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PPC Ltd to put the tough times behind

by Samuel Chee

“We had to steady the ship and make it sustainable” were the words of Johan Claassen, Chief Executive Officer (CEO) of PPC Ltd, who would be glad that the company is stable at last. While PPC Ltd manages to achieve a certain degree of stability today, the journey towards “steadying the ship” was anything but smooth sailing for South Africa’s leading cement producer. The past 2 years turned out to be a trying period for PPC, during which the company appeared to be unable to sustain its growth, evident from the fall in headline earnings, impairments made to investments and emergence of liquidity issues. Debts that were taken on became too much to handle for PPC, leading to a substantial drop in creditworthiness in the years 2016 and 2017.

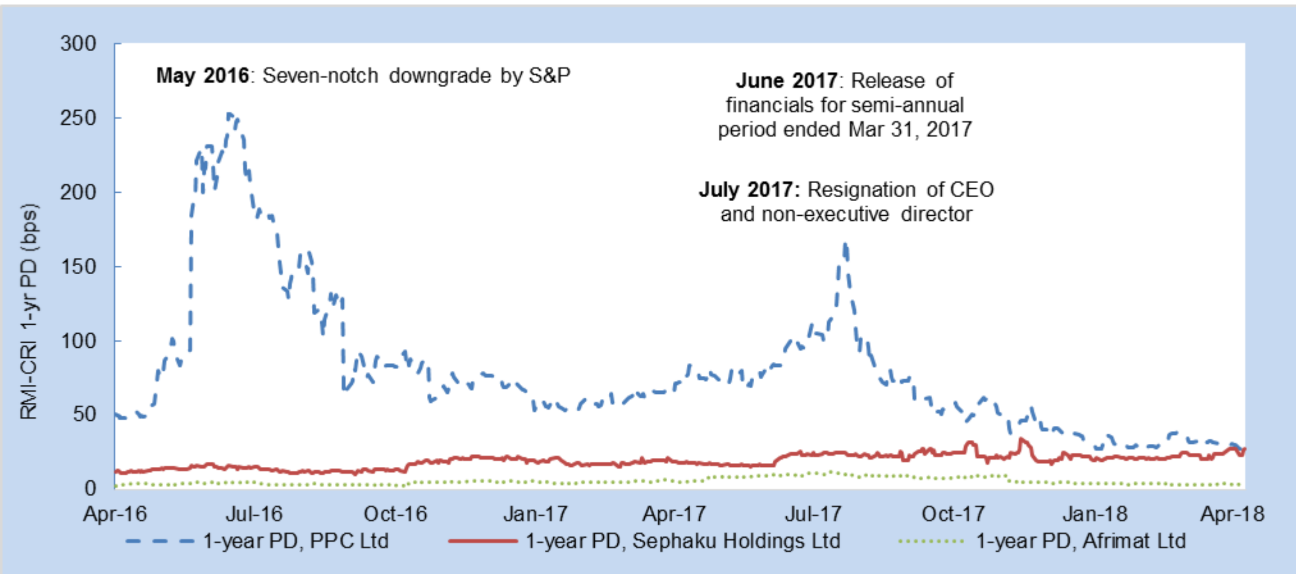

Figure 1: RMI-CRI 1-year PD for PPC Ltd and selected sector peers. *Source: RMI-CRI*

Throughout this tumultuous two-year period, PPC was burdened by its debt levels and needed to shave off excess debt to de-leverage its balance sheet. PPC tried lowering debt levels in a bid to improve the company’s ability to service its debt obligations. By referring to PPC’s RMI-CRI 1-year Probability of Default (PD) for the period (see Figure 1), we can look at the credit-related events and their impacts on PPC’s creditworthiness. Graphically, the data also allows for comparisons with PPC’s sector peers which are less leveraged in terms of capital structure (see Figure 2) and have relatively more stable income. We can see from Figure 1 that they had lower levels of PD during the time period observed.

