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Chinese developers seek to raise capital to pare down debts

By Jiang Zhengyi

Chinese developers have found different ways to deal with the industry downturn. Now more developers, including Greentown, Fantasia and Kaisa, are beginning issuing perpetual bonds to pay their debts. One of China's top 10 developers Evergrande started issuing such an instrument last year. As of June 2014, Evergrande became the biggest issuer of perpetual securities among all the Chinese developers at CNY 44.5bn (USD 7.24bn), followed by Guangzhou R&F at CNY 15.6bn (USD 2.54bn), Agile at CNY 4.5bn (USD 732.5mn), Greentown China at CNY 3bn (USD 488.4mn), Kaisa at CNY 1bn (USD 162.8mn) and Fantasia at CNY 700mn (USD 113.95mn). The floods of perpetual issues have raised concerns among general investors as this continues with the limited disclosures on the issuers' redemption terms. Chinese developers' financial health has not been in the pink lately, i.e. indebtedness may be worse than what their interim results have shown as increasing perpetual bonds are being issued. One example is that Evergrande's net gearing ratio will rise above 100 per cent if perpetual bonds are classified into debts instead of equity, greatly higher than the 89.6 per cent it announced this week.

Under International financial Reporting Standards (IFRS), perpetual instruments are typically classified as equity and it is reflected in Evergrande's balance sheet (page 91). Therefore developers like Evergrande could issue this kind of security to cover debts. However as Figure 1 shows, Evergrande's PD has been in a rising trend since 2013, despite several drops reflected by the company's attempts to improve its credit worthiness. The average interest rate cost for Evergrande as suggested by its CFO Tse Wai Wah, is between 9% and 11%.

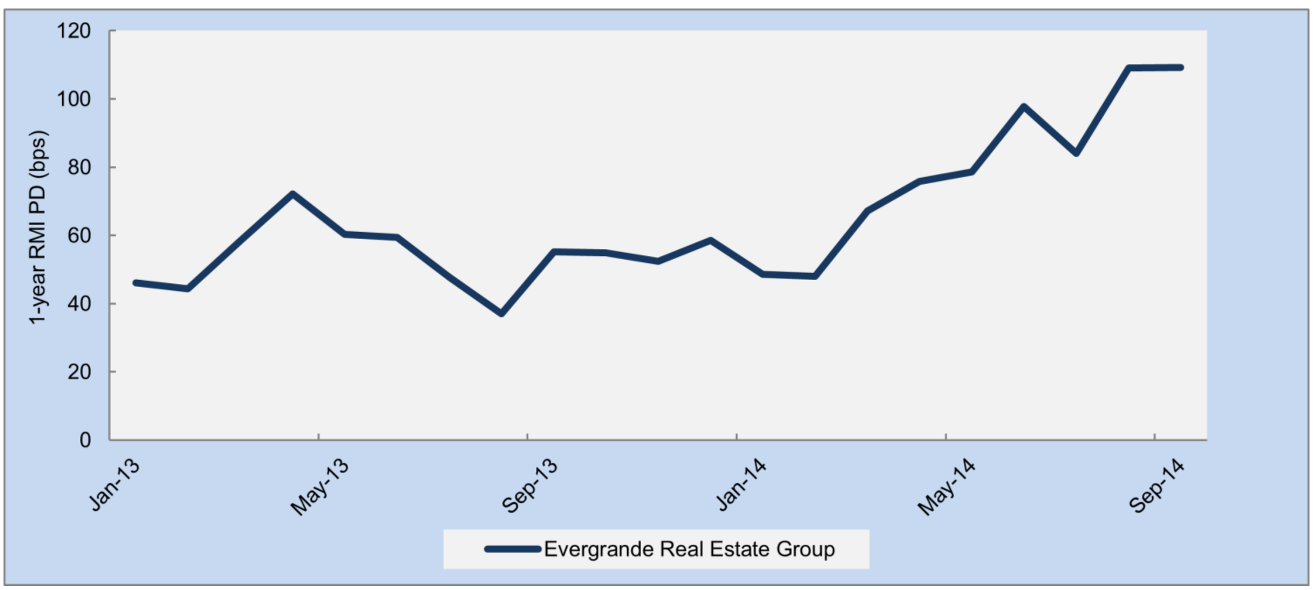

Figure 1: 1-year RMI PD of Evergrande Real Estate Group. Source: *Risk Management Institute*

