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Weekly Credit Brief September 16 - September 22

CRAs punish debt laden Chinese companies with downgrades

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As increasing debt obligations accrued over the past years, more Chinese companies have their credit ratings slashed by major Credit Rating Agencies this year than in 2013. For example, S&P downgraded 16 Chinese non-financial firms, up from 12 a year earlier. These unprecedented downgrades hit China's companies even deeper, because in an economy not as vibrant as before was dragged by the latest industrial output in August. Thus, Chinese companies are now finding it hard to rebalance the debts and to maintain a stable cash flow.

CRA	Companies	From	To	Remarks
S&P	Guangzhou R&F Properties	BB	BB-	16 Chinese non-financial firms, up from 12 a year earlier, are downgraded
	China Shanshui Cement	BB-	B+	
	Zoomlion Heavy	BB+	BB	
Moody	China Oriental	B1	B2	
Fitch	Anton Oilfield Services Group	BB(Stable)	BB(Negative)	non-financial companies including Hengdeli Holdings are downgraded
	Zoomlion Heavy	BBB-	BB+	

Table 1: Overview of the Chinese companies whose credit ratings or outlooks are downgraded by CRAs in 2014. (Trading of its shares were suspended) Source: *Reuters*

China's economic growth momentum has yet to pick up but its credit is turning more expensive in the third quarter. The China Beige Book report shows that borrowers are increasingly shifting to shadow banks despite the higher rates. The mean interest rate this quarter across all borrowers rose to 7.54 percent, with 31 per cent of the loans coming from non-bank lenders according to the findings.

Figure 1: RMI 1-year aggregate PD for six Chinese firms downgraded in 2014 (China Oriental has been suspended since May 2014). Source: *Risk Management Institute*

Figure 1 tracks the 1-year RMI PDs for 6 Chinese firms, including property developer Guangzhou R&F Properties, construction raw materials supplier China Shanshui Cement, steel producer China Oriental, energy provider Anton Oilfield Services Group, Hengdeli Holdings and construction machinery manufacturer Zoomlion Heavy, which suffered downgrades in September. Companies, which have their credit ratings downgraded, are spread across various industries including steel, metals, chemicals sectors and real estate developers. In some cities, Chinese companies often find it difficult to raise cash as idling production capacity failed to optimize their revenue growth. Therefore, there exists a systemic risk among companies in China's selected industries like the property related sectors, where a lackluster real estate market brings along negativity to a chain of industries that are related to the property market.

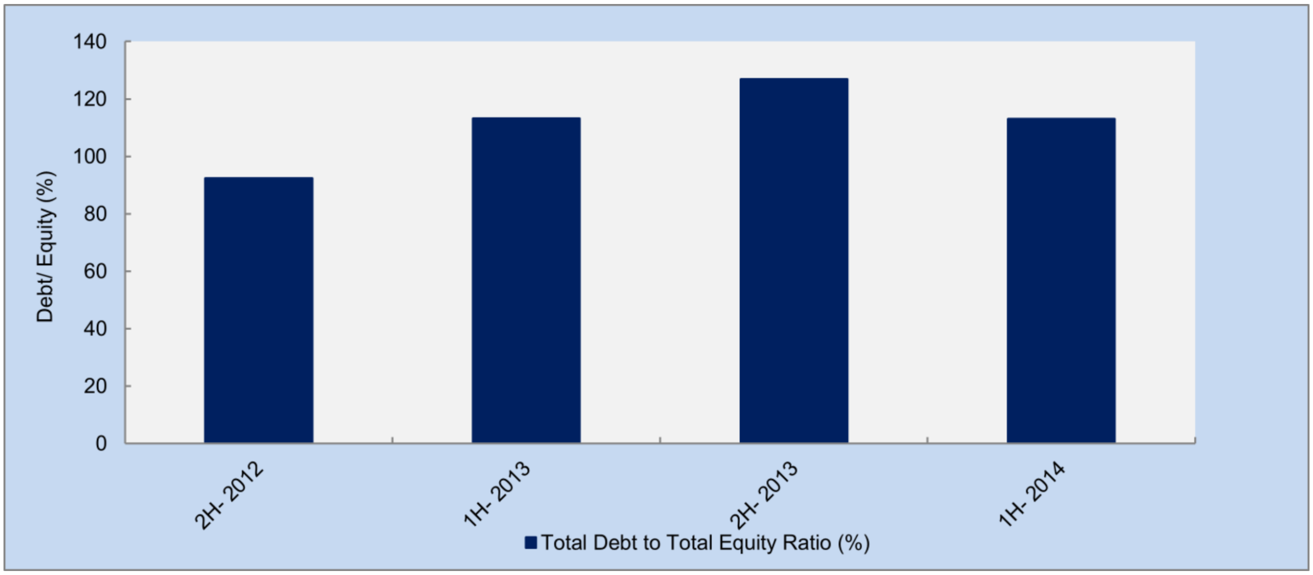

Figure 2: Aggregated total Debt to total Equity Ratio of Guangzhou R&F Properties, China Shanshui Cement, China Oriental and Anton Oilfield Services Gro, Hengdeli Holdings, and Zoomlion Heavy. Source: *Bloomberg (semiannual data)*

