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Weekly Credit Brief **Mar 19- Mar 25 2019**

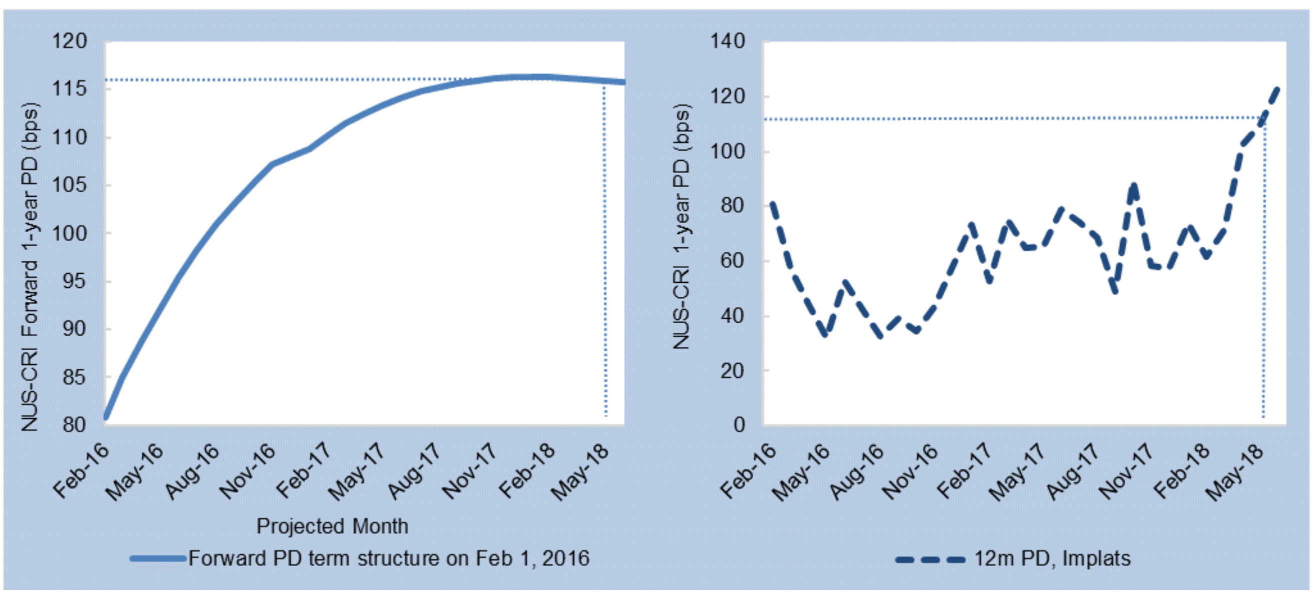
World's third largest palladium miner turns around as prices soar to record high

By Dexter Tan

Bond prices of Impala Platinum Holdings Limited (Implats) 3.25% 6/7/2022 note are soaring on the back of record high palladium prices. Palladium – a precious metal similar to gold and platinum has gained nearly 28 percent so far this year to a record high, outpacing the 7 percent climb in the Bloomberg Commodity Index, which is a broader measure of commodity prices.

Impala Platinum Holdings, a listed miner on the Johannesburg Stock Exchange operates 20 underground mines in two of the world's most significant palladium ore deposits - the Bushveld Complex in South Africa and the Great Dyke in Zimbabwe. The firm is the world's third largest supplier of palladium, having produced over 485 thousand ounces of palladium during the second half of 2018. Last year, the mining giant achieved nearly USD 3.1bn in revenue and its market cap topped USD 3.4bn recently.

When palladium prices plunged to a five year low during the first two months of 2016, the term structure of the NUS-CRI Forward 1-year Probability of Default (Forward PD) on Feb 1, 2016 indicated that Implats' default risk profile would continue rising to 116bps by May 2018 (see Fig 1a). The Forward PD computes the credit risk of a firm on a future period, which works like a forward interest rate. For instance, the 7th month Forward 1-year PD is the probability that the firm defaults during the period from month 7 onwards to 1-year plus 7 months, conditional on the firm surviving the next 7 months.



Figures 1a and 1b: Term structure of Forward 1-year PD for Implats on Feb 1, 2016 and 12-month PD. *Source: NUS-CRI*

Implats' 1-year PD declined initially but eventually climbed to 116bps in May 2018 (Fig 1b), which showed that the trend of Implats' credit risk was successfully forecasted by the Forward PD term structure on Feb 1, 2016. Implats' default profile continued rising in June 2018 and soared to more than 250bps in September last year (Fig 2). Compared with other miners, Implats' 1-year default probability was significantly higher than the industry's aggregate 1-year PD, which is a median of PDs for 12 companies. The rise in PD coincided with the increase in liabilities as the miner took on a USD 285mn credit facility in 1H18 to finance a retrenchment exercise and to develop the Impala Rustenburg underground mine.

