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Stories of the Week

OCBC's potential offer for Hong Kong's Wing Hang Bank is credit positive
By James Weston

Singapore-based Oversea-Chinese Banking Corporation (OCBC) said it had entered exclusive talks with Hong Kong based Wing Hang Bank Ltd (Wing Hang) on January 6 to finalize terms of a potential takeover offer. OCBC is believed to have offered less than the two times book value Wing Hang was seeking, with analysts' estimating an all-equity offer of around 1.8x book value, or SGD 6bn. If completed at this value, by combining the two companies' financials and assuming no other market or fundamental changes, the hypothetical RMI probability of default (RMI PD) for the combined banking entity would fall suggesting the potential merger is credit positive, especially for Wing Hang (Figure A1, left).

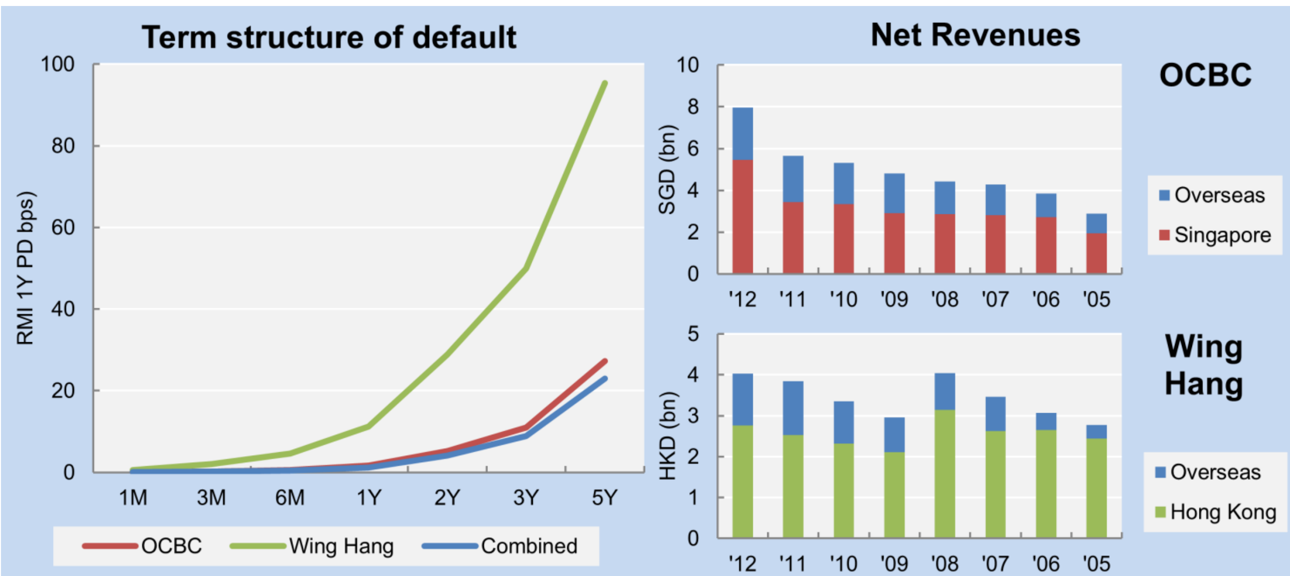

Figure A1: Term structure of default for OCBC, Wing Hang, and the combined entity, assuming an all-equity offering of 1.8x Wing Hang's book value (left), and net revenues by geographic segment for the two banks. *Source: Risk Management Institute, company reports*

Combining with OCBC would create the scale Wing Hang has sometimes lacked when competing with larger mainland and regional banks in Hong Kong, which has affected revenue growth over the last 12 months. A loan guarantee scheme for SMEs introduced by the HKMA at the beginning of 2011 encouraged larger regional banks to move into a sector that was once a lucrative domain for smaller banks. Wing Hang responded by growing lending outside of Hong Kong (Figure A1, bottom right), largely in Macau and mainland China. Moreover, we have suggested previously that increased M&A activity in the Hong Kong banking system may be credit negative for local institutions due to potentially weaker governance and controls, especially as a number of mainland entities had expressed interested in acquiring smaller Hong Kong banks. OCBC's proven risk management record, as well as a strong parent-level regulator in the Monetary Authority of Singapore eases these concerns.

