Credit Research Initiative
Risk Management Institute, National University of Singapore
transforming big data into smart data
Weekly Credit Brief
Mar 28 - Apr 03

Copper rally eases Freeport-McMoRan Inc.'s margin pressure

By Ernest Sim

Since early November 2016, prices of copper had surged before maintaining at elevated price levels. The London Metals Exchange (LME) spot price of copper stood at USD 4768 per tonne in Aug 2016 and currently hovers above USD 5500 per tonne (See left panel of Figure 1). While the latter half of 2015 saw sinking copper prices attributed to concerns of China's waning growth, the copper price rally in late 2016 came on the back of signs of a steadying China economy and was boosted by expectations of large infrastructure spending following the election of US President Trump. Correspondingly, the RMI-CRI aggregate 1-year Probability of Default (PD), a simple median for 74 copper producers, had declined marginally over the past 7 months (See Figure 2).

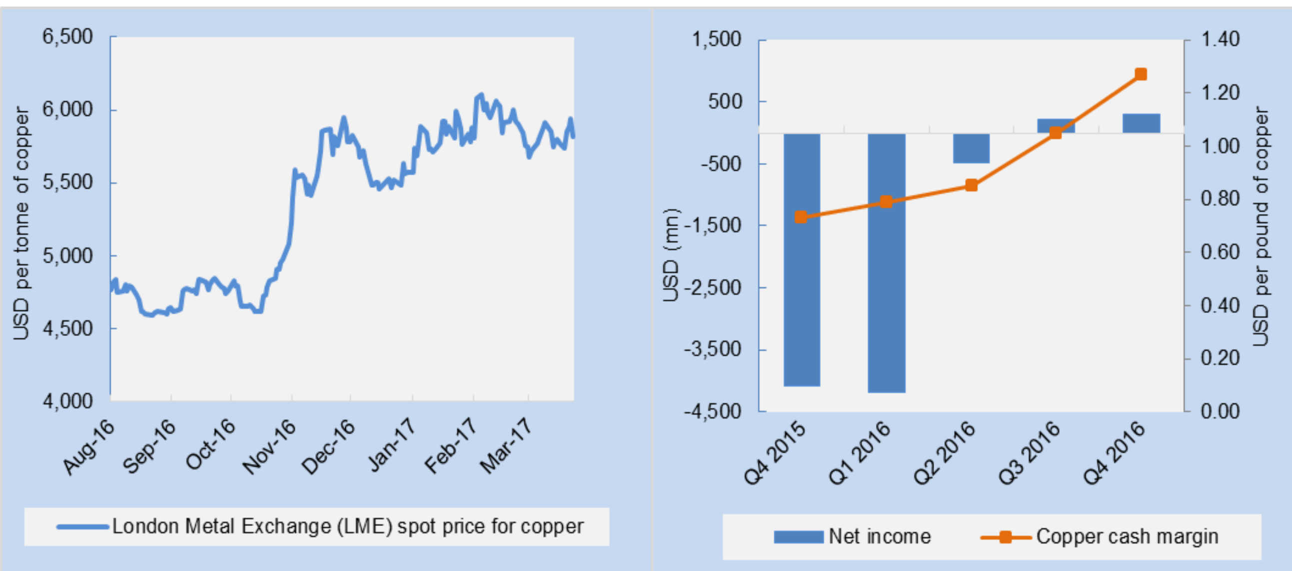

Figure 1: London Metal Exchange spot price for copper (left panel) and net income, copper cash margin of Freeport-McMoRan Inc. (right panel). *Source: Bloomberg*

Among copper firms, the RMI-CRI 1-year PD for US copper producer Freeport-McMoRan Inc. displayed a significant plunge across the period, converging towards the aggregate PD for copper producers. The PD for Freeport, the largest publicly listed copper producer globally, dived from a peak of 132bps on Oct 17, 2016 to under 40bps on Oct 22, 2016, indicating a pronounced improvement in its credit profile (See Figure 2).

Buoyed by a stronger copper pricing environment and coupled with aggressive cost reduction, such as job cuts which was undertaken by Freeport since the copper price slump, pressures on Freeport's margins seem to have alleviated. Copper cash margin, which is the unit profit on copper sales, had increased from 0.73 USD per pound in Q4 2015 to 1.27 USD per pound in Q4 2016 (See right panel of Figure 1). Consequently, Freeport has seen a turnaround in its earnings over the past two quarters, which had been in the red since Q4 2014, with net income rising from USD -4bn in Q4 2015 to USD 292mn in Q4 2016 (See right panel of Figure 1). Furthermore, the marked increase in EBITDA margin suggests an increase in operational efficiency for the copper mining giant on both a QoQ and YoY basis.

