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AirAsia soaring into clearer skies

by Samuel LIM Kok Hong

AirAsia is the biggest budget airline in Asia in terms of revenue. Since its establishment as a short-haul low-cost carrier in 2001, it has grown to serve 121 destinations from 16 hubs in Malaysia. The credit profile of the carrier has improved in the last eight months. Its RMI-CRI 1-year Probability of Default (PD) has fallen from 258.4bps in Aug 26, 2015 to 37.8bps on Mar 24, 2016 (see Figure 1).

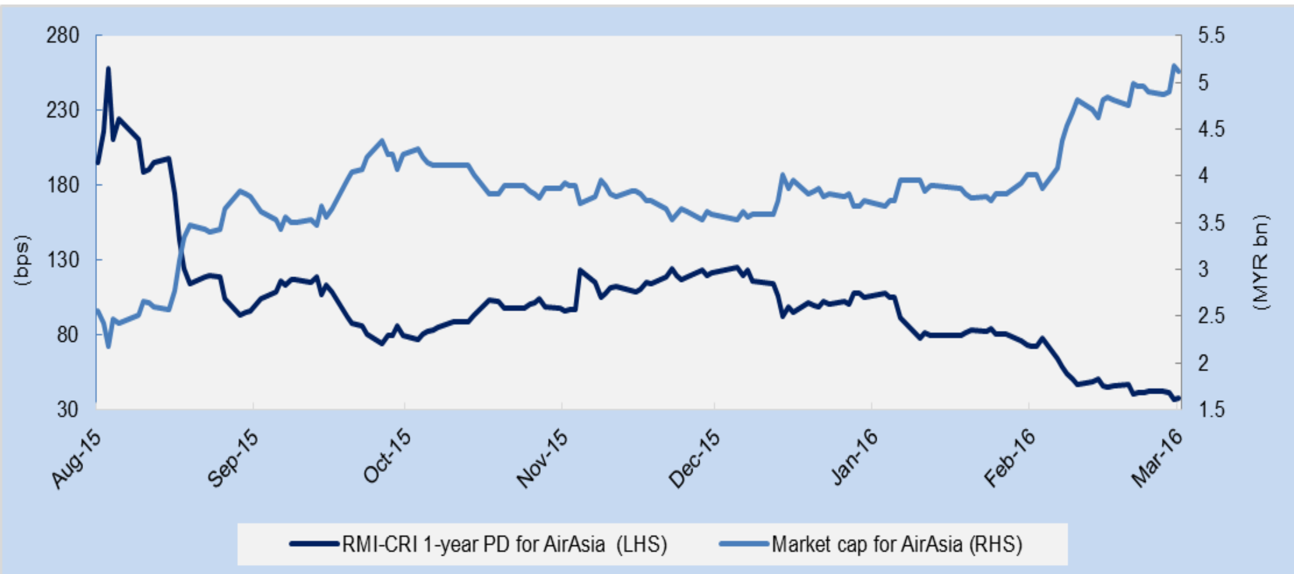

Figure 1: RMI-CRI 1-year Probability of Default and market cap for AirAsia. *Source: RMI-CRI, Bloomberg*

AirAsia's share price hit a five-year low of MYR 0.77 on Aug 26 last year. Since then it has recovered remarkably as it leaped to MYR 1.81 on Mar 25, 2016. A report issued in Jun 2015 by GMT Research questioning the firm's accounting, capital outflows from Malaysia, and the requirement by the Indonesian government to strengthen AirAsia's equity position were the main reasons for the plunge in the stock price. However, the bleeding stopped when investors felt that the stock was undervalued and began accumulating the firm's shares. According to data compiled by Bloomberg, at least six funds have purchased the stock since AirAsia's share price rock-bottomed in Aug 2015, aiding in the resurgence of the stock. In Sep 2015, AirAsia announced its plan to conduct share buybacks, which materialized in Mar 2016, signalling to the market that its shares were undervalued. The sudden surge in the market capitalization at the end of February was largely due to a favourable earnings report. The market capitalization of the carrier has increased considerably, rising 135% from MYR 2.17bn in Aug 26, 2015 to MYR 5.12bn in Mar 24, 2016.

On Feb 26, the carrier reported its Q4 2015 and FY 2015 earnings. It returned to black with a net profit of MYR 554.2mn in Q4 2015, compared with a net loss of MYR 428.5mn in Q4 2014. The earnings report beat analysis estimates and exceeded market expectations. Quarterly revenue rose 47% to MYR 2.17bn from MYR 1.48bn a year ago, on the back of a 10% YoY growth in the number of passengers carried. Subsequently, the company recorded a high load factor of 85% which is a 7 percentage point YoY growth. In spite of the decision to remove the fuel surcharge in early 2015, the revenue per available seat kilometre (the operating income divided by the available seat kilometre, which is the total available seats multiplied by the distance flown) was MYR 0.22, an increase of 40% YoY. Fuel expenses dropped 15% YoY in Q4 2015 due to lower average fuel prices at USD 75 per barrel, compared to USD 95 per barrel in the same period the year before. This was despite a 7% increase in the amount of fuel used, as a result of a 1% growth in the number of flights and a 4% growth in the average flight length of the airline.

