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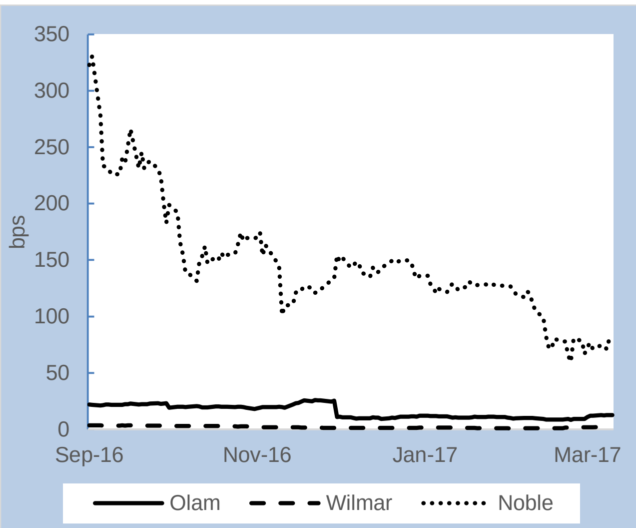
Singapore listed commodity traders good run comes with caveats

By Kenny Liew

A commodities price slump in 2015 sent ripples throughout financial markets – and notably to commodity traders worldwide. Singapore listed Noble Group Ltd (Noble), once the largest commodity trader in Asia, faced a period marred with billion dollar write-downs in assets, which triggered skepticism leading to its stocks becoming the target of short sellers. Removal from Singapore's benchmark STI Index then followed the accusations of accounting irregularities. Olam International Ltd (Olam) and Wilmar International Ltd (Wilmar), which together with Noble form Singapore's 'OWN' commodities trio, also reported drops in earnings – worsened by fluctuating exchange rates and curbs on output. However, these commodity traders seem to have been on a turnaround since the second half of 2016, in tandem with the improvement in commodity prices.



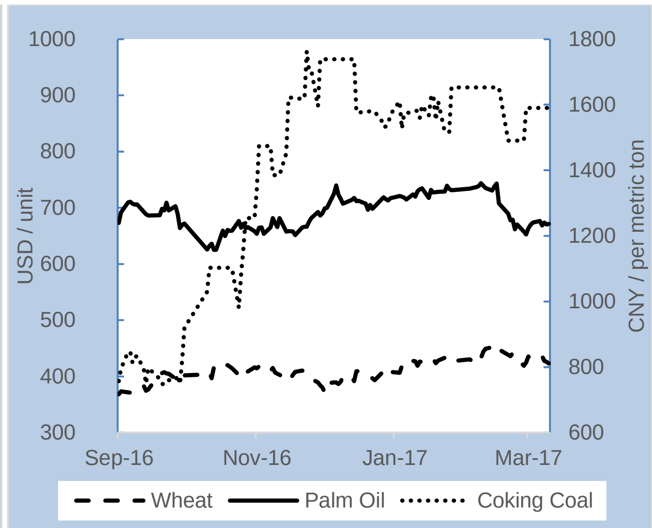


Figure 1 (left panel): RMI-CRI 1-Year PD for Noble Group, Olam International and Wilmar International. *Source: RMI-CRI*
Figure 2 (right panel): 1-month futures prices for wheat and palm oil (USD per bushel and metric ton respectively) (LHS), and coal (CNY per metric ton) (RHS). *Source: Bloomberg*

Company Name	% Change in PD since Sep 1, 2016
Olam International Ltd	- 42.05%
Wilmar International Ltd	- 43.09%
Noble Group Ltd	- 74.97%

Table 1: Percentage change in PD for selected Singapore listed commodity traders since Sep 1, 2016. *Source: RMI-CRI*

The surge in commodity prices across the sector signals better earnings potential. All three traders reported net profits and positive YoY growth in Q4 2016. In addition, Olam and Noble just announced note issues of USD 300mn and USD 750mn in March, a move that possibly demonstrates their eagerness to seize more investment opportunities in 2017.

The RMI-CRI 1-year Probability of Default (PD) reveals that the creditworthiness of Noble improved the most among the three major Singapore-listed commodity traders amidst the commodity price rally. This could be attributed to the difference in main sources of revenue between the three firms. While Noble derives a majority of its revenues from the coal business (80.4%), Olam derives its revenues primarily from grain and equivalent agricultural products (86.5%) and Wilmar from grain and oilseed milling businesses (83.2%). As shown in Figure 2, the sharper increase in coal price helped Noble's credit profile recover faster than its peers.

