Credit Research Initiative

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Cloud Live Tech highlights the default risk of Chinese corporate bonds

by RMI staff

Cloud Live Technology Group (Cloud), China's second largest restaurant chain operator by market cap, became the second company to default in the onshore RMB bond market on April 7, following the first default by Shanghai Chaori Solar Energy Science & Technology Co. in 2014. This event has raised the spectre of more defaults in China's corporate bond market.

Cloud, formerly known as Beijing Xiangeqing Group, operated a high-end food catering company. The firm was hit by a drop in sales due to a clampdown on lavish spending by government officials, as part of the nationwide anti-corruption campaign. As a result, the company expanded its business to cloud computing in July 2014. However, the diversification did not improve the firm's financial situation. On April 3 last week, Cloud announced that it might not be able to pay back RMB 240.6mn of coupon and principal due on April 7. According to the company's filing, Cloud has RMB 161.4mn of cash in its account, which is significantly less than its immediate liabilities. Trading of the company's bond and stock were suspended on April 2. The yield of Cloud's bond reached 18.91% on Apr 1, 2015 from 5.5% in Jan 2013.

	Q1 2013	Q2 2013	Q3 2013	Q4 2013	Q1 2014	Q2 2014	Q3 2014
Net Income (RMB mn)	-68.4	-151.9	-82.7	-261.3	36.0	-42.6	-78.8
Cash from Operations (RMB mn)	-25.8	-124.2	-154.4	99.6	103.8	-155.7	-47.5
NI/TA (%)	-1.55	-9.78	-15.95	-29.14	-22.44	-18.23	-19.07
Cash Ratio*	0.28	0.22	0.17	0.14	0.16	0.22	0.21

Table 1: Credit metrics of Cloud Live Tech. *Source: Bloomberg*

* Cash Ratio = (cash and near cash items + marketable securities) / current liabilities.

Although the company expanded into the cloud computing industry in 2014, its main food catering business still accounted for 73.6% of its total revenue in 1H 2014. After the Chinese government pushed to curb lavish spending by government officials in 2013, revenues and earnings have declined. As shown in Table 1, Cloud lost RMB 564.3mn in 2013. Cash flow from operations, except in Q4 2013 and Q1 2014, were deep in the red. Moreover, net income to total asset ratios during this period were all in negative territory, while cash ratios fluctuated around the 0.2 levels. Reflecting the firm's deteriorating financial situation, the RMI 1-year Probability of Default (PD) of Cloud has increased sharply from 91.86bps on Jan 1, 2013 to 447.23bps on Apr 2, 2015. Pengyuan Credit Rating Co, a Chinese rating agency, lowered its credit rating on the company's bond from BB to CC on Apr 3.

