Flash by EIC

SCB Economic Intelligence Center

27 January 2017

Debt default by a steel trader - any sign of contagion?

Event

- **A recent default by a SET-listed steel-trading company prompts a concern over the possibility of widespread defaults among others in the industry.** On January 11th, 2017, a company trading steel pipes and steel products announced its default on bank loan, debentures, and bills of exchange (B/E). Even though the company has proposed a debt-restructuring plan on January 24, 2017, investors remain worried whether default risks will spread to other players in the industry.

Analysis

- **Liquidity constraint and high debt accumulation are key contributors to the default.** A recent slowdown in construction added pressure on the defaulting company which has been struggling with maintaining liquidity. This is reflected in its long cash conversion cycle of 340 days. The time period needed to collect debt took as along as 300 days on average in the first 9 months of 2016. Moreover, its choice of funding led to high debt accumulation with a D/E ratio at 2.5 times. These aforementioned factors and the company's failure to raise funds rendered it unable to pay for incurred debts.
- **However, the steel trader overall maintains healthy liquidity with a moderate level of debt accumulation.** The average cash conversion cycle for other companies with similar business is short at 75-120 days. The average D/E ratio also stays low at 1.3 times. Therefore, the recent default was due to company-specific factors and should be well-contained without spreading to other companies in the industry.

Implication

- **EIC recommends steel-trading companies to pay close attention to liquidity management with an appropriate level of debt accumulation.** Steel traders should manage liquidity by: 1) properly limiting overstocking of products whose orders have not yet been placed, and 2) improving timely debt collection processes, for example, by offering a cash discount. These approaches can help increase liquidity by shortening the cash conversion cycle. In addition, companies should evaluate capability of debt accumulation by comparing with other companies in the industry or with industry-wide average. This can help gauge whether the current debt level is appropriate.

By: Kanit Umsakul (kanit.umsakul@scb.co.th)
Economic Intelligence Center (EIC)
Siam Commercial Bank Public Company Limited
EIC Online: www.scbeic.com

Disclaimer: The information contained in this report has been obtained from sources believed to be reliable. However, neither we nor any of our respective affiliates, employees or representatives make any representation or warranty, express or implied, as to the accuracy or completeness of any of the information contained in this report, and we and our respective affiliates, employees or representatives expressly disclaim any and all liability relating to or resulting from the use of this report or such information by the recipient or other persons in whatever manner. Any opinions presented herein represent our subjective views and our current estimates and judgments based on various assumptions that may be subject to change without notice, and may not prove to be correct. This report is for the recipient's information only. It does not represent or constitute any advice, offer, recommendation, or solicitation by us and should not be relied upon as such. We, or any of our associates, may also have an interest in the companies mentioned herein.