Spread Research quoted in Financial News

CSN Bond Collapse Averted on Worst-to-First Surge: Brazil Credit

2013-09-02 23:34:13.14 GMT

By Juan Pablo Spinetto

Sept. 3 (Bloomberg) -- After posting the worst bond loss in the steel industry, Cia. Siderurgica Nacional SA is transforming into its best bet as a slump in the real pares competition from Chinese imports and makes room for higher prices.

The $1.2 billion of 2020 bond from Brazil's third-largest steelmaker, known as CSN, has returned 3.2 percent in the past month, the most of any junk-rated peer in emerging markets, according to data compiled by Bloomberg. Steel industry debt with a composite rating equal to or lower than BB+ had an average gain of 0.2 percent in August.

The real's 4.2 percent slump since the end of July is helping Sao Paulo-based CSN charge more for flat steel used to make cars in Brazil and boost revenue as Latin America's largest economy recovers from the worst two-year stretch in a decade. CSN's price increases also reflect better prospects for Brazil's steel industry, according to **Cedric Rimaud, a managing partner at Spread Research.** "It's a mixture of weaker real and stronger demand," Rimaud said in a telephone interview from Lyon, France. "That's providing some support for the bonds to rally."

CSN declined to comment on its bond performance and pricing policy in an e-mailed response to questions. The third-largest Brazilian steelmaker last month raised domestic steel prices for a second time this year to strengthen its profit margins, a person with knowledge of the plan told Bloomberg News on Aug. 14. The increase followed similar moves by rivals Usinas Siderurgicas de Minas Gerais SA and ArcelorMittal.

Declining Leverage

CSN's 2020 bonds lost 14 percent in the year through July and slumped to an all-time low of 92 cents on the dollar on Aug. 6. The company also cut its net-debt ratio by more than half in a quarter to 5.4 times earnings before interest, taxes, depreciation and amortization, or Ebitda, at the end of June, according to data compiled by Bloomberg. It had 12.4 billion reais ($5.2 billion) of cash as of June 30, 8.5 percent more than at the end of the previous quarter. Yields on the 2020 bonds, which jumped 2.6 percentage points in the first seven months of the year, fell 0.4 percentage point last month to 7.3 percent, compared with an average 0.4 percentage point increase in borrowing cost for issuers in the Bloomberg High Yield Emerging Market Corporate Bond Index.

Yield Gap

The extra yield investors demand to buy the notes relative to similar-maturity debt from Gerdau SA, Latin America's largest steelmaker, narrowed to 1.2 percentage points at the end of last month from a record 2.1 percentage points on Aug. 6. CSN's debt is rated one level below investment grade by Moody's Investors Service at Ba1, while Standard & Poor's ranks it one level higher at BBB-. Fitch

Ratings cut its grade on the bonds to junk on July 17. Brazilian steelmakers were quick to take advantage of the weaker real to boost domestic steel prices before the currency rebounds, said Fernando Pertini, CEO of Panama-based Millenia Asset Management International SA, which holds CSN bonds. “They timed the increase perfectly, because now that the real is a bit stronger, they won’t reverse those increases,” he said. CSN’s talks with ThyssenKrupp AG for the possible purchase of two steel plants in Rio de Janeiro and Alabama from the German steelmaker still poses a risk the company may boost spending and debt, Spread’s Rimaud said.

‘Always Negative’

“Initially it’s always a negative event because they need to finance the acquisition and they need to demonstrate that this is bringing synergies,” he said. “This has been going on for some time and we don’t know what’s going to happen at the end.” Shares of the company rose 5.3 percent in Sao Paulo yesterday after newspaper Frankfurter Allgemeine Zeitung said ThyssenKrupp will abandon its planned sale of steel plants in the Americas, citing unidentified people. Thyssenkrupp is in “very advanced” talks with a leading bidder and still seeking a “prompt signing” on the Steel Americas unit, spokesman Stefan Ettwig said in an e-mailed statement yesterday. CSN declined to comment on the acquisition talks.

The extra yield investors demand to own Brazilian government dollar bonds instead of U.S. Treasuries slipped 2 basis points, or 0.02 percentage point, to 255 basis points in New York, according to JPMorgan Chase & Co. Brazil’s five-year credit-default swaps, contracts protecting holders of the nation’s debt against non-payment, dropped 1.6 basis points to 206 basis points. The real added 0.3 percent to 2.3774 per U.S. dollar. Yields on interest-rate futures contracts due in January 2015 rose 3 basis points to 10.5 percent.

‘More Bullish’

Brazilian steelmakers including CSN are likely to improve operating results in the current and next quarters as domestic demand recovers and a weaker real lessens competition from imports, Rimaud said. “There is a view that the second half of the year will be much more bullish,” he said. “There’s room for further rally”.

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