NUS National University of Singapore | RMI Advancing Risk Management for Singapore and Beyond

Transforming Big Data into Smart Data

Weekly Credit Brief

Mar 04 - Mar 10 2014

Stories of the week

Chaori default highlights increasing default risk in CNY bond markets

By James Weston

China's local-currency (CNY) bond markets witnessed the first default in almost 20 years last week, as Shanghai Chaori Solar Energy Science & Technology Co (Chaori) paid investors a tiny fraction of a CNY 89.8mn coupon payment due on March 7. Expectations the company would default were high, as Chaori had advised on March 4 that it would not be able to make the full payment, and the company had previously almost missed a payment on the same bond a year ago. The company has a grace period that lasts until April 7 to repay the funds, although this is unlikely as the company has less than CNY 60mn of cash on hand.

The 1-year RMI probability of default (RMI PD) Chaori has long been relatively high (See Figure A1); jumping in February 2013 when the company projected a CNY 1.37bn loss for 2012, and on concerns the company would miss a coupon payment in March 2013. Since then, the RMI PD for Chaori almost doubled, as the company continued to post losses, saw its cash levels plunge and market capitalization halve. The latter led to a significant decline in the company's RMI distance-to-default (DTD). DTD is a volatility-adjusted leverage measure, and changes in the measure are a significant determinant of RMI PDs. Numbers close to or below zero suggest potential insolvency.

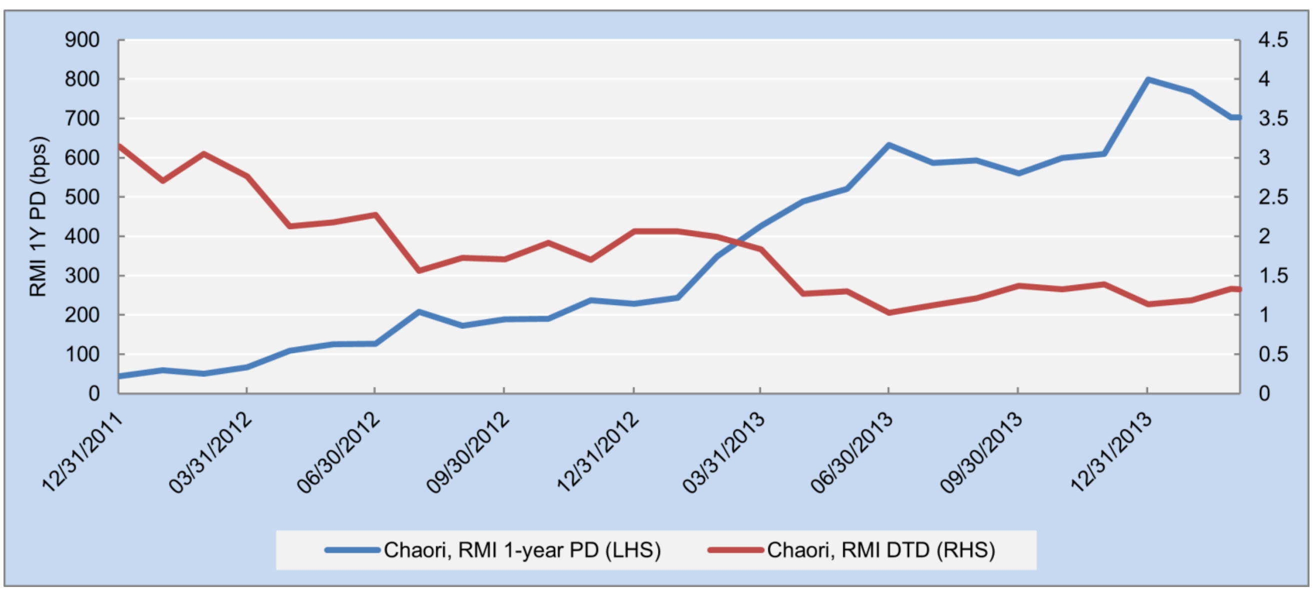

Figure A1: The aggregate 1-year RMI PD for Shanghai Chaori Solar Energy Science & Technology Co Ltd (Chaori, LHS), and the distance-to-default (DTD, RHS) for Chaori. *Source: Risk Management Institute*

