NUS-CRI PD showed warning signs of credit health deterioration before Tianqi Lithium's default

by Shuai Shuai

- **The NUS-CRI Forward 1-year PD in our February issue indicated an increasing risk of default for the Chinese lithium giant - it defaulted in November 2020**
- **Tianqi Lithium's enormous leverage and low liquidity levels lead to the default**

In our February Weekly Credit Brief issue, we discussed how one of China's largest lithium producers, Tianqi Lithium Corp, was facing heightened credit risks driven by its aggressive overseas expansion. At that time, the NUS-CRI Forward 1-year Probability of Default (Forward PD[1]) suggested a worsening credit outlook. Unsurprisingly, on 29th November 2020, Tianqi Lithium defaulted on the payment of its domestic syndicated loan comprising of USD 1.3bn in Type A loans and USD 584mn of overseas syndicated loan. As a result, the company signed an extension for the payment to take place no later than 28th December 2020. This phenomenon is not surprising given the company's innately risky credit profile, as shown by the NUS-CRI 1-year Probability of Default (1-year PD) in 2020.

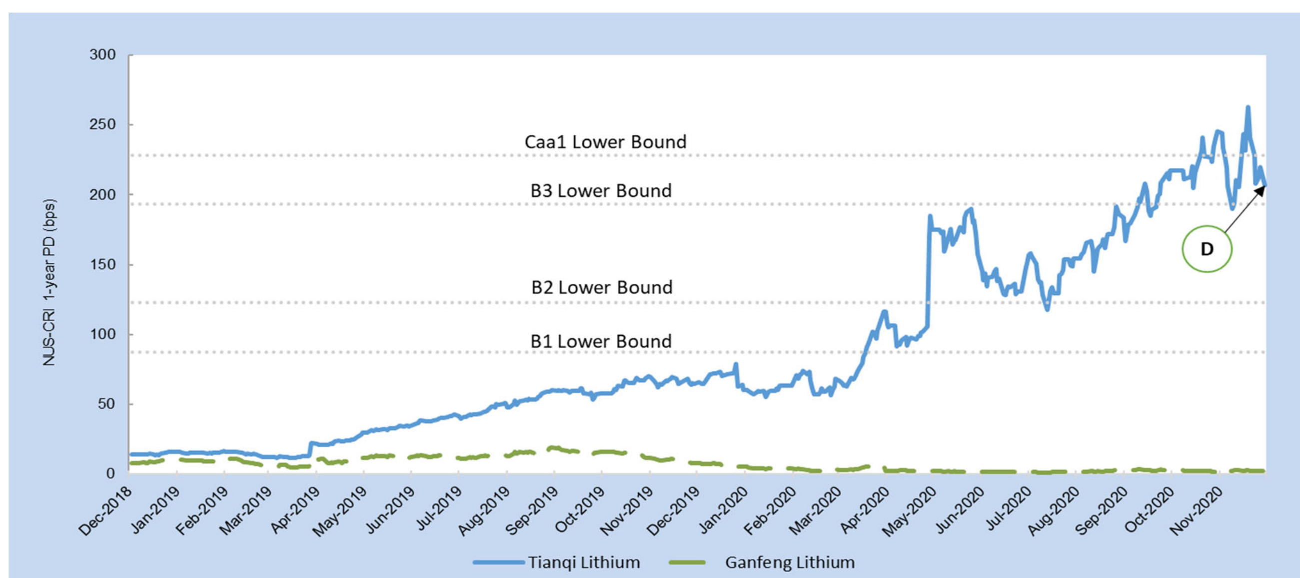

Figure 1: NUS-CRI 1-year PD of leading lithium producers in China with default point highlighted for Tianqi Lithium with reference to PDiR2.0 bounds[2] Source: *NUS-CRI.*

Ever since the February Weekly Credit Brief Issue, the 1-year PD of Tianqi Lithium continued to increase until its default. In contrast, Jiangxi Ganfeng Lithium (Ganfeng Lithium), China's biggest lithium producer, has a

[1] The Forward PD estimates the credit risk of a company in a future period, which can be interpreted similarly to a forward interest rate. For example, the 6-month Forward 1-year PD is the probability that the firm defaults during the period from 6 months onwards to 1 year plus 6 months, conditional on the firm's survival in the next 6 months.

[2] The Probability of Default implied Rating version 2.0 (PDiR2.0) provides a more familiar interpretation through mapping the NUS-CRI 1-year PDs to the Moody's letter grades. The method targets Moody's historical credit rating migration experience exhibited by its global corporate rating pool instead of relying solely on the reported default rates..

decreasing 1-year PD over the same time period (see Figure 1). Due to lower lithium prices (prices fell from CNY 84,000/T in Dec 2018 to CNY 35,000/T in Nov 2020), the net loss in the first half of 2020 was CNY 708mn (USD 101mn). The company had also previously confirmed a loss of CNY 5.98bn in 2019.

