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Weekly Credit Brief Oct 20 - Oct 26

Nyrstar's refinancing difficulty illustrates default risks

by Justin Hsiao

Nyrstar NV (Nyrstar), the world's largest refined-zinc producer in terms of capacity, saw its shares drop 30% last Thursday after the company announced that it would have to raise more capital to repay its upcoming bond obligations, highlighting the elevated default risk and refinancing risk.

As shown in Figure 1, the RMI-CRI 1-year Probability of Default (PD) for Nyrstar has increased significantly since the beginning of this year from around 10bps to over 100bps, coinciding with a surge in the company's 5-year bond yield. The company has an outstanding loan of EUR 415mn due in May 2016 but only has cash and cash equivalent of EUR 30mn, according to its latest Q3 2015 interim report. Nyrstar is nonetheless confident that it would not have to restructure any of its debt obligations and that it will repay in full amount of all its outstanding notes on or before the maturity date.

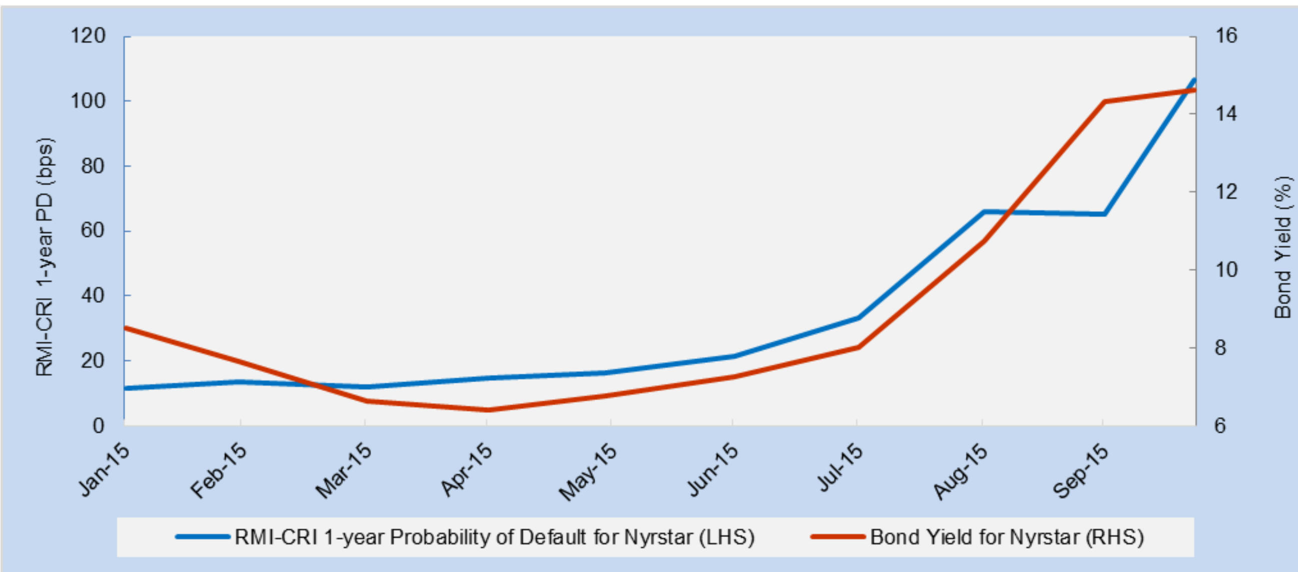

Figure 1: RMI-CRI 1-year probability of default and 5-year bond yield for Nyrstar. *Source: RMI-CRI, Bloomberg*

Nyrstar is evaluating both debt and equity capital market alternatives to address its upcoming debt repayment. However, bond investors and banks are now less willing to lend to commodity companies amid the bleak outlook for the industry. The cost of funding for Nyrstar would be high given that its junk-rated debt now yields more than 13% (see Figure 1). A possible fundraising in the equity market would dilute the value of its share. An analyst at ABN said that the company needed to raise at least EUR 250mn to help repay the EUR 415mn bond that matures in 2016. This is on the top of the EUR 600mn which was raised through bond and equity issuances less than a year ago.

The company's net debt increased to EUR 841mn in Q3 2015, growing by 45% YoY. Earnings have been persistently negative in recent quarters due to dismal sales in the mining segment and the growing cost in key projects. As shown in Table 1, Nyrstar is highly leveraged as its total debt to equity ratio was above 100% and stood at 111.39% in the first half of 2015. And the company's liquidity has been draining. Nyrstar's ability to finance its debt obligation, as denoted by the interest coverage ratio, has been diving in the negative territory since 2012, dropping sharply to -6.18x in 2015. The firm's operating margin also slumped drastically in the first half of 2015.

	S1 2014	S2 2014	S1 2015
Total Debt to Equity (%)	115.32	98.06	111.39
EBIT to Interest Expense	-0.31	-3.98	-6.18
Operating Margin (%)	-1.34	-15.13	-25.39

Table 1: Credit metrics for Nyrstar. *Source: Bloomberg*

If the global demand stays low, the company would have to cut more costs and capital spending amid low zinc prices. The company said that it does not rule out more operation suspensions at some of its mines, a move that may result in extra impairments by the end of the year. Overall, the company is still battling with the current commodity price environment. Although the company maintains a positive medium to long term outlook for zinc, the key question is whether Nyrstar can gain sufficient financial strength and flexibility to face the current headwinds.