The rising RMI 1-year PDs could be due to the ever growing Debt to Equity ratio. Figure 2, which captures the aggregated total Debt to total Equity Ratio of the 4 downgraded companies, shows that the total debts have been exceeding total equity since 2012. Although the ratio declined in the first half of FY 2014, the PDs just stabilized and fluctuated slightly, as a result of various factors including the insignificant drop of Debt to Equity ratio.

Companies that got its outlook downgraded also saw their PDs suffer. Take Anton Oilfield Services Group for example, earlier this month, Fitch cut its outlook on oil and gas field services provider Anton Oilfield to negative from stable, because of the squeeze on its margins from competition, reduced capital spending by customers in China and a longer working capital cycle that was hurting its cash flow. As a result, its 1-year RMI PD climbed from about 10 bps to over 40 bps.

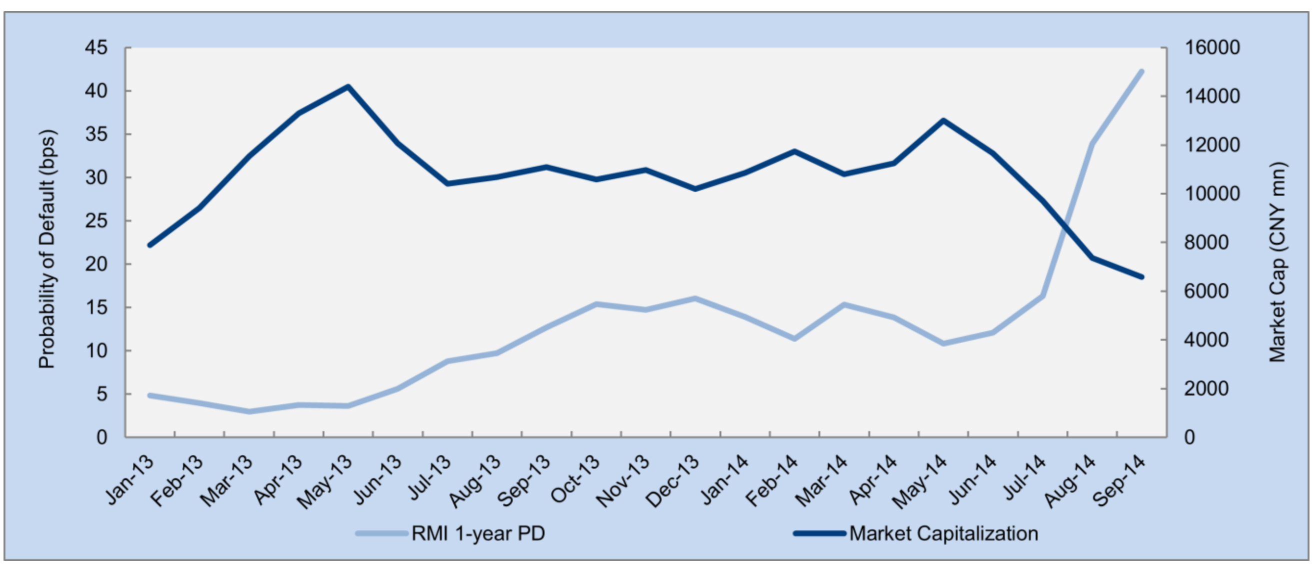

Figure 3: Anton's RMI 1-year Probability of Default vs Current Market Cap. Source: *Risk Management Institute, Bloomberg*

Figure 3, the1-year RMI PD of Anton Oilfield Services Group has experienced a significant climb in its PD since July 2014, accompanied by a declining trend of Market Cap. This could be the result of its debt fuelling expansion over the past years. Anton's condition is further aggravated by the signs of slowing down in the Chinese economy. In the event of any severe economic downturn, the companies like Anton could still meet their financial obligations but could instead be troubled by additional interest premium imposed by lenders, which would result in a company burning more cash. Alternatively, these debt laden companies may seek to liquidate some of their assets to buy time. But, such move may not be welcome by investors as an increasing debt-to-equity ratio may force investors to exit their investments in such companies. Based on an assumption that such troubled companies do not have any improvement in growth prospective, any reduction on market capitalization of the company may exert pressure on its credit profiles.

