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Transforming Big Data into Smart Data

Weekly Credit Brief

Feb 18 - Feb 24 2014

Chart of the Week

Global aviation industry maintains a healthy credit outlook
By Dexter Tan

The global airline industry is expanding and companies are eager to grow their fleet size on the back of healthy travel volumes and manageable fuel costs. A record USD 32bn of deals were announced during Asia's largest airshow in February 2014, including a USD 9bn agreement by VietJetAir to buy 63 Airbus aircrafts, partly financed by China Construction Bank. Orders were also flowing in from the Dubai Airshow in November 2013 with more than USD 200bn of deals. Emirates Airlines placed a USD 76bn order for 150 Boeing 777X planes, in addition to 50 Airbus A380s for USD 23bn at the exhibition. Other carriers, Etihad Airways to Lufthansa placed some USD 95bn in purchase orders for Boeing 777x during the Dubai airshow.

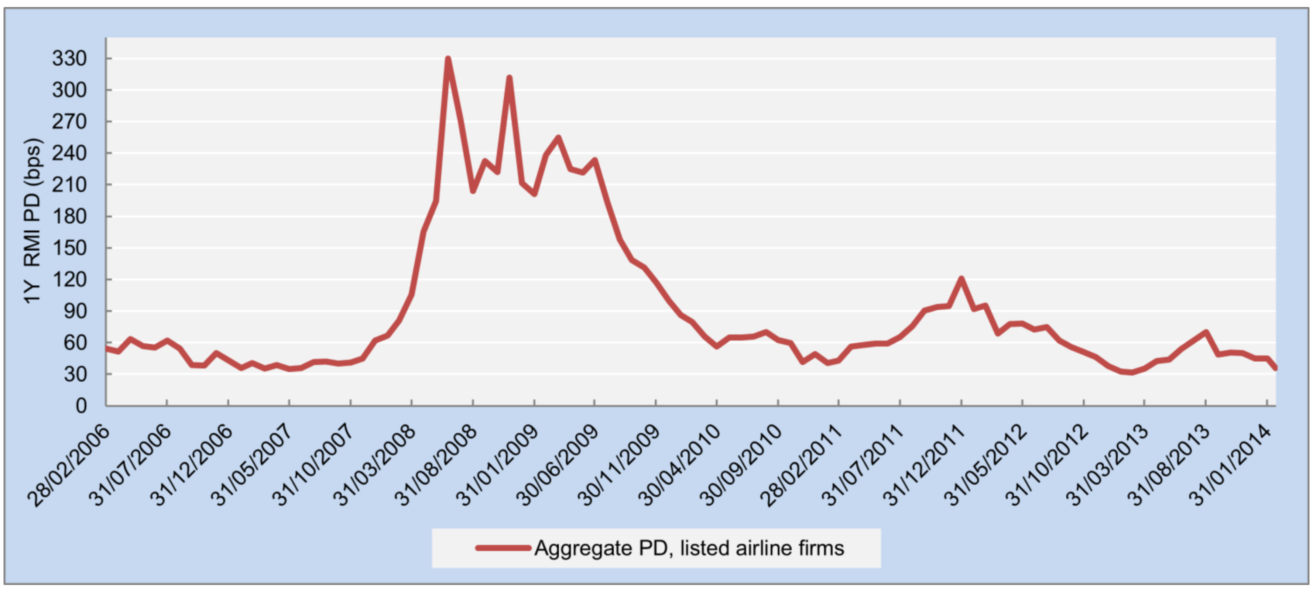

Figure A1: Aggregate 1-year RMI PD for listed global aviation firms. *Source: The Risk Management Institute*

The aggregate 1-year RMI probability of default (RMI PD) for global airlines stayed below 100bps after the end of 2011. After touching 329bps in June 2008 during the US financial crisis, the aggregate RMI PD dropped to 36bps this year. Reflecting an improvement in credit quality, RMI PD for the aviation sector decreased 111bps in 2009, 50bps in 2010 and 82bps in 2012. Some of the largest airline companies recorded significant declines in RMI PD. For example, the RMI PD for United Continental Holdings (formerly UAL Corporation) dropped 2729bps between June 2008 and February 24, 2014. The company is the product of a completed merger between United and Continental Airlines in May 2010. Delta Airline's acquisition of Northwest Airlines to form what was then the largest commercial airline in the world in 2008 also saw a similar downtrend in RMI PD for the merged entity.

