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Weekly Credit Brief December 02 - December 08

Business risk for Kaisa escalates despite rate cut by PBOC

by Victor Liu

On Nov 21, People's Bank of China (PBOC) cut the benchmark one-year lending rate by 40bps to 5.6% and the one-year deposit rate by 25 bps to 2.75%. The move by PBOC is expected to benefit the property market in China as the funding costs would decrease, thus providing some relief for property companies with high levels of onshore debt. As shown in Figure 1, the China Real Estate Owners and Developers Competitive Peers Index, which measures the equity returns of 84 listed Chinese developers, has been on an upward trend since June 2014. This trend is due to the lower interest rates that the Chinese government imposed on the first-purchase's mortgages and the increase in house quota that each person can buy. After PBOC cut the benchmark rate, the index continued to increase and reached 103.83 bps on Dec 5. The credit profiles of Chinese developers listed in Hong Kong improved as well. The RMI aggregate 1-year PD for HK-listed, big-market cap Chinese real estate developers decreased to 23.45 on Dec 5.

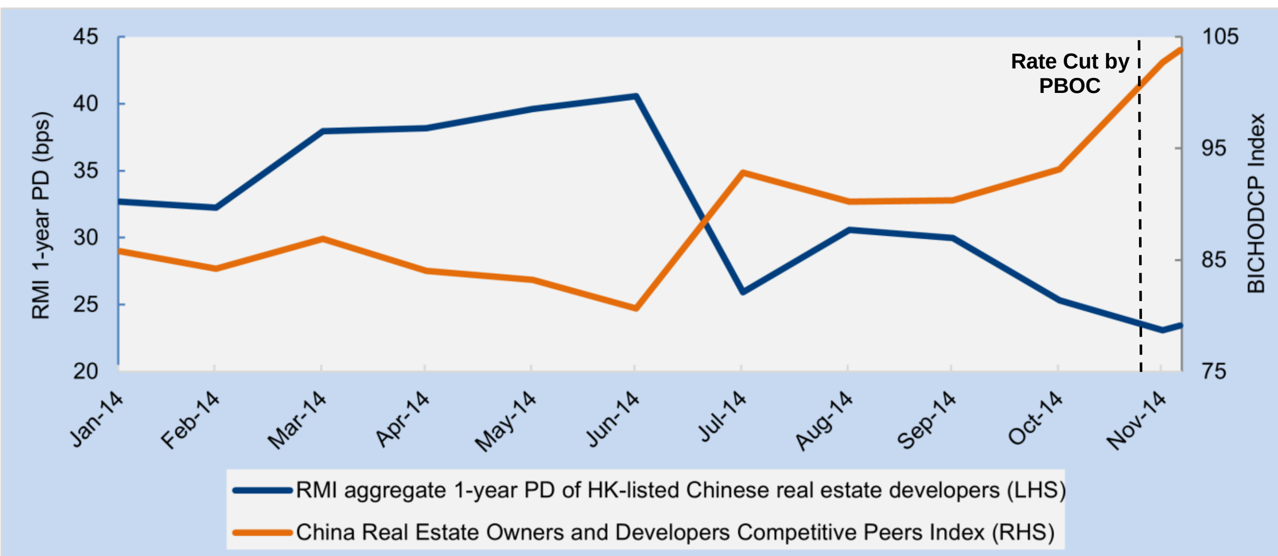

Figure 1: RMI aggregate 1-year PD of HK-listed Chinese real estate developers with big market cap (larger than USD 1bn) versus China Real Estate Owners and Developers Competitive Peers Index (BICHODCP Index). Source: *Risk Management Institute, Bloomberg*

Nevertheless, not all real estate developers can see an improvement on the backdrop of rate cut. Kaisa Property Holding, an HK-listed Chinese developer with market cap of more than USD 1.5bn, suspended its stock trading on Dec 3 and saw a slump in its stock price by 13% on Dec 4 when it resumed trading. The stock price drop was due to a shocking restriction on 3 projects by the authority, the Shenzhen's urban planning commission. The company hadn't received any notification yet and was also unaware of the reason for the action that sparked panic among investors.

