



Glencore weathers storm after successful debt reduction program

by [YONG Kit Siong](#)

Glencore plc, one of the world’s largest global diversified natural resource companies and a major producer and marketer of more than 90 commodities, has recently launched its first euro bond sale after the [huge fall in the price of its shares](#) last year. The EUR 1bn bond sale is almost six times oversubscribed and the strong demand serves as a positive signal that Glencore has regained international investors’ confidence to be able to refinance its existing bonds that are maturing in the coming year.

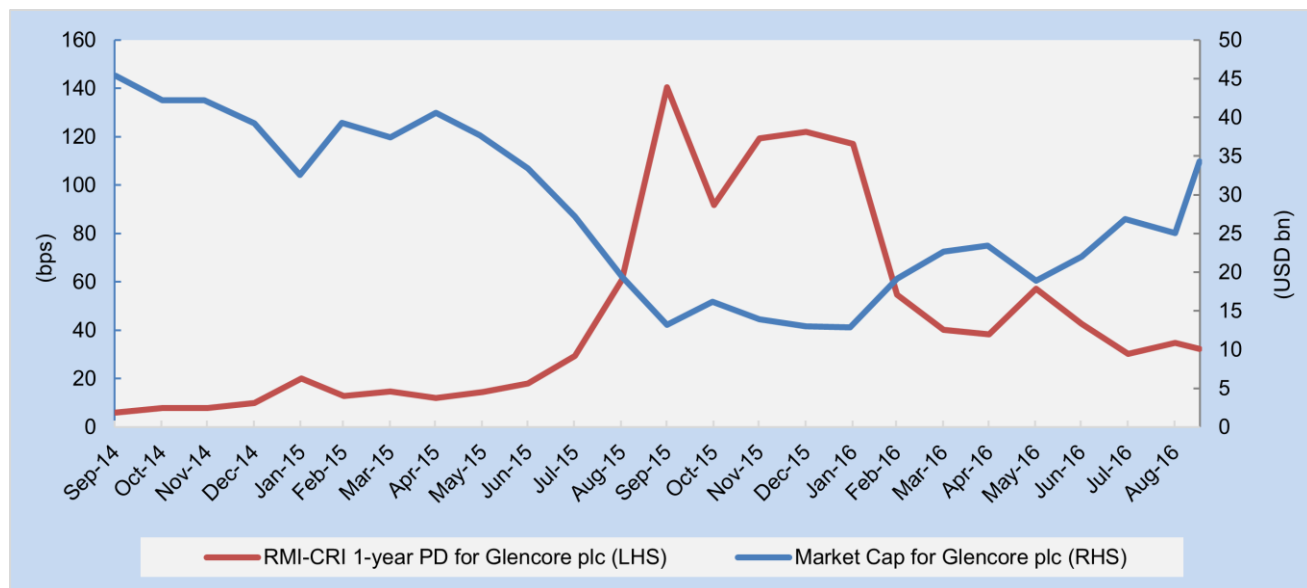


Figure 1: Market cap and RMI-CRI 1-year Probability of Default (PD) for Glencore. Source: Bloomberg, RMI-CRI

Figure 1 shows that the RMI-CRI 1-year Probability of Default (PD) for Glencore had decreased significantly from around 133bps at the end of September 2015 to 32bps on September 16 2016, suggesting a healthy improvement in the credit profile of the firm. The sudden spike in the RMI-CRI 1-year Probability of Default (PD) last year corresponded with a dramatic plunge in Glencore’s market capitalization that occurred between April 2015 and September 2015 because international investors were gravely concerned about the company’s high debt load and also the company’s future business prospects at a time when [commodity prices were plunging](#).

6 Months Ending	S1 2015 06/30/2015	S2 2015 12/31/2015	S1 2016 06/30/2016
Net Debt (USD mn)**	29,550	25,889	23,580
Net Debt To Shareholders Equity (%)	98.01	99.90	87.00

Table 1: Credit metrics for Glencore plc. Source: Bloomberg, company reports. ** indicates from Glencore’s semi-annual reports.

Deeply shaken by the loss of investors’ confidence, Glencore’s CEO Mr. Glasenberg started rolling out a [net debt reduction plan](#) that included suspending dividend payments, laying off workers and selling stock and assets of the company. As seen in Table 1, there is a clear indication that the program has been successful in achieving its objective. The company’s Net Debt to Shareholders Equity, as a measure of its financial leverage, had been reduced from 98.01% in S1 2015 to 87.00% in S1 2016. In spite of a lighter debt load, the company still strives to cut its [net debt level](#) to the range of USD 16.5bn - USD 17.5bn by the end of 2016.

6 Months Ending	S1 2015 06/30/2015	S2 2015 12/31/2015	S1 2016 06/30/2016
Free Cash Flow (USD mn)	4,823	2,941	2,900
EBITDA Margin (%)	5.57	4.42	4.12

Table 2: Financial metrics for Glencore plc. Source: Bloomberg

Glencore's share price, having hit an all-time low in September 2015, has been gaining strength, [increasing by almost 170%](#) from its abyss. However, last week, shortly after Glencore posted its financial reports for the first half of 2016, the company's shares finally took a respite. Having marginally missed the consensus estimates, [Glencore's shares](#) were trading 5% lower after the dismal earnings were made public. As shown in Table 2, the company's EBITDA margin suffered a decline from 5.57% in S1 2015 to 4.12% in S1 2016. Additionally, Glencore's free cash flow decreased to USD 2.9bn in S1 2016 from USD 4.8bn in S1 2015.

