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Risk Management Institute, National University of Singapore
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Weekly Credit Brief Aug 30 - Sep 05

Korean Air may breathe easy after Hanjin Shipping court filing

By Dexter Tan

Korean Air Lines Co Ltd (KAL) and Hanjin Shipping Co Ltd (HJS), two prominent companies in the Hanjin Chaebol appear to be heading in different directions. Korea's top shipping company, HJS filed for court receivership on Aug 31 after creditors ended financial support for the firm. By contrast, the market value of KAL hit its 52 week high as the massive failure of HJS granted its largest shareholder, Korean Air a temporary reprieve from injecting more capital into the troubled shipping carrier.

HJS's abrupt closure, quite possibly the largest corporate demise in container shipping history, sent retailers scurrying for alternative transportation solutions after port operators refused to handle cargo left stranded on Hanjin's ships. Ship-owners who leased vessels to HJS such as Danaos Corp and Navios Maritime Partners, stand to lose millions as creditors seized the company's assets at shipping ports. To block creditors from seizing more vessels and taking further US legal action against the company, HJS filed for Chapter 15 on Sep 2.

HJS struggled with financial losses over many years. In 2013, a restructuring plan put forward by the shipping firm resulted in a KRW 150bn capital injection from KAL, in exchange for a 15% stake in the company. KAL later raised their interest in HJS to 33.2% in 2014, bringing their overall investment to KRW 519bn at the end of Dec 2015.

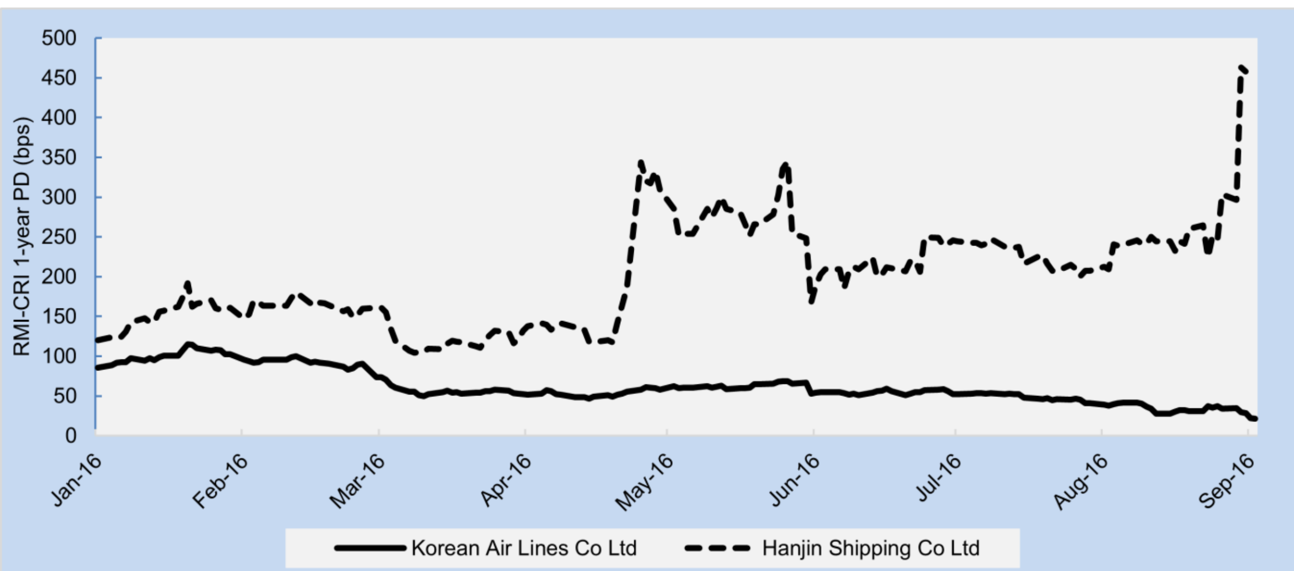

Figure 1: RMI-CRI 1-year PD for Hanjin Shipping and Korean Air. *Source: RMI-CRI*

As shown in Figure 1, the RMI-CRI 1-year Probabilities of Default (PD) for KAL and HJS have diverged after moving in sync with each other between January and March. HJS's 46% market cap decline in April and May coincided with the surge in 1-year PD to 344bps on May 26, after the firm announced plans to restructure its debt.

KAL's credit profile continued to improve despite the poor performance of its associate shipping firm. The RMI-CRI 1-year PD decreased to 22bps on Sep 1, tracking the upward movement in the airline's market cap. Despite the gain in market cap, KAL lost KRW 430bn in the first half of 2016 mostly due to HJS impairment adjustments and FX losses. However, excluding these two items, consolidated losses would have narrowed to KRW 16bn.

With a debt to total asset ratio of 67%, KAL's leverage is higher than most peers (vs. China Southern: 54%; ANA Holdings: 33%; Cathay Pacific: 37%). The company raised KRW 900bn in a space of four months this year as more than KRW 2tn of bonds and loans will mature in 2017. It is also disconcerting that 63% of KAL's short term borrowings are tied to the 3 month LIBOR benchmark as another rate hike by the Federal Reserve may increase interest expenses for the company.

Korean Air expects a KRW 383bn net loss on its investment in HJS. The airline's recovery value from HJS is unclear although HJS's ships are said to be worth KRW 1.8tn according to VesselsValue. The airline's management did not break down what the KRW 383bn might consist of, but they might include a KRW 220bn perpetual bond and a KRW 157bn swap contract, in addition to the 33% equity stake. Based on fair market value on Sep 5, KAL's 33% equity stake would have likely declined to KRW 87bn, which is 53% lower than what was booked on the balance sheet in Q2 2016.