Tianqi Lithium's worsening financial health was partly caused by the acquisition of a minority stake in its Chilean rival SQM for USD 4.06bn in 2018. Coupled with the unfavourable macroeconomic environment for lithium producers over the past two years, this has led to a worsening of the company's leverage and liquidity levels. From Figure 2a below, we can see a deterioration in the company's ability to meet its short term liabilities as the current ratio decreased from 2.74 in Q2 2018 to 0.16 in Q3 2020. Simultaneously as seen from Figure 2b, Tianqi Lithium has dramatically increased its leverage as its Total Debt/Total Equity level reached a high of 396% in Q3 2020, compared to 50.68% in Q2 2018. To put this in perspective, its Ganfeng's current ratio and leverage levels stayed above 1 and below 100% respectively over the same time period. As such, the worsened financial position of the company contributed to the heightened probability of default proxied by the NUS-CRI 1-year PD in Figure 1.

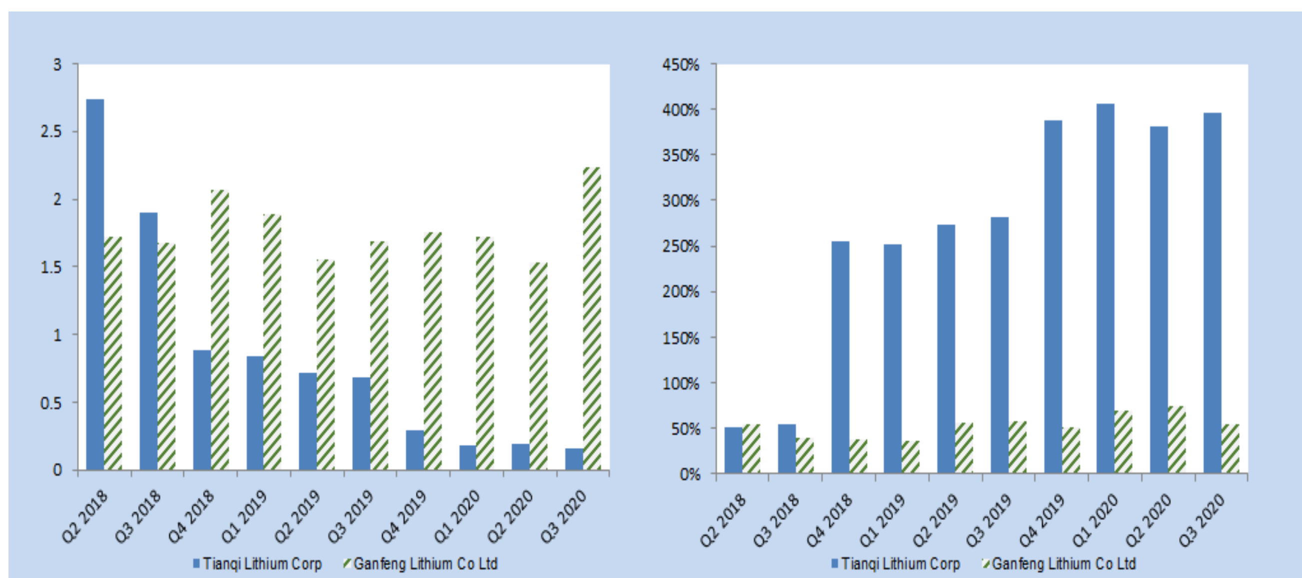

Figure 2a (LHS): Current ratio of leading lithium producers in China. Figure 2b (RHS): Debt to equity ratio of leading lithium producers in China. *Source: Bloomberg.*

Suffice to say, Tianqi Lithium's default has been brewing steadily over the past few quarters. Looking forward, the company still has more than USD 460mn of short-term debt, over USD 1.99bn of long-term loans, and USD 300mn in dollar denominated bonds maturing in November 2022. This heavy debt burden has led to Tianqi Lithium's offer to sell almost half of its interest in the world's largest lithium mine. The company is selling its 49% stake in the investment vehicle holding its stake in the mine at Greenbushes, Western Australia for USD 1.4bn to IGO Ltd. Sale of this investment should aid in meeting future short-term liabilities. The company has also explored equity financing to reduce its leverage. However, its rights issue at the end of 2019 raised only USD 424mn out of its USD 990mn target, signifying the poor investor sentiment in investing in the company.

Nevertheless, industry trends suggest that lithium producers are well poised to grow over the next few years due to domestic consumption and rising importance of lithium. As the raw material for the production of lithium batteries, the demand for lithium will grow rapidly since increases in battery demand will be a strong driver of lithium consumption in the near future. More specifically, the demand for lithium batteries is poised to dramatically increase as electric vehicles sales are expected to increase from current 1.7 million to 8.5 million in 2025 globally. In 2030, the demand for lithium for non-rechargeable batteries is expected to reach 5,034 metric tons of lithium carbonate equivalent. At the same time, lithium production will become the key factor in the EV market. As such, should Tianqi Lithium survive its current financial distress, it may witness a turning point in the future and may benefit in the long term.