Apart from perpetual bonds, right issues of shares have also becoming another choice for China's developers. From September 23 to October 8, Country Garden, China's seventh largest property developer will offer a rights issue of HKD 3.2bn (USD 410mn). Its share price slumped 5 percent to HKD 3.44 immediately after the announcement that it was seeking the capital raise at a ratio of 1 share for every 15 shares, offering the shares at a 31 percent discount from the last closing price. Figure 2 indicates that while Country Garden's portion of debt has been increasing since 2013, its stock price has been in downturn since late 2013.

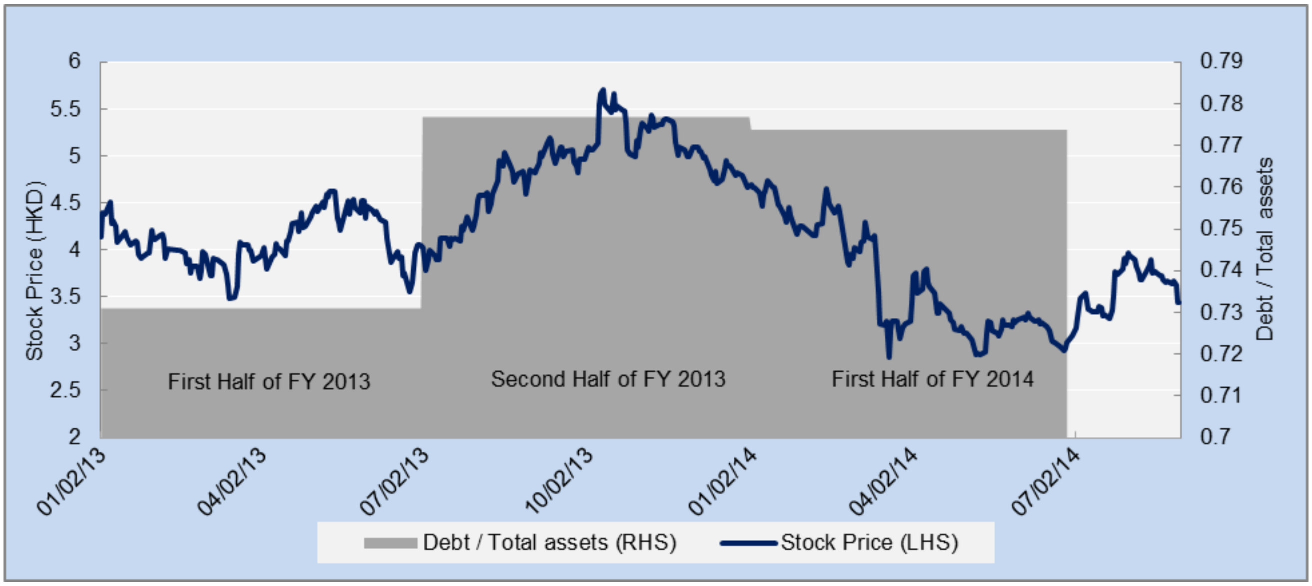

Figure 2: Changes of Country Garden Stock Price and Debt / Asset (the financial reports were provided semiannually, so the data of Debt / Asset from Jun 30, 2014 is not available yet). Source: *Bloomberg*

These actions taken to pare down the piling debts because of the market's downturn may have helped to improve the property developers' health as illustrated in Figure 3 amidst declining Real Estate Climate Index. The PD of China's Real Estate Industry has been seen in an upward trend since Aug 2013. Although there have been some slight dips, overall, it is still above 2013's low of 93bps. The negativity is also supported by the ever dropping Real Estate Climate Index, which plumped by more than 3 units, a considerable amount compared with 10 units decrease in the 2008 financial crisis.