However, KAL's projected loss of KRW 383bn may not materially affect the carrier's credit profile. The firm's cash and cash equivalents were KRW 602bn in Q2, which covers the HJS write off costs. KAL's credit performance has also improved. T12 operating income in Q2 was its highest since 2013, and it helped to lift the company's EBIT to interest expense ratio to 3.14X.

In an environment of low Jet Kerosene prices, KAL may be able to maintain a healthy credit profile. The company estimates that a 10% decline in jet fuel results in a KRW 266bn profit gain for the firm. Demand for air travel should pick up in Q3 and Q4 as seasonally, these are the best quarters for airlines. In addition, KAL does not need to provide any more capital to shore up HJS. With this burden off its shoulders, KAL may breathe easy.

Credit News

China is about to get serious with bad debt

Sep 5. China's banks, which dialed down fundraising efforts this year even as bad debts swelled, are making up for lost time. As of Jun 30, 2016, China's bad loans had risen to 11-year high, while so far Chinese financial firms only sold USD 24.1bn of hybrid securities counted as capital, down 38% from a year earlier. Therefore, more banks are on the way to engage in fundraising for supplementary capital positions to tackle higher loan impairments and strong loan growth. (Bloomberg)

Emerging markets on track to set sovereign debt record

Sep 4. Emerging markets are set to reach record figures as the low yield environment raises demand for emerging market fixed debt. With low inflation rates in major developed economies, monetary easing measures adopted by central banks of these economies such as the European Central Bank, the Bank of Japan and the Bank of England, has spurred demand for emerging market fixed debt, driving down borrowing costs for emerging economies. Analysts from JPMorgan project that the sales of debt by emerging markets in "hard currencies such as dollars and euros is expected to increase more than USD 125bn". Furthermore, weak jobs data in the US has pushed back expectations of a Federal Reserve rate hike, possibly eliminating the threat of a dampening market for emerging market assets. (FT)

Borrowers tap Europe's debt markets as risks simmer

Sep 1. Europe's debt market has recovered after the summer break, with record-low interest rates enticing companies to secure financing, before the potential risk approaches, by instantly issuing bonds with long maturities. Coca-Cola and Evonik are good examples which have together raised more than EUR 2bn in the previous week by issuing debt with a maturity of more than ten years. The potential risk for the European bond market arises from the Italy referendum and the US election at the end of November, and thus market analysts expect a possible peak in bond issuance seen in early October. (FT)

South Africa's biggest debt manager halts loans to state firms

Aug 31. Six South Africa's largest state companies were suspended from procuring loans from Africa's biggest specialist fixed-income money manager. The state companies are Eskom Holdings SOC Ltd., Transnet SOC Ltd., South African National Roads Agency SOC Ltd., the Land Bank of South Africa, the Industrial Development Corp. of South Africa and the Development Bank of Southern Africa. The move, undertaken by Futuregrowth Asset Management, was due to concerns over the state companies' operations and threats to the independence of the finance ministry. Chief Investment Officer Andrew Canter mentioned that plans to lend over ZAR 1.8bn were placed on hold for three state companies and they will only continue lending to these firms after restoration of proper oversight and control of the state companies. (Bloomberg)

African Development Bank chief warns Africa on international debt

Aug 30. In a released statement, African Development Bank chief Akinwumi Adesina urged African governments to raise tax revenue and reduce international borrowing. With the region facing its worst economic slowdown in more than a decade, attributed to the slump in commodity prices and China's growth slowdown, the African Development Bank chief expects a sustained downturn in Africa for up to another 3 years. While the African Development Bank chief mentioned that Africa was facing a debt "challenge" instead of a crisis, he had also warned about the need for "a lot more fiscal consolidation." The current low growth environment saw many nations troubled over falling revenues, heightening debt and widening budget deficits as they took on foreign debt during the previous years of commodities boom. (FT)

SoftBank's USD 120bn debt nearing Moody's downgrade trigger (Bloomberg)

Zinc producer's shareholders fall short in bankruptcy fight (Reuters)

Unreliable credit ratings deter overseas investors from China's onshore bond market (SCMP)

Regulatory Updates

UAE Cabinet adopts final version of federal bankruptcy law

Sep 4. The United Arab Emirates' cabinet adopted a final version of the federal bankruptcy law, as the oil-rich nation tried to attract investors put off by current rules that criminalize an inability to repay debt. The law is expected to be modeled on Chapter 11 proceedings in the US, which allows companies to renegotiate the terms of their debts with creditors. It also aims to enhance foreign investment and ease the work of commercial companies. (Bloomberg)

Singapore eases refinancing rule for homeowners as economy cools

Sep 2. The Monetary Authority of Singapore (MAS) is relaxing refinancing rules for some homeowners. Households who are refinancing their existing mortgages will be exempted from a 60% cap on their total debt-servicing ratio, a restriction framework that was introduced in 2013. This move aims to ensure the stability of the property market based on concerns that the recent retrenchment and pay cuts due to weakness in the energy and financial industries could affect the home owners' ability to refinance existing mortgage loans. The MAS, however, emphasized that the adjustment does not represent an easing of the property cooling measures. (Bloomberg)

Banks win converts in campaign to blunt Basel capital revamp (Bloomberg)

IMF insists on international audit of Mozambique debt (Reuters)

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