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Profitability of China's steel industry in 2018 becomes uncertain

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Note: text in italics highlights revisions made to the article on March 28, 2018

The RMI-CRI 1-year aggregate Probability of Default (PD), a simple median of PDs for 43 Chinese public steel companies, fell 75.8bps during 2017 and reflected a positive credit outlook for China's steel industry. The improvement in the aggregate credit profile coincided with an increase in steel price last year. *However, the Chinese steel industry could still face headwinds due to the US steel tariff and uncertain prospect of a lower steel price in 2018.*

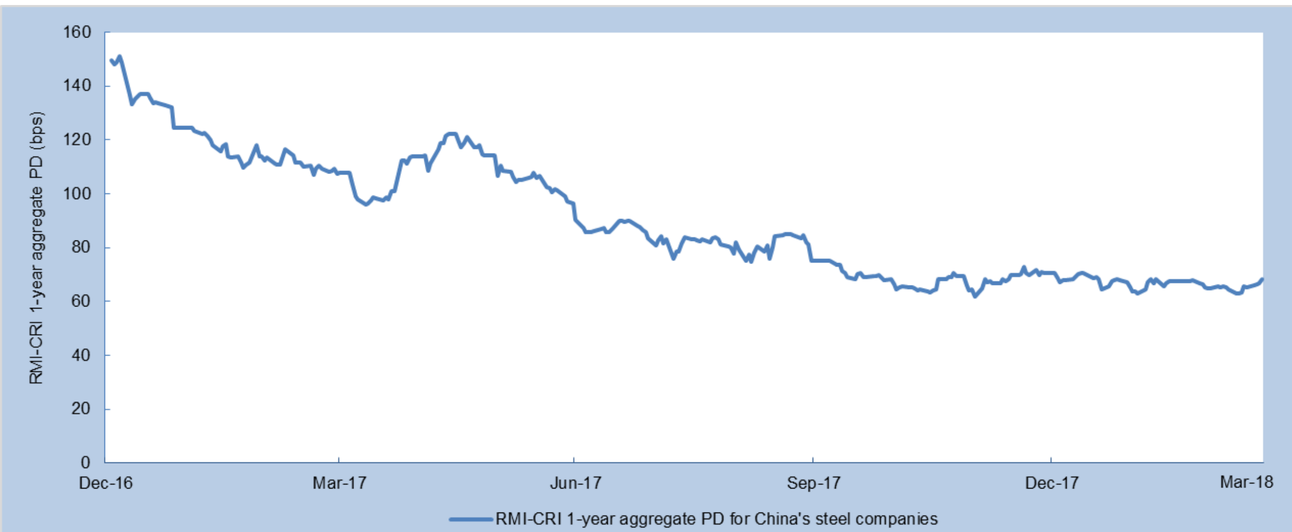

Figure 1: RMI-CRI Aggregate PD for 43 public Chinese steel companies with market capitalization over USD 1bn. *Source: RMI-CRI*

In 2015, excess capacity in the global steel industry resulted in plunging steel price to the lowest in a decade. As the largest steel producer and net exporter in the world, China plans to cut annual steel production capacity by 100-150mn metric tons over the next five year to resolve its excess capacity issues. China also ordered industrial plants across 28 cities to curb production output and reduce air pollution. Meanwhile, the decision to build Xiongan into a new special economic zone, which was announced in April 2017, lifted the domestic steel demand. As a result, spot Chinese steel prices increased in the subsequent months to a nine-year high in December 2017. The increase in steel price and *drop in iron ore* costs boosted the profit margin of China's steel industry. The average EBIT of 43 Chinese public steel companies with market capitalization over USD 1bn (with valid financial data) has showed an upward trend since Q4 2016, together with an increase in ROA and decrease in Total debt/equity ratio (see Table 1).

	Q4 2016	Q1 2017	Q2 2017	Q3 2017
EBIT (USD mn)	37.09	61.81	60.65	116.04
ROA (%)	1.49	2.29	2.58	4.34
Total Debt/Equity (%)	187.01	165.17	147.66	128.76

Table 1: Financial data for 43 steel companies in China with market capitalization over USD 1bn. *Source: Bloomberg*

Despite Chinese steel industry's improving credit performance in the past one year, a series of anti-trade policies may hold a detrimental effect on the industry's credit outlook in future. On February 8, the European Union imposed five-year tariffs ranging from 17.2% to 27.9% on corrosion-resistant steel from China, which followed provisional levies as high as 28.5% in August last year. Last week, American president Donald Trump signed an executive memorandum imposing a 25% tariff on imported steel and 10% tariff on imported aluminum. *Following the steel tariff declaration, China's domestic steel price plunged as concerns were raised on the knock-on effects of US import tariff amidst intensifying steel export competition in other countries.* As of March 26, the

China domestic steel rebar 25mm spot price of Shanghai fell to USD 613.1/ton, which was more than 11% drop from the highest price in the same month.

With a diminished outlook for steel demand, environmental restriction, and normalized steel supply in future, steel price *may continue to remain low*. The market expected steel demand to increase after the Chinese New Year holidays but turned out weaker than expected. Infrastructure investment from January to February in 2018 *was* 2.9% lower from the growth rate last year. Steel inventories of Chinese steel industry also started the year with a higher than usual level. According to the Lanzhou Iron and Steel Research Center, steel traders increased the winter storage before spring this year and steel stocks climbed to 17.65mn tonnes up from 14.08mn tonnes in the same period last year. At the same time, Chinese steel companies may incur higher costs as regulators impose a stricter enforcement *of* anti-pollution laws.

