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Weekly Credit Brief
Feb 11 - Feb 17 2014

Stories of the Week

Troubles at Chinese coal companies fuel further problems with WMP

By [James Weston](#)

Last week, the second bailout of a failed wealth management product (WMP) by a state-owned Chinese bank. [China Development Bank agreed](#) to lend CNY 2bn to bankrupt Liansheng Resources, based in Shanxi-province, in exchange for 50% stake in the company, and three unidentified companies will invest a further CNY 3bn. This restructuring allows Liansheng to pay off loans underlying WMPs sold by trust companies including Jilin Province Trust Co Ltd, which [said that another WMP tranche](#) linked to Liansheng affiliates maturing last week could not currently be repaid. [A CNY 1.2bn WMP sold by](#) Changan International Trust Shareholding Co Ltd that also is linked to Liansheng subsidiaries is due to mature in the coming weeks. The restructuring of Liansheng and its affiliates follows a [January 28 bailout](#) by private investors of a CNY 3bn WMP sold by China Credit Trust, which in turn was backed by loans made to another Shanxi-based coal mining company.

Reflecting deteriorating credit amongst Chinese coal companies, the aggregate 1-year RMI probability of default (RMI PD) for the sector has jumped dramatically over the last few month (Figure A1), as economic growth has slowed and government-led efforts to boost use of alternative fuels has dampened demand. Moreover, the industry has been constantly mired by overcapacity, which has amplified downwards pressures on coal prices. Increasing credit risk in the Chinese coal industry is also reflected in the average RMI distance-to-default (DTD) for listed Chinese coal companies, which has fallen sharply recently. RMI's DTD is a volatility adjusted measure of leverage, with a lower DTD number indicating higher potential insolvency.

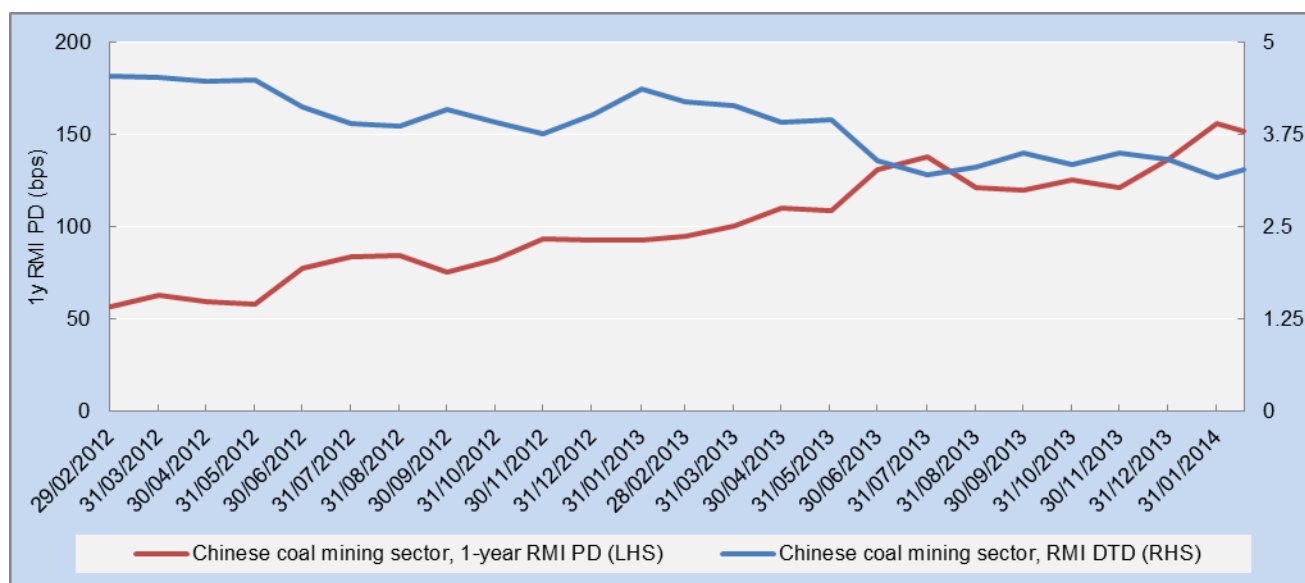


Figure A1: The aggregate 1-year RMI PD for Chinese coal companies (LHS), and the sectoral distance-to-default (DTD, RHS).
Source: Risk Management Institute

In late January, the China Banking Regulatory Commission (CBRC) [ordered banks](#) to increase scrutiny of loans made to coal companies, signaling possible concerns about potential defaults. At the same time, the CBRC asked its local branches to step up monitoring of risks from trust and WMPs. As seen in Figure A1, RMI data has reflected increased risk in the coal mining sector for some time. Moreover, the deterioration in the

credit quality of larger Chinese coal companies likely heralds even more drastic declines at smaller companies, many of which underlie popular WMP products. This is due in part to the nature of WMPs in China; they largely channel funds to companies that have trouble raising finance through official channels.