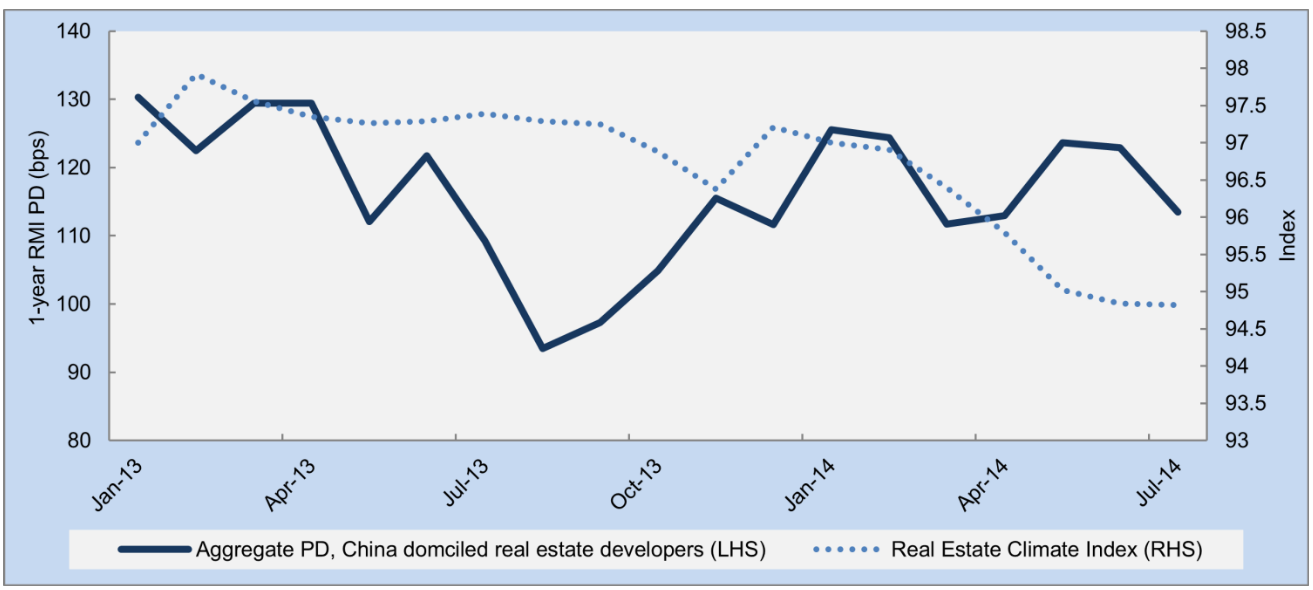

Figure 3: Rising Real Estate PD against Falling Real Estate Climate Index (China's real estate climate index is a composite index released monthly by the National Bureau of Statistics of China, reflecting the current situation and development trends of the Chinese real estate market. Real Estate Climate Index is not available in every January, so here we take the average of those in Feb and Dec last year). Source: *Risk Management Institute, CEInet Statistics Database*

The influx of perpetual bonds may brew another storm in the Chinese property market as they pare down their current debts with a much more huge disguised debt. This action attempts to improve the on-paper PDs, in its nature, by decreasing long term liabilities and increase its equity capital base.