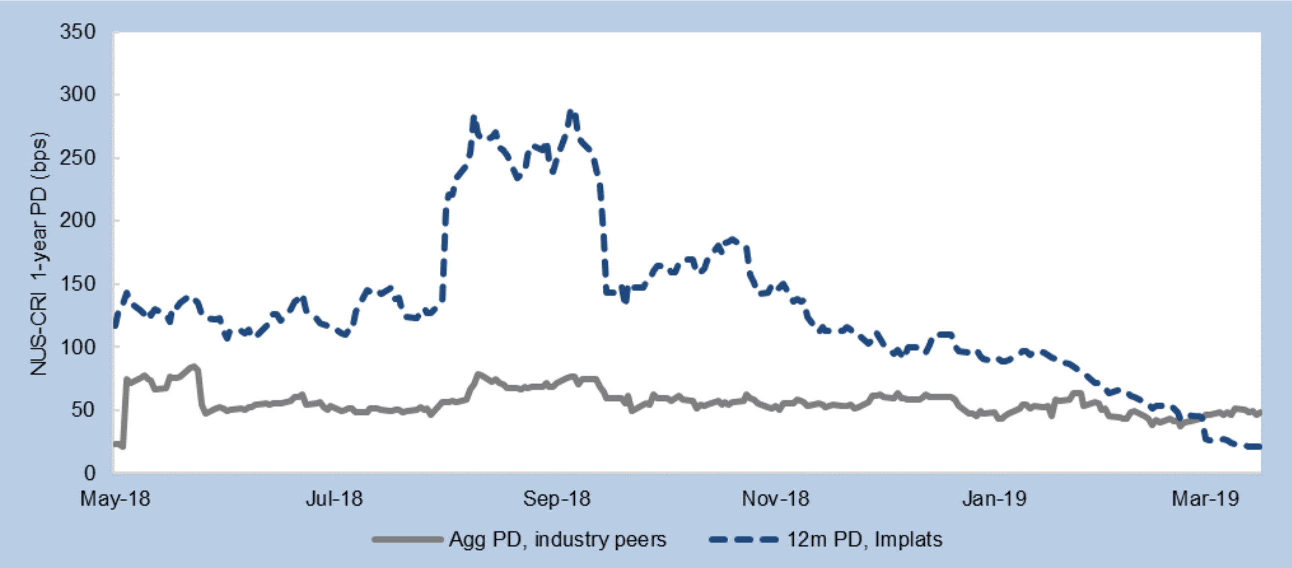


Figure 2: NUS-CRI 1-year PD for Implats vs industry peers. *Source: NUS-CRI*

But high palladium prices, cost cutting measures and the company's asset sales soon after led to a significant improvement in Implats' credit profile. Retained cash flow as a percentage of total debt increased from 3.7 percent to 88.5 percent in December. The company's cash flow exceeded USD 541mn with positive contributions from all of the company's operating segments, lifting its cash balance from USD 269mn in June 2018 to USD 442mn at the end of December. Operating income increased considerably from USD 39mn in 2017 to USD 259mn last year. The upgrade in credit performance over the recent six months is also reflected in Implats' 1-year PD as it declined below the industry median in March this year.

Twelve months ending	6/30/2017	12/31/2017	6/30/2018	12/31/2018
Operating income (USD mn)	-29.6	39.3	61.1	259.8
Retained cash flow (USD mn)	98.1	21.9	28.3	542
Debt / enterprise value (%)	30.4	29.1	43.3	27.6
Retained cash flow / debt (%)	13.5	3.0	3.7	88.5

Table 1: Debt coverage and leverage ratios for Implats *Source: Bloomberg*

With higher projected demand and a lower supply of palladium, Implats' credit fundamentals could continue to improve. Palladium is used to manufacture catalytic converters and tighter auto-emission rules in China and India are creating demand for the converters. On the supply side, Russia recently considered restricting or banning entirely, the export of palladium as US authorities ordered Fiat Chrysler Automobiles to recall 965,000 vehicles after failed emission tests. Estimates say that the required palladium to bring the recalled vehicles could require as much as 100,000 ounces of the precious metal. Implats expects palladium demand to continue and is building a new mine in South Africa that will come online in 2024.