Chaori's default illustrates problems across the Chinese corporate sector, where debt is estimated to be around CNY 70tn, or 120% of GDP. A significant portion of the debt has been used to expand capacity in a number of industries linked to the domestic real estate boom, or that were assigned importance by the Chinese government in response to the Global Financial crisis. As a result, industries including the solar, steel, cement and shipbuilding sectors are now plagued by overcapacity.

Table A1 lists the Chinese companies which currently have bonds outstanding and are in the worst 5% of Chinese RMI PD. The table identifies bonds which may have a high chance of default over the next year, including bonds issued by Ruitai Materials Technology Co Ltd and Leshan Electric Power Co, which both have bonds maturing in Q3 2014 but lack the cash needed to repay investors. MCC Meili Paper Industry Co Ltd 6.3% is also a concern, with a CNY 37.8mn coupon payment due in September; the company last reported CNY 3mn of cash on hand.

Both Hangzhou Iron & Steel Co and Xinjiang Ba Yi Iron & Steel Co Ltd also have significant bond issuance maturing in Q3 2014, and currently lack the cash needed to redeem their bonds. However, both companies have a direct governmental owner, suggesting they may receive support. The comparatively higher relative size of these companies act as a proxy for government ownership, as larger Chinese companies tend to have significant government controlled stakes. Given the rest of the companies' financials, the RMI PD would be even higher if their relative sizes were lower. The relative size used in the RMI PD model measures the size of a company's market capitalization relative to the median market capitalization within an economy, and is a significant determinant of RMI PDs for Chinese companies.

Company	RMI PD (bps)	RMI DTD	Relative Size	Amt Out (CNY mn)	Coupon (%)	Next Payment Date	Bond Maturity	Cash (CNY mn)	Net Debt (CNY mn)
Shanghai Chaori Solar Energy Science & Technology	767	1.3	-0.48	1000	8.98	In default	7-Mar-17	62	3629
Liuzhou Chemical Industry	487	3.2	-0.74	510	7.00	27-Mar-14	27-Mar-19	119	2151
Jiangxi Black Cat Carbon Black	333	2.3	-0.53	200	4.87	15-May-14	15-May-14	673	3924
Yunnan Yunwei	384	1.0	-0.44	1000	5.65	1-Jun-14	1-Jun-18	762	6461
Xining Special Steel	431	2.3	-0.33	1000	5.75	15-Jun-14	15-Jun-19	772	9081
-	-			430	5.50	16-Jul-14	16-Jul-20		
-	-			500	6.20	7-Mar-15	7-Mar-16		
Xiamen XGMA Machinery	342	2.7	-0.02	1500	4.55	18-Jun-14	18-Jun-17	568	4638
Hubei Shuanghuan Science and Technology Stock	435	2.7	-0.68	100	5.93	25-Jun-14	25-Jun-15	472	3637
	-			300	6.14	11-Dec-14	11-Dec-15		
Zhe Jiang Kangsheng	375	4.6	-0.69	200	7.80	5-Jul-14	5-Jul-17	100	817
Ruitai Materials Technology	420	3.6	-1.03	200	7.00	2-Aug-14	2-Aug-14	150	1211
Hangzhou Iron & Steel	344	2.8	-0.17	1400	6.35	24-Aug-14	24-Aug-14	223	2421
Xinjiang Ba Yi Iron & Steel	487	1.6	-0.17	1200	6.78	16-Sep-14	16-Sep-14	108	10779
MCC Meili Paper Industry	710	2.9	-0.97	600	6.30	17-Sep-14	17-Sep-15	3	271
Leshan Electric Power	368	3.6	-0.35	200	7.00	21-Oct-14	21-Oct-14	82	1632
China Erzhong Group Deyang Heavy Industries	367	1.9	0.54	310	6.80	14-Oct-14	14-Oct-15	1221	12059
Sichuan Guodong Construction	337	6.0	-0.35	400	6	22-Nov-14	22-Nov-15	100	1014
Fiyta Holdings	330	4.3	-0.26	400	5.04	27-Feb-15	27-Feb-18	154	1412