Shanxi-province based coal miners in particular are at risk, [according to RMI data](#). Figure A2 depicts the RMI PD for Taiyuan-based [Shanxi Xishan Coal & Electricity Power Co Ltd](#) (Shanxi Xishan), a subsidiary of Shanxi Coking Coal Group Co Ltd, the largest metallurgical (coking) coal producer in China (Shanxi Xishan is also the fifth largest coal company in China). As the price of one of the company's primary sources of revenue has declined, the RMI PD for the company has increased markedly. Table A1 shows the pro-forma financials for Shanxi Xishan; declining prices for coking coal have led to lower net income, declining cash balances and a decrease in the company's RMI DTD, which has driven an increase in the RMI PD for Shanxi Xishan.

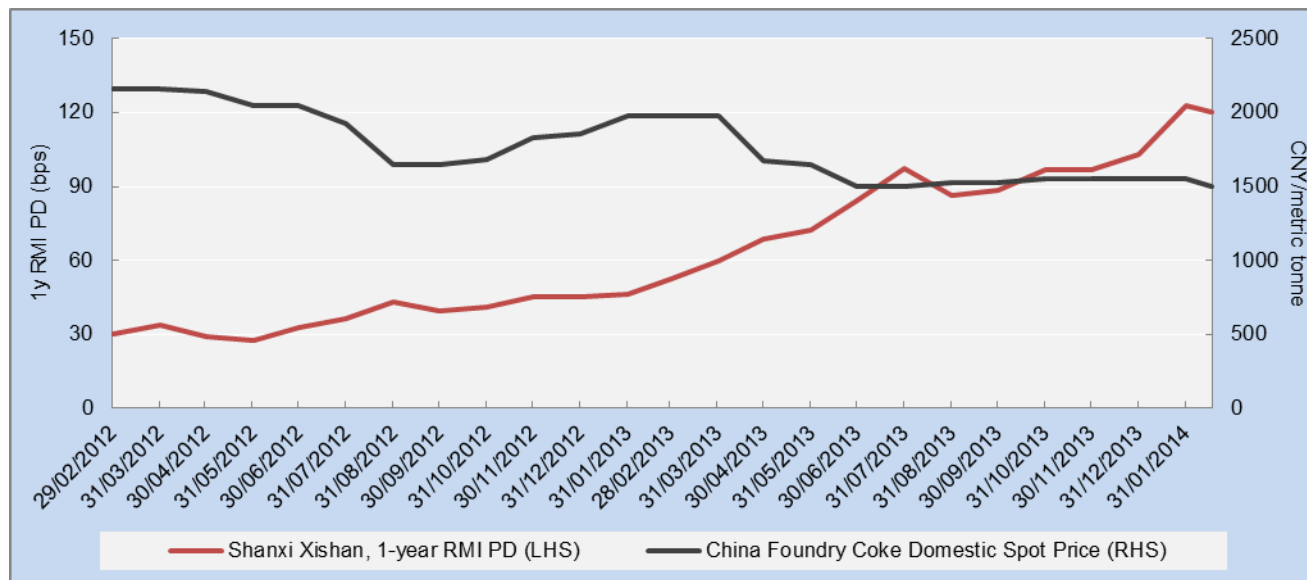


Figure A2: The 1-year RMI PD for Shanxi Xishan Coal & Electricity Power Co Ltd (Shanxi Xishan, LHS), vs the CNY price for domestically-sourced foundry coking in Shanghai (RHS). Source: Risk Management Institute, Bloomberg