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Credit News

Junk bonds are a 2021 must-have for Asia's leading credit funds

Dec 21. Global funds are optimistic about the prospects of debt securities in the Asian market, as volatile market behavior led to above-average gains this year. These bonds are expected to outperform their US and European counterparts, but investors are worried about a potential slowdown in China, as companies will be expected to reduce debt funding, diminishing the available credit pool next year. Debt buyers were betting that cash-strapped companies affected by the pandemic early in the year would make a significant turnaround in the future, which paid off, as they netted over 10% in returns year-to-date. Chinese property bonds and Indonesian government issuances were some of the big winners during the year, and investors are now looking to sovereign bonds in ASEAN as well as Green issuances from India as potential targets going forward. (Bloomberg)

Small businesses, hit hard by pandemic, are being starved of credit

Dec 20. The Paycheck Protection Program funneled USD 525bn in forgivable loans to millions of small businesses in the early days of the pandemic. However, the small businesses that have cleared the pandemic currently face the obstacle of banks starving them of credit as the year-long trend contraction in small business lending alongside a big-business borrowing boom looks set to continue. The reason for this could be that many banks have disappeared over the past decade, removing the main source of funding for local businesses. JP Morgan has scaled back its non-PPP loans to small businesses to its lowest levels since 2010. The Main Street Lending Program has also seen a few businesses meeting the criteria to borrow from the USD 600bn Treasury and Fed effort. (WSJ)

Chinese province turns to highway operator to bail out Yongcheng

Dec 18. Yongcheng Coal and Electricity Holding Group failed to redeem four notes totaling up to over USD 600mn. Analysts expect the provincial government to help the firm fulfill its debt obligations and tide it through the liquidity crunch. However, the plight seems to be independent of Yongcheng's performance as the firm recorded a pretax profit of over CNY 1bn. As such, the issue lies with its parent company Henan Energy which has been drawing out liquidity. Due to the misconduct, the government sought to replace the current chairman of Henan. (Nikkei Asia)

Fed's Main Street lending sees record volume in closing days

Dec 18. US Small and Medium Enterprises (SMEs) are now requesting loans from the US government at breakneck speed, with over USD 2.7bn in loans issued in the second week of December, doubling the drawdown of the previous week. Businesses would be able to borrow funds as necessary to maintain their operations under the Main Street Lending Program, with investors enjoying increased security as the Federal Reserve purchases 95% of the face value issued. The initial uptake of the program was slow, given the stringent demands placed upon would-be borrowers, but businesses are now struggling to stay afloat with the rise in COVID-19 cases sweeping the nation. As a result, the program is seeing SME lending skyrocket. (Reuters)

China suspends top credit rating agency as defaults hit market

Dec 15. Golden Credit was suspended by regulatory watchdogs as the agency could not account for some of their ratings and upgrades. The firm was accused of taking bribes in exchange for better credit ratings. As such, the China Securities Regulatory Commission stopped the credit rating agency from onboarding new clients for three months. This was a political statement to other credit rating agencies as well. China Chengxin rating agency will also be looked into in light of Yongcheng Coal and Electricity Holding's default – whose debt was rated triple-A by Chengxin. (FT)

Canada waives CAD 844mn payment due on troubled hydroelectric plant project (Reuters)

China regulator approves opening of fifth nationwide bad loan bank (Reuters)

Finland plans to help Finnair with EUR 400mn loan (Reuters)

Regulatory Updates

EU regulator launches revamp of insurance rules

Dec 18. The EU's insurance regulator has launched a revamp of its Solvency II capital regime looking to take into account the effect of ultra-low inflation rates on the insurance industry. The low and even negative rates have hit insurers hard, reducing the returns that they can make on their investments and forcing them to hold more capital against some types of long-term insurance policies. The review has made proposals on the recovery and resolution regimes for troubled insurers and on insurance guarantee schemes that protect customers if companies fail. However, this has been met with backlash from the industry with some feeling that it would result in a less competitive industry, offering lower returns to customers. (FT)

Russia keeps rates at record low, puts more cuts in question

Dec 18. The Bank of Russia has kept its key rate at its record low 4.25% in a decision in line with expectations. The lower rates have supported the economy through cheaper lending, however, it has also made the rouble more vulnerable to external shocks and increased the risk of inflation. This has seen the bank take a more hawkish tone amid higher inflation as inflation is expected to accelerate to 5% in Q1 2021, up from 2020's annual inflation of 4.7%. (Reuters)

Fed keeps countercyclical capital buffer at zero (Reuters)

BOJ says to examine steps to make policy framework sustainable (Reuters)

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