Credit News

Singapore law firm sees more Southeast Asia credit strains

Mar 25. Rajah & Tann, a law firm which deals with dispute resolution, has seen increasing demand from clients to review security and loan documents and advise on enforcement options. The law firm is expecting to see more distress and restructuring events in the near future and have found that private equity firms, which have been a major capital provider after the global financial crisis, are more risk averse in providing capital. Southeast Asian companies is expecting to repay USD 17.9bn worth of bonds and rises to USD 23.2bn in 2023. The slowing economic growth in China may hamper companies' cash flows and the law firm expects to see more distress events in the weakening construction and shipping sector. (Bloomberg)

Corporate bond funds boosted before Fed's dovish shift

Mar 22. Investors channelled funds into corporate bond funds in the build-up to the Federal Reserve's dovish shift, when the central bank shelved plans to raise interest rates for the rest of the year and announced its intention to halt its balance sheet shrinkage by September. US investment-grade corporate bond funds took in USD 695mn for the week ended March 20 and high-yield bond funds saw USD 240mn of inflows — the fourth straight week of investors adding cash to the market. Investors are increasing bets on corporate bond markets and investment-grade bonds are on track for the best one-week performance since May 2018. But there are also concerns over the health of the US economy, which could eventually weigh on riskier corners of the corporate bond market. (FT)

Neither billionaires nor poor can escape India shadow lender woe

Mar 22. After a series of loan defaults by IL&FS in late 2018, a major Indian Non-Banking Financial Company (NBFC), and debt concerns at Essel Group and mortgage lender Dewan Housing Finance Corp have increased funding costs for Indian shadow banking institutions to multi-year high levels. As a result, the growth of NBFC lending is expected to halve in the second half of 2019. With NBFC occupying an estimated market share of 50% of overall Indian borrowing, this may translate into higher financing cost for many businesses and individuals in the midst of a slowing economic activity. (Bloomberg)

Direct lenders ready to step in where Brexit makes banks retreat

Mar 21. As uncertainties around the exit of the United Kingdom from the EU persist, regular bank lending activities have sunken to reduced levels around the country. Sensing opportunity, private credit funds are directly lending at an increased rate, offering potential creditors a source of capital in lieu of traditional bank credit offers. Direct lending has historically been popular in the United Kingdom, accounting for 38% of all direct lending transactions in Europe from the end of 2012 to Q2 2018, making the country the biggest contributor, according to a report from Deloitte LLP. (Bloomberg)

Borrowers cash in as UK banks seek triple-A bonds as Brexit insurance

Mar 20. Demand for top-rated sterling bonds shot up this year as regulators began to impose stringent new safeguards to prevent any crises in the event of Brexit. One of the drivers for this demand was the requirement for lenders to hold enough high-quality liquid asset (HQLA) to withstand a 100-day market stress scenario instead of the previously stipulated 30-day scenario. Top-rated public firms have sold GBP 11.1bn of sterling bonds this year, versus GBP 7.2bn in the same period last year and over half of the total GBP 21.6bn raised in the whole 2018. The triple-A sterling boom has benefited both investors and issuers, with borrowers being able to raise debt more cheaply than last year. For instance, the German bank KfW was able to raise GBP 250mn 4-year cash at a yield of 1.167% versus the 1.496% it paid to raise GBP 200mn cash with the same maturity year last October. (Reuters)

Europe's bond markets left with lowest number of primary dealers since crisis (Reuters)

SIA to offer SGD 500mn 5-year fixed rate bonds to institutional, retail investors (Straits Times)

Loans get cheaper for some (WSJ)

Regulatory Updates

Fed sees no further rate rises in 2019

Mar 21. The Federal Reserve (Fed) has signaled that it will refrain from raising interest rates for the rest of the year amid waning economic momentum in the US and overseas by keeping the target range for the Federal Funds rate unchanged between 2.25% and 2.5%. In response, the US dollar fell and the yield on the benchmark 10-year US Treasury dropped 8bps to just under 2.53%, the lowest level since January 2018. Most economic data in recent weeks supported the Fed's move towards a more dovish approach to interest rates increases as inflation data have been relatively soft and the latest readings on job creation and industrial production have been weak. Although the median projection of US monetary policymakers suggested there would be one interest rate increase in 2020, markets were increasingly predicting that the Fed might be forced to cut interest rates this year. (FT)

China banks face huge capital hole as stimulus spurs lending

Mar 20. Chinese listed banks are facing capital hole as regulations force shadow-bank loans back on to balance sheets and global rules on systemically important groups impose extra requirements on the largest lenders. In response, the PBOC encourages commercial banks to issue perpetuals to meet capital needs and BoC became the first Chinese bank to issue a perpetual bond, which qualifies as additional tier one capital under the Basel rules. However, additional tier one and tier two capital represent less than a tenth of Chinese banks' overall capital needs and listed banks will need to raise about CNY 1.74tn in regulatory capital over the next 3 years based on analysts' estimation. (FT)

India RBI officials meet bankers, seek feedback on new liquidity tool (Reuters)

Banks progress on adhering to stricter international rules (FT)

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