



## Miners in dire straits as gold loses its luster

by [Jacky Lin Tingting](#)

The gold bullion has fallen out of favor with a long stretch of declining prices since 2011. The price of gold hit a five-year low last week with its steepest intraday fall in two years. This latest dip was triggered by a string of setbacks, including the impending US rate hike and the debacle in the Chinese equity markets, which prompted bouts of [heavy loss-covering gold sales](#). The strengthening greenback has now [replaced](#) the yellow metal as the preferred safe haven asset. While the dollar-denominated gold naturally loses its purchasing power as the dollar appreciates, the prospect of a rate hike in the US further diminishes the appeal of non-yielding assets, like gold.

The recent gold price rout has pummeled gold mining companies as their shares slid in tandem. When the outlook for gold prices turned bearish in 2012, most miners saw the cloud on the horizon and responded rapidly by reducing their capital spending, mining high-grade reserves and improving operating efficiencies. Yet, many still underestimated the intensity and extent of the headwinds awaiting them. According to [Bloomberg](#), a quarter of global gold production will not be [sustainable](#) if the gold price falls below USD 1100/ounce. The latest plunge in the gold price to a level around USD 1100/ounce has set the alarm bells ringing as the already strained balance sheets of miners verge on their tipping point. The Bloomberg Intelligence Global Senior Gold Valuation Peers Index, which measures the stock performance of major gold mining companies globally, fell as much as 23% from the end of Dec 31, 2014 to Jul 24, 2015. As a matter of fact, miners in general suffered a heavier blow than the slump in the gold price. It is because during the 2001-2011 bull-run in which gold prices surged sevenfold from USD 279/ounce to USD 1564/ounce, scores of miners borrowed heavily for exorbitant expansion projects. As capital expenditures rose monumentally, many were unprepared for a turnaround in the market in late 2012. The miners struggled to expunge the resultant debt load of a record USD 31.5bn at the end of Q1 this year with a trilemma of dwindling revenues, spiraling operating costs and severe impairments. Their financial predicament is reflected in the RMI-CRI aggregate probability of default (PD) measure, which is a simple median of the PDs of 13 gold miners (see Figure 1).