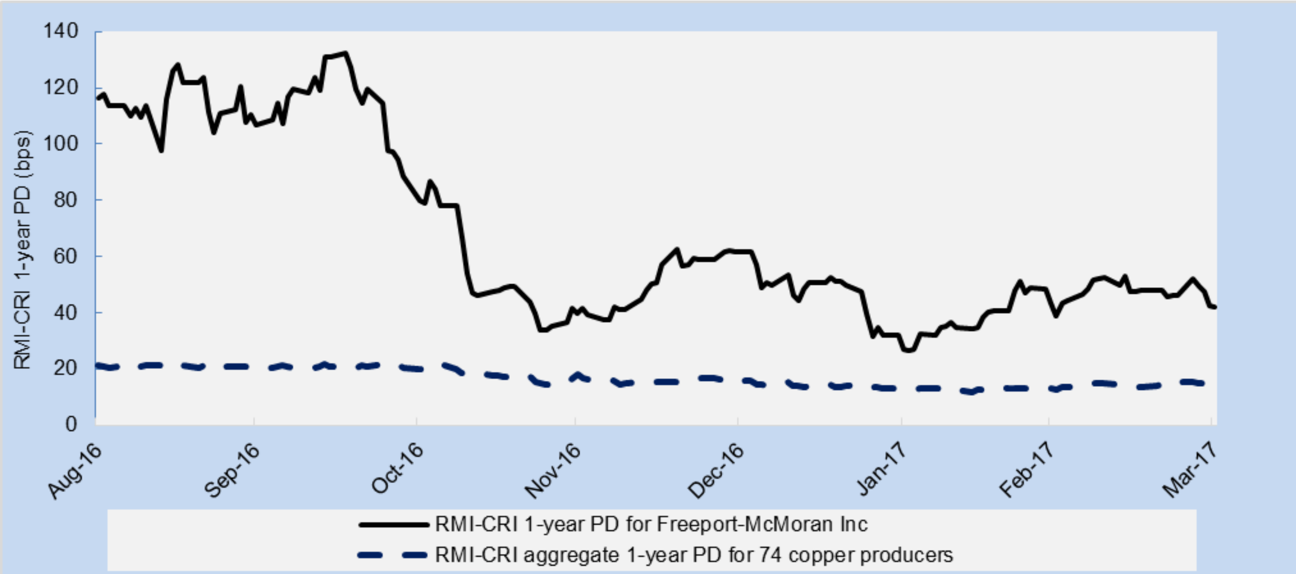

Figure 2: RMI-CRI 1-year PD for Freeport-McMoRan Inc. and aggregate PD for 74 copper producers. *Source: RMI-CRI*

Besides cost reduction, prior to the copper price rebound, Freeport had ramped up on measures to pare back on debt in light of the deterioration in its financial health. Freeport divested various assets in 2016, most notably in its oil assets as it faces questioning over its strategy of diversifying into oil and gas investments. Starting with the initial sale of a 13% interest in Morenci mine for USD 1bn, Freeport sold its interests in TF Holdings Limited for USD 2.65bn, its Deepwater Gulf of Mexico properties for USD 2bn and its onshore California oil & gas properties for USD 742mn.

With the sale of its assets and efforts to reduce cost, Freeport was able to raise cash and slash its net debt by over USD 8bn to USD 11.8bn. As such, Freeport's EBIT to interest expense ratio increased substantially from -22.89x in Q4 2015 to 3.88x in Q4 2016, indicating improving ability to repay interest expenses (See Table 1).In addition, current ratio had also risen from 1.73x in Q4 2015 to 2.45x in Q4 2016 (See Table 1).

	Q4 2015	Q1 2016	Q2 2016	Q3 2016	Q4 2016
EBIT to Interest Expense (X)	-22.89	-19.38	0.09	1.92	3.88
Current Ratio (X)	1.73	1.63	2.36	2.56	2.45

Table 1: Credit metrics and financials for Freeport-McMoran Inc. *Source: Bloomberg*

Despite broad improvements in Freeport's credit profile, Freeport's worries extend to its Indonesian operations. Following the issuance of new regulations by the Indonesian authorities in January 2017, PT Freeport Indonesia, Freeport's subsidiary operating the Indonesian Grasberg mine, is required to convert its pre-existing Contract of Work (COW) to a special operating license to resume exports of its copper concentrate along with other conditions. However, no agreement has been reached between the Indonesian government and PT Freeport Indonesia, halting exports of copper concentrate.

Given that Freeport's Indonesian Grasberg mine comprises 49.6% of Freeport's operating income as of Q4 2016, the company's ability to maintain its bottom line would depend on the outcome of its ongoing negotiations with the Indonesian government. While Indonesia's mining minister has stated that PT Freeport and the Indonesian government are close to an agreement that would allow PT Freeport to continue copper exports temporarily, analysts have been doubtful of the progress of a deal.