Figure 2 illustrates that the market cap increased from June to November due to solid financial fundamentals, followed by a sharp drop in December, while the RMI 1-year PD of Kaisa increased to 70.77bps as of Dec 5 from 42.88bps at the end of November, reflecting escalating business uncertainty as a result of the event of restriction on project sales.

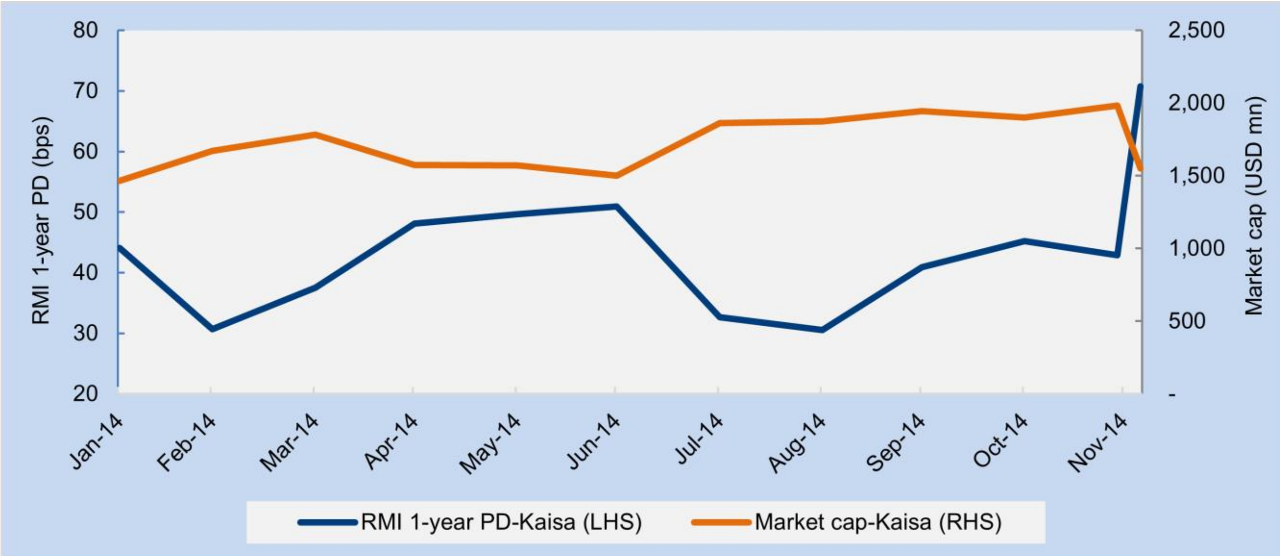

Figure 2: RMI 1-year PD and market cap for Kaisa (USD mn). Source: *Risk Management Institute, Bloomberg*

According to the company's management, Kaisa largely expanded the end-user property market in upper-tier cities from 2009 to 2011; however, as other big competitors, such as China Vanke, Sunac, etc., also strived for larger market share, the company has begun focusing more on urban development projects since 2012, which delivered better margin and sustained the company's sales growth in the past 2 years. Compared with doing business of end-user property market, doing business of urban development projects required much closer relationship with the local government. Kaisa used to achieve success in urban development projects in Shenzhen due to recognition of the government. As a matter of fact, Kaisa possessed solid financial fundamentals. Its sales revenue in the first 11 months achieved almost 29% YoY growth. As of the latest financial report, it had a benign gross margin of 40% versus 30% of the current industry average, while it delivered modest debt ratio of 28% versus 33% of the current industry average. On top of that, Moody's just upgraded Kaisa's long-term corporate credit rating to "Ba3" from "B1" in May, while S&P upgraded it to "BB-" from "B+" in the same month.

Despite good financial performance, the unexpected restriction on project sales could directly affect the sales revenue of the coming years, as the business from Shenzhen accounted for 39% of total sales as of Oct 2014. It also manifested that the company's advantage of good government relationship might disappear, which increases the business risk of Kaisa in the long term perspective.

