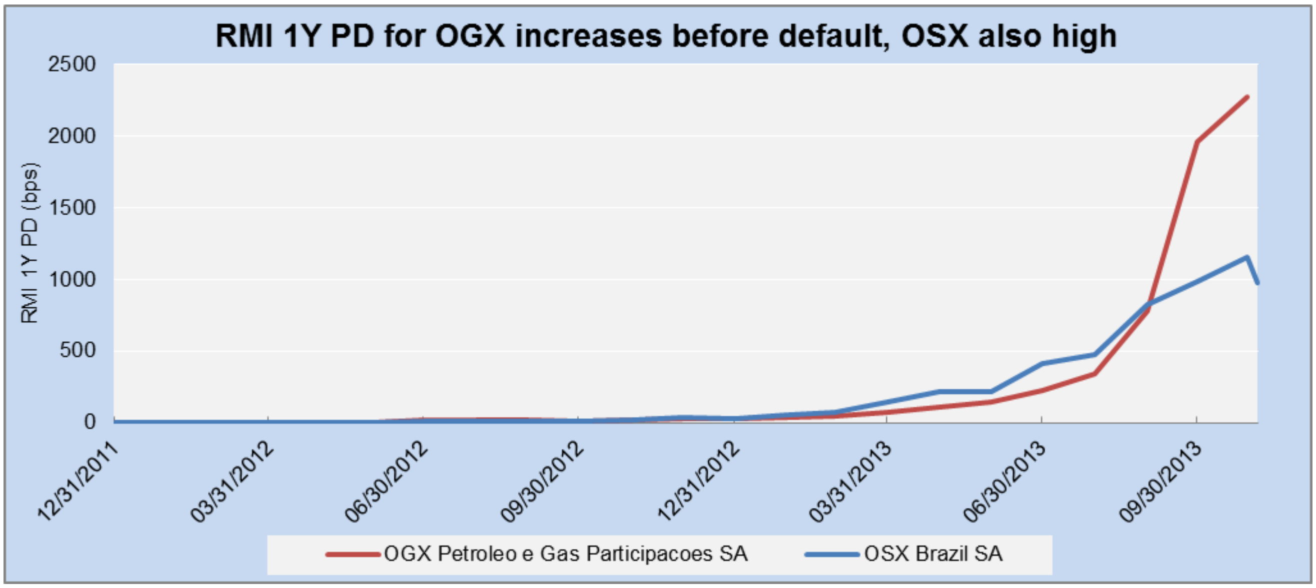
Weekly Credit Brief Oct 29 - Nov 04 2013

Stories of the Week

RMI data highlighted default risk of OGX; OSX could be next to file

OGX Petroleo & Gas Particpacoes SA (OGX), a Rio De Janeiro-based oil and gas exploration and production company, filed for bankruptcy October 30, in the largest corporate debt record in Latin American, ending a 16-month decline in the company's fortunes. The RMI probability of default (PD) model projected deterioration in the credit profile of OGX as early as June 2012 (Figure 1), with the company's credit quality declining rapidly through the first half of 2013. OGX was the flagship company within Brazilian billionaire Eike Batista's EBX Group, which also includes offshore equipment provider OSX Brasil SA (OSX). OSX could also be close to default, given its relatively high RMI PD and its revenue dependence on OGX.