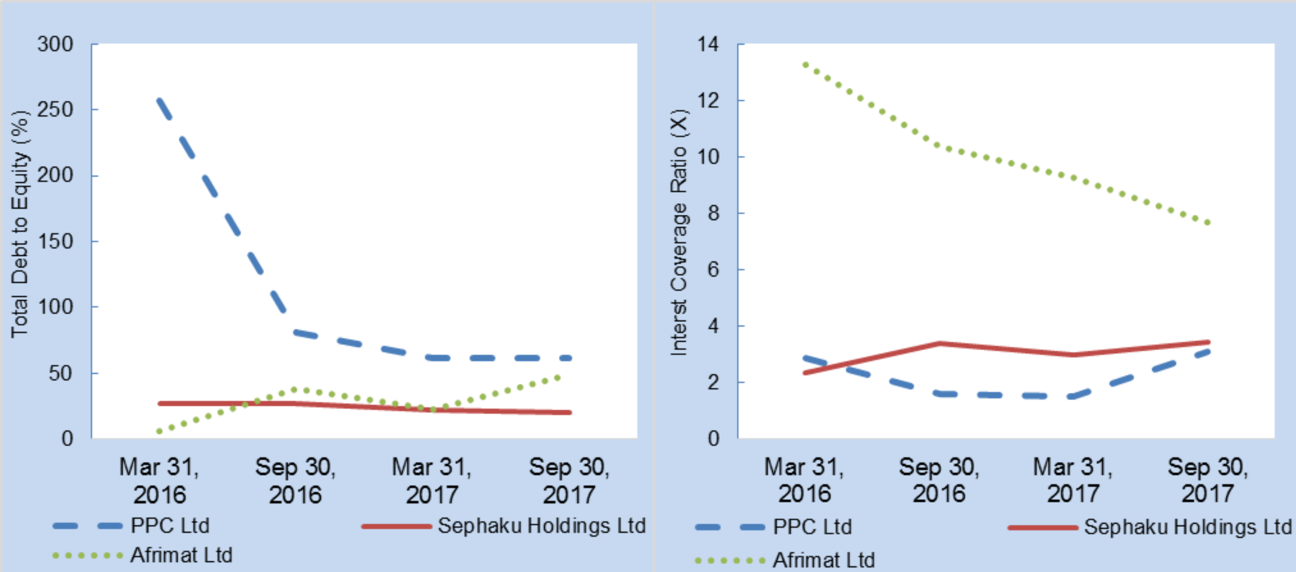

Figure 2: Data graphs for PPC Ltd and sector peers. *Source: Bloomberg*

In May 2016, PPC was struck by a massive downgrade by S&P Global Ratings. Following huge debt accumulation and weakening operating margins, its corporate credit rating suffered a seven-notch drop from A to BB-. As a result, a clause was triggered which mandated an early redemption of its bonds, burdening the company with an overnight liquidity requirement of ZAR 1.75bn. This posed a huge problem considering that PPC only had ZAR 460mn of cash and cash equivalents on hand as of March 31, 2016. Its credit profile was hit so massively that the external auditor Deloitte even issued a disclaimer on the company's ability to carry on as a going concern. Correspondingly, PPC's PD spiked, reaching a high of 254bps on July 8, 2016. As PPC searched for a solution for its liquidity issue, the company decided to raise funds from the equity market via a rights issue. Fortunately for PPC, shareholders responded well and PPC managed to raise around ZAR 4bn from its equity holders. The proceeds were then used to pay for the immediate bond redemption, with the remainder utilized to cut its debt liability.

After crossing the massive hurdle caused by its credit rating downgrade, it was clear that PPC needed to start decreasing its debt levels further – a process which ultimately involved leaning its operations. This process proved to be challenging especially when it came to maintaining a sustainable credit position. In particular, PPC was hit with an adjusted net income loss position for the semi-annual period ending March 31, 2017. From a credit standpoint, its interest coverage ratio saw massive deterioration, hitting an all-time low of 1.49 for a semi-annual period (see Table 1). The financial results, released in June 2017, highlighted the impact of suppressed cement prices and increased cost of sales on its profit earnings. Shortly after, in July 2017, PPC saw the resignation of then-CEO Darryll Castle and non-executive director Tito Mboweni. In the light of PPC's weak financial results, coupled with the shuffles at the top management, PPC's PD made a sharp climb once again, showing signs of a weakening credit profile.

Semi-annual period ending	Mar 31, 2016	Sep 30, 2016	Mar 31, 2017	Sep 30, 2017
Adjusted Net Income (mn ZAR)	297.7	109.0	-9.0	297.0
Cash from Operating Activities (mn ZAR)	4,557	2,465	1,584	2,267
Interest Coverage Ratio (X)	2.85	1.59	1.49	3.09

Table 1: Financial Data for PPC Ltd. *Source: Bloomberg*

As we look back from present day, PPC's most recent financials seem to signal that the worst is over for the company. While PPC seeks to improve its credit ratios, it is working towards the aim of restoring investment grade levels as per rating agencies. Much to PPC's luck, the wind is in its sails as the industry outlook changes for the better. Demand for build infrastructure is set to see a boost which would positively affect the derived demand for cement and other construction elements. Specifically, Johan Claassen pointed out newly elected President of South Africa, Cyril Ramaphosa's pledge to boost the economy and initiate new infrastructure projects as an upside for PPC. President Ramaphosa's intent can already be observed from the signing of around ZAR 56bn worth of renewable power projects. Johan Claassen is upbeat on benefits PPC can expect to reap from similar contracts in the future.

In terms of its debt situation, PPC has announced the success in negotiating a postponement for close to ZAR 1.6bn worth of debts, which originally had their maturities set in June 2018. PPC managed to gain its creditors' confidence and created substantial financial headroom for itself. As of current day, PPC is looking to ride the uptrend of the African industrial environment, so much so that Johan Claassen labels Addis Ababa, the Ethiopian capital, a "construction site". Therefore, it is no surprise that PPC had recently opened a new branch in Ethiopia in April 2018. Not forgetting the credit-related issue PPC faced when pursuing growth in the not-too-distant past, Johan Claassen reinforced his intention to keep debt levels sustainable which was detailed in PPC's FOH optimization strategy (an abbreviation of financial, operations and human capital). The financial aspect of the FOH strategy is aimed at achieving an optimized capital structure, improved liquidity as well as to instill financial discipline when dealing with the group finances. The company hopes to achieve them within the next 12 to 16 months. Given the positive outlook of the industry and a clear strategy moving forward, one would not bet against PPC cementing its position as the market leader in South Africa in the near future.

