



BT Group PLC relay signs of weaker 2017 outlook

by [Ernest Sim](#)

The start of 2017 saw UK telecommunications incumbent BT Group PLC meeting a series of challenges. Preliminary investigations into the accounting practices of BT's Italian business segment unveiled accounting errors and managerial issues and upon further enquiry, the issues with the BT's Italian business ran deeper - alongside improper accounting, [improper sales, purchase, factoring and leasing transactions were uncovered](#). With overstated earnings accrued to the faulty practices in BT's Italian business, the initial write-down of [GBP 145mn](#) in earnings was raised to GBP 530mn. Following the announcement of the investigation, BT's shares dived, with market capitalization posting a drop of [almost GBP 8bn](#).

Mired in the backlash from the improper malpractice probe, the UK telecommunications giant revised its FY2016 Q3 EBITDA (earnings before interest, depreciation, and amortization) downwards by GBP 120mn. Although the Italian business's contribution to BT Group's EBITDA stands at [approximately 1% as of March 2016](#), suggesting that potential recurring impact on BT's bottom line would be limited, the company also faces other headwinds. BT is expecting a double-digit YoY percentage decline in its Q4 EBITDA from the UK public sector and international corporates. With write-downs and lackluster revenue growth on its horizon, BT revised its outlook on its underlying revenue from ["growth"](#) to ["broadly-flat"](#).

While the yield of the 5-year German government bond had remained fairly stable, which is a proxy for the risk-free rate, the yield spread between BT Group's 5-year senior unsecured note and the 5-year German government bond has been widening for the past six months, revealing increased credit risk (see left panel of figure 1). The yield spread across a 6-month period rose in tandem with the RMI-CRI 1-year Probability of Default (PD) for BT Group (see right panel of Figure 1). However, the sharp rise in PD above 62bps on January 24, 2017 follows the plunge in market capitalization of BT Group on the same day.

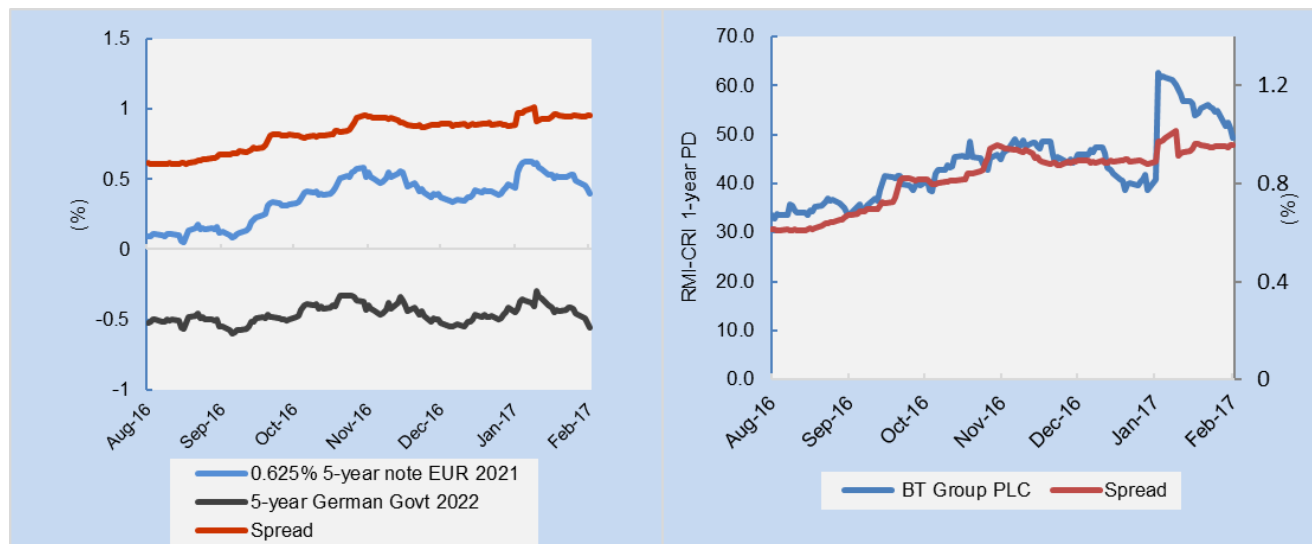


Figure 1: BT Group 5-year senior unsecured note yield, 5-year Germany government bond yield and yield spread of 5-year senior unsecured note on 5-year Germany government bond (LHS) and RMI-CRI 1-year PD for BT Group PLC versus yield spread (RHS) Source: Bloomberg, RMI-CRI

While the write-down might be a one-off event, BT's long term pressure over its sole ownership of broadband network infrastructure through its subsidiary, Openreach, could be a larger headache. Already, attention had been drawn towards the probe, stating that BT's [reduced cash flow](#) would impede investments in fibre network, further compounding UK's lag in digital infrastructure. In light of the heightened regulatory strain to [separate Openreach](#) from BT and revenue headwinds, maintaining its margins could be an uphill task for the UK telecommunications giant.