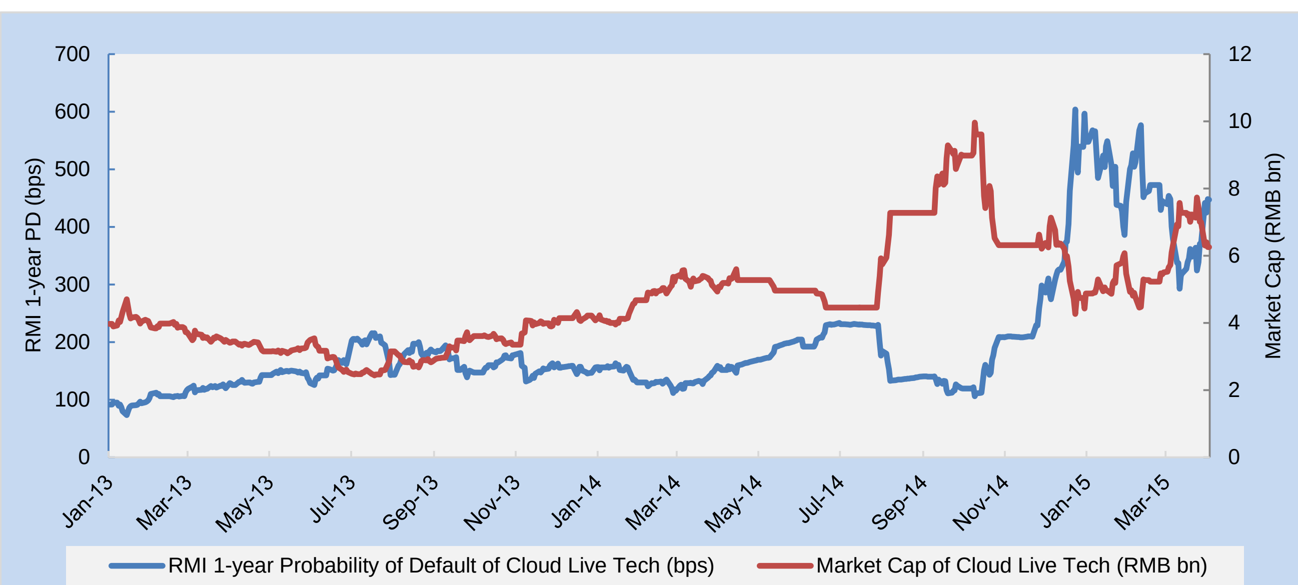

Figure 1: RMI aggregate 1-year PD and Market Cap of Cloud Live Tech. *Source: Risk Management Institute, Bloomberg*

Cloud's troubles illustrate problems across the Chinese corporate sectors. Table 2 displays a list of Chinese listed onshore firms with bonds outstanding that have the highest RMI 1-year PDs in the country. It highlights some companies that have weak credit profiles and higher chances of default within a year. In China, firms that are state-owned find it easier to issue bonds, since their debt obligations are guaranteed by the government. Thus, the credit ratings of these firms' bonds are usually higher than those of non-state owned firms. Cloud is not a state-owned firm and is the only company with a credit rating in the C range, as demonstrated in Table 2.

Even though some of the companies in Table 2 are in bad shape, they still have high ratings by virtue of their state-ownership. As the Chinese government tries to rationalize the price of credit in the local market, this phenomenon could change. While the country's growth is slowing down and companies hold high debt levels, the Chinese corporate bond defaults should be closely watched. For example, due to the anti-corruption campaign and the plummeting material prices, Huatian Hotel Group Co Ltd and Xining Special Steel Co, with negative profitability and the highest leverage ratios in the list, are some companies in distress.