Credit News

Top Greek banks would lose EUR 15.5bn of capital in stress scenario: ECB

May 5. The latest stress test results from the ECB showed that no new funding plans were needed for Greece's largest banks. ECB projections revealed that lenders could take a EUR 15.5bn hit to their average capital in a future economic downturn scenario. The annual check of the Greek banking system was to determine if banks needed extra capital before negotiating with creditors to exit the bailout program. Greek banks have been recapitalized three times since 2010 and officials have agreed to reduce the level of bad debt from its current level of EUR 96bn to EUR 65bn by 2019. (Reuters)

British banking leverage remains 'dangerously high'

May 3. After British regulators failed to impose a higher capital requirement on lenders, British banking system's leverage position remains at an alarming level with the leverage ratio doubled since 2007. John Vickers, the Chairman of Independent Commission Banking, has criticized the regulators for being too soft to banks, concerning that their capital levels were only doubled since the financial crisis. He also mentioned that the regulators were too reliant on the resolution plans that allows banks' bondholders to be wiped out and the banks to avoid taxpayer bailout during crisis. His critics underline the concerns on whether the banking system is safe a decade after the Lehman Brothers crisis. (FT)

S&P cuts Turkey's debt rating on deteriorating finances, inflation

May 2. Rating agency S&P downgraded Turkey's foreign debt on May 1 due to deteriorating finance outlook and rising inflation. The rating for the country's foreign debt dropped to BB- and B for long-term and short-term issues respectively, both with a stable outlook. The downgrade undermines the risk of Turkey's overheating credit-fueled economy. It is shown by the worsening current account, fiscal deficits, as well as higher inflation that leads to an increase in short-term debt. Furthermore, the weakening dollar position of lira adds a significant risk to the country's financial stability, with signs of distress in the private sector are starting to show and capital outflows are accelerated. (Business Times)

US groups warned of credit hit from US-China trade war

May 2. The US has threatened to impose tariffs on almost USD 150bn of Chinese imports while China has also levied higher taxes for US exports. S&P Global Market Intelligence warned that US companies, especially US-listed industrial, energy and financial groups, would see a greater impact on its credit profiles as the US engages China in a trade war. After a week following Trump's tariff move, 65% of US publicly traded companies saw an increase in their probability of default over the next year and about 58% of Chinese stocks saw the same risk of default increase. Analysts and economists are expecting that the trade war may have unintended damaging consequences and disruptions to international supply chains. (FT)

Rise in bad loans impairs monetary policy transmission: RBI

May 2. According to a RBI research paper, rising bad loans in the banking system could impair the effectiveness of monetary policy as banks would charge higher interest rates for possible loan losses. Lenders may become risk adverse and reduce lending if the amount of bad loans continues to increase. The banks' net interest margins are an indicator of monetary policy effectiveness. Banks with high non-performing loans will increase the risk premium on existing loans, which raises interest rates and net interest margins. (Livemint)

Higher default risk flagged as US car loan terms lengthen (FT)

Islamic banks' asset quality remains weaker (Gulf News)

Fitch downgrades Commonwealth Bank's long-term debt default outlook (Reuters)

Regulatory Updates

Libor refuses to die, setting up USD 370tn benchmark battle

May 7. Despite being tainted with numerous scandal that questioned its credibility, LIBOR is still showing a strong position as the premier global for the dollar-based asset. The strong position of the benchmark with more than USD 370tn of financial assets in five currencies tied to it and the recent scandal of its strongest competitor, SOFR, has retained market's trust on LIBOR. In 2014, the Federal Reserve set up an Alternative Reference Rates Committee to identify LIBOR replacement due to mounting concerns on the benchmark reliability and robustness. The result shows that SOFR is the best candidate as it is less vulnerable to exploitation and based on repurchase agreement. However, SOFR has just recently faced mounting scrutiny after the erroneous inclusion of some transactions in its debut last month. (Bloomberg)

Regulators express concern over CCP lag on risk management and recovery planning

May 3. The Committee on Payments and Market Infrastructures said that central counterparties (CCP) have made limited progress in meeting regulatory requirements to ensure that payment, clearing and settlement systems are able to withstand financial shocks and maintain their support of global markets. For example, CCPs did not conduct a sufficiently wide range of liquidity stress test scenarios as they were largely confined to settlement banks, custodians and liquidity providers. Many CCPs also did not implement internal rules to address uncovered liquidity shortfalls or credit losses. (IOSCO)

Central bank steers painful reforms (Frontier Myanmar)

Argentina pushes interest rates to 40% to defend the peso (The Guardian)

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