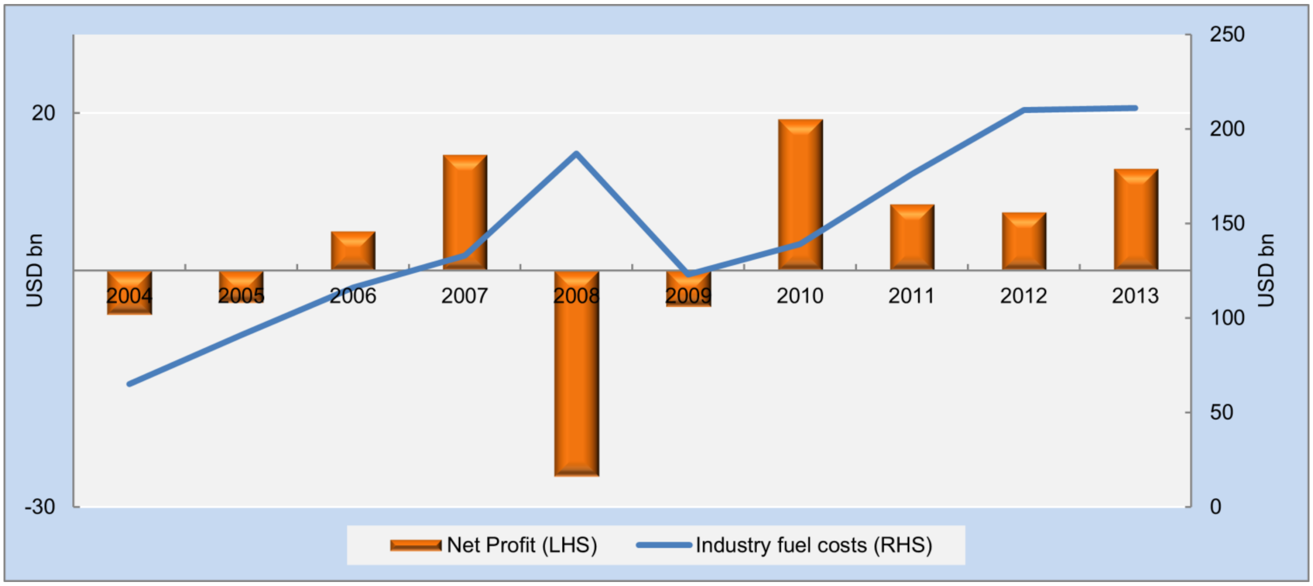

Figure A2: Global commercial airline profitability. 2013 figures are forecasts from the International Air Transport Association (IATA). *Source: International Civil Aviation Organization.*

Profitability for the global aviation sector has been increasing since 2010. The industry is expected to generate USD 12.9bn of after-tax earnings in 2013, due to improvements in industry structures and better airline operating efficiencies. Commercial airlines made USD 14.7bn of profits in 2007, but, an unexpected rally in jet fuel costs and an ensuing global economic crisis resulted in aggregate industry losses of USD 26.1bn in 2008. In that year, total fuel costs amounted to USD 187bn, accounting for 33% of operating costs. In 2009, industry fuel costs retreated momentarily to USD 123bn but have since risen above USD 200bn. Despite facing higher fuel costs, jetliners delivered USD 47.9bn of net income to stakeholders between 2009 and 2013, due to higher passenger yields and better hedging fuel cost capabilities. Jet kerosene made up 26% of operating costs in 2009, 25% in 2010 and 28% in 2011.

Regionally, North American airlines recorded the best performance in terms of earnings for 2012 and 2013. Combined earnings for commercial airlines topped USD 5.8bn in 2013 and USD 2.3bn the year before. A stronger US economy coinciding with a consolidated airline industry in the country created better working synergies for North American carriers. While, Asia Pacific airlines made the second largest net profit for 2013, surpassing Middle Eastern and Latin American airlines both in EBIT (earnings before interest and tax) margins and absolute net incomes. In 2012, Asia Pacific international carriers were the best regional performers in terms of earnings, but lagged the American airlines in terms of EBIT margins.