Shanxi Xishan Coal & Elec Power	Q3 FY13	Q2 FY13	Q1 FY13	Q4 FY12	Q3 FY12	FY 2012	FY 2011
Turnover	6,816.0	7,503.9	7,573.0	7,891.9	7,463.8	30,853.4	30,018.9
Cost of Sales	5,131.8	5,395.1	5,378.9	6,268.4	5,398.1	22,367.6	21,180.1
Admin & Other Expenses	1,330.8	1,317.7	1,130.8	1,606.6	1,399.4	5,020.9	4,293.7
EBIT	353.4	791.1	1,063.3	17.0	666.3	3,464.8	4,545.0
Financial Expense/(Income)	200.9	236.5	227.1	118.6	216.7	647.2	418.5
Income Tax Expense/(Benefit)	37.0	128.1	215.8	(10.6)	161.1	813.5	1,121.4
Net Income	115.5	426.5	620.4	(91.1)	288.5	2,004.2	3,005.1
Working Capital Needs	(1,659.5)	(1,059.1)	(861.2)	(2,502.6)	(1,135.6)	(2,502.6)	(11,892.1)
CFO	781	1,123	121	750	-21	750	3,297
CL	14,655	15,134	16,101	16,470	15,172	16,470	14,167
Cash / Near Cash	4,503	4,728	5,157	5,068	6,354	5,068	6,713
TA	45,527	45,996	45,845	45,126	46,087	45,126	38,643
RMI DTD	(Feb 17: 3.44)	3.35	3.06	3.67	3.91	4.24	3.80
Net Debt	8,757.8	9,058.6	9,734.8	9,634.3	8,450.6	9,634.3	2,275.4
Cash / TA (RMI Adjusted)	9.89%	10.28%	11.25%	11.23%	13.79%	11.23%	17.37%
Cash / CL	0.31x	0.31x	0.32x	0.31x	0.42x	0.31x	0.47x

Table A1: Pro-forma financials for Shanxi Xishan. Figures are in CNY millions, except for RMI DTD and where otherwise indicated. Shanxi Xishan's financial year ends December 31st. Source: Company financial reports, Risk Management Institute

Peugeot's Dongfeng deal seen as credit positive in RMI PDs

By [Siddharth Batra](#)

France's largest automobile manufacturer, [Peugeot SA](#) has burnt more than EUR 4bn of cash over the last 2 years. On February 19 the company is due to report its 2013 results, which are likely to be in the red for a second year in a row.

Peugeot SA's shares have tumbled more than 50% over the past three years as the effects of the sovereign-debt crisis bit into demand for mid-market European cars. However, [news](#) of a potential deal with Chinese state-owned car maker, [Dongfeng Motor Group](#) has helped to lower Peugeot's 1-year RMI probability of default (RMI PD) from 55bps in December 2012 to 30bps in December 2013. Currently, Peugeot SA's 1-year RMI PD stands at around 21 bps, while the company's shares, currently at EUR 12.70 a share, trade at nearly three times the value they traded at in early December 2012. If the deal is approved on Tuesday, Peugeot SA would raise EUR3 billion capital via stake sales to the French government and China's state-owned Dongfeng Motor Group.