Looking forward, despite an improvement in its Net Debt to Shareholders Equity ratio, Glencore still has to move carefully as it faces unsettling uncertainty in the prices of its major commodities. According to Bloomberg, zinc, coal and copper mining in total accounted for about two-thirds of the [company's adjusted EBITDA](#) over the 12 months through June. The bad news for Glencore is that imminent risks are building up in two of the commodities mentioned above. A sudden increase in the supply of copper, believed to be caused by China throwing off excesses, is putting pressure on copper prices. Furthermore, coal prices are forecast to fall as well due to India's cut-down on its coal imports. Fortunately, after merging with Xstrata in 2013, Glencore is now the [world's largest miner of zinc ores](#) that has considerable impact on the zinc market. By cutting its own supply, the firm has helped push zinc prices up and it has also reduced the risk of zinc prices collapsing later this year.

In conclusion, although Glencore seems to have recovered from its dire situation caused by the plunge in global commodities prices and high debt, given the uncertainty in the future prices of its major commodities, how well this saga will eventually turn out remains to be judged in the coming months.

Credit News

BIS warns China banks risk crisis within three years

Sep 19. A report from the Bank for International Settlements (BIS) has warned that excessive credit growth in China is signaling an increasing risk of a banking crisis in the next three years. China's credit-to-GDP gap hit 30.1, which is the highest of the countries assessed by the BIS. Debt has played a key role in shoring up China's economic growth following the global financial crisis. Outstanding debt reached 255% of GDP in 2015, up from 220% just two years earlier. The BIS also said the estimated debt service ratio - which measures principal and interest payments relative to income - is at 5.4, which is a "potential concern". This underlines the default risk as borrowers struggle to repay loans. ([Reuters](#))

Global bond issuance highest in nearly a decade

Sep 18. Global bond issuance is at its fastest pace in nearly a decade as companies binge on debt in a low interest rate environment. A total of USD 4.88tn debt has been sold since the start of the year, just below USD 4.91tn of debt issued in the same period in 2007. The bond sales have been fueled by central bank expansionary monetary policies, such as negative interest rates policies and outright bond-buying. Furthermore, investor's hunt for income has also suppressed borrowing cost for countries and companies. However, as yields on Treasuries, Gilts and Bunds have climbed rapidly in September, prices of some highly sought after bonds also fell recently. ([FT](#))

Deutsche Bank settlement could strain capital

Sep 16. Half of the USD 14bn proposed by the US Justice Department to Deutsche Bank AG for legal settlement of a mortgage-backed securities case would be beyond Deutsche Bank's litigation provisions, further weakening its capital position. However, Deutsche Bank stated that it expects the settlement amount to be at "materially lower amounts." Similar to the banks expectations, analysts and investors also expect a significantly lower settlement, if there is one. ([WSJ](#))

EU banks more vulnerable than peers to Basel revamp ([Bloomberg](#))

Portugal's bond yields rise sharply after budget warning ([Reuters](#))

Loaded with cash, some European banks still have to sell bonds ([Bloomberg](#))

Regulatory Updates

Basel Rule blitz forces Danes to fix USD 420bn bond market

Sep 18. Denmark's government expressed its readiness to alleviate liquidity shortages, addressing the risks, which come with global regulation. In a statement, Business Minister Troels Lund Poulsen mentioned that he will support a proposal by a government-appointed panel to discontinue the practice of making mortgage lenders offer loans based on CITA and CIBOR. The minister also expressed willingness to consider other measures as he pledges to contest the Basel Committee on Banking Supervision on plans he warns could "destroy" Denmark's mortgage market. ([Bloomberg](#))

Asset managers told to hold more capital

Sep 16. Financial regulators are now paying more attention to asset managers' balance sheets in order to reduce systemic risks to the economy. The Financial Conduct Authority in the UK had asked Aberdeen Asset Management to increase its cash reserve from GBP 335mn to GBP 475mn to cover for any "unsighted and unquantifiable risks". The increased scrutiny casted doubt over asset manager's profitability at a time when profit margins are under pressure from investors demanding cheaper fees for investment products. However, many asset managers are already well prepared for the more stringent capital requirement. ([FT](#))

Basel Committee published results of Basel III monitoring exercise

Sep 13. The Basel Committee published the results of its latest Basel III monitoring exercise recently. Data have been provided for a total of 228 banks, comprising 100 large internationally active banks and 128 Group 2 banks. On a fully phased-in basis, data as of 31 December 2015 show that all large internationally active banks meet the Basel III risk-based capital minimum Common Equity Tier 1 (CET1) requirements as well as the target level of 7.0%. There is no capital shortfall for Group 2 banks included in the sample for the CET1 minimum of 4.5%. For a CET1 target level of 7.0%, the shortfall remained constant at EUR 0.2bn since the previous period. The monitoring reports also collect bank data on Basel III's liquidity requirements. The weighted average Liquidity Coverage Ratio (LCR) for the Group 1 bank sample was 125.2% on 31 December 2015, slightly up from 123.6% six months earlier. For Group 2 banks, the weighted average LCR was 148.1%, up from 140.1% six months earlier. ([BIS](#))

Federal Reserve stress test may be illegal ([Reuters](#))

China tightening bond issuance by property firms in smaller cities ([SCMP](#))

UK Prudential Authority proposes amendments to risk weight calculations for residential mortgage portfolios ([Lexology](#))