Company	RMI 1-year PD (bps)	Credit Rating	Market Cap (RMB bn)	Amount issue (RMB mn)	Coupon (%)	Next payment date	Maturity date	Cash & near cash items (RMB mn)	NI/TA (%)	Debt/ equity (%)
Foshan Huaxin Packaging Co Ltd	639.36	AA[1]	2.22	800	5.80	26-Nov-15	26-Nov-17	474.55 (Q4 14')	1.36 (Q4 14')	70.48 (Q4 14')
Cloud Live Technology Group Co Ltd	425.04	CC[4]	6.40	480	6.78	Defaulted	5-Apr-17	82.09 (Q3 14')	-19.07 (Q3 14')	124.83 (Q3 14')
Shandong Airlines Co Ltd	378.01	AA+[2]	5.40	500	4.29	13-Jun-15	13-Jun-15	460.74 (Q4 14')	2.44 (Q4 14')	212.80 (Q4 14')
Hubei Shuanghuan Science and Technology Stock Co Ltd	377.62	AA-[3]	3.20	100	5.93	25-Jun-15	25-Jun-15	655.9 (Q3 14')	-4.38 (Q3 14')	278.22 (Q3 14')
-	-	AA-	-	300	6.14	11-Dec-15	11-Dec-15	-	-	-
Tieling Newcity Investment Holding Ltd	370.28	AA[1]	6.86	1,000	8.45	6-Mar-16	6-Mar-19	372.77 (Q3 14')	11.25 (Q3 14')	66.33 (Q3 14')
Western Metal Materials Co Ltd	351.76	Private Placement	3.75	400	6.90	12-Nov-15	12-Nov-16	220.3 (Q3 14')	1.33 (Q3 14')	111.86 (Q3 14')
Qinghai Jinrui Mineral Development Co Ltd	348.97	AA[4]	4.12	150	7.90	29-Aug-15	29-Aug-17	5.85 (Q4 14')	0.72 (Q4 14')	93.19 (Q4 14')
Hangzhou Advance Gearbox Group Co Ltd	329.59	AA[5]	4.18	300	5.25	23-Mar-16	23-Mar-16	192.00 (Q3 14')	0.50 (Q3 14')	69.22 (Q3 14')
-	-	AA+[6]	-	400	6.30	11-Jul-15	11-Jul-19	-	-	-
Ruitai Materials Technology Co Ltd	325.24	A+[2]	3.36	150	6.60	24-Oct-15	24-Oct-15	185.98 (Q4 14')	0.21 (Q4 14')	163.98 (Q4 14')
Huatian Hotel Group Co Ltd	321.41	AA-[1]	5.86	300	7.00	6-Sep-15	6-Sep-16	233.03 (Q3 14')	-0.52 (Q3 14')	225.32 (Q3 14')
		AA-[1]	-	300	8.70	17-Jan-16	17-Jan-17	-	-	-
Shanghai Highly Group Co Ltd	311.81	AAA[3]	0.86	1,000	4.85	28-Feb-16	28-Feb-18	338.16 (Q3 14')	1.17 (Q3 14')	140.04 (Q3 14')
Xining Special Steel Co	284.74	Private placement	4.67	500	6.20	7-Mar-15	7-Mar-16	861.14 (Q3 14')	-1.35 (Q3 14')	359.32 (Q3 14')
-	-	Private placement	-	500	8.80	13-Jun-15	13-Jun-16	-	-	-
-	-	AA[1]	-	1,000	5.75	15-Jun-15	15-Jun-19	-	-	-
-	-	AA[1]	-	430	5.50	16-Jul-15	16-Jul-20	-	-	-
Guodian Nanjing Automation Co Ltd	280.92	A-1[1]	5.83	600	5.50	6-May-15	6-May-15	698.53 (Q4 14')	-3.31 (Q4 14')	109.46 (Q4 14')
Changchun Eurasia Group Co Ltd	278.75	A-1[3]	4.54	300	5.46	12-Sep-15	12-Sep-15	1,035.04 (Q3 14')	2.73 (Q3 14')	150.30 (Q3 14')
-	-	AA+[4]	-	470	7.00	21-Mar-16	21-Mar-19	-	-	-
Shanghai Datun Energy Resources Co Ltd	278.11	A-1[1]	8.69	500	4.40	4-Nov-15	4-Nov-15	170.62 (Q4 14')	0.36 (Q4 14')	25.47 (Q4 14')
-	-	AA+[1]	-	1,000	5.28	23-Oct-15	23-Oct-19	-	-	-

Table 2. The bonds profile and selected latest financials of Chinese listed companies with bond outstanding and worst 5% of RMI 1-year Probability of Defaults as of March 31, 2015. *Source: Risk Management Institute, Bloomberg*

[1] Rated by China Lianhe Credit Rating Co., Ltd
[2] Rated by Dagong Global Credit Rating Co., Ltd
[3] Rated by China Chengxin Credit Rating Group
[4] Rated by Pengyuan Credit Rating Co., Ltd
[5] Company's rating by Shanghai Briliance Credit Rating
[6] Rated by Shanghai Briliance Credit Rating & Investors Service Co., Ltd

Credit News

Four 'too big to fail' Philippine banks have insufficient capital

Apr 7. According to regulators, four of the 14 domestic systemically important banks (DSIBs) in the Philippines were found to have insufficient capital. Two banks received a borderline pass in required core capital levels. However, the majority of the 14 banks were found compliant with the total common equity tier 1 (CET1) requirement. This means that the possibility of a banking crisis remains low. As recommended by the Basel III guidelines, systematically important banks are required to increase their minimum common equity tier 1 ratio by 1.5 to 3.5 percentage points starting Jan. 1, 2017. The Philippine central bank will adopt a phased-in approach for the higher CET1 ratio requirement for DSIBs as part of the country's Basel capital compliance. (Xinhua)

Deposit levy at 20-year low helps Japanese banks

Apr 7. The Deposit Insurance Corp of Japan lowered from 8.4 bps to 4.2 bps what it charges Japan's banks to insure deposits and then uses as a reserve to rescue failed lenders. The state-run fund is cutting what it charges lenders to protect savers. According to BNP Paribas SA and Keefe Bruyette & Woods Inc, the cut to the lowest rate since early 1996 reflects the recovery of Japan's financial system, and will boost banks' profits. The Nikkei Shimbun reported that Japanese companies expect to cut capital investment in the year that started on Apr 1, even as Toyota Motor Corp plans to spend USD 1.3bn to build plants in China and Mexico. (Taipei Times)