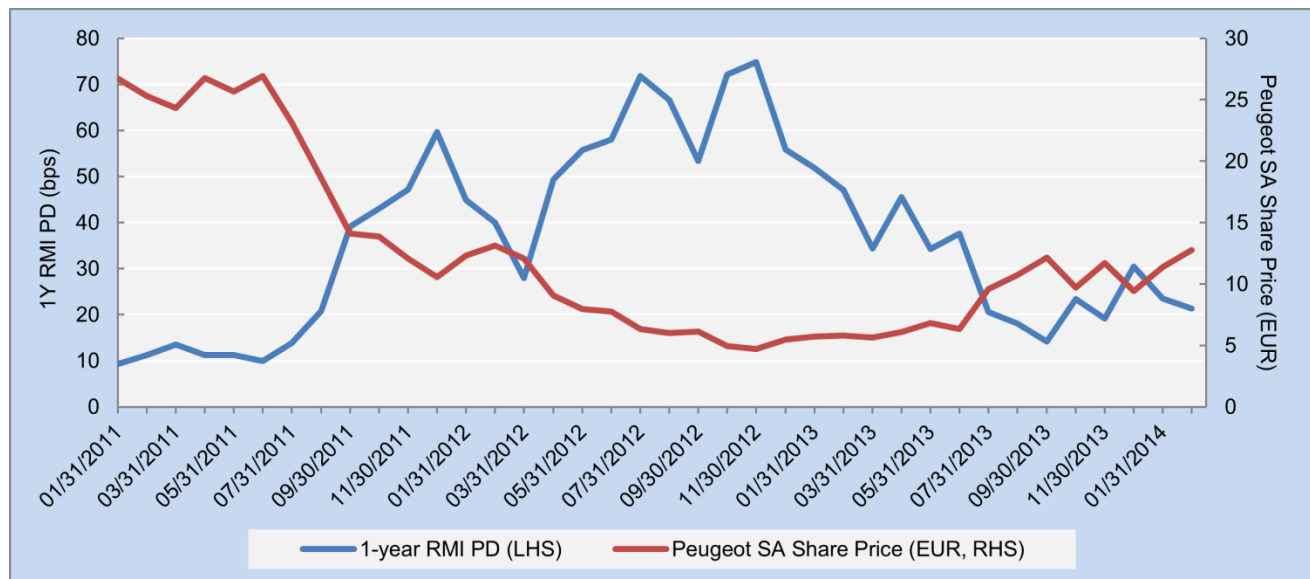


Figure B1: The 1-year RMI PD for Peugeot SA (LHS) vs the company's share price (RHS).

Source: Risk Management Institute, Bloomberg

Peugeot SA is in a dire need of a capital injection and eager to expand its footprint outside Europe but the deal would trigger a divergence of interests among the three major shareholders. The Peugeot family's 25% stake and 38% of voting rights would be diluted to parity with the French government and Dongfeng, short of the one-third required to veto corporate decisions. The new ownership structure will make an aggressive push towards efficiency, competitiveness and growth difficult and may actually slow down decision-making at a time when the European car market demand is at a two decade low.

Even if the board approves the stake sale on Tuesday, the deal will still require shareholders' approval. Minority shareholders may argue that Dongfeng, the French state and the Peugeot family are acting in concert and hence may demand an open offer from them instead. A share sale to Dongfeng also further needs an approval from the six main unions at Peugeot SA.

In the News

China banks' bad loan ratio hits two-year high

Feb 13. According to figures released by the China Banking Regulatory Commission, Chinese banks' non-performing loans rose to the highest level since September 2008. Bad loans rose to CNY 592.1bn in Q4 2013, an increase of CNY 28.5bn from Q3 2013, sparking concerns about the risk of another financial crisis. Analysts and bankers believe that non-performing loans are expected to grow further and loan quality will worsen noticeably. The economy could grow at a slower pace while government efforts to curb shadow banking activities would make it harder for borrowers to repay existing debt. ([Reuters](#))

Indonesia holds rates as current-account deficit narrows sharply

Feb 13. Bank Indonesia maintained its main reference rate at 7.5% for the third straight month on the back of higher exports and moderating inflation. The nation's Q4 current-account deficit shrunk to 1.98% of its GDP, less than half of what it was six months ago at 4.4% and its lowest level in 1.5 years. Indonesia's worrying current-account deficit had previously exacerbated the large capital outflows from the emerging economy, which caused the IDR to be one of the world's worst performing currencies last year. With an improved current-account deficit, the country is less susceptible to volatile flights of capital. ([Reuters](#))

Malaysia budget deficit shrinks more than government target

Feb 12. The Malaysian government reported a lower than expected fiscal deficit of 3.9% for 2013, down from 4.5% of GDP in 2012, after scaling back its blanket subsidies on fuel and sugar while curbing non-essential government spending such as ministers' entertainment budgets and the renovation of government offices. The aforementioned measures were implemented by Prime Minister Najib Razak to bring the budget shortfall down to 4% of Malaysia's GDP, following an outlook downgrade by Fitch Ratings citing high-levels of public debt. The cabinet is aiming to further trim the fiscal deficit to 3% in 2015 before achieving a balanced budget by 2020. ([Bloomberg](#))

IBM pays more to borrow in bond market as sales decline

Feb 11. Revenues at IBM dropped 5.5% in the last 3 months of 2013 to USD 27.7bn, as customers shifted demand to offsite data storage solutions. The hardware division at the technology giant is facing new challenges as the industry steps into the cloud era, where information is kept online instead of onsite. Faced with a prospect of lower future profits, the company sold its lower margin businesses, including its low end server division to Lenovo this year for USD 2.3bn and its customer service unit for USD 505mn in January. Bondholders recently demanded a higher yield for the company's bonds. The firm issued 10 year notes at 3.625% in February 2014, surpassing the cost of similar maturity 3.375% notes issued in July 2013. ([Bloomberg](#))

China trade growth defies signs of slowdown ([Bloomberg](#))

Investors turn to 'shadow' bond market ([FT](#))

Negative interest rates an option for ECB, says Liikanen ([Reuters](#))

Singapore top lenders post quarterly profit rises, sound upbeat ([Reuters](#))