Uncertainty shrouds SunEdison despite cost reduction strategy

by Lee Yanru

The market capitalization of SunEdison, the world's largest renewable energy developer, has been on a downward trend from more than USD 9bn in late July to a low point of almost USD 2bn on Sep 29, 2015. Price declines in traditional energy sources, such as coal and oil, have made investing in renewable energy resources less attractive. In the lackluster macro backdrop, SunEdison's aggressive acquisition strategy, high debt profile, and persistently negative earnings have added to concerns that the firm may not return to profitability soon.

Formerly known as MEMC Electronic Materials, SunEdison operates in the business of providing semiconductor and solar products solutions for its clients. The company has aggressively made many billion-dollar acquisitions of wind and solar energy companies over the years. More notably, SunEdison spent or pledged more than USD 6bn on the acquisition of renewable energy companies in the past year, which included the acquisition of First Wind for USD 2.4bn, solidifying its position as the leading renewable energy development company in the world, as well as its recent announcement of the controversial acquisition of Vivint Solar, which hurt investor's confidence in the company. Due to sustaining net losses for the past several years, the company could only fund its acquisitions through leverage. The debt level of SunEdison had soared to USD 10.7bn at the end of June this year from USD 7bn at the end of last year, significantly worsening the company's credit profile. As a result, the RMI-CRI 1-year Probability of Default (PD) for SunEdison surged from 62.29bps at the beginning of August to a 3-year high of 887.43bps in late September, coinciding with the sharp decline in its market cap, as shown in Figure 1.

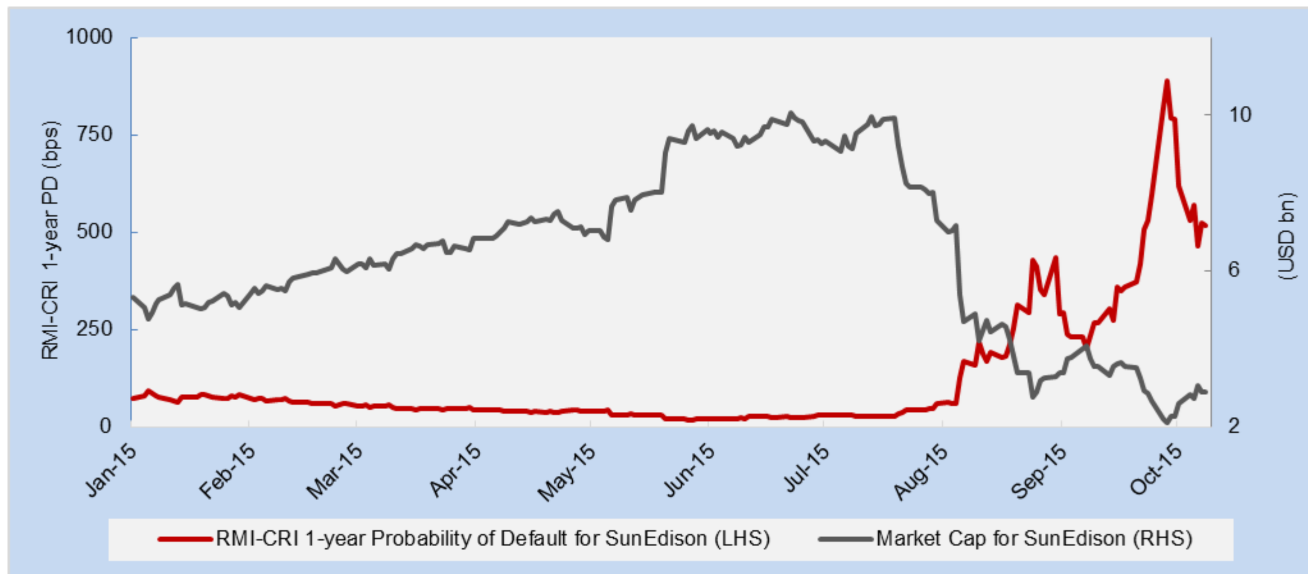

Figure 1: RMI-CRI 1-year probability of default and market cap for SunEdison. *Source: RMI-CRI, Bloomberg*

As the financial pressure was mounting, the management announced a new business strategy on Oct 7, 2015, which involves cutting down the operating cost by laying off a thousand employees, which constitutes about 15% of the company's workforce. In addition, it planned to forego investments in countries, such as the UK, where renewable energy projects are not as profitable as in the US, and to put a halt to the purchase of Latin America Power that was thought to be unprofitable. These timely efforts had made commendable results in regaining some of the investors' confidence, as evidenced by the recent uptick in the company's stock price, in tandem with a sharp drop in the RMI-CRI 1-year PD to 464.31bps, just on the day it made the announcement of its new business strategy.

Although the company has showed a QoQ improvement on its Q2 2015 financial performance and pledged to cut back on unnecessary costs as mentioned above, its substantially negative net income margin and high leverage ratio (see Table 1) indicates that the company is in a long-lasting financial swamp and may not recover in the short term. Without an effective prescription for stable profitability, the firm's current cost-reduction strategy may only just be a temporary postponement of its worsening credit condition.