Central Bank of India tops list of highest non-performing assets among public sector banks

Apr 5. The data provided by the Reserve Bank of India to the Finance Ministry indicates that 21.5% of Central Bank of India's assets are either bad or have been restructured. The other banks with significant amount of gross non-performing assets and restructured loans include United Bank of India (19.04%), Punjab & Sind Bank (18.25%) and Punjab National Bank (17.85%) as on December 2014. (Moneycontrol.com)

Default jitters grow for Chilean car dealer hit by peso drop

Apr 2. Chile's exclusive Hyundai motor dealer Automotores Gildemeister SA, could default on its USD 400mn note on the back of weak sales and a slump in the Chilean peso against the USD. The weak currency has increased the cost of importing vehicles while earnings have dropped by USD 137mn in 2014. The company said that demand for cars in Peru and Chile have declined as economic growth fell to the slowest in five years. Gildemeister is struggling to pay off its debt burden after the firm tripled its debt over the last four years. (Bloomberg)

Russia says Ukraine should seek direct debt restructuring talks (Bloomberg)

China's Anhui province to offer debt under swap plan (NASDAQ)

Greece pledges to meet 'all obligations to all its creditors' (Japan News)

Australia's AAA rating could be at risk (The Australian)

Regulatory News

EU mulls probe into 'deferred tax assets' of southern Europe's banks

Apr 7. The European Commission is investigating whether Greece, Portugal, Spain and Italy have illegally provided state aid to the banks in the form of deferred tax assets (DTA). Such assets will progressively be phased out under Basel III rules on bank capital, but the four countries have classified them as bona fide capital under local rules. European states may have to generate rescue capital from taxpayers to replace these tax credits in the event of a bank failure. As a result, the ECB has announced that it would increase the capital buffers on banks who over-reliant on DTAs to boost capital requirements. According to the ECB, the four countries hold more than EUR 40bn in DTAs in the banking system. (FT)

South Korea to streamline financial regulations, supervision via reform

Apr 7. A representative of Korea's Financial Supervisory Service (FSS) said that regulators will streamline supervisory processes to alleviate the regulatory burden facing the industry. Net interest margins of financial firms have been falling as competition among lenders has intensified. Moving forward, regulators will reduce the reporting frequencies of firms, remove unnecessary red tape that prevents companies from financial innovation and allow employers to deal privately with employees for minor offences. Major financial offences will still be handled by the FSS. (Xinhua)

Nigeria rolls out new rules on capital markets

Apr 6. The Securities and Exchange Commission has released new rules to introduce new levels of transparency to the Over the Counter market in Nigeria. One of these rules is a rule on trading in unlisted securities of the private and public companies' shares that are not quoted on the Nigerian Stock Exchange. The rules seek to ensure that all securities of unlisted public companies are traded within securities exchanges that are registered with the commission. (Nigeria Bulletin)

Basel III requirements to strengthen Islamic banks' liquidity

Apr 5. In October 2014, the Islamic Finance Services Board (IFSB) published guidance on measures for liquidity management in institutions offering Islamic financial services. Three main characteristics of high quality liquid assets (HQLA) were defined: low correlation with risky assets, an active and sizeable market, and low volatility. S&P analysts expect that the implementation of Basel III and its new liquidity coverage ratio (LCR) could increase offerings of liquidity management instruments and could help address some of the industry's long-standing weaknesses, particularly the lack of high quality liquid assets (HQLA) (Gulf News)

New rules on global banks' interest-rate risks face delays

Apr 3. As Britain and Germany seek requirements for banks to increase their capital, while the United States and Japan argue that the issue should continue to be left to local regulators, the Basel Committee's agreement on new rules of rate-risk requirements is likely to be delayed by at least several months. As part of the response to the financial crisis, the Basel Committee has been toughening rules, but as the banking crisis fades and the economy slows down, governments are losing interest in financial reform and focusing on economic growth. (Reuters)

RBI's new provisioning laws to help banks act at the earliest signs of stress (Economic Times)

Indonesia's central bank revises rules on Jakarta interbank rate (Business Times)

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