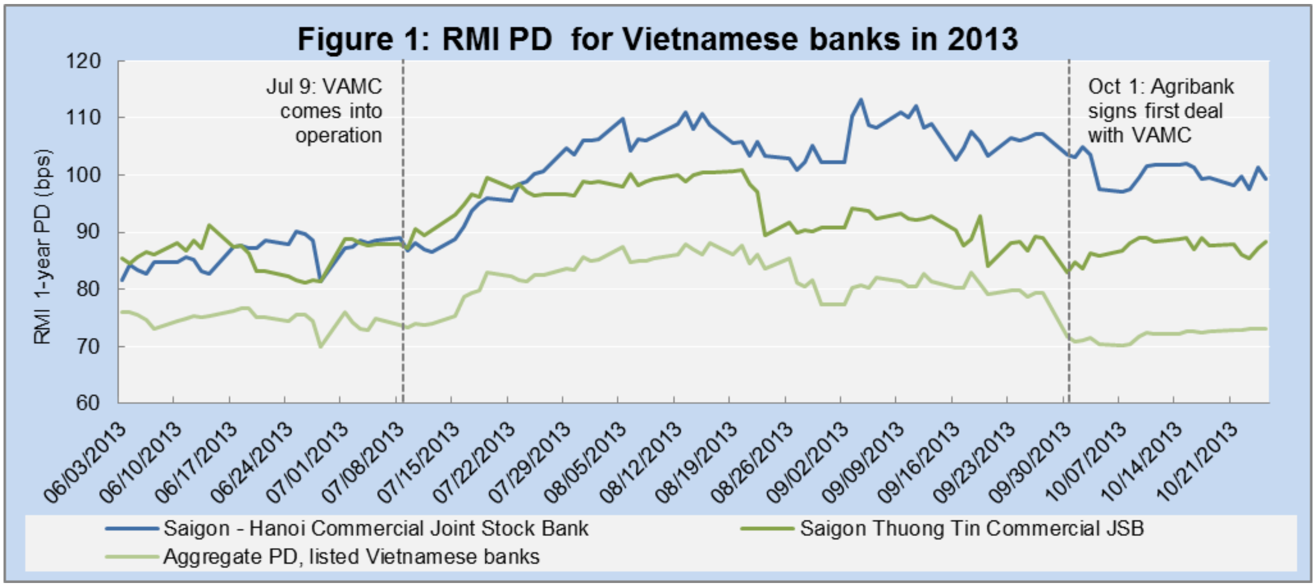
Degradation in the company's credit quality first became evident in June 2012, according to RMI PD data. The company slashed production targets on its first two wells in the Tubarão Azul offshore oil field by as much as 75% on June 26. The company's market-implied asset value dropped 33% over the week following the announcement, leading to a large decline in the company's distance to default (DTD), or market-implied leverage, pushing up the RMI PD for OGX. Production below expectations led to widening losses, while continued oil field exploration and development drained cash, placing further upwards pressure on the company's RMI PDs through 2012.

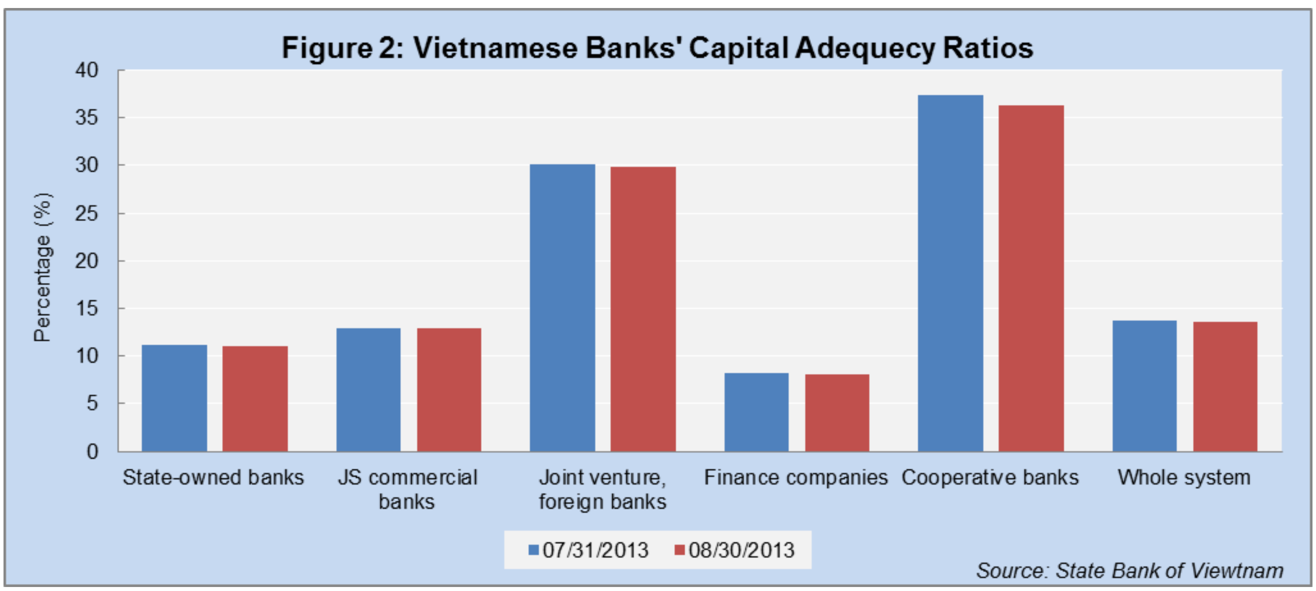
In July 2013, OGX said that its three production wells in the Tubarão Azul field would never be profitable with current technology, and would cease production in 2014. The company reached similar conclusions for three other oil fields currently under development moved to suspend the development of these fields. Keeping the unviable wells running and a push to get a well in the Tubarão Martelo field online severely impacted OGX's ability to service a large amount of debt falling due in October, forcing the company to file for bankruptcy last week.