Credit News

Bleeding continues for Korean shipbuilders on Hyundai heavy loss

Oct 26. South Korea's shipbuilding industry continued to reel from a failed international expansion and a slump in demand for new vessels, as the world's biggest shipbuilder reported a net loss of KRW 434.1bn in the third quarter. The deficit highlights the continued challenges facing South Korea's largest shipbuilders, which shifted strategy to focus on deep-sea drilling rigs and production facilities after the global financial crisis damped orders and Chinese shipyards out-priced them. (WSJ)

Asset managers suffer as oil funds withdraw cash

Oct 25. Global asset managers are facing a double hit to their fees, as sovereign wealth funds withdraw billions to support their oil-dependent economies, and switch to a cheaper in-house investment approach. A collapse in the price of oil since June 2014 is taking its toll on the investment management industry as oil-producing countries pull money from their wealth funds to make up for a loss of export earnings. Of the world's 50 sovereign wealth funds, which collectively oversee about USD 6.5tn, one third have reported a reduction in their invested assets. (FT)

AIIB head vows to be clean, lean and green – and fast

Oct 25. Mr. Jin Liqun, the incoming head of the AIIB, promised to run an internationally compliant organization which would operate at a faster pace than its peers. The Asian Infrastructure Investment Bank will avoid the mistakes of other development banks by adopting faster lending procedures and setting up a non-resident board who will not micromanage the fund's activities. The majority of the loans will be issued at the management's discretion, but loans above a certain borrowing limit will have to be approved by the board first. The loans will be co-financed with the World Bank and the Asian Development Bank, although most of the funds will be channeled towards meeting the needs of Asian countries. (FT)

Korea's economy rebounds from MERS outbreak as shoppers return

Oct 23. Korea's Q3 GDP grew by 2.6% from a year ago as private consumption and investment expanded more than expected. The government introduced consumption tax cuts in May after the MERS outbreak resulted in a drop in retail spending. The overall economic output was also boosted by higher housing sales and construction activity in the infrastructure sector. A positive surprise in the Q3 GDP figure is likely to curb further monetary easing by the central bank. Citigroup's analysts expect interest rates to remain at the current level till 2016 citing the expansion in domestic demand. (Bloomberg)

China's overheated bond market showing strain for local bankers

Oct 21. Chinese bankers say a debt-driven bond market rally is starting to show the same signs of overheating that preceded a collapse in equities. Credit spreads near the narrowest in six years are being questioned after a state-owned steel trader missed a bond payment. If equities continue to perform well, or initial public offerings resume, the liquidity-fueled rally may come to an end. According to the Chief Economist at Essence Securities, the bursting of bond market bubble could hurt lending and the real economy, as banks would suffer from capital losses and become less willing to lend. (Bloomberg)

Vietnam seeks new tools to beat bad-debt woes (Reuter)

Israel debt risk rises most in 14 months as violence increases (Jewish Business News)

Valeant's shares fall on report's fraud claim (New York Times)

Regulatory Updates

Australian regulator investigates spoofing as ASX futures expire

Oct 26. The Australian Securities & Investments Commission (ASIC) is currently looking into the possibility of spoofing in the futures market, by investigating a number of traders for excessive order entry and cancellation on a derivatives platform run by ASX Ltd., the country's main exchange operator. This investigation focused on the quarterly expiration of equity-index and bond contracts. ASIC estimates that about 93% of Australian futures trading takes place on equity-index and bond contracts and claims that the current levels of high-frequency trading and dark liquidity are not adversely affecting the functioning of Australian markets. (Bloomberg)

China targets financial sector in corruption probe

Oct 24. China's anti-corruption watchdog said that it would conduct checks on more major financial institutions, which includes the central bank and regulatory authorities. These major institutions are in the hot seat after the crash of the Chinese stock market. The Central Commission for Discipline Inspection, the Communist Party monitor, sets its sights on the financial sector after multiple investigations into large state-owned enterprises. The new round of checks will now include central People's Bank of China, the China Banking Regulatory Commission, China Insurance Regulatory Commission and the watchdog China Securities Regulatory Commission (CSRC). (Business Insider)

ECB picks Irish regulator to help tackle soured Euro-Area loans

Oct 23. The European Central Bank's (ECB) oversight arm appointed Ireland's head of banking regulation, Sharon Donnery, to lead a charge on handing soured loans across the euro area. Her responsibility comprises leading a working group on resolving loans in partial or full default across euro-region banks. Currently, an average 12% of loans across 123 lenders under direct ECB supervision are non-performing and this working group aims to implement at the ECB's Single Supervisory Mechanism level what was earlier successfully done in the Irish system to reduce the amount of loans in default. (Bloomberg)

Swiss banks warned over global expansion (FT)

Basel 4 banking reforms take shape (Australian Financial Review)

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