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Agile Property Plays China

Real Estate's Weak Link

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Investors have been looking for a weak link among Chinese-listed property companies for some time. They may have finally found it in Agile Property Holdings.

The midsize apartment seller said last month that it would launch a share rights issue to raise money to pay down debt. The structure of the deal, which involved the controlling Chen family borrowing from the company's bankers to pay for its portion of the rights issue, raised eyebrows. That the rights issue was at a steep discount to its shares, at only 0.3 times the company's book value, showed the low price the company was willing to accept for fresh cash. If it could have gotten the deal done, that is.

The company said Friday that the rights issue is off, without saying exactly why. It promised that in the future, if it tries to raise cash in a similar way, the Chen family would source its own funds. The question is whether it will get the chance. The company's shares have been suspended pending the release of inside information since Oct 3. Meanwhile, yields on Agile's dollar-denominated bonds maturing in 2017 have risen from 6.6% after the rights issue was announced to more than 11% Friday.

The company has issues besides debt. A mainland media report linked the company to Zhou Yongkang, China's former security chief who is now at the center of a corruption probe. The company calls the allegations "groundless and totally fabricated," but has disclosed that prosecutors had its chairman in custody. Investors are spooked.

As any market turns down, as China's property sector is doing now, it is easy to dismiss the travails of an individual company as problems of its own making. Some of its competitors even saw decent sales over the past week's National Day holiday, an important buying period.

But the heart of Agile's problems isn't unique. It borrows lots of money to buy land and build apartment towers and hopes to sell them quickly. It is a tried-and-true formula in China's market, which hasn't experienced a prolonged downturn since Chinese were allowed to own apartments in the 1990s. Agile has cut prices to keep sales going. Across China's cities, the developer formula is being stretched.

Chinese companies under stress have proved remarkably able to find fresh cash to save the day. That could still happen here. But it is unlikely that the problems Agile is grappling with are just its own.

-- Alex Frangos

Beijing Prolongs the Pain in Coal

China made a splash last year saying it wants more market pricing for natural resources. Yet it is now intervening in the coal market to drive up the price. It is an old-school move that should have coal investors wincing.

The world's top coal importer sent shock waves when it announced tariffs on imported coal of up to 6% Thursday. Shares of Australia's Whitehaven Coal fell on the prospect it will have to cut prices to stay competitive in China. Those who mine out of Indonesia are spared by a free-trade agreement.

China's state media explicitly said this move is intended to protect local companies, 70% of whom are logging losses as Chinese thermal coal prices have dropped 24% this year. The import tariff now gives these locals the room to raise prices. Higher prices would be supported if they can also cut production, as China's coal industry association recently advocated.

The irony is that Beijing used to push for cheap coal. China got rid of its tariffs on imported coal last decade to let industries such as power and steel access more inexpensive coal from Indonesia or Australia. It also built out rail networks to lower transport costs and extract more coal from the interior.

There is some consolation for international miners in the near term. By nature of China being the price setter for global coal prices, the higher Chinese prices that result from the tariff could help support coal globally, says IHS analyst Scott Dendy. A trader who exports to China may not get to enjoy the price rise entirely -- thanks to the tariff -- but the higher nominal price he gets in China could help him demand a higher price from customers in, say, Japan or South Korea.

Yet the long-term effect of the tariff is to delay the needed consolidation a plummeting coal price would have encouraged. Beijing probably isn't interested in coal prices that are too high, since that would hurt the coal-fired power plants that feed China's industrial complex. But it is afraid of letting coal miners fail, both because of the thousands they employ and the shadow-banking products they are thought to support.

By not tolerating low prices now, Beijing is consigning the coal industry to more pain in the future.

-- Abheek Bhattacharya

China's Slower Growth Story

Could Give the Fed the Chills

The slowing of China's economy is pushing down on prices in the U.S. There may be much more pressure to come.

With recent economic data even weaker than expected, there lately has been a reassessment of how fast China is likely to grow. Last week, the World Bank lowered its forecast for Chinese gross-domestic-product growth in 2014 to 7.4% from 7.6%, and in 2015 to 7.2% from 7.5%. Many private forecasts are lower.

Slower Chinese growth may presage a cooling in prices that could give the Federal Reserve the fits. Its preferred measure of inflation already is below its 2% target, raising the risk of deflation if a recession hits, as well as offering a signal that plenty of slack remains in the economy.

China's slowdown is an big reason commodity prices have fallen so much recently. China-made raw materials, like aluminum, that used to be absorbed by domestic demand now are getting exported, weighing on prices globally. Years of rising Chinese energy demand led to the development of new sources of oil, like shale, and drove the developed world to improve fuel economy. But now that China's economy has decelerated, there is a threat of a glut, and oil prices have fallen sharply.