Credit News

Bosses and cash vanish at Ultrasonic

Sep 16. The chief executive and chief operating officer of Ultrasonic disappeared with most of the firm's cash. Ultrasonic is a Chinese footwear firm listed in Germany, and its shares fell 79% and shrank EUR 57mn market value right after the managers' disappearance was announced. However, Ultrasonic had seen its revenues grown nearly 10% to EUR 163.8mn (GBP 130.7mn) over the last five years and its net income risen nearly 14% to EUR 35mn. The incident has made Ultrasonic in an effort to clarify matters immediately. (BBC)

Russian Billionaire's Arrest Causes His Company's Stock to Plunge

Sep 17. The arrest of billionaire Vkadunur Yevtushenkov amid a money-laundering probe has led to the plunge of his company's stock, since investors thought it would be a replay of Yukos. On Wednesday, his holding company, Sistema, has witnessed a share price fall of 36%. Likely, the shares of Bashneft, the company's oil unit, also fell by 21%. The arrest shows that Russia still face stress caused by the Europe and US sanctions due to its intervention in Ukraine. (Forbes)

Fed will end QE next month, 'considerable time' remains

Sep 18. The US central bank proposed that it would cut the bond-buying program down to USD 15bn a month and would end the QE in October. Meanwhile, the Fed's Open Market Committee did not remove language that said interest rates would rise "a considerable time" after the buying program ended, which aroused market fears about whether a rate hike would come 6 months later. However, Yellen highlighted that any future decisions about interest rate would depend on committee's assessment of the economy instead of a specific calendar target. In order to cut down the monetary accommodation, the Fed will change the rate on excess reserve balances and will use overnight repo on its USD 4.5tn portfolio. (CNBC)

Singapore banks likely safe from housing slowdown

Sep 19. Anti-speculation measures and positive economic factors should help the Singapore banks to shrug off mortgage weakness in Singapore. Anti-speculation measure, imposed in late 2009, helped to curb demand in property market by imposition of a 50% loan-to-value ratio on second housing loans for individual and a 40% one for their third and subsequent home loans. This measure shields the banks from sharp slowdown in housing market. Besides, an expected modest 3% growth in Singapore's economy could keep employment high and also support the local banks to stave off the runaway non-performing loans scenario. (Asiaone)

Sears needs USD 4bn to survive till 2016 (Bloomberg)

Caesars said to engage more lenders in debt restructuring (Bloomberg)

Regulatory Updates

Singapore op risk charge 16 times greater than Solvency II

Sep 16. Monetary Authority of Singapore (MAS) proposed a charge on risk-based capital (RBC) at 4% of gross premiums or liabilities, whichever is bigger, 16 times higher than that under the European Union's Solvency II regime. Given the size of liabilities, life insurers' overall capital risk charges are thus significantly increased. Though also a feature of the Indonesian RBC regime, operational risk charges to them are much lower than proposals by the MAS. This increase may result in a much bigger focus on operational risk among local players, but the approach is not wholly logical, because how much the charge will be depends on various matters. (Risk.net) (Subscription required)

US lawmakers press FSOC for more transparency

Sep 17. The Government Accountability Office (GAO) faulted the Financial Stability Oversight Council (FSOC) for failing to enact reforms in terms of transparency and accountability in testimony to Congress. The FSOC has come under criticism of making designation decisions without doing enough research or outreach to the companies in its sights. And the rules will apply to the designated firms, GE Capital, AIG, Prudential Life, and recent MetLife, have not written by the regulators just leave the companies in limbo. FSOC plans to update tis transparency policy to give the public more insight and considers additional reforms to its designation process in the coming months. (Reuters)

SEC announces creation of new risk office

Sep 18. The US Securities and Exchange Commission (SEC) has announced the formation of a new office within the Division of Economic and Risk Analysis (DERA) which is mandated to use data-driven tools to aid in risk analysis for the US regulator. The office of risk assessment which will build on the existing expertise of DERA reflects SEC's ongoing focus on deploying data-driven analytics to assist in routing scarce resources to areas of the greatest risks to the market. (Risk.net) (Subscription required)

EU bank stress tests: Who will pass and who will fail?

Sep 22. European Banking Authority (EBA) is going to implement stress tests on the banks across the continent in November, ahead of European Central Bank (ECB) taking over regulation of the financial sector for the first time as part of the Single Supervisory Mechanism. Since the stress tests could to be the toughest the EBA has imposed to date, there is a real chance that some banks will fail to meet the standards. What ECB does after is perhaps more significant, and the firms can expect tougher requirements in the further rounds of this three-year stress test exercise. (International Business Times)

ISDA announces updated implementation date for 2014 ISDA Credit Derivatives Definitions (ISDA)

Largest EU banks could pay lion's share of new bank levies (Bloomberg)

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