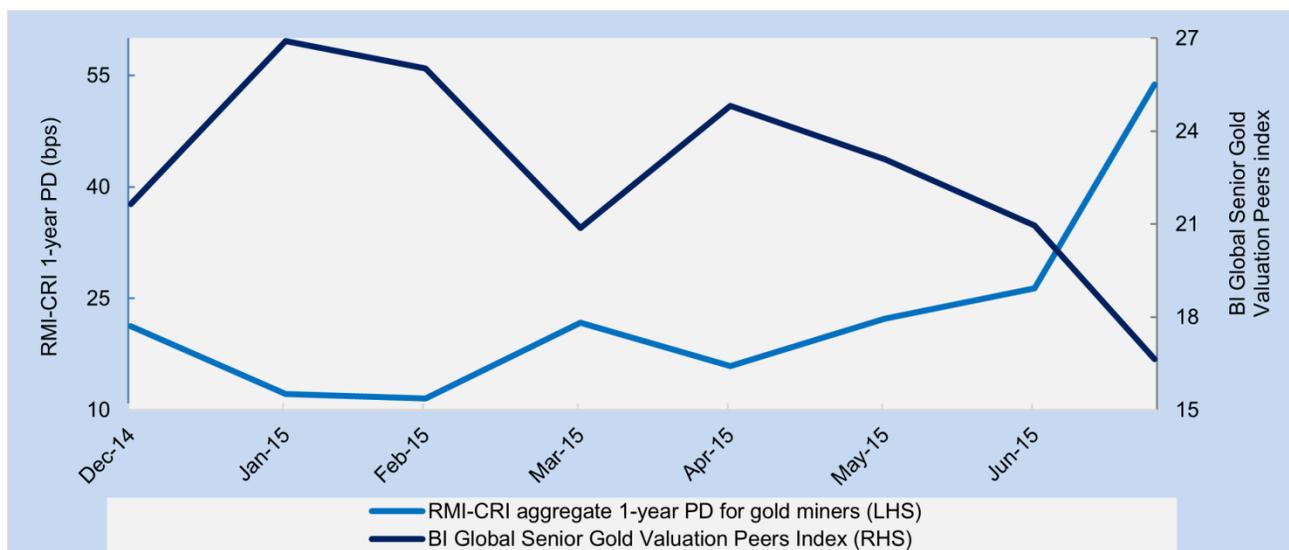


Figure 1: RMI-CRI 1-year aggregate PD for 13 gold miners vs. BI Global Senior Gold Valuation Peers Index. Source: RMI-CRI, Bloomberg

The largest gold mining company in the world, Barrick Gold Corp has one of the worst credit outlooks among its peers with its share price falling below USD 10 for the first time since June 1990 on 13 July 2015. Mistakenly forecasting the gold mining sector's prospects, the ambitious company had developed new mining projects and aggressively pursued acquisition-driven production growth through extensive borrowing. Unfortunately, as the gold price began a downward trend in 2012, the high leverage left the company exposed to the risk inherent in large projects and the erratic demand for gold. The company was burdened with a debt load of more than [USD 13bn](#) at the end of Q1 2015 with a year-on-year increase in its debt-equity ratio. Additionally, the appreciation in the USD since the end of 2014 has battered Barrick with a double-barreled assault. It is because its operating cost is relatively more exposed to the US currency as the 40% of the company's gold mines operate in the United States. Barrick has also been forced to write down its assets to reflect the real value of its mines and its net income margin has reduced substantially over the last couple of years (see Table 1).

	Q1 2013	Q1 2014	Q1 2015
Revenue (USD mn)	3,399	2,647	2,245
Net income margin	24.1%	4.9%	2.6%
Total debt / total equity	59%	81%	101%

Table 1: Financial data for Barrick Gold Corp. Source: Bloomberg

Despite the financial woes, the silver lining is that Barrick has just [sold off stakes](#) in the Cowal and Porgera mines to lower production costs, reduce its debt burden and improve cash flow. However, as gold has lost its sheen and costs continue to rise, this short term expediency may not help the company to operate sustainably in the long run unless there is a long-lasting gold price rebound in the future.

## Credit News

### Oil groups have shelved USD 200bn in new projects as low prices bite

**Jul 26.** The world's big energy groups have shelved USD 200bn of spending on new projects in an urgent round of cost-cutting aimed at protecting investors' dividends as the oil price slumps for a second time this year. The slump in oil prices pushed the Bloomberg commodities index to a 6-year low over concerns of weaker Chinese growth and rising supplies across the board. "The upstream industry is winding back its investment in big pre-final investment decision developments as fast as it can," Wood Mackenzie, a consultancy, said in a report to be released on Jul 27. "This is partly because it is one of the quickest ways to free up capital in response to low oil prices." ([FT](#))

### IMF: Japan debt risks rise to triple GDP without change

**Jul 23.** The International Monetary Fund (IMF) claimed that Japan's debt is unsustainable and could potentially reach triple the size of its economy by 2030, if the government does not have appropriate plans to cut its budget. IMF also suggested that Japan should consider rules to reduce its expenditure and should not risk relying on an optimistic economic outlook to reduce its debt burden. The yield on Japan's benchmark 10-year government bond was the second lowest in the world for this maturity, when it hit 0.41% on Friday. The Japanese yen has depreciated by about 25% against the US dollar since Governor Haruhiko Kuroda introduced unprecedented easing in April 2013, which may be beneficial for Japan given the stage of its economic cycle and the need to address low inflation. ([Bloomberg](#))

### Indian banks opt for offbeat tactics to tackle USD 49bn of bad debts

**Jul 23.** India's state-owned banks are resorting to unconventional methods, such as naming and shaming smaller borrowers, and advertising seized assets for sale at shopping malls, to combat the USD 49bn of bad debt incurred. The main reason cited for the colossal bad debt was the failure of banks chasing down these debtors. Pressures from the Indian government have left these banks no choice but to adopt these harsh measures. Gross bad debts rose to INR 3.1tn by the end of March which is equivalent to 4.6% of the total debts. ([The Business Times](#))