Credit News

HHGregg said to prepare for bankruptcy as soon as next month

Feb 24. Falling revenues and stiff competition could force HHGregg to file for bankruptcy next month. Consumers are changing their shopping habits as more of them prefer to shop online than visit the traditional shopping centers. After sales plunged 24% in Q4, the firm hired restructuring specialists Stifel, Nicolaus & Co. and Miller Buckfire & Co. to improve the company's financial situation. The retailer may be delisted from the New York Stock Exchange as it could not meet its listing requirement. ([Bloomberg](#))

China's public-private projects pose state debt risks

Feb 22. China's public-private-partnerships, in which local governments have contractual obligations to pay for the projects or fill the cash flow gap for user-pay ventures, are considered public debts which are adding pressure to China. BofAML said that while the PPP model can be used to stoke economic growth, this "undisciplined" government borrowing may add pressure on inflation and the yuan, and gradually limit its ability to stimulate growth. Agencies including the IMF have also warned of risks from China's rapid expansion of credit to stoke its economy. ([Bloomberg](#))

Brazil builder PDG seeks court protection from creditors

Feb 22. Brazilian homebuilder PDG Realty SA files for bankruptcy filing in order to seek protection from creditors. It is Brazil's second publicly listed builder to file for bankruptcy in less than six months. PDG's gross debt amounted to BRL 5.4bn but it had only BRL 235mn of cash as of September 2016. Facing weak demand, increasing sales cancellations, delaying construction projects and lawsuits from clients, PDG struggles to survive. The management has hired RK Partners as adviser to manage its negotiations with creditors to get access to construction financing. If the bankruptcy protection is granted, PDG will have 60 days to present a viable restructuring plan to its creditors. ([Reuters](#))

Greece needs debt restructuring, interest rate cuts

Feb 22. The standoff between the EU and the IMF over the sustainability of Greek debt has ended after Athens agreed to adopt tax and pension reforms. The IMF cut interest rates on new loans and restructured the country's existing debt, stating that the measures were necessary for the country to reach a fiscal surplus target in 2019. Creditors are likely to extend the maturity of the loans and cap interest rates rather than take a loan collateral haircut during the next debt-restructuring phase. ([Reuters](#))

Creditors of Saudi steel giant agree to USD 1.7bn debt deal

Feb 21. Saudi Arabia's largest private steel manufacturer, Al Ittefaq Steep Products has reached an agreement with its creditors to pay interest on its debt for another two years. Steel manufacturers have been struggling in the face of lower steel prices, increased supply of Chinese steel imports and weak demand. Chinese steel producers, which account for half of worldwide supply, have flooded the export markets. This is the company's second debt restructuring deal in the last seven years. ([Arabian Business](#))

Fashion house BCBG Max Azria to file for bankruptcy ([Channel NewsAsia](#))

Seair announces default on senior debt ([Reuters](#))

UK sells inflation linked bond at record low yield ([Reuters](#))

Regulatory Updates

China launches fresh attack on shadow banking risk

Feb 22. China's central bank has drafted new rules to tackle risks from shadow banking, reflecting that a series of measures in recent years to control off balance sheet credits have failed to control its risks. UBS estimates that China's ratio of debt to GDP hit 277% at the end of 2016, increasing by 133 percentage points since the global financial crisis. Non-bank lending has made the largest contribution to the surge. PBOC warned that banks seemed not able to effectively recognize and control off balance sheet risk, as despite escalating macroeconomic risk for expanding wealth management business, it does not trigger the requirement to deleverage. ([Financial Times](#))

IMF adopts decisions to strengthen the financial stability in countries with Islamic Banking

Feb 21. The Executive Board of the International Monetary Fund (IMF) has adopted a set of proposals on the role the Fund should play in order to strengthen the financial stability in countries with Islamic Banking (IB). Although it accounts for a small portion of global financial assets, IB is growing rapidly, establishing its presence in more than 60 countries and has entrenched deeply into some countries' financial system. IB also assist to enhance financial intermediation and promote funding for economic development for many member countries. Therefore, it is important to put in place measures to promote IB financial stability and ensure it is of sustainable development. Not only the legal and governance frameworks have to be in place, regulatory and supervisory standards for IB need to complement international standards. The development of the government Sukuk markets will also assist in building liquidity management in the banking system. IMF also highlighted the importance of IB-specific resolution regimes and financial safety nets. ([IMF](#))

China securities regulator to focus on stability, reform ([CNBC](#))

MAS forms council to review Singapore's code of corporate governance ([Straits Times](#))

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