Credit News

Singapore eDevelopment's auditor draws attention to group's ability to continue as a going concern

Apr 3. The auditor for eDevelopment has flagged concerns over the company's ability to continue as a going concern. According to Ernst & Young LLP, eDevelopment is unlikely to meet its short term liabilities and may liquidate its assets at prices significantly lower than its book amount. eDevelopment may also reclassify long term liabilities as current liabilities, which would increase its debt obligations in the coming months. The firm is extending the maturity of its loans and issuing new shares to fund its business operations. eDevelopment's largest shareholder, Hengfai Business Development has pledged to provide financial support to keep the company afloat. (Business Times)

Australia home prices rise most in 7 years amid bubble concern

Apr 3. Average home prices in eight Australian capital cities and territory capitals surged 12.9% in March, the highest gain in almost seven years amidst an accelerating housing boom. The boom is being led by Sydney, where average house values grew 18.9% in the past 12 months, and 5% since the start of 2017. Concerns of a runaway price growth prompted the Australian Prudential Regulation Authority to announce stricter lending curbs last week, binding banks to restrict interest-only loans to 30% of total new residential mortgages. The Reserve Bank of Australia also announced that regulators are prepared to do more to cool the heated housing market. The property boom is attributed to record-low interest rates, high investor demand and rapid population growth. (Bloomberg)

China has its worst-ever start to a year for defaults

Apr 3. According to data compiled by Bloomberg, there are 9 onshore bonds from 7 companies in China that have defaulted so far in 2017 as compared to 29 defaults for the whole of 2016. The record defaults in a quarter on corporate bonds was racked up by China's effort to deleverage. Most of the corporates are dependent on the heavy and construction industry which exhibit struggling signs faced by China's old economic model. The name of the debtors are revealed as following: Dalian Machine Tool Group Corp., Dongbei Special Steel Group Co., Inner Mongolia Berun Group Co., China Shanshui Cement Group Ltd., China City Construction Holding Group Co., Huasheng Jianquan Group Co. and Zhuhai Zhongfu Enterprise Co. (Bloomberg)

Fed signals it could promptly start shedding bonds from portfolio this year

Mar 31. New York Fed President William Dudley commented that the Federal Reserve could begin shrinking its USD 4.5tn balance sheet as soon as this year. The hawkish-sounding statement resulted in the lower dollar temporarily and raised yields on longer-date bonds. The statement also added to the views of at least three other officials at the Fed pointing towards the end of a crisis-era monetary policy. The Fed's plan is to begin letting the bonds naturally roll off rather than to be sold once the interest-rates hikes are in progress. Dudley also mentioned the bond roll-off action could influence the Fed's pace to raise short-term interest rates. (Reuters)

China's biggest property developer unveils plan to scale back debts

Mar 29. After reporting its net profit has halved from a year earlier, Evergrande, China's largest property developer, announced that it would pare down its debt. Evergrande attributed the drop in net profit to the doubled interest payments to holders of its bonds. Its net debt of USD 50bn was 777% of its equity as of end 2016 compared to the sector average of 90% as of Jun 2016. Despite plans to reduce its debt, analysts are skeptical of Evergrande's promises given that it has raised more debt. Evergrande's strategy of leveraging on debt to buy up land has made it susceptible to a slowdown in the property market. Government officials have highlighted that the property bubble and rising corporate debt are some of the biggest risks the Chinese economy is facing. (FT)

Venezuela bonds fall most in two years on political uncertainty (Bloomberg)

Pan Ocean's full-year profit more than doubles on debt restructuring (Business Times)

Ezion to take control of JVs with Swissco unit (Straits Times)

Regulatory Updates

Central banks cut euro exposure in favour of sterling amid bloc jitters

Apr 3. According to a survey by the Central Bank publications and HSBC, central banks are dumping euros amid concerns over political instability, weak growth and ECB's negative interest rate policy, while favouring sterling as a long-term, stable alternative. Despite uncertainty over Brexit, central bankers see the UK as a safer prospect for their reserve investments as compared to the euro zone. Developing and emerging-market central banks, some of which are among the world's biggest reserves holders, were more likely than those from advanced economies to have shifted out of the euro. (FT)

PBOC raises interest rates on Standing Lending Facility loans

Apr 1. The People's Bank of China increased the overnight SLF loans rate by 0.2% to 3.3% from March 16. The central bank also raised the rate for its 7-day loans to 3.45% and the 1-month rate to 3.8%. The SLF rates play an important role as it is the ceiling of an interest rate-corridor and helps in the stability of rates in the currency markets. The PBOC has been increasing borrowing costs as the economy has stabilized and inflation has been accelerating which provide financial institutions the incentive to expand credit. (Bloomberg)

APRA strengthens macroprudential rules for banks (Australian Financial Review)

Chinese corporate deals face scrutiny at home and abroad (FT)

Published weekly by Risk Management Institute, NUS | Disclaimer
Contributing Editor: Victor Liu