The drop in oil prices, especially, will cool consumer inflation in the months ahead as it shows up at gasoline pumps. And as it moderates manufacturing and freight costs, it will over time damp price increases for other goods.

The more persistent effect of China's slowdown on inflation, however, could come through the prices of the Chinese goods the U.S. imports. These have lately shown hints of slippage: The Labor Department reported Friday that its index of Chinese import prices was down 0.1% in September from October, which put it 0.1% above its year-earlier level. If China moves to ramp up exports in a bid to keep the economy from slowing too quickly, U.S. import prices could get a lot softer.

China has targeted GDP growth of about 7.5%, and Beijing will tolerate it growing a bit more slowly next year. Unwilling to court unrest, it will be at pains to ensure growth doesn't fall too quickly. With low Chinese inflation readings suggesting consumer demand is still too weak to drive the economy on its own, China may turn to exports to keep it purring. But export-fueled growth won't be as easy to pull off as in the past.

In the 2000s, China massively increased its export position. Its share of U.S. manufactured-goods, machinery and transportation-equipment imports went from 10.4% in 1999 to 29.2% in 2009. But then its import penetration stalled, with its share of those imports coming to 28.8% last year.

One reason is the financial crisis. As well, events such as 2011's tsunami in Japan and floods in Thailand prompted many firms to rethink the logic of long supply chains. In addition, rising wages cut into the cost savings China could offer. And in many product categories, Chinese imports were close to the saturation point, with remaining categories much harder to crack.

That doesn't mean China's share of imports in the U.S. and other countries can't grow. But China may have to charge lower prices to do this. The date when the Fed finally meets its 2% inflation target is looking even further off.

-- Justin Lahart

Blackstone Investors Are Wary

Blackstone Group is in the business of buying low and selling high. So it is only fair for investors to ask why they should buy what it is selling.

That was true when the private-equity firm went public in 2007. It took 81 months for the shares to trade above the $35.06 price they closed at on the first day of trading. And the question should again ring in investors' ears in light of Blackstone's announcement Friday that it is spinning off its financial-advisory business.

Blackstone claims this will unlock value. Conflicts of interest with its much-larger asset-management business were preventing its investment bankers from competing for many deals, it said on an analyst call Friday. The implication is that a stand-alone firm will expand faster than it could within Blackstone. Yet that isn't the story Blackstone told when it went public: Back then, it touted the combination of its private-equity and advisory businesses, saying this gave it "unique insights into how to best maximize value."

It is true that Blackstone's financial-advisory business has expanded more slowly than the rest of the firm. Revenue there rose 15% last year, compared with 76% revenue growth in private equity. Yet growth at Blackstone's advisory business was about in line with that of competitors such as Evercore Partners.

True, boutiques trade at much higher multiples than asset managers. Blackstone is at about eight times forward earnings, while Evercore and Moelis are around double that. So a spinoff may clarify the advisory business's valuation and remove some drag.

But investors were likely assigning it a similar multiple in their sum of Blackstone's parts. And the advisory business isn't an automatic route to riches for shareholders. It remains highly dependent on deal flow and the macroeconomic environment.

Investment bankers don't come cheap. Compensation ate through about 62% of Blackstone's advisory revenue last year. That expense could rise at a stand-alone firm. Compensation at Evercore devoured nearly 66% of advisory revenue.

That is evident in the price that Blackstone shareholders are paying for the spinoff. Just 65% of the new company will be owned by them, while its investment bankers will own the other 35%.

-- John Carney

Overheard: The ECB's Scenic Route

The European Central Bank has resisted calls to buy government bonds in large quantities. But is it engaging in stealth quantitative easing?

With ECB deposit rates at minus 0.2%, about 1.3 trillion euros ($1.6 trillion) of short-dated eurozone government debt is now trading at a negative yield, Bank of America Merrill Lynch notes. That is a problem for investors like banks and central banks, which are traditionally big buyers of such debt.

BofA calculates that if these investors were to try to offset the hit to interest income since the beginning of June, there could be 400 billion euros to 600 billion euros of demand for longer-dated or riskier paper. That relies on the same mechanism -- making very safe assets unpalatable and encouraging risk appetite -- as quantitative easing in other countries.

That could be one way in which the market is underestimating the effect of the ECB's actions so far. But it still represents an indirect, passive route to easing, rather than the shock-and-awe effect that might eventually be needed.

CO eurcb : European Central Bank

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