

Basic resources

China outlines rescue plan for Bohai Steel

Conversion of some assets into bonds sets precedent for stricken industry



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Christian Shepherd in Beijing SEPTEMBER 19 2016

The Chinese coastal city of Tianjin plans to issue corporate bonds to ease the debt burden of a local state-owned steelmaker — in a flagship case of restructuring in the domestic industry.

Tianjin's city government has finalised a plan to restructure the Rmb192bn (\$28.6bn) debt of Bohai Steel Group by placing its most profitable assets into a new company and converting a portion of the liabilities into bonds, according to Caixin, a respected financial magazine.

The deal involving Bohai and its 105 creditors comes as local governments across [China](#) struggle to restructure state-owned companies that creditors believe have implicit state guarantees.

The [bloated Chinese steel industry](#) has become a battleground for state enterprise reform, as a slowdown in growth piles pressure on companies that have long subsisted on government handouts and preferential loans.

Last year, falling steel demand in China also turned a domestic oversupply problem into a global industry crisis, as cheap Chinese steel products flooded international markets and dragged down prices.

Tianjin's plan will restructure Rmb110bn of Bohai Steel's debt — partly by creating a subsidiary from Bohai's most profitable assets that will assume debt of Rmb50bn.

A further Rmb60bn of debt will be taken on by a newly founded asset management company — supported by a Rmb10bn investment from the Tianjin city government — that will issue bonds to resolve the debt, according to Caixin.

The remaining Rmb80bn — about 40 per cent of the borrowings — will stay with the original company, now stripped of its most profitable assets, with a portion potentially being written off, Caixin said.

As central government pressures local administrations [to cut excess steel capacity](#), the provinces and cities are looking for ways to ensure their producers remain afloat.

Banks are expected to take a [significant hit](#) to their balance sheets during the restructuring of the coal and steel industries, with such programmes threatening to worsen their declining profitability and mounting debt levels.

Caixin also noted in the report that banks would be required to buy the newly issued Bohai debt bonds in proportion to the level of debt they owned before the swap.

Bond issuance and asset restructuring are tested methods in China's attempts to avoid state-defaults, but the co-operation of debt holders in agreeing to such deals is uncertain, as converting bank loans to bonds may hurt margins, according to a note from NSBO, a research group.

[A spike](#) in non-performing loans could be in store for the banking sector should Tianjin Bohai set a precedent, leading other local governments to roll out similar bond issuance plans to deal with their own SOE zombies, said NSBO.

The new company will probably try to offset banks' fears of decreasing profits by bringing in everyday investors, said Zhu Ning, a finance professor at Peking University. "The attraction of having a fund is that you can bring in social capital," he explained.

Such a programme would be innovative and may become a model in how local governments could restructure local SOE debts but many poorer provinces would struggle to pull it off, said Mr Zhu. "It is something worth trying and given the situation, what else can they do?" he said.

Bond issuance may not be a popular model with creditors, but it is a more attractive option to local governments than a debt-for-equity swap model. A proposal to swap the debt of defaulting Dongbei Special Steel, partially owned by the Liaoning government, into equity resulted in creditors [calling for a ban](#) on new loans to Liaoning companies.

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