Sister company OSX could be the next large Brazilian company to default, as OGX is the firm's major client for its offshore equipment businesses. OGX cancelled a majority of its orders and contracts with OSX in June; significantly curtailing the latter's order backlog and future earnings potential. OSX recorded BRL 171mn in write-downs related to OGX orders in the quarter ending June 30, and a loss of BRL 153mn over the same period. The latter, and an ongoing decline in OSX's DTD have placed upwards pressure on the company's RMI PD in recent months. Moreover, ongoing investment in its new shipyard in Brazil has put enormous strain on the company's liquidity, with the cash/short-term debt ratio falling to 0.5 at the end of Q2, from 2.4 a year earlier.

Default risk for Vietnamese lenders falls after government's action
By Kim Vu

Credit quality for Vietnamese lenders has improved following the establishment of the Vietnam Asset Management Company (VAMC) to address the increasing amount of non-performing loans on banks' balance sheets. The RMI 1-year aggregate probability of default (RMI PD) for Vietnamese banks, including those for Saigon Commercial Bank (SCB) and Saigon-Hanoi Bank (SHB), has decreased since September (See Figure 1). The Vietnamese banks' effort to increase their capital against the raising level of bad debts can be observed through the banks' Capital Adequacy Ratios (CARs). In July and August 2013, the banking system recorded a much higher level of CARs than the requirement of 9%, signaling the resilience of the banking system in this difficult juncture (Figure 2).





On November 4, Vietnam's central bank, the State Bank of Vietnam said that bad debts accounted for 4.64% of total loans in August, up from 4.58% the previous month. Lenders have been blamed for the high proportion of bad debt on their balance sheets due to their lax underwriting policies during the real estate boom. Many lenders, including Vietnamese state-owned enterprises (SOEs) are struggling to find capital to resolve the bad debt issue. The finance ministry said some USD 300mn, is waiting to be disbursed to buy their liabilities through the DATC and the newly set-up VAMC.

The establishment of VAMC seems to be the solution to the ever increasing amount of NPLs in the credit-starved economy. On October 1, the VAMC signed their first ever agreement with the Vietnam Bank for Agriculture and Rural Development (Agribank), the country's largest lender, to buy USD 118mn of its bad debts. In mid-October, Saigon Commercial Bank, Saigon-Hanoi Bank and Petrolimex Group Bank (PG Bank) also followed suit to sell their bad loans. The three banks have sold a total of USD 39.8mn worth of bad debts.

"At first, lenders were reluctant to work with VAMC because "they didn't understand the regulations and mechanisms" for selling debts," said Nguyen Quoc Hung, the company's vice chairman. However, after their first deal with Agribank, other banks became more "enthusiastic" given that their concerns were addressed and clarified. Viet Nam Construction Bank, Phuong Nam Bank, Techcombank, GPbank and Maritime Bank are the other financial institutions that are negotiating with VAMC.

Foreign investors' interest in the SOE debts

Following the VAMC's deals, there have been a rising number of foreign investors showing interest in buying these SOE debts. On October 28, Dang Quyet Tien, deputy head of the Corporate Finance Agency, the unit which advises that the finance ministry, is currently working with the Japanese International Cooperation Agency (JICA) over an agreement to take over the debts of the SOEs. JICA will ask private investors to purchase bad debts of state owned enterprises, in exchange for equity positions in the enterprises. Under the JICA framework, the banks will be required to supply more capital for the restructuring of state owned enterprises on condition that the lenders' demands are met. This method was employed by Japan several years ago, which was proven successful. The Japanese government chose companies to reduce loans over a five year period and called upon private investors to drive fiscal reform, without moving the State's budget.