Table A1: Listed Chinese corporates with bonds outstanding within the worst 5% of Chinese RMI probabilities of default (RMI PDs) as of March 7, 2014. Distance-to-default (RMI DTD) is a volatility-adjusted leverage measure. Relative size measures firm size relative to median market capitalization; red shading indicates a direct ownership by a governmental entity. Balance sheet numbers are as of September 30, 2013, except for Fiyta Holdings Ltd and Leshan Electric Power Co, where data are as of December 31, 2013.
Sources: NUS Risk Management Institute, Bloomberg

Poor Q4 results, liquidity worries drive up RMI PD for NII Holdings
By Chiranjiv Sawhney

The 1-year RMI probability of default (PD) chart for NII Holdings Inc, a US-listed mobile communications provider for businesses in Latin America, presents a scary picture. The 1-year RMI PD for the firm has risen to 31%, an all-time high for the firm. The current PD is some 30 times the levels of 1% seen at the end of April last year (see Figure B1).

While most fundamentals have remained shaky during the past couple of years, the primary contributors to the increase in RMI PD have been deterioration in the firm's distance-to-default (DTD) and its relative size to the economy's median market cap. DTD has fallen from 1.24 on April 30, 2013 to -0.65 on March 7, 2014. DTD, an input to RMI PD model, is a measure of the leverage of a company, adjusting for the volatility of the firm's assets, with numbers close to or below zero suggesting potential insolvency. In the same time period, falling stock price despite a broader bull-run for US equities has reduced the log of market cap to median market cap from 0.93 in April last year to -1.28 now.