The merger would give OCBC access to Wing Hang's rapidly growing cross border CNY lending business based out of Hong Kong and into southern China's Pearl Delta heartland, a commercial crossroads where OCBC currently has little presence compared with larger regional players and mainland Chinese banks. Wing Hang currently has 47 branches in Hong Kong, 12 in Macau and 16 in mainland China, while OCBC currently has offices in Hong Kong and Shanghai, and 13 other branches across mainland China. The Chinese government restricts the rate at which foreign banks can add braches, making Wing Hang's mainland presence quite valuable. The acquisition will potentially increase OCBC's Greater China loan book to around SGD 43bn, or 23% of outstanding loans, from around 15% currently. OCBC would also look to benefit from further integration of regional cash flows and ongoing CNY internationalization, which may justify the high price tag.

Our lower RMI PD estimate for the combined entity arises from relatively lower debt levels at Wing Hang, which when combined with OCBC's financials lead to a higher distance-to-default (DTD), or volatility adjusted leverage. DTD is a major input into RMI's PD model, and is negatively correlated with RMI PDs.

Default risk for Singapore property sector increases

By Dexter Tan

According to flash estimates for prices of mass market condominiums, Singapore suburban homes have registered their first quarterly price decline in nearly 2 years. Overall, prices of private residential property have also cooled with Singapore's Urban Redevelopment Authority (URA) private housing price index registering a drop 0.8% QoQ in Q4 2013 after rising 0.4% in Q3 2013. Lofty home prices and low interest rates led regulators to implement a slew of cooling measures since 2009. The most recent measure was the total debt servicing ratio (TDSR) framework, which has eroded borrowing capacity and also affected upgrader demand for mass market private condos. The curb restricts borrowers from overstretching their financial means by limiting monthly mortgage repayments to not more than 60% of the borrower's gross monthly income.

The aggregate 1-year RMI probability of default (RMI PD) for 41 SGX- listed Singapore real estate developers has increased since the introduction of the TDSR framework. RMI PD remained at elevated levels after reaching 19.09bps in December. Developers have begun cutting prices in existing and new projects and take lower profit margins. Even, large real estate deals were affected as well in Singapore with transactions falling close to 75% to USD 3.67bn in Q4 2013 from USD 13.3bn in Q3 2013.

Singapore real estate developers have been seeking growth overseas in light of weaker domestic property demand. Singapore listed developers have been active in overseas markets such as Australia, London and US cities. OUE Ltd paid SGD 459mn to purchase a Los Angeles bank tower in July while Oxley Holdings announced it would be investing GBP 200mn in Royal Wharfs, located in East London's docklands.