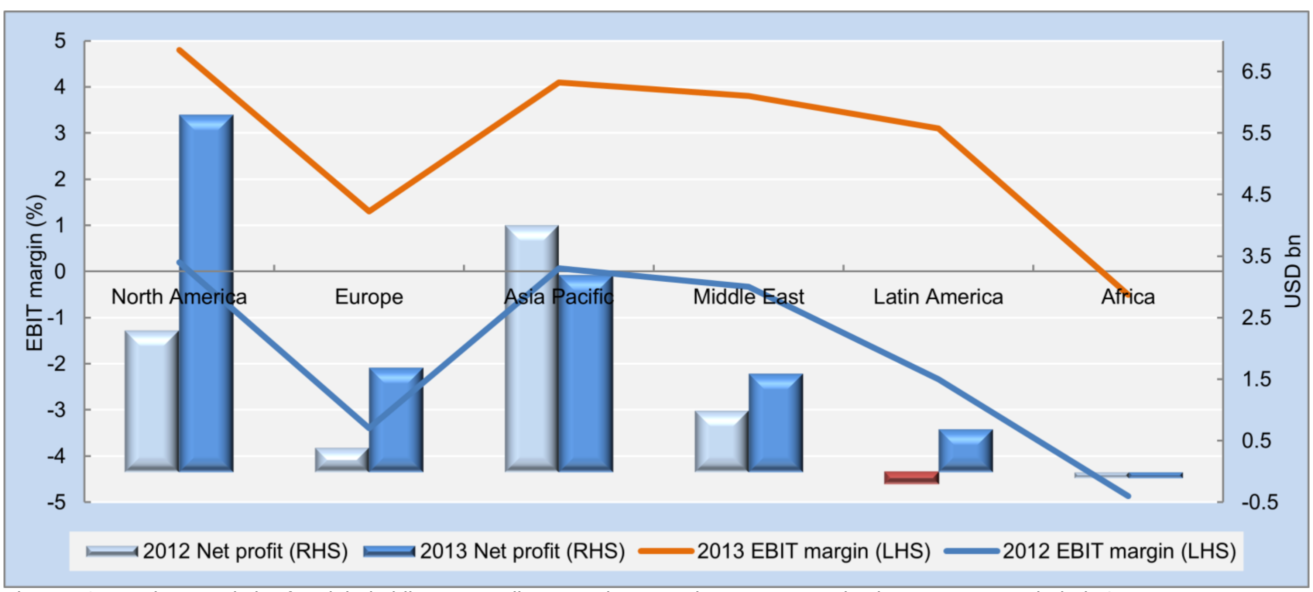

Figure A3: Earnings statistics for global airlines according to regions. Bankruptcy reorganization costs are excluded. *Source: IATA*

Story of the Week

Continuous restructuring of DLF balance sheet helps to improve its RMI PD
By Siddharth Batra

The 1-year RMI PD for DLF Ltd, India's largest real estate developer, has been on the decline since September 2013 as DLF restructures its balance sheet. During the last 6 months of 2013, DLF raised about USD 165mn from sale of assets such as windmills, and a majority stake in a life insurance venture. It has also managed to raise about USD 300mn of fresh equity through a private placement. From a high of 188.5bps in Sep 2013, the 1-year RMI PD slipped to 147bps on January 31. As of February 24, 1-year PD is further down to 135.7bps indicating a lower stress situation for DLF.

A fortnight ago, DLF announced the divestment of its Aman resorts chain of luxury resorts, which owns and manages 26 resorts in 18 countries for a consideration of USD 360mn. This asset sale will help DLF to pare its net debt further by about USD 290mn and exit its non-core businesses that saddled DLF books in an anemic real estate market in India.