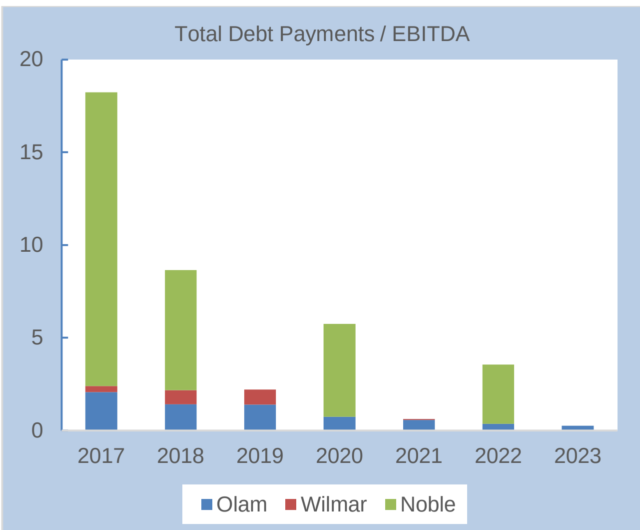
Noble also improved its liquidity by disposing its North American energy distribution unit for USD 1.05bn in Q4 2016 – part of a USD 2bn effort announced in May 2016 to redeploy capital by selling non-core assets. In doing so, the group reduced its net debt by over USD 1bn. Its Q4 2016 results demonstrate improved profitability and decreased leverage (See Table 2).

3 months ending	Q4 2015	Q1 2016	Q2 2016	Q3 2016	Q4 2016
Total Debt to Total Equity	178.36	148.01	148.17	128.42	101.59
Net Income (USD)	-1865.91	40.48	-54.89	-28.11	51.18
Free Cash Flow (USD)	291.63	-551.66	-168.76	-143.07	-48.41
Cash Ratio	0.19	0.17	0.11	0.19	0.21

Table 2: Credit metrics and financials for Noble Group Ltd. *Source: Bloomberg*

Despite the rally in commodity prices, these three firms should continue to be wary of their debt profiles. The firms seem to rely heavily on revolving debt facilities, which accounted for 39.5%, 56.5% and 47.7% of Olam, Wilmar and Noble's total debt respectively. Revolving loans are largely uncommitted – meaning banks are able to reduce limits on basis of revenue, which happened when a syndicate of banks, which underwrote a USD 2.3bn revolving credit line to Noble Group in 2015 sought to cut their exposures after the commodity price slump.

Debt distribution by maturity allows us to identify imminent obligations of the three firms. It is shown in Figure 3 that Noble has the most significant immediate debt obligation along with notable debt repayments in coming years. The firm also has the worst repaying ability with Net Debt/EBITDA of 39.71 in Q4 2016 compared with 9.89 for Olam and 6.18 for Wilmar. This is also reflected in the bond yield spreads for the three firms. Figure 4 suggests that Noble has a much higher and more volatile spread compared with that of Olam and Wilmar, which remained low even during the commodity price slumps.



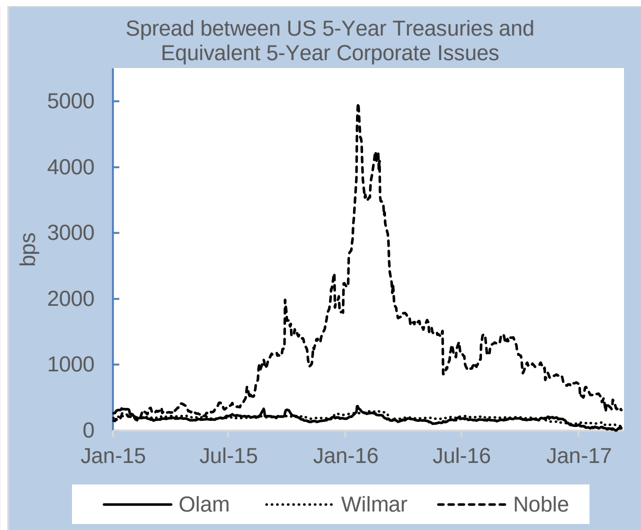


Figure 3 (left): Total debt payments due in a given year divided by 2016 EBITDA for Olam, Wilmar and Noble. *Source: Bloomberg*
Figure 4 (right): Spread of yields between Olam's 5-year 5.75% bonds, Wilmar's 4.15% 5-year bonds and Noble's 3.625% 5-year bonds against generic 5-year US Treasuries. *Source: Bloomberg*

Ultimately, commodity traders require liquidity to grasp investment opportunities – and utilize debt instruments such as revolving loans, debt issuance and conventional loans to fund their growth. Nevertheless, prudent debt management is key, and an over-dependence on debt could very well send their fortunes tumbling if commodity prices were to tumble once again.

