CRI Credit Research Initiative

NUS National University of Singapore | RMI Advancing Risk Management for Singapore and Beyond

transforming big data into smart data

Weekly Credit Brief March 03 - March 09

Japan Inc. reported record profits amidst weak JPY

by Jiang Jiayuan

Last week, the Japanese Ministry of Finance announced that total quarterly profit for companies across all industries, excluding finance and insurance, rose to a quarterly record high of JPY 18.06tn during the Oct-Dec quarter. Profits for electronics companies, for instance, increased 56.6% from a year ago. Companies said that incomes from overseas operations have increased. Meanwhile, the market values of Japanese firms have risen sharply. On Mar 5, the Nikkei 225 index reached its highest level in 15 years. Higher market caps and elevated earnings have created stronger credit profiles for Japanese companies.

In April 2013, the Bank of Japan embarked on a monetary easing program which aimed to raise the core inflation rate to 2% by April 2015. The central bank bought exchange traded funds (ETFs) and Japan real estate investment trusts (J-REITs) which boosted the market values of Japanese firms. Subsequently, the creditworthiness of Japanese companies has improved as indicated in the lower RMI 1-year probabilities of default (PD).

The RMI aggregate 1-year PD, which is a simple median, for all Japan-listed firms, continued to decline, falling from 7.28bps in Aug 2013 to 3.12bps on Mar 6, 2015. As shown in Figure 1, RMI 1-year PDs for 13 Japanese electronic product markers and 10 automobile manufacturers have also decreased markedly over the last year.

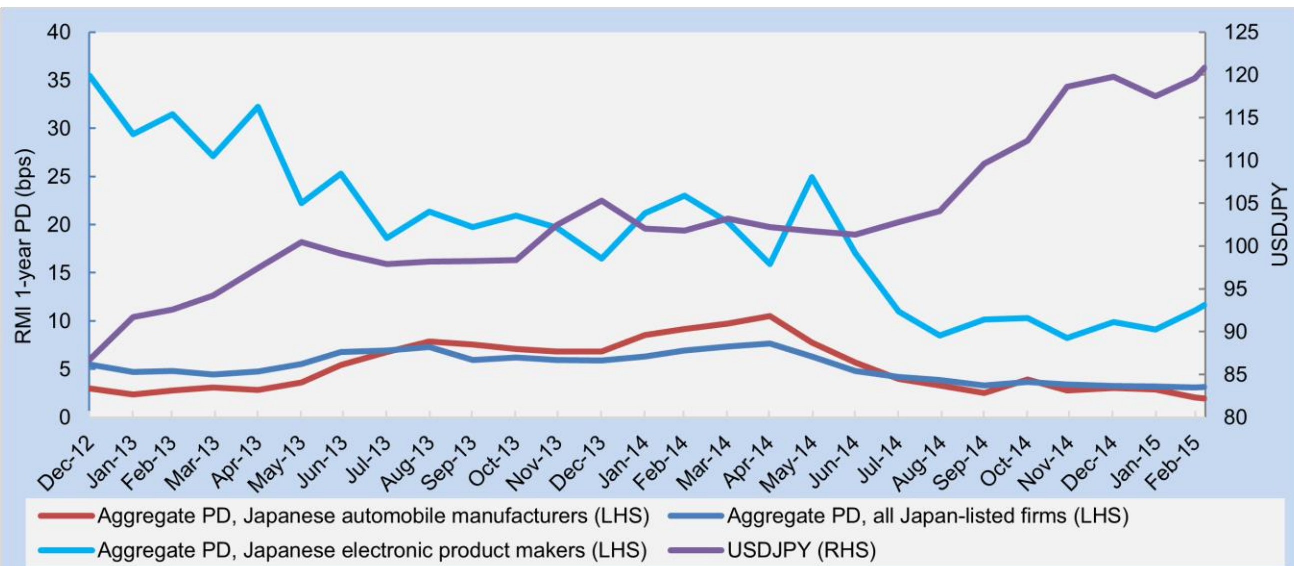

Figure 1: RMI 1-year PD for all Japanese firms vs. the USDJPY FX cross. The USDJPY is chosen as a comparison because the US is Japan's largest single country trading partner. *Source: Risk Management Institute, Bloomberg*

The depreciating JPY, low oil prices and low interest rates have been a tailwind for Japanese corporates. Before 2013, companies invested heavily in foreign markets when the JPY was strong and were able to benefit from FX translation gains when their reporting currency weakened subsequently. In addition, Japanese products have become more competitively priced and demand for Japanese products has grown. The amount of exports from the country increased from JPY 5.78tn in Apr 2013 to JPY 6.14tn in Jan 2015.

	Panasonic			Sony			Toyota		
As of	Sep 2014	Dec 2013	Dec 2012	Sep 2014	Dec 2013	Dec 2012	Sep 2014	Dec 2013	Dec 2012
12m overseas sales	3892.6	3790.3	3443.4	5825.5	5350.7	4493.6	19807.1	19419.7	15615
Overseas sales/ Total sales	50.2%	50.2%	47.0%	72.9%	70.1%	67.4%	75.9%	77.8%	71.2%
Market capitalization	3015.4	2829.4	1206.7	2287	1894.8	961.5	20505.5	20347.1	12683.3
Current ratio	1.13	1.08	0.99	0.9	0.9	0.82	1.06	1.05	1.03
Total debt / equity	34.49%	51.56%	109.89%	34.98%	44.67%	55.90%	108.67%	110.01%	109.15%
RMI 1-year PD (bps)	7.96	7.92	45.03	8.17	30.44	57.2	1.35	6.84	2.35

Table 1: Pro forma financials and RMI 1-year PDs for Sony, Panasonic and Toyota. Figures expressed in JPY bn, unless indicated otherwise. *Source: Risk Management Institute, Bloomberg*

Sony, Toyota and Panasonic are examples of companies that have exhibited lower default risks, stronger financial performance and higher market caps. Overseas sales increased for all three firms during 2013 and 2014. Moreover, current ratios have improved and leverage (using the ratio of total debt to equity as a proxy) has declined. Panasonic and Sony have restructured their businesses after falling prices in the television divisions weighed on their earnings. Panasonic is shutting down its TV manufacturing factory in China and will sell its plant in Mexico. The company is moving away from the consumer electronics segment, and in July 2014 it signed a deal with Tesla to build electric vehicle batteries.