Sources:
Japan to pump JPY 30bn into buying Vietnamese SOE debts (Tuoitre News)
Bank giants to offload USD 47.6mn in bad debts (Vietnam News)
VAMC buys USD 40mn in bad debts from three banks (Thanh Nien News)

In the News

Red flags waving over Asian corporate debt

Nov 04. The Bank for International Settlements estimates that foreign currency loans in China grew 35% in the 12 months to last March. Some investors look at this as a typical indication of problems just around the corner. Concerns over Chinese companies' appetite for borrowing in USD bond markets point to a wider concern about Asian emerging corporate debts. While attention has been focused on how companies in the West have been deleveraging since the 2008 global financial crisis, companies in Asia are doing the opposite– leveraging up, reversing a trend of efforts to cut debt and repair balance sheets since the region's own crisis in the late 1990s. (Financial Times)

Blackstone tests waters with first security backed by rented homes

Nov 03. Blackstone has been working with Deutsche Bank to issue a security backed by thousands of foreclosed homes which have been converted into rental properties. The USD 479mn deal, backed up by payments across more than 3000 single family rental properties, is expected to be completed in the week ending November 8. Dealers are unsure about how to price the issue as it has characteristics of both a commercial and residential mortgage backed security. Credit rating agencies Moody's, Morningstar and Kroll assigned AAA ratings to the most senior tranche valued at USD 278mn. The ratings assigned to the tranche surprised market participants as not many were expecting a rating at all. (Financial Times)

China banks' bad loans point to trouble ahead

Oct 31. Although Chinese state-owned banks reported healthy profit growth in the third quarter, a big increase in loan impairment and reduced buffers in loss-absorbing capacity for China's state-owned banks point to more trouble ahead for China's financial system. Despite reporting an increase in net profits from CNY 62.4bn to CNY 67.2bn in Q3, bad loans at Industrial and Commercial Bank of China (the world's largest bank by market capitalization) increased at an annualized rate of 30% in Q3. Other state-owned banks like China Construction Bank and Bank of Communications have also seen a rise in non-performing loans, suggesting a decrease in asset quality. (Financial Times)

Spain's yield spread shrinks to 2-year low as retail sales rise

Oct 30. 10-year Spanish government bonds gained on evidence the country's economic recovery was gaining momentum, sending yields to a 6-month low and spreads relative to German bonds to its smallest since June 2011. The performance of Spanish bonds, which have returned 11% this year through last week, was also supported by a EUR 21bn interest and bond maturities payout, injecting liquidity that needed to be reinvested. Spain's economy grew 0.1% in Q3 2013, signaling the first annualized retail sector expansion in three years as strong exports pulled the nation out of a 2-year long recession. (Bloomberg, Reuters)

Venezuela's Christmas saved for all as bonds pay for toys

Oct 30. Venezuelan President is ensuring the nation's happiness during Christmas by using bond sales to fund imports of toys, alcohol, bicycles, tress, wrapping paper and food. The South American nation started weekly currency auctions this month after a two-month hiatus, and allowed local companies a chance to buy almost USD 300mn, to purchase goods that are not produced domestically. The central bank sells USD-denominated bonds abroad issued by state oil producer Petroleos de Venezuela SA (PDVSA). The USD amounts are held by the central bank, and the current supply of foreign currency should be enough to last until December 31, according to Maduro. The auctions have placed upward pressures on Venezuela's borrowing costs, which already are the highest among emerging economies. (Bloomberg)

Demise of Kirchner era seen as bondholders win

Oct 29. Argentina's sovereign bonds rallied after President Cristina Fernandez de Kirchner failed to secure enough votes in October 28's mid-term election to push through a constitutional change and enable her to seek a third term in office. ARS denominated debt rose on October 29, adding to a 14% jump since August 11 primaries and narrowed the premium between Argentine debt and US Treasuries by 1.62 percentage points to 8.74 percentage points. According to Barclays Plc, the election results may boost confidence that the next administration will abolish some of the economic policies such as currency controls and government takeovers of private companies, which pushed Argentina's borrowing costs to 11.6% – among the highest in developing nations. (Bloomberg)

EU delays bank capital rule following Nordic protest (Bloomberg)

Troubled loans at Europe's banks double in value (FT)

Dutch Gamble on U.S. Housing Debt After Patience Wins (Bloomberg)

Banks fret over Fed's planned liquidity requirement (Bloomberg)

Coca-Cola borrows USD 5bn with its biggest bond offering ever (Bloomberg)

China's big banks to further diversify as traditional lending business wanes (Business Times)

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Contributing Editor: Dexter Tan