Overall, Chinese steelmakers, that released their financial performances *hitting their highest levels in recent years*, may record slower profit growth driven by falling steel price in 2018. This might be further weighed down by lower infrastructure spending and lower steel exports.

Credit News

Remington files for bankruptcy as gun-control pressure mounts

Mar 26. One of the United States' largest gun makers, Remington Outdoor Co Inc., filed for bankruptcy on Mar 25, 2018, amid public pressure for gun control. US anti-gun rallies and numerous shooting incidents pressured firearm sales that weighed on Remington's revenues. Even though the company's asset exceeds its liabilities, Remington has announced a debt-cutting deal of USD 950mn in February that will transfer control of the company to creditors. The bankruptcy will allow creditors to sell their holdings or exchange them for equity. While Cerberus Capital will lose ownership, Franklin Templeton and JP Morgan will have equity as a result of the debt exchange. (Straits Times)

Big banks develop the new platform for bond issuances

Mar 25. JPMorgan, Bank of America and Citibank are developing a new platform to overhaul the disjointed bond issuance process and improve communication between underwriters and asset managers. Underwriting fees have partially offset a decline in trading revenue, which some executives fear is in a secular downturn. A recent slowdown in corporate debt issuance has threatened underwriting fees, magnifying the importance that banks contain costs in their bond sales units. The move to establish a new platform underscores how banks are increasingly turning to technology to improve the efficiency of a bond market that has largely been left behind by seismic changes in other corners of the financial system. (FT)

Steel companies bankruptcy to help woo MNCs; help consolidation

Mar 25. Bankruptcy proceedings against many large steel companies may lead to consolidation in the industry and the entry of global players in the alloy segment. A few large players with strong financial positions have an opportunity to expand by acquiring stressed capacities at attractive valuations. Contributing half of the steel sector's bad loans, Bhushan Steel, Essar Steel, Monnet Ispat & Energy, and Electrosteel Steels are among the 40 largest defaulters. According to EY, a strong policy in the form of the national steel policy, coal deregulation and a focus on infrastructure development will boost demands and assist in building a globally competitive metals and mining industry. (Economic Times)

IMF warns of mounting debt crisis risk in poor countries

Mar 22. International Monetary Fund (IMF) has warned that the world's poorest countries are increasing their borrowing at worrying pace and face the mounting debt crises risks. According to its research, IMF stated that the median ratio of public debt to gross domestic product in low-income countries has risen 13% since 2013 to hit 47% in 2017, and 40% of low-income countries face "significant debt-related challenges", up from 21% just five years ago. The riskiest countries are selling debt at record rates, and sales of long-dated debt are at high levels. The increasing bond market activity in low-income countries has pushed up the amount they spend on servicing their debt, with debt payment in developing countries increased 60% in the three years to 2017. (FT)

Weinstein Co files for bankruptcy, ends all non-disclosure agreements

Mar 20. The Weinstein Company filed for bankruptcy on March 19 after its ex-Chairman Harvey Weinstein had been accused of sexual harassment, listing USD 500mn to USD 1bn in liabilities and USD 500mn to USD 1bn in assets. It is reported that Weinstein used non-disclosure agreements to silence his accusers, which would all cease. The company's bankruptcy comes after the company spent months looking for buyers, during which an investor group terminated its offer after finding more liabilities than previously disclosed. The company has stated that an offer had been made by an affiliate of private equity firm Lantern Capital affiliate. Lions Gate Entertainment Corp and Miramax are said to be making offers as well, with both emerging as potential bidders. (The Straits Times)

Sinopec offers record dividend as profit surges (Bloomberg)

Sears' debt downgraded to default status after refinancing (CNN Money)

Mozambique seeks to defer debt repayment for a decade (FT)

Regulatory Updates

China default risks flare on scrutiny of company accounting

Mar 23. China's President Xi Jinping is increasing efforts to control excessive borrowings as the nation's corporate bond market is facing greater default risks. While the nation's economic planning body is tightening oversight of public employment-related assets held by companies seeking to sell bonds, the National Development and Reform Council (NRDC) is improving regulation implementation on bond sales by public-private partnership projects. As the result of President Xi's current attempts, the yield premium on AA five-year Local Government Financing Vehicles (LGFV) bond climbed to the highest since 2015 at 2.29%. (Business Times)

India mulls easing bankruptcy deadline as lawsuits mount

Mar 22. Indian regulators are considering to allow more time for the restructuring plans of defaulting companies to be approved. The rules mandate that a bad-loan resolution plan must be passed within 270 days, failing which the company's assets will be liquidated. India has been struggling to unwind about USD 210bn of soured loans that have weighed on lending growth and investment. Last year, the government ordered 12 of the largest debtors to go through bankruptcy tribunals. Since then, India's fledgling insolvency process has come under increased scrutiny. But as the first few companies wend their way through proceedings, the decisions of court-appointed resolution professionals and creditors have increasingly been challenged. (Bloomberg)

Banks win break on capital requirement hitting trading desks (Bloomberg)

Social media stocks tumble as Wall Street fears regulation (Channel NewsAsia)

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