Toyota is expected to report record annual profits in this fiscal year, which would make it the world's best-selling car maker. Sales had been affected by worsening China-Japan ties and product recalls, but the company managed to increase its profits in spite of the operating challenges. Recently, falling petrol prices lifted US sales of sport utility vehicles and pickup trucks while luxury demand for Lexus vehicles remained strong in 2014. The company said that vehicle revenue is weak in Japan and Southeast Asia but continues to see robust demand in the US.

Credit News

BPZ Resources files for bankruptcy protection amid oil-price drop

Mar 9. As the second Texas oil company, BPZ Resources Inc. filed for Chapter 11 bankruptcy protection after skipping a USD 60mn payment owed to bondholders in early March. BPZ's chief executive said that the drop in oil prices and the general "industry downturn" made it difficult for the company to refinance its debt. This is the second publicly traded Texas oil company to file for bankruptcy after Dune Energy Inc. bankrupted on Mar 8. BPZ said it will continue to operate, along with its subsidiaries, under court protection. (WSJ)

China Inc. flocks to euro debt for funding

Mar 8. Chinese companies are flocking to the euro to raise new offshore debt. So far this year, mainland-based companies have sold USD 2.9bn worth of euro-denominated debt. Funding costs for euro debt have been tumbling since the ECB announced plans to start its own program of quantitative easing, which is due to begin on Mar 9. Meanwhile, Chinese borrowers have shunned offshore RMB debt, known better as "dim sum" bonds. Only USD 250mn was raised in the market this year, way less than the USD 6.6bn issued during the first quarter last year. (FT)

Tougher US stress test challenge looms for lenders in round two

Mar 8. The result of the first round of the Federal Reserve's stress test was a small sigh of relief for bankers. All the thirty-one biggest US banks passed the test. However, the tougher examination is to come, as the Fed will announce on Mar 11 whether it has accepted or rejected each bank's plans for returning capital to shareholders over the next couple of years. This Comprehensive Capital Analysis and Review (CCAR) has become Washington's preferred way of keeping banks on a tight leash, as the Fed is anxious to see no repeat of 2008. (FT)

Energy companies seek conversations with banks on evaluating collateral

Mar 5. Energy producers are facing a test through the spring as they enter a period where banks re-evaluate the assets against which they can. The slumping price of oil has led to the depreciation of many energy companies' assets. Some firms were cautiously optimistic about this. "Banks don't want to create a problem for us, which then becomes a problem for their loan portfolio," said Mr. Peterson, vice president and chief financial officer of another MLP, Mid-Con Energy Partners LP. Instead of waiting for banks to call them, some other energy companies have contacted banks to have a conversation about their asset valuation and borrowing base. (WSJ)

Oil and gas contractor Cal Dive files for bankruptcy

Mar 4. Offshore oil and gas contractor Cal Dive International Inc., which has been hurt by the slump in oil prices, said the company and its US subsidiaries filed for voluntary bankruptcy protection. "With our current capital structure, we are no longer able to financially withstand the industry downturn," Chief Executive Quinn Hebert said. However, Cal Dive's foreign units have not sought bankruptcy protection and will continue to operate outside of any reorganization proceedings. (Reuters)

Kaisa seeks concessions on offshore debt (WSJ)

Nuclear power firms feel squeeze (WSJ)

Dune Energy files for Chapter 11 bankruptcy protection (WSJ)

Regulatory Updates

Tougher regulation hits investment banking power houses

Mar 9. When Anshu Jain and Jürgen Fitschen deliver their new strategic plan for Deutsche Bank next month, most analysts expect them to focus on cutting underperforming high street banking operations. But the German group's co-chief executives are also gearing themselves up to take an axe to their vast investment bank, according to people familiar with the situation. Other banks could also rarely earn profit from investment banking, including JPMorgan Chase and Goldman Sachs. The biggest reason is tougher regulation. (FT)

World's biggest banks still EUR 300bn short of safe assets

Mar 4. The world's biggest banks are still short of EUR 300bn worth of safe assets to comply with new rules designed to reduce their vulnerability to panics. For 2015, banks must have 60% of the liquidity buffers in place set by the Liquidity Coverage Ratio (LCR) which came into force in January and will be fully phased in by 2019. That target gives banks a EUR 155bn shortfall. The Basel committee said in January that it would press ahead this year with plans to overhaul the financial reporting standards. (FT)

Basel III monitoring results published by the Basel Committee

Mar 4. The Basel Committee today published the results of its latest Basel III monitoring exercise. It is based on the rigorous reporting process set up by the Committee to periodically review the implications of the Basel III standards for banks. A total of 224 banks participated in the current study, comprising 98 large internationally Group 1 banks and 126 Group 2 banks. Basel III's Liquidity Coverage Ratio (LCR) came into effect on Jan 1, 2015. The minimum requirement is set initially at 60% and will then rise in equal annual steps to reach 100% in 2019. (BIS)

Bank of England embroiled in money-market fraud probe (FT)

Regulators call for resignations under Commerzbank US settlement (FT)