Written by **Bob Adelmann** on September 30, 2015

Will Glencore's Financial Troubles Trigger an International Collapse?

Investors in the stock of Glencore, the giant commodities mining and trading company founded by Marc Rich (disgraced friend of Bill Clinton), lost almost a third of their portfolios' value on Monday, only to see the company's stock price rebound strongly the next two days. The company's statement seemed reassuring to those unwilling to dig deeper:

> We have positive cash flow, good liquidity and absolutely no solvency issues. Glencore has no debt covenants [about to be triggered] and continues to retain strong lines of credit and secure access to funding thanks to long term relationships we have with the banks…. We … are confident the medium and long-term fundamentals of the commodities we produce and market remain strong into the future.

A primary driver behind Glencore's troubles is China. Its slowing economy is reducing the demand for all the commodities that the company mines or trades for: copper, zinc, grain, nickel, and aluminum. As prices of these commodities have crashed (25 percent compared to just one year ago), so has the company's revenue stream. This caused the financial services firm Investec to issue this warning, heavily laden with "investment-ese" but clear enough to trigger Monday's selloff:

> Using a PE-based approach to evaluate [Glencore's] equity value going forward … we note that the heavily indebted companies [Glencore, Anglo American] could see almost all equity value eliminated … leaving nothing for shareholders….
>
> [Glencore's] recent restructuring may prove just the start [of the selloff] for the majors if [commodity prices remain low]. This supports our concern that we are still a distance from the "value point" in this sector.

In English: if commodity prices don't rebound soon, Glencore's recently announced efforts to improve its balance sheet will fall short of rescuing the company from massive defaults.

At the moment the company employs around 181,000 people around the globe, operates more than 30 mines from Australia to Africa to South America, controls more than 150 mining, metals, and oil production facilities, and enjoys revenues approaching a quarter of a trillion dollars a year. It also operates one of the world's largest commodities trading desks on the planet, making markets in those commodities which it produces.

It also has debt that exceeds the company's total value, twice that of its nearest competitor, Rio Tinto. It stock market capitalization has fallen from $60 billion in March of 2011, when Rich took the company public, to just $16 billion at present. With $30 billion in debt, measures like selling more shares, selling off one of its units, and suspending dividends aren't likely to make much of a difference.

Its stock has lost 73 percent of its value in the last 12 months, and its bonds are being offered at just 70 cents on the dollar, if buyers can be found. And insurance against default has nearly tripled in cost just since the first of the year. Standard & Poor's has calculated that, unless something remarkably positive happens, the company has a 53-percent chance of defaulting in the next five years, if not sooner.

The fly in the punchbowl, however, is this: If commodity prices drop just another five percent, that will trigger credit downgrades that will push the company's bonds to junk status. And that event will trigger a ripple effect, as explained by Goldman Sachs: "Glencore's trading business relies heavily on short-term credit to finance commodity deals, and its financing costs would increase if it were to lose its Investment Grade credit rating. In addition, it could even lose some counterparties due to increased counterparty risk."

This is how Goldman explains the "domino effect" — those counterparties are counting on each other to make good on their promises. If one party defaults, the dominoes come tumbling down. Such a scenario was explained by Nyshka Chandran, writing for CNBC: "Glencore could be the name that drags the entire [commodities] market down because it has an elevated leverage ratio in order to secure high returns…. The firm has many counterparty transactions, so there are concerns about a domino effect [impacting] the leverage of other parties."

This is beginning to sound like a "Lehman" moment, when that gigantic investment firm collapsed in September 2008, just after announcing it was profitable and sound and solvent. In an eerie replay of Glencore's stock rebound on Tuesday and Wednesday, Lehman's stock bounced an astonishing 46 percent after CFO Erin Callan's conference call reassured investors in March of that year.

A month later, Lehman Brothers announced a staggering $2.8 billion second-quarter loss, and by September stockholders' equity had been wiped out.

To be completely accurate, China's problems aren't the primary driving force behind the potential collapse of Glencore; cheap money manipulated by central banks around the globe is. Andrew Sullivan, the managing director at Haitong International Securities, nailed it: "Cheap money has fueled companies for so many years, so to an extent we've been living in cuckoo land. But all this money has not had the desired effect. At some point, we have to let companies go bust so the good companies can actually do well."

For Glencore, that point may be now.

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