	Q4 2014	Q1 2015	Q2 2015
Net Income Margin	-40%	-115%	-58%
Total Debt (USD bn)	7.2	9.2	10.7
Debt / Equity ratio	412%	518%	277%

Table 1: Financial data for SunEdison. *Source: Bloomberg*

Credit News

Commodity contagion sparks second credit crisis as investors panic

Oct 11. Recent developments in the credit markets bear similarities to the collapse of Bear Stearns during the start of the Great Financial Crisis. As investors dumped high-yield bonds issued by commodity traders, following the collapse in commodity prices, the cost of borrowing to fund operations soared. Under current market conditions, commodity traders are unable to refinance their debts at rates that allow the business to run profitably. As a result, some companies, such as Glencore, had no choice but to reduce their debt levels by raising equity, discontinuing dividend payments and selling assets. (Telegraph)

Colt Defense, 179-year-old gun maker, nears exit from bankruptcy

Oct 11. Colt Defense LLC, is expected to exit from Chapter 11 bankruptcy by the end of this year after filing for legal insolvency in June. The firm reached an agreement with its owners about a restructuring plan and managed to receive funding from external investors. Last year, the firm was hit by falling demand for its sporting rifles, M4 carbines and M16 weapons, leading to rumors that it might default on a USD 70mn loan from Morgan Stanley. Colt had to consider selling part of its operations to pay off its USD 350mn debt but a USD 212mn contract with the US Department in September revived the firm's business prospects. (Bloomberg)

Credit Suisse prepares substantial capital raising

Oct 8. Credit Suisse is set to launch a substantial capital raising in two weeks' time, according to people with knowledge on the matter. The fresh capital is likely to be used to absorb losses triggered by a faster restructuring of the Swiss group, as well as to boost capital ratios to meet regulatory requirements. A poll published last week by analysts at Goldman Sachs revealed that 91% of investors expected the Swiss bank to raise more than CHF 5bn in new equity. (FT)

Tesco swings to a loss

Oct 7. Tesco swung to a first-half loss as the company reported lower sales and felt the impact of discontinued operations. The company reported a net loss of GBP 365mn for the 26 weeks ended August 29, compared to a profit of GBP 6mn for the same period last year. Revenue, excluding value added taxes and fuel, fell to GBP 23.9bn from GBP 24.3bn. The retailer's first-half results included GBP 563mn in charges related to restructuring and the reversal of commercial income recognized in previous years. Accounting issues tied to commercial income had previously led to profit being overstated by GBP 236mn. (WSJ)

IMF warns on worst global growth since financial crisis

Oct 6. According to a semi-annual report by the IMF, global economies are expected to post their slowest growth rate this year due to a slowdown in China and emerging markets. The average GDP growth rate is poised to fall to 3.1% even though many developed countries could expand at their fastest pace since 2010. The international fund gave a mixed outlook for emerging markets, as they were positive on India's economic outlook but predicted that Russia and Brazil will be mired in deep recessions during 2015. Countries with strong public finances were encouraged to implement pro-growth policies as the possibility of a high growth outcome in 2016 had been revised lower. The IMF also advised the US Federal Reserve to delay raising interest rates as there is no clear evidence of rising inflation as yet. (FT)

Alcoa earnings disappoint as China slows (FT)

Klitschko announces Kiev to default on Eurobond debt (Sputnik)

Historic German nutcracker company declares bankruptcy (US News)

Regulatory Updates

SGX reviewing companies' compliance with corporate governance code

Oct 12. The Singapore Exchange has asked international audit firm KPMG to conduct a review of 550 firms, as an attempt to find out if Singapore-listed companies are complying with the newly introduced Corporate Governance Code. This Code requires companies to follow a strict corporate governance conduct, otherwise shareholders should be informed about the areas in which companies deviate from the reporting standard. SGX introduced the corporate governance rules in January this year, which include recommendations about the board's composition, risk management, internal controls and remuneration disclosures. The auditor's findings will be published to the management of the firms, while a final compilation of the results will be made known to the public in early 2016. (Straits Times)

Basel may restore ratings role in credit risk rules

Oct 10. The Basel Committee on Banking Supervision is likely to restore the role for ratings companies as it revises rules for assessing credit risk, according to Chairman Stefan Ingves. The global regulator will propose a revised standardized approach to measuring credit risk, which accounts for the "vast majority" of most banks' risk-weighted assets, by the end of the year. This would then be followed up by a quantitative impact study early next year. (Bloomberg)

Banks urge EU to retain capital relief for small-company loans

Oct 9. Banks pressed European Union regulators to preserve preferential capital treatment for loans to small businesses, as the 28-nation bloc's politicians try to boost SME financing and kick-start growth. The call was made in response to a European Commission consultation that ended on October 7, stressing that bank-capital rules for loans should continue to include supportive provisions to SME, in view of limited alternatives to bank financing. Under existing EU law, capital requirements for credit risk on SME exposures carry a reduced weight and banks should use the relief exclusively for lending to small businesses. (Bloomberg)

India's Raghuram Rajan urges IMF and World Bank reforms (FT)

Britain's financial watchdog launches review of home loans competition (SCMP)

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