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Glencore Bond Investors Remain Wary on Debt-Repayment Risk

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While Glencore Plc shares have recouped much of Monday's losses, credit investors still seem cautious about the commodity producer's outlook.

The yield premium on the company's $1.75 billion of 2.45 percent notes due October 2017, its largest outstanding dollar bond, is about 740 basis points more than Treasuries, Bloomberg-compiled prices show. Swaps to protect against a default within 12 months also remained elevated, CMA data show.

Glencore's shares rebounded following Monday's 29 percent plunge after the Swiss-based commodity producer and trader said it has "absolutely no solvency issues" and secure access to funding. For credit investors, it's still too early to relax, according to Mitsubishi UFJ Morgan Stanley Securities Co., which noted in a report Wednesday that the company's debt has an average maturity of 3.4 years, short for an industry where long-term investments are required.

"I think the equity market panicked and now people are reevaluating their position," said Dilip Parameswaran, the Hong Kong-based chief executive officer of Asia Investment Advisors. "Bond investors may be taking a more measured approach when it comes to concerns about the company's solvency."

Debt Repayments

Glencore had about $29.6 billion in net interest-bearing debt as at the end of June, according to calculations by Shoko Tsukamoto, a credit analyst at Mitsubishi UFJ Morgan Stanley Securities. It could repay its liabilities with 2.71 years of cash flow, even assuming low earnings before interest, taxes, depreciation and amortization, she wrote.

The company reiterated in a statement this week that it plans to cut debt by as much as $10.2 billion and highlighted "long-term relationships" with lenders and a lack of debt covenants.

Spreads on its bonds may have widened to levels that don’t reflect the company’s actual position after it was caught “by a market looking for a target,” Tsukamoto said. The lack of covenants is “comforting,” she said. The yield premium on the October 2017 bonds surpassed 12 percentage points earlier this week.

‘Addicted’ to Debt

The blowout in spreads may mean Glencore faces difficulties, or at the very least, increased costs, when it comes to refinancing debt as investors remain concerned tumbling commodity prices will hurt its business.

“My guess is the company is dependent on 24/7 access to capital markets and addicted to easy financing,” said Lutz Roehmeyer, who oversees about $1.1 billion for Landesbank Berlin Investment. “They are trading billions of dollars of goods and need cheap financing for warehousing.”

Given the heightened cost of selling notes to investors, it’s “realistic” for Glencore to refinance through bank loans, Mitsubishi UFJ Morgan Stanley’s Tsukamoto said. The company has a $350 million 6 percent bond that matures Oct. 15 and $1.25 billion of 1.8 percent notes that fall due Oct. 23, according to data compiled by Bloomberg.

For a successful bank financing, Glencore would likely have to outline a detailed plan for reducing its debt burden and cutting costs, according to Tsukamoto.

“There used to be concerns about Glencore’s liquidity, but as asset values are falling and the future recovery in commodities seems increasingly uncertain, the latest worries seem to be about solvency,” Parameswaran said. “Credit markets can afford to take a more cautious approach as they are ahead in the line in the worst-case scenario” of a bankruptcy, he said.

Peter Grauer, the chairman of Bloomberg LP, the parent of Bloomberg News, is a senior independent non-executive director at Glencore.