Sources:

[Chinese developers sinking into disguised debts] (South China Morning Post) (subscription required)
[Country Garden plans $410m rights issue] (FinanceAsia)

Credit News

Surge in bad loans squeezing profit at China's biggest banks

Sep 01. The outstanding balance of bad loans at China's four largest banks i.e. Industrial & Commercial Bank of China, China Construction Bank, Agricultural Bank of China and Bank of China reached CNY 384.7bn at the end of June after an increase of CNY 102.3bn in the first half of this year. Rising bad loans, especially from the manufacturing and wholesale and retail sectors, contributed the most to the slowdown in banks' profit growth of 9.6% during the period compared to the double-digit growth rate in the past. Although China's bad loan ratio is still low compared to its international counterparts, the banks have tightened their control over new lending to real estate companies and businesses in sectors where supply gluts may be problematic. (Nikkei Asian Review)

Singapore banks strong, regulations robust

Sep 01. According to Fitch, Singapore banks are as strong as the local regulatory standards. Under the rules of the Monetary Authority of Singapore (MAS), Singapore banks have maintained high capitalisation levels based on Basel III such that its minimum capital ratios are higher than many other jurisdictions. The three local banks including DBS Bank, OCBC Bank and United Overseas Bank will have to meet a minimum core Tier 1 capital adequacy ratio (CAR) of 9 %, a Tier 1 CAR of 10.5% and total CAR of 12.5% by 2019, which are key indicators measuring a bank's capital against its risk assets. Starting from Jan 1, 2015, the three banks are required to meet new liquidity coverage ratios which are to ensure banks have sufficient high-quality liquid assets to match their total net cash outflows over a 30-day period. (The Straits Times)

Qantas posts record AUD 2.8bn annual loss on fleet write-offs

Aug 28. Owing to a massive fleet write-down of Airbus A380 and Boeing 747 planes, amounting to a total of AUD2.6bn, Qantas posted a net loss of AUD 2.84bn for the full year 2014 (ending June 2014) compared with a AUD 1mn profit last year.. Over the last two years, the growth in airline industry capacity in Australia has outstripped demand which has been subdued due to lower consumer confidence, which has hurt pricing power. The, record high fuel costs have also put downward pressure on the profitability of the airline. The write-downs by Qantas are part of a 3-year plan to reduce costs by AUD 2bn. (The Australian)

Tesco shares drop on profit warning

Aug 29. Sliding sales have been affecting UK's supermarket chain, Tesco as the operator embarked on a cost cutting measure. The supermarket chain cut its full year profit forecast for 2014 to GBP2.4bn from GBP2.8bn and slashed half-year dividend by 75% compared with last year. Tesco has been losing market share – the biggest slide of the big four supermarkets. Its market share fell to 28.2% in august compared to 30.2% a year ago. Spending on its business for the current financial year will be capped under GBP2.1bn, which is GBP400mn less than planned and GBP600mn less than last year. IT spending will be affected and plans to refurbish its stores will be slowed. (BBC)

Macau casinos suffer third straight month of falling revenue (SCMP) (subscription required)

China's Li Ning stumbles from the podium position (Reuters)

Regulatory News

Robot risk managers excite swap market-makers

Sep 01. As markets become more electronic, foreign exchange options and government bonds are increasingly being hedged by robots, and banks and dealers are hoping to apply the same techniques to rates products with the arrival of swap execution facilities (SEFs), which are required to offer order-book trading. Algorithms can monitor multiple venues, and use the information to price and hedge faster and more efficiently than a human trader, enabling market-makers to process more trades per day. Coupled with anonymous screen trading and straight-through processing (STP), auto-hedging could deliver significant cost savings and higher volumes for banks going forward. (Risk.net) (subscription required)

Rating agencies must report on controls under new SEC rules

Aug 28. In response to claims that rating agencies did not act unbiasedly towards certain clients, lowering evaluation criteria and not undertaking reasonable due diligence reviews during the financial crisis, SEC came out with amendments to credit rating agency rules on Aug 28 to ensure robust internal controls and preventing conflicts of interest. Under the new requirements, rating agencies will need to provide annual reports on internal control efficiency, while each rating announcement must be accompanied by additional paperwork demonstrating that the rating decision was independent of other business links between the agency and the subject. (Risk.net) (subscription required)

Banks say funding rules will make key equities trades more expensive (Risk.Net) (subscription required)

Tighter banking regulation benefits alternative sources of funding (Mondaq)

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Contributing Editor: Dexter Tan