**Microsoft drops as Nokia charge leads to largest quarterly loss**

**Jul 22.** The share price of Microsoft Corporation fell after its largest-ever quarterly loss due to a USD 7.5bn write-down. The Nokia deal which has lost almost all its value after the failure to revive the smartphone business was the reason for the write-down. Microsoft bought Nokia's phone unit in 2014 but the unit has continued to lose money ever since then. Another reason for the disappointing earnings report was the strengthening of the USD which depressed the revenue and earnings. ([Bloomberg](#))

**Toshiba must adjust operating profit down by USD 1.2bn**

**Jul 20.** Three consecutive Toshiba Corp. chief executives fueled more than USD 1bn in accounting irregularities by setting unrealistic profit targets and demanding that subordinates meet them, an independent panel hired by the company said on Jul 20. Toshiba's own checks discovered that it needs to reduce the operating-profit figure by an additional JPY 4.4bn. Toshiba said it would take the report's findings seriously and work to regain the public's trust. Toshiba's share price closed last week at JPY 376.8, after having risen above JPY 500 in March shortly before the problems emerged. ([WSJ](#))

**UBS shares slip despite surge in profits ([FT](#))****Hyundai profit slumps on weak sales in China and US ([WSJ](#))****Regulatory Updates****China online finance rules balance innovation and risk control**

**Jul 27.** China's move to regulate internet finance is a positive step towards legitimising a sector that has largely operated in a vacuum, analysts say, but the rules also reflect the government's support for incumbent banks. Ten agencies including the central bank, the banking regulator and the securities regulator jointly issued guidelines this month that provide an official definition of "internet finance" and specify which agencies are responsible for regulating which types of internet financial institutions. The new rules seek to draw a clear line between P2P lending and banking. As the regulation takes effect, analysts say big players stand to benefit. ([FT](#))

**Basel / IOSCO proposal underwhelms ABS industry**

**Jul 24.** Policymakers set criteria to identify Simple, Transparent and Comparable securitisation but refused the immediate recommendation of lower capital charges for qualifying deals. The industry expected the softening of capital treatment for qualifying deals to boost the market. The paper, however, lacked any concrete capital proposals but the Basel Committee is pushing for revised capital charges. As compared to the previous versions, the recommendations for an established track record of the originators and other parties involved in the deal were relaxed. ([Reuters](#))

**Working group to strengthen code of conduct standards and principles in foreign exchange**

**Jul 24.** The Foreign Exchange Working Group (FXWG), announced by BIS governors in May to strengthen code of conduct standards and principles in foreign exchange markets, is now established. This group, which operates under the Markets Committee, consists of membership covering major financial centres in both advanced and emerging market economies. The code is intended to cover all parts of the global wholesale FX market, with appropriate consideration to local circumstances. The Market Participants Group (MPG) was also established to support the FXWG. FXWG and MPG will work closely with the foreign exchange committees to reach out to jurisdictions beyond those represented on the Markets Committee. ([BIS](#))

**Fed calls for USD 200bn of extra capital buffers in US banks**

**Jul 20.** In response to the new Federal Reserve rules to prevent a major financial collapse, the eight leading US banks will hold additional capital buffers totaling USD 200bn. All of these eight banks, except JP Morgan, have already complied with the new requirements. The final draft rules set new capital requirements for the US's top bank holding companies to exceed minimum international standards set by the Basel Committee on Banking Supervision. The banks must comply with the rules to avoid being restricted with limits on bonus payments and dividends. The central bank is considering whether to incorporate the capital surcharge into its stress-testing framework. The new risk-based capital surcharges range from 1% to 4.5%, and are intended to provide significant economic benefits by reducing the risks in the failure of very large banking organizations. ([FT](#))

**Volcker bank-risk rule set to start with little fanfare** ([WSJ](#))

**UK regulator eyes greater clarity for savers** ([FT](#))

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