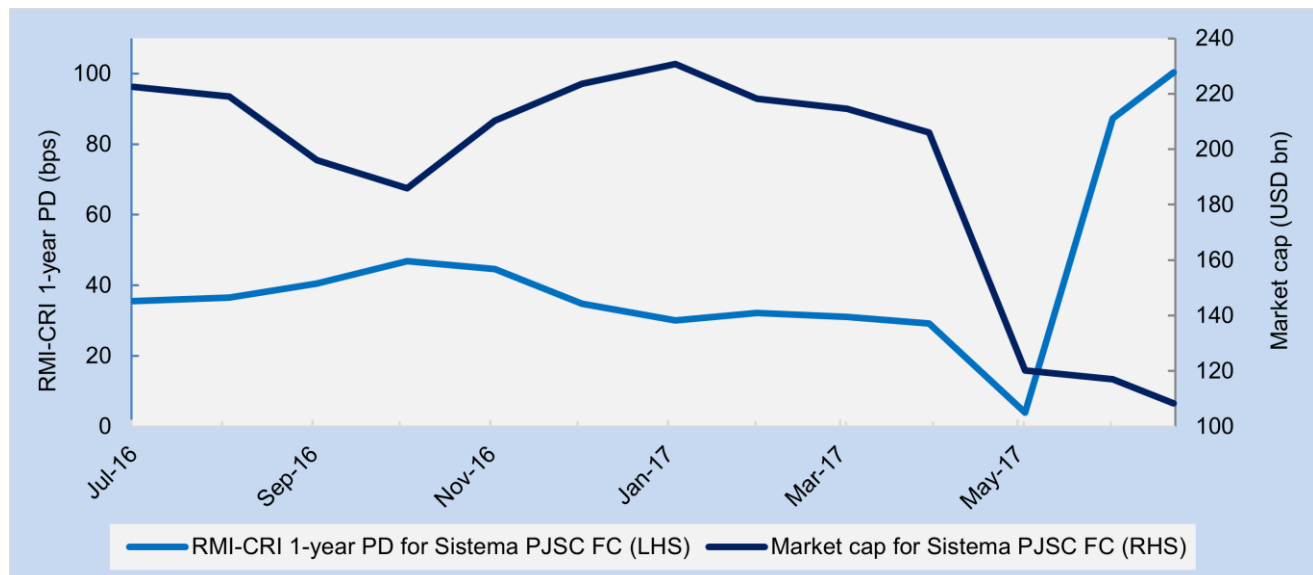


Figure 1: RMI-CRI 1-year PD and market capitalization for Sistema PSJC FC. Source: RMI-CRI, Bloomberg

Although the lawsuit has not finalized, the arbitration court has frozen more than USD 3bn assets, a move that triggered a technical default on a RUB 3.9bn credit obligation. While Sistema does not anticipate creditors to demand early repayments, the main concern lies in its inability to sustain positive earnings. [Some analysts](#) think that if Rosneft wins the lawsuit, Sistema may lose control over MTS, a subsidiary that contributed more than 80% to Sistema's total revenue. Looking back at Sistema's earnings for the past two years, Sistema would have posted negative operating margins with the exclusion of revenue contribution from MTS. It suggests that if Sistema loses MTS due to the lawsuit, Sistema might have difficulty in generating positive core profits in the future.

(RUB bn)	2015		2016	
	Actual	Adjusted	Actual	Adjusted
Revenue	678.82	253.15	697.71	263.73
Operating Income	68.39	-23.32	79.84	-6.38
Operating Margin	10.07%	-9.21%	11.44%	-2.42%

Table 1: Sistema PJSC FC's core profitability and adjusted figures (excluding the contribution from MTS). *Source: Bloomberg*

As the main bulk of Sistema's outstanding debt expire in 2020, the firm's liquidity might not be in imminent danger. However, the potential loss of the lawsuit could decay Sistema's core profitability, leaving the firm [challenged](#) to maintain its credit profile and continue to pay high dividends in the long term.

