NUS National University of Singapore | RMI Advancing Risk Management for Singapore and Beyond
Transforming Big Data into Smart Data
Weekly Credit Brief
Mar 11 - Mar 17 2014

<u>Stories of the week</u>

<u>RMI PD for Olam International continues to slide as Temasek seeks control</u>

By Siddharth Batra

The RMI 1-year probability of default (RMI PD) for Olam International Ltd – the world's largest trader in rice, coffee and cocoa, has decreased to an all-time low of 2.76bps after Temasek Holdings, already its largest shareholder, offered to raise its stake. The PD has declined steadily since December 2012 (from ~50bps), reflecting receding fears on Olam's ability to tide through big acquisitions and its stretched balance sheet.

Temasek announced on March 15 that it would buy the rest of Olam that it does not own for an offer price of SGD 2.23 a share– valuing the commodity trader at SGD 5.3bn. Temasek currently holds a 24.07% stake in the firm. The deal is viewed as a positive for Olam's creditors, shoring up shareholder support ahead of its bonds which will mature in the coming years. According to Bloomberg data, Olam has USD 2bn of bonds due in the next few years, and 4 SGD issues amounting to SGD 1.375bn.

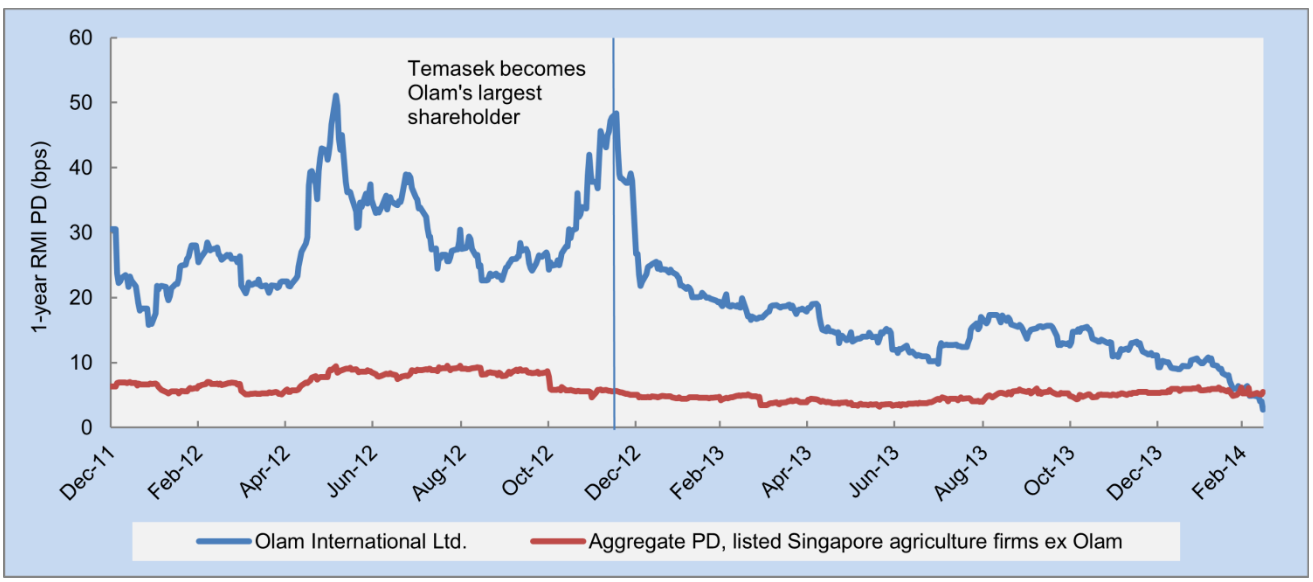

Figure A1: 1-year RMI PD for Olam International Ltd and listed Singapore agriculture firms. *Source: The Risk Management Institute*

Olam has been funding its operations and acquisitions by raising its financial leverage (SGD 5.8bn in Long Term Debt as of June 2013 vs. SGD 2.9bn LT debt in June 2011) – making the company potentially more risky as brought up by short-seller Muddy Waters for its accounting practices and unmanageable leverage.