Source:

Leveraged China developers to benefit from PBOC's interest rate cuts (SCMP)
Kaisa Suspends Trading After Shares Plunge Most Since 2013 (Bloomberg)
Kaisa Falls Most in 3 1/2 Years as Chairman's Trust Sells (Bloomberg)

Credit News

As oil prices fall, risk may rise

Dec 9. Falling oil prices may be the good news for consumers, but they could be bad for some banks in the oil patch. Oil prices fell another USD 2 a barrel on Monday, which is now less than USD 65 a barrel- a five year low. This would lower the revenues of US crude producer, who have to pay the borrowed money for manpower and expensive equipment. Some banks holding those loans and their investors are looking closely at this exposure. The low oil prices could also hit the broader economies of states that rely heavily on the oil industry for jobs and consumer spending, such as Texas and Oklahoma. (CNBC)

Greece gets two-month extension to bailout

Dec 8. Euro group finance ministers agreed to extend the terms of the loans of the Greek bailout as lawmakers attempt to resolve the impasse between Troika officials and the Greek government. Euro group chief Jeroen Dijsselbloem said that it was vital that Greece ensures a quick and full implementation of all the reform measures necessary to conclude the fifth review, and the euro group was in favour of a precautionary credit line for Greece when it exits the programme. Greece has received EUR 240bn in bailout funds from the EU and the IMF when the country's bond yields rose to record high levels. The country is waiting for the final disbursement of the bailout fund from the EU. (Irish Times)

Australian banks seen needing USD 25bn in capital

Dec 7. Commonwealth Bank of Australia and its three main competitors may need as much as USD 25bn after a government-commissioned inquiry called for "unquestionably strong" capital levels, analysts said. The shortfall is based on lenders needing to boost levels to within the top quartile of their global peers and set aside additional funds against potential losses on home mortgages, as recommended by the Financial System Inquiry report released on Dec 6. (Bloomberg)

ISDA asked if Radioshack triggered CDS

Dec 5. The International Swaps and Derivatives Association determinations committee will have to decide if 5 year CDS tied to Radioshack's USD 250mn term loan has been triggered as lenders claimed that it is in breach of covenants. The claims relate to the firm's credit facility which it has formed with Standard General. A second creditor, Salus Capital Partners, is also demanding full payment on its second lien term loan due December 2018. Radioshack CEO said that the claims are blocking the firm's turnaround efforts and creating problems during the critical holiday shopping season. (Forbes)

A Russian default? (Seeking Alpha)

Haitong Securities to buy Portugese bank for EUD 379mn (Dealbook)

Venezuela needs cash (CNBC)

Regulatory Updates

BOE looks beyond rate guidance in UK bank stress test

Dec 8. The Bank of England is willing to put aside its own forward guidance to determine how well the country's eight largest lenders would fare in a crisis. Governor Mark Carney has said rate increases from the current record-low 0.5% are likely to be gradual and the peak in rates lower than in previous cycles. But the BOD assumes an increase to 4% by the end of 2015. (Bloomberg)

Proposed US bankruptcy rule changes spark debate from lenders

Dec 8. The American Bankruptcy Institute's Commission could be changing laws to give companies more leeway to impose restructuring plans over creditor's objections. The commission recommends secured lenders to share profits with junior creditors in the event that a company regains financial health. Lawyers say that most of the recommendations would take years to implement, while a few laws, such as those to interpret current disputed case law could be imposed now. (Reuters)

US Watchdog sees risk of repeated liquidity crunches

Dec 2. The US Office of Financial Research, a new arm of the Treasury Department, said that the financial system is vulnerable to repeats of what happened in October, when turmoil in the trading of US Treasury securities spread to the futures, swaps and options markets. The report said that the volatility in the markets were related to the decline in the liquidity and could be exacerbated by computerized trading and algorithms. Banks are less willing to facilitate trading as new regulations make lending cash and securities more expensive. (WSJ)

Banking book rate risk project splits in two (Risk.Net) (Subscription required)

FVA, correlation, wrong-way risk (Risk.Net) (Subscription required)

EU materially non-compliant on Basel III (IfrAsia)

Tight new rules may boost shadow banks (Reuters**)**

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