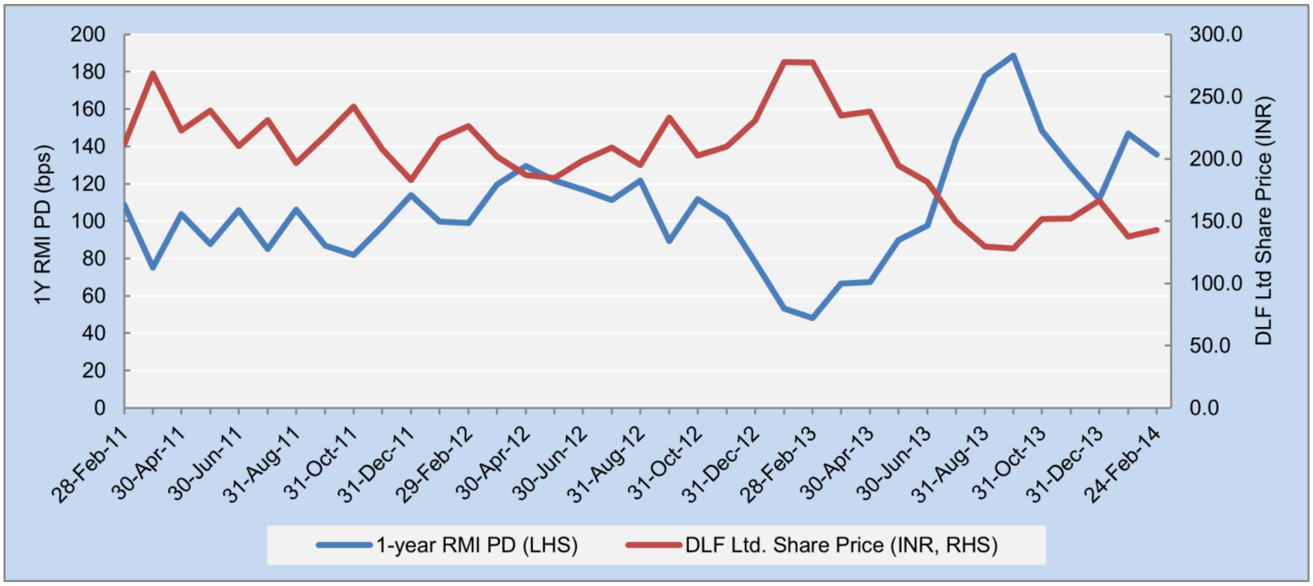

Figure B1: 1-year RMI PD and share price of DLF Ltd. *Source: The Risk Management Institute*

In December 2012, DLF had announced its intention to sell Aman but the deal collapsed soon after. This resulted in DLF's share price plunging from a high of INR 277 per share in January 2013 to low of INR 128 in September 2013. The 1-year RMI PD during the same period spiked from 53.3bps to 188.5bps on fears that DLF may fall – especially with a high interest cost, the property developer was floundering to repair its balance sheet and lower its gearing. However, after multiple asset sales and raising fresh equity, the RMI PD has lowered down considerably since September 2013.

In the News

UAE's Abu Dhabi Commercial Bank raised USD 750mn from 5-year bond issuance

Feb 24. Abu Dhabi Commercial Bank has sold its USD 750mn 5-year dollar notes to yield 140bps over the benchmark midswap rate after receiving about USD 4bn in bids. The offering is the first Persian Gulf lender this year, snapping a drought that had contributed to the slowest start to debt offerings since 2011. (Reuters)

Ukraine bond investors remain anxious despite relief rally

Feb 24. Hopes for a deal with the International Monetary Fund boosted Ukrainian dollar bonds by 5 to 9 cents across all maturities on Monday. The rally reduced the country's bond yield premiums to US Treasuries by just a half percentage point on average. Although, this offered some relief to bondholders but data provider, Markit estimated that the probability of default is as high as 52% in the next five years based on its calculations on prices for credit default swaps. Ukraine has said it needs around USD 35bn in foreign assistance over the next 2 years as the government needs to repay some USD 6.5bn due to creditors this year. (Reuters)

Brazil cuts USD 18.5bn from budget as downgrade looms

Feb 20. The Brazilian government will cut spending by BRL 44bn in 2014 to meet a primary surplus target of 1.9% of its GDP and help tame inflationary pressures. Last year, the government fell short of its revised primary surplus aim of 2.3%, which led to its year-end budget deficit hitting an all-time high of BRL 157.6bn. Over the past 8 months, Brazil had its credit outlook cut by both S&P and Moody's on its deteriorating fiscal position. Meanwhile, inflation in January remained high at 5.59% despite a drastic 325bps hike in the benchmark Selic rate to 10.5% in less than 12 months. (Businessweek)

Mexico growth slows in Q4, 2013 expansion at 4-year low (Reuters)

UK interest rates likely to rise in 2015, warns bank policymaker (The Guardian)

Singapore posts higher surplus for FY2013; will see small deficit for FY2014 (Channel News Asia)

Moody's ratings upgrade pegs Spain yields at 8-year lows (Reuters)

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