Since then, Olam has gained financial support from Temasek which subscribed to a USD750mn rights issue to back the agricultural producer. After all, Olam's interim net profit for FY 2014 (end December 2013) of SGD 180.5mn exceeded its profit of SGD 165.3mn in the first 6 months of 2013 as shown in Table A2. Despite this, credit rating agency Moody's labeled Olam's credit profile as "relatively weak" with a gross debt of SGD 9.1bn and an EBITA of SGD 1.2bn in 2013.

RMI PD for Olam, in the meantime, has retreated from a high of nearly 50bps in December 2012 to 2.76bps in

March 2014, which is below the aggregate 1-year RMI PD of agriculture listed companies on the Singapore Exchange. Its RMI Distance-To-Default (RMI DTD) has increased from 2.18 in November 2012 to 5.21 marking a significant improvement in its credit profile. RMI DTD is a volatility adjusted leverage measure, and changes in this measure are a significant determinant of RMI PDs. Numbers close to or below zero suggest potential insolvency.

	FS1 2014	FS2 2013	FS1 2013	FS2 2012	FS1 2012	FS2 2011
Period ending	31/12/2013	30/06/2013	31/12/2012	30/06/2012	31/12/2011	30/06/2011
RMI DTD	3.89	3.58	2.64	2.35	2.34	2.09
Revenue	8827.78	11212.27	9589.53	9377.32	7716.43	9326.72
Cost of Revenue	7892.53	9305.02	8723.97	7600.00	6266.58	7979.40
Income Before XO Items	173.50	198.39	193.13	217.06	186.76	269.07
Minority Interests	-7.02	33.09	-4.19	8.88	24.04	14.40
Net Income	180.52	165.30	197.32	208.18	162.73	254.67
Assets						
Cash & Near Cash Items	1236.04	1591.01	1091.83	1110.86	1154.61	872.25
Total Current Assets	9738.31	9875.37	9770.00	9385.73	9829.67	9599.44
Total Long-Term Assets	5784.51	5508.81	4768.74	4442.25	3206.02	2980.70
Total Assets	15522.82	15384.18	14538.74	13827.98	13035.69	12580.14
Liabilities & Shareholders' Equity						
Accounts Payable	1494.30	1188.24	905.11	678.33	853.18	613.11
Short-Term Borrowings	3167.92	2965.56	3791.98	3148.33	2746.48	3610.04
Other Short-Term Liabilities	774.88	1283.10	1040.39	1938.43	1266.12	2906.81
Total Current Liabilities	5437.10	5436.90	5737.48	5765.10	4865.78	7129.96
Long-Term Borrowings	5945.35	5882.68	5044.40	4341.05	4737.69	2970.53
Other Long-Term Liabilities	238.72	240.88	207.55	194.07	160.64	177.28
Total Long-Term Liabilities	6184.07	6123.56	5251.95	4535.12	4898.34	3147.81
Total Liabilities	11621.17	11560.46	10989.43	10300.22	9764.12	10277.77
Total Equity	3901.65	3823.73	3549.32	3527.76	3271.57	2302.36

Table A2: Key company financial information stated in SGD mn. RMI DTD is measured in standard deviations.
Source: Bloomberg, Risk Management Institute

Potash Price Drop Strikes K+S AG When Their Investment Hits The Highest

By Birger Jacobs

The potash and magnesium products industry was influenced by severe price competition in the second half of 2013. The reason for the drastic price decrease was due to the world's biggest potash producer Uralkali withdrawing from a sales organization that it operated jointly with Belaruskali. Instead, Uralkali announced it would begin full utilization of its production capacities and flooded the market with an increase in potash output. As a consequence, the price of potash tumbled over 20% from USD 392.9 a metric ton in July 2013 to a recent low of USD 309.5 a metric ton in February 2014.