Credit News

Banks that funded HNA's USD 40bn spending spree halt new loans

Jul 24. HNA's offshore 2018 bond reached a record yield of 12.6% after lenders halted new lending to the company, underlying concerns about the firm's elevated credit risk. Chinese authorities who are checking the financial risks of large firms, have asked lenders to examine their exposure to selected companies including HNA and other prolific acquirers. HNA Group took a lot of debt to grow into a global conglomerate after completing USD 40bn of acquisitions spanning across six continents since 2016. Although HNA told that the firm is well funded with strong cash flow and has access to equity capital market lenders are rethinking their relationships with the company. ([Bloomberg](#))

European banks struggle to solve toxic shipping debt problem

Jul 24. A glut in shipping capacity and slower demand for shipping leading to low profitability has caused a credit crunch for shipping firms and banks. Consolidation has begun for the shipping industry with international lines acquiring each another and some others having filed for bankruptcy. The shipping industry is estimated to have a capital shortfall of USD 30bn this year due to banks being driven out of shipping. European banks are one of the worst hit as the banks are estimated to have accumulated more than USD 100bn of debt burden with at least 70% of these loans suffered a drop in value. These banks are also experiencing tough conditions to sell these shipping loans as they were deemed toxic, e.g. Germany's HSH Nordbank found prices offered in a selling attempt were too low. Analysts are expecting further losses as shipping loans problem continue to worsen which is likely to affect banks' profitability. ([Reuters](#))

Deutsche Bank and Barclays face hit from fixed-income falls

Jul 24. Deutsche Bank and Barclays are expected to emerge as the biggest European losers from the falling fixed-income trading revenues that also reduced earnings for the big five Wall Street banks. The US banks attributed it to the low volatility that persisted for most of the second quarter, when an absence of market turbulence meant prices remained steady and clients had no incentive to trade. Kian Abouhossein, a JPMorgan banks analyst, noted that equities, on the other hand, were performing quite well in comparison to fixed incomes. This situation favors Swiss banks UBS and Credit Suisse which had previously reduced their exposures to the fixed-income business under restructuring plans. Optimistic about the prospects lying ahead, Abouhossein believed that conditions will turn back in their favor when the Fed eases off on its quantitative easing program in September and markets become more active. He also noted that there was "nothing structural of concern" in the fixed-income market. ([FT](#))

Bond bubble brews as central banks retreat from QE

Jul 24. Fixed-income investors are becoming increasingly worried as central banks across the world are expected to move away from the quantitative easing (QE) practice. They worry that a shift in central banks' course would suck out liquidity in the market, increase market volatility and trigger a bond market crash. In the mutual fund market, consumers and big investors are piling into bond funds, drawing mixed opinions by experts in the investment industry. Bond fund managers, however, acknowledged the increasing challenge in finding investment avenues amid rising uncertainties posed by the tightening said to be the largest thing to happen in decades. ([FT](#))

Nam Cheong to restructure in blow to Singapore bond market

Jul 20. The Kuala Lumpur based group Nam Cheong Ltd. that had USD 429mn of bank loans and bonds on March 31, is seeking a moratorium on principal repayments and asking creditors for a haircut and to convert their debt into equity. The news came right after the event on July 20 when the group decided to temporarily cease repayment on all borrowings, including a semi-annual coupon due July 23 on USD 55mn of notes. Nam Cheong's debt woes are the latest blow to Singapore's bond market that reflect widening cracks in the region's offshore and marine services industry, triggered by a slump in oil prices over the past three years and a cutback in spending on exploration. ([Bloomberg](#))

ABG Shipyard agrees to insolvency process ([TradeWinds](#))

Charter Airline Dynamic International airways files for bankruptcy ([WSJ](#))

SOEs steps up deleveraging via debt-to-equity swap ([China Daily](#))

Regulatory Updates

China central bank to coordinate work of new financial oversight body

Jul 18. The People's Bank of China will be coordinating efforts by the newly formed Financial Stability and Development Committee to contain rising credit risks within China's financial markets. The new committee will be located within the central bank to help coordinate supervision efforts across the financial sector. The new regulatory unit is expected to introduce stronger risk controls, develop the financial sector and oversee regulatory policies. With the establishment of the new committee, the central bank will play a stronger role in macro prudential management and the prevention of systemic risks. ([Reuters](#))

India court dismisses Essar Steel appeal against bankruptcy proceedings

Jul 18. India's high court has dismissed Essar Steel India Ltd's appeal against the central bank's order that asked creditors to start bankruptcy proceedings against the company. The ruling is a move supported by the government which has empowered the Reserve Bank of India (RBI) to direct lenders to force defaulters into insolvency courts. The RBI has asked lenders to start bankruptcy proceedings against 12 companies in June in order to help the country cut more than USD 150bn of stressed assets in the banking system. ([Reuters](#))

Indian regulator suspends issuance of 'masala bonds' ([FT](#))

Regulation: Chile to adopt Basel III ([Euromoney](#))