Credit News

French electoral showdown makes Japan's bond investors nervous

Mar 13. Bank of Japan's negative interest rate policy accelerated efforts by Japanese investors to seek higher fixed-rate returns overseas, and has raised the sensitivity of their portfolios to global political uncertainty The French election showdown has been recently worrying Japanese institutional investors because they have nearly tripled their weighting of French bonds to 10% of their total portfolios since the end of 2011. A Nomura strategist expects the steady sell-off of foreign bonds by Japanese to continue until the election result is known in early May. (FT)

Thousands of Japanese firms dodging bankruptcy

Mar 13. Critics have pointed that easy refinancing terms, rolled out during the financial crisis, are supporting ailing Japanese companies. With a worsening labour shortage on the horizon, the Japanese government has planned to increase the turnover rate of nonviable enterprises from 5% to 10% but faces opposition implementing the stricter financing rules. Although 70% of Japanese workers are employed in small firms and the easy refinancing has been credited to reduce Japanese unemployment rate since 2009, the OECD stated that keeping nonviable firms afloat would result in misallocation of resources for viable companies, which would lower Japan's growth potential. (Bloomberg)

Copper concentrate supply hit by disputes in Chile and Indonesia

Mar 13. A workers dispute at the Escondida mine in Chile and an ongoing export ban at the Grasberg mine in Indonesia are cutting global mined copper supply by about 9%. In spite of this supply shortfall, copper has risen just 4% this year as analysts are saying that there is no shortage at the moment. However, if the supply shortfall drags on, the market may tighten and the price may be pushed higher. One indication of the tightening market is that the treatment and refining charges of copper concentrate are falling which indicate that the material is insufficient in part of the supply chain. (FT)

Vallianz Holdings successfully completes debt restructuring

Mar 10. A framework agreement between Vallianz Holdings and its lenders was reached on Mar 10 to refinance some of the group's USD 163.2mn borrowings. The profile of the borrowings was restructured from a repayment term of an average 5.8 years to about 8.2 years, extending the maturity of these borrowings to December 2022. The debt restructuring, which is subject to the group granting lenders a shared security package over some of Vallianz subsidiaries and fixed assets, will relieve the company's cash flow by USD 103.5mn over the next two years upon completion. (Straits Times)

Electronics store RadioShack files for bankruptcy again

Mar 9. RadioShack Corp has filed for bankruptcy again – its second time in just over two years. General Wireless Operations Inc, which acquired the brand in 2015, last Wednesday listed liabilities in the range of USD 100mn to USD 500mn in the US bankruptcy court. Sprint, which partnered RadioShack two years ago to co-brand stores with the company will convert several hundred locations into Sprint corporate-owned stores. RadioShack had hoped to benefit from increased liquidity in the form of rent and commission payments from Sprint, but a drop of sales at the mobile carrier reduced commission payouts. RadioShack also struggled to compete against other retailers, including Internet giant Amazon. (Channel NewsAsia)

Gander Mountain, 'America's Firearms Supercenter,' files for bankruptcy (Reuters)

TD Bank under pressure over sales tactics claims (FT)

Regulatory Updates

Companies Act amended to enhance transparency

Mar 11. Changes made to the Companies Act, aimed at providing greater ease to restructure debt for distressed companies, was approved by Parliament on March 10. With the Companies Act adopting various elements of Chapter 11 of the United States bankruptcy code, the high court would be able to order a moratorium in favour of a company proposing or planning to propose a scheme of arrangement for debt restructuring. Other changes includes a loosened clause which allows a judicial management process to start earlier. Courts will also be able to give rescue financing higher priority over other debts. In addition, new rules to increase transparency will be rolled out by the end of March, with firms required to maintain registers of their beneficial owners. Regulatory burden will also be eased, allowing private companies to be exempted from holding annual general meetings, subject to safeguards. (Straits Times)

China plans stricter bank capital rules to contain risks

Mar 9. Plans to apply a stricter method for assessing banks' capital will be proposed by China's central bank as part of efforts to contain financial-sector risk. An intermediary category will be removed in the PBOC's evaluation of capital adequacy – meaning that banks will either get a full score if they meet capital requirements, or a zero score if they do not. Banks with capital inadequacy will be encouraged to raise capital or slow asset growth. The PBOC will also penalize banks with low scores by paying lower interest rates on reserves held with the central bank, while higher scores will mean higher rates. These measures will affect the Macro Prudential Assessment (MPA) framework, and are introduced amidst swelling outstanding credit, which surged to 264% of GDP in 2016. (Bloomberg)

FCA flooded with feedback over plans to curb risky trading bets (FT)

MAS eyes more efficient way to settle cross-border payments (Straits Times)

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