The supply glut affected another top potash producer, K+S AG, which saw its share price getting hammered from EUR 26.81 a share on July 29 2013 to as low as EUR 16.16 on August 16 2013. During this period, the company's RMI PD spiked from 1.53bps to 12.69bps. Despite the unfriendly climate, K+S AG increased its investments by 60% to EUR 742.5mn from a year ago. Of this, EUR 362.0mn are attributable to the company's biggest investment in Canada, a potash plant to augment and replace declining reserves at its aging, high labor-cost German mines. The increased capital expenditure is financed by loans with the net debt increasing from EUR 827.3mn to EUR1.037bn, resulting in a decrease in the company's RMI DTD to 5.19 from 7.23, keeping the company's RMI PD at historically high levels.

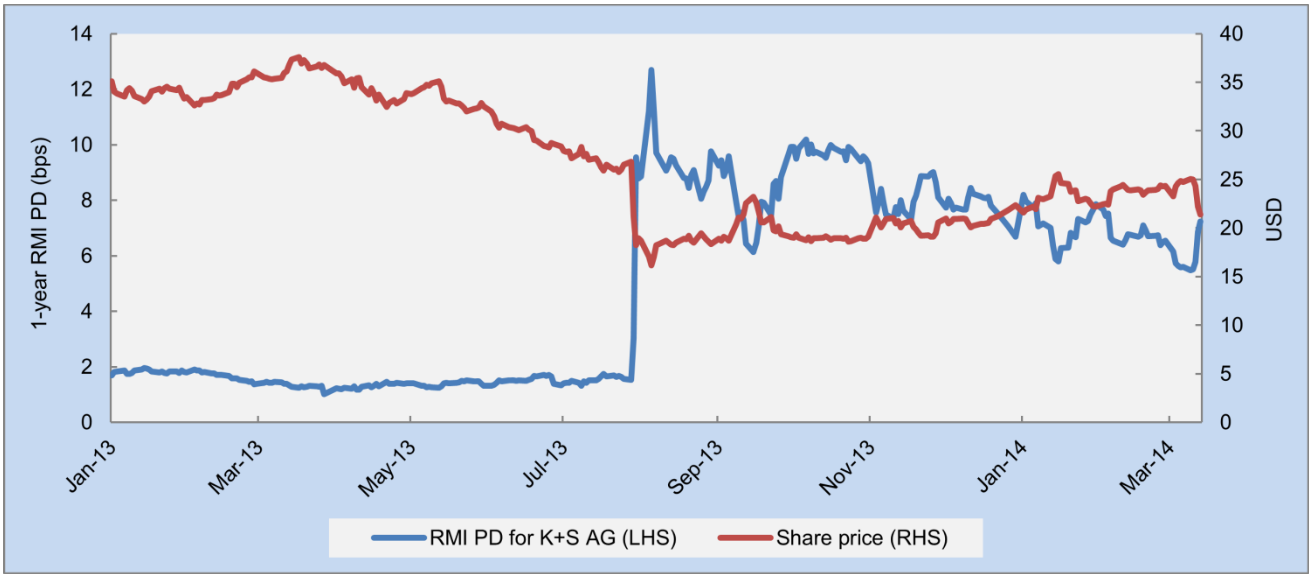

Figure B1: 1-year RMI PD for K+S AG vs Share price. *Source: The Risk Management Institute, Bloomberg*

Last week K+S AG released its annual report, announcing a dividend payment of EUR 0.25/Share. This is less than a fifth of last year's dividend of EUR 1.40/share (shown in Table B-2). Though the revenues remained stable despite the price decrease, EBIT decreased significantly by 18.4%. This was mainly due to a decrease in the profit margin of its Potash and Magnesium businesses. The share price reacted and fell from EUR 25.05/share to EUR 21.375/share. Again, the 1-year RMI PD of K+S AG started to trend upwards from 5.47 bps on March 10 to the current 7.23 bps.