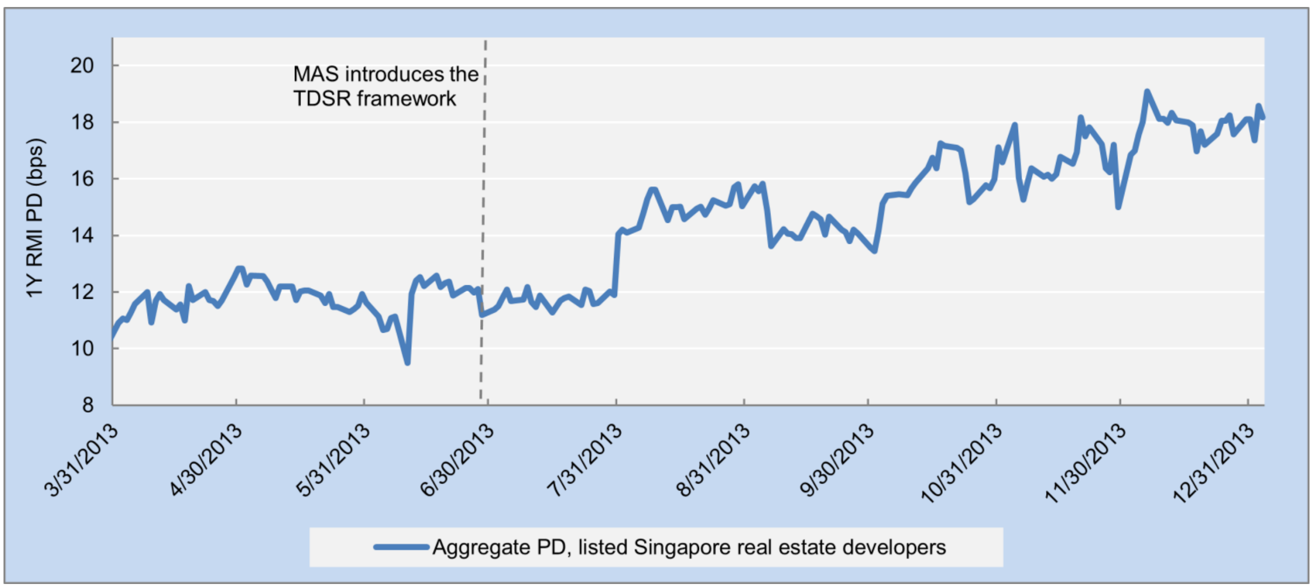

Figure 1: 1-year aggregate RMI PD for Singapore listed developers. *Source: Risk Management Institute*

In the News

GE leads USD 427bn of US debt due in 2014

Jan 02. General Electric has the highest amount of debt due this year among US corporate issuers, with USD 35.2bn of bonds maturing in 2014. The amount of debt due this year for US corporate borrowers dropped 5% to USD 427bn, thanks to an unprecedented stimulus from the Federal Reserve which helped companies extend their maturities to the future and reduce short term funding requirements. The amount of bonds maturing in 1 year as a percentage of total borrowings has been falling. Debt due within a year was about 12% of borrowings at the start of 2012; this figure fell to 8% at the beginning of 2013 and the amount of maturing debt in 2014 accounts for 7% of total outstanding obligations at present. (Bloomberg)

Italian, Spanish debt premiums fall to lowest since mid-2011

Jan 02. The yield premium offered by Italian and Spanish sovereign bonds over benchmark German bonds fell to its lowest since 2011 last week, as PMI data beat expectations and spurred a move from relatively safer German bonds to sovereigns of less safe eurozone countries. Yields for 10-year Spanish bonds shrank 16bps on the PMI data to 205bps over German bonds, while Italian bonds shrank 14bps to a premium of 203bps. Signs of a eurozone recovery and diminished risk of a eurozone split resulted in a poor year for German bonds overall, as the yield of 10-year German sovereign bonds rose 61bps in 2013, the highest yearly increase since 2006, to end the year at 193bps. (Reuters, Bloomberg)

Early spotlight on Portugal, France in new credit ratings calendar

Jan 02. Europe's new calendar for sovereign credit ratings, an EU measure to clarify the procedures of credit ratings agencies, will focus on bailed-out Portugal and recently downgraded France. European Union rules came into effect this month requiring Standard and Poor's, Moody's, Fitch and other credit ratings agencies operating in Europe to for the first time lay out the dates on which they review a country's rating. The rules are part of an endeavor to increase regulation on the agencies, which came under pressure for underestimating the risks of mortgage-related securities in the run-up to the 2007/08 global financial crisis. (Reuters)

Chinese banks eye global bond market

Jan 02. Chinese banks are set to depend on foreign bond buyers instead of domestic markets for funds in the next couple of years. Increasing bad debt in the Chinese economy, tighter capital regulations and the lackluster performance of the stock market have resulted in Chinese banks no longer being able to depend on the domestic market to raise funds. In addition, the need to raise CNY 2tn from bond sales in the next 5 years to meet rising capital requirements and refinance debt has forced Chinese banks into looking towards overseas funding for obtaining capital. (WSJ)

Singapore's economy grows 4.4% on-year in Q4 2013

Jan 02. Advance estimates from Singapore's Ministry of Trade and Industry showed that the city-state' economy expanded 4.4% YoY in Q4 2013, decelerating from 5.9% YoY in the preceding quarter. Although this figure falls short of economists' expectations of 4.8%, Singapore's 3.7% GDP growth for the year is in line with the government's growth forecast of 3.5 to 4%. In Q4, a decline in biomedical manufacturing output and transport engineering activity contributed to a slowdown in manufacturing, whereas services was bogged down by weaker growth in the wholesale and retail trade, and the finance and insurance industry. Nevertheless, this QoQ contraction is expected to be short-lived as economic recovery in the US, Europe and China gathers pace. The economic outlook for Singapore thus remains positive. (Channel News Asia)

Euro zone corporate lending shrinks at record pace in November (Reuters)

Companies sell record USD 1.11tn of bonds in 2013 (WSJ)

Bond tab for biggest economies seen at USD 7.43tn for 2014 (Bloomberg)

China gives local governments go-ahead to roll over debt (FT)

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Corrections
January 8: On page 1, paragraph 3 has been change to reflect OCBC's mainland China branch presence.