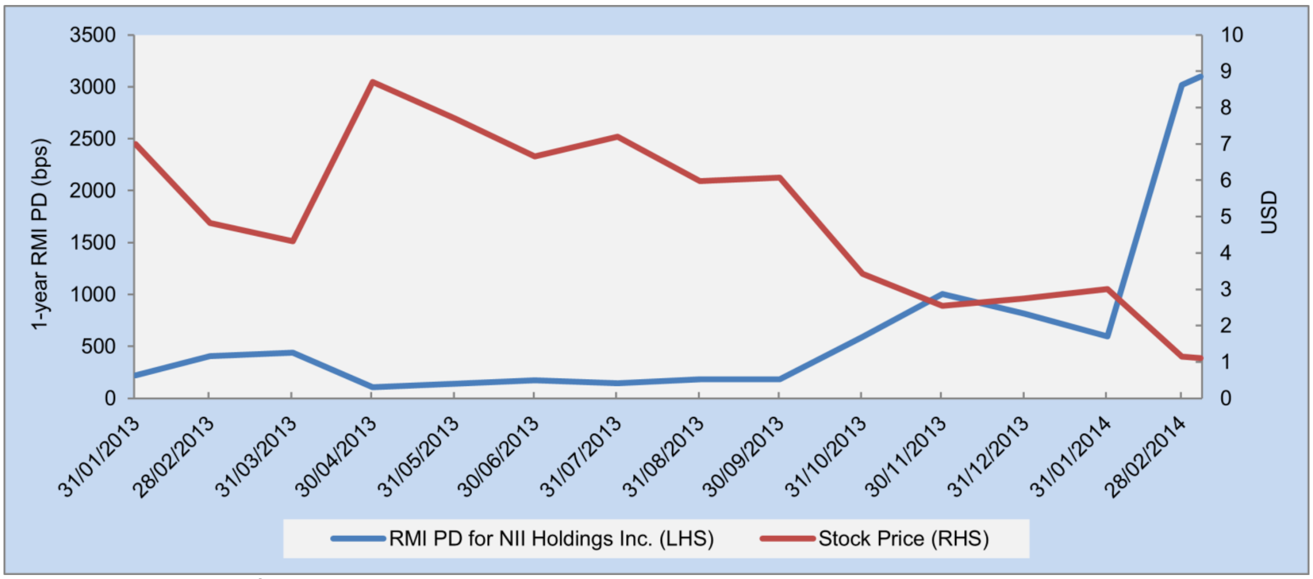

Figure B1: 1-year RMI PD for NII holdings vs NII holdings' stock price. *Source: Bloomberg, The Risk Management Institute*

Q4 2013 reported earnings added to the company's problems as the data was worse than the already bearish market estimates. Earnings per share were USD -4.42 versus Bloomberg consensus estimates of USD -1.6. EBITDA was negative at USD -7.7mn versus USD 179bn for Q4 of 2012. Debt continued to climb, with total debt reaching USD 5.793bn, up significantly from a reading of USD 4.85 at the end of Q4 2012. A loss of subscribers and management guidance indicating another negative EBITDA for 2014 is a further cause for worry. The firm also said that it may not be able to fulfill its financial obligations in 2015 and beyond, adding to investors' concerns about the company. In the company's 10-K report, it was reported that "…these conditions, and their impact on our liquidity, in combination with the potential impact if we cannot satisfy certain financial covenants under our current debt obligations in 2014, raise substantial doubt about our ability to continue as a going concern under the applicable authoritative literature."

In the News

Verizon in the market again with USD 4.5bn bond sale

Mar 10. Verizon Communications Inc. is looking to raise a further USD 4.5bn after its USD 49bn bond sale in September last year. The company acquired Vodafone Group for USD 130bn and is looking to take advantage of low interest rates to refinance debt which mature between 2016 and 2018. Last month, the company sold USD 5.4bn of bonds and in January, raised USD 500mn to finance its acquisition. Investment grade US companies issued USD 48bn of corporate bonds in the week ending March 7, making it the second busiest week on record. (WSJ)

Venezuela opens foreign exchange market as protests continue

Mar 08. Venezuela's government announced that it will relax exchange controls imposed over the past decade. This move is aimed at easing a shortage of basic goods and dampening protests over the rising cost of living. A shortage of USD has dwindled imports and has pushed inflation to 56%, the fastest in the world. The economic crisis led to protests against the President, leaving 19 people dead. (Bloomberg)

Spain changes bankruptcy law to help companies restructure

Mar 07. Spain announced changes to its bankruptcy rules last week, allowing distressed companies to avoid liquidation easily. Under the new rules, companies will find it easier to get agreements on write-offs, maturity extensions and debt-for-equity swaps, and decrease the majority needed for creditor agreements to be approved. It is hoped that the change will allow viable companies with heavy debt burdens to be properly refinanced. Spanish companies seeking creditor protection rose 20% in 2013 from the year before to a record of 8,716 companies. (Bloomberg)

Singapore sees structural deficit risk as revenue growth wanes

Mar 05. Singapore could incur structural budget deficits in the next decade if revenues are not raised to meet the increasing expenditure on infrastructure and health care, according to Finance Minister Tharman Shanmugaratnam. It is projected that by 2020, the city-state's spending will increase by 2 percentage points of its GDP, while annual health care expenditure will rise to SGD 12bn from SGD 8bn in 2015. Government revenue on the other hand, will experience slower growth as a result of reduced asset market-based tax receipts and converging foreign worker levies. (Businessweek)

Japan's economy expands less than initially estimated (Bloomberg)

China export decline shows growth-goal challenge for premier (Bloomberg)

China heralding USD 1.5tn emerging market debt wall (Bloomberg)

Global debt exceeds USD 100tn as governments binge (Bloomberg)

ECB and BoE hold fire (CNBC)

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