This gloomy outlook and its further investment of EUR 800mn in the Canada-based Legacy project in 2014 is likely to further decrease the company's RMI DTD. Furthermore, the company's operating earnings are expected to go significantly down due to price pressures. However, big markets like China recently sealed a contract with major suppliers for as low as USD 305 per metric ton for the next six months setting a below market price benchmark for potash. Even with the price decrease, countries are not expected to increase potash imports such as India recently cut subsidies on potash by nearly a fifth to control its fiscal deficit.

However, K+S is expecting the volume to stay around the current level, K+S AG anticipates tangibly lower revenues in 2014. Due to a high percentage of fixed costs in mining, the company assumes that operating earnings could fall significantly in 2014 in comparison to the 2013 result. On top of that, in times where economies of scale are needed most, an October 2013 accident in K+S AGs German mine will put a further handicap on the company's ability to compete with larger players.

Year	Revenues	Operation Earnings	Capital Expenditure.	Equity	Net debt	Dividend per Share(in EUR)	Free Cash flow
2013	3950.4	656	742.5	3396.60	1037.00	0.25	-53.60
2012	3935.3	804	465.5	3393.90	827.30	1.4	-359.40

Table B2: Selected K+S financial information. *Source: Company website*

Credit News

Developers' bonds decline amid China housing bankruptcy

Mar 18. Securities issued by Chinese real estate firms have declined in value following the announcement a property developer is on the brink of bankruptcy. Yields on bonds issued by Evergrande Real Estate Group have increased to 10.345%, the highest since October 2013. Yields on 2017 bonds sold by Agile Property Holdings have also increased significantly to 7.459%. Zhejiang Xingrun Real Estate Co. could not possibly pay its USD 567mn debt amidst China's slowing housing market as the value of home sales nationwide has fallen 5% in the first two months of the year. (Bloomberg)

China doubles CNY trading band, seen as sign of confidence

Mar 15. China's central bank announced over the weekend that it will expand the trading band for the CNY, doubling it from 1% to 2% in an attempt to allow market forces to play a bigger role in the economy and its markets. The last widening was in April 2012, when the band was doubled to 1%. Analysts saw the latest move as a sign of confidence that the central bank had successfully fended off market speculators, and that the economy is stable enough to handle future financial market reforms. (Reuters)

Europe fails to bridge divide on banks reform (Reuters)

Europe's coco bonds risk turning into coco pops (FT)

New Zealand hike rates as post-quake recovery kicks in (AFP News)

US SEC proposes new rules to safeguard clearing agencies (Reuters)

Thailand reduces key rate as political unrest hurts economy (Bloomberg)

Regulatory Updates

US banks USD 75bn payout at stake in stress tests

Mar 12. US lenders will know if they will be able to pay out more than USD 75bn in excess capital to investors when the Federal Reserve releases the results of its annual stress tests on March 20 and March 26. The tests are designed to prevent a repeat of the 2008 financial crisis, as firms will be required to show that they can handle a plunge in the value of risky loans or another housing bust. Although market analysts expect the bigger institutions to pass, there is concern that smaller US banks taking the test for the first time may fail the assessment. (Bloomberg)

ECB to take a tough stance in bank health check, forces Italian banks to face up to reality

Mar 12. The European Central Bank released guidelines for its asset quality review (AQR), communicating the methodology by which 128 leading European banks would be assessed. The asset quality review will be followed by stress tests that are unprecedented in scope, combining backward and forward looking stress scenarios. With previous tests relying on locally approved data, this will be the first time Eurozone banks are measured against common thresholds.

Italian banks meanwhile have announced large write-downs ahead of the industry-wide health checks by the European Central Bank. Unicredit, Italy's largest bank by assets, announced a EUR 13.7bn write-down, with several other banks following suit. With the ECB's health check forcing banks to come clean or risk being shut down, Italian lenders have been forced to address EUR 160bn of accumulating bad loans. 7 out of 15 Italian banks have already set aside EUR 8bn of additional capital to restore their financial strength ahead of the review. (ECB, Reuters)

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