	Q4 2014	Q1 2015	Q2 2015	Q3 2015	Q4 2015
EBIT/Interest Expense	1.40	1.59	1.61	2.10	5.87
Total Debt/EBIT	17.24	17.16	14.01	13.85	7.95

Table 1: Financial data for AirAsia. *Source: Bloomberg*

AirAsia has also improved on its ability to repay the interest on its debts, as the EBIT/Interest expense ratio increased to 5.87 in Q4 2015 (see Table 1). Its revenue has been increasing at a faster rate than operating expenses. Concurrently, the company's interest expense has declined over the past four quarters. The carrier now has better financial ability to repay its debts, given that the total debt to EBIT has fallen to 7.95. This is mainly due to the improving operating income, as the total debt has been relatively constant over this time period.

Despite improvements in its earnings and financial profile, certain underlying operating factors still pose downside risks to AirAsia's credit strength. The company's bottom line continues to be dragged down by its associates. Indonesia AirAsia (IAA) in particular, has been making losses since 2013 and reported substantial losses in FY2015. AirAsia booked a total loss of MYR 797mn at its Indonesian associate in FY2015; the loss consisted of prior-year unabsorbed losses of MYR 469mn and current year losses of MYR 332mn. IAA's attempt to be a major player in the domestic market has been largely unsuccessful over the years. Indonesia's airline industry is highly saturated and thus, highly competitive. Many people usually choose the carrier that offers the lowest price because the switching costs between the airlines are low. In addition, oil prices have rebounded from its decade-low in Feb 2016. If the price of oil continues to increase, it might pose a threat to the carrier's profitability as fuel expenses make up about 40% of its operating cost.

Taking into account this loss-making streak as well as the nature of Indonesia's airline industry, divesting itself of Indonesia AirAsia might be a sensible option. Doing so would immediately boost the profitability of the company. Furthermore, AirAsia will also be able to put to rest, the allegations against the accounting treatment of its troubled associate. The greater financial stability would then provide further support to its credit strength.

Credit News

Forbes says Australia vulnerable to debt crisis

Mar 28. According to Forbes magazine, Australia is one of the seven countries which are most likely to face a debt crisis within the next three years. Australia comes second on the list of seven, just behind China. The magazine used public and private debt data in their forecast, closely investigating the period which credit growth begins to drop. The drop in credit growth is especially important because it indicates that debt servicing is exhausting the funds to finance it and it would lead to a change in available credit. The report states that Australia met the two key prerequisites of having a high level of private debt to GDP and rapid growth of credit like the other six countries in the list. (Sydney Morning Herald)

Singapore budget 2016: property players fret over absence of relief

Mar 28. The absence of any measures in Budget 2016 to help the beleaguered property sector was greeted with an air of resignation among industry players, and disappointment by some home owners hoping to buy some investment property. The vacancy rate of private homes hit a 10-year high of 8.1% in the fourth quarter of last year. The government had earlier flagged that it is still premature to lift cooling measures on residential transactions. (Straits Times)

Oil services ditch Singapore for Malaysia

Mar 27. Multinational oil services companies are pulling staff out of Singapore and relocating to neighbouring Malaysia to cut costs, in a further sign of the damage being inflicted on the city-state by the crude price slump. Businesses that have relocated to the Malaysian capital of Kuala Lumpur over recent months include McDermott, Technip, and Subsea 7. Reasons for changing location include: lower cost of real estate, cheaper car prices, closer to customers in Malaysia and a slump in the value of the ringgit. (FT)

Japan's Mitsubishi to post first net loss on slumping metals, energy

Mar 24. Japanese trading firm Mitsubishi Corp said on March 24 that it would post its first ever annual loss of JPY 150bn in the year ending March 31, caused by a massive write-down due to a price slump in commodities. Like major international oil and mining companies, Japanese trading firms have been suffering from steep falls in the prices of goods from oil to iron ore as China's economic growth has slowed. In addition to Mitsubishi Corp, its local rival Mitsui warned of its first net loss since 1947, while another trading house Sumitomo Corp halved its net profit forecast for 2015 due to heavy write-downs. (Channel NewsAsia)

PetroChina income drops to '99 low on USD 3.8bn write-down

Mar 23. PetroChina Co. profit tumbled to the lowest since 1999 as the company reported a USD 3.8bn write-down amid the crash in energy sector. Net income at China's biggest oil and gas producer dropped 67% to RMB 35.5bn from RMB 107bn. The firm warned in January that 2015 profit may fall 60-70%. Brent, the global benchmark, dropped to an average of about USD 54 per barrel last year, prompting global oil energy companies to write down assets, slash earnings and cut capital expenditure plans. (Bloomberg)

Spain's Abengoa wins backing from creditors to avoid bankruptcy (Reuters)

China companies 'bleeding' from yuan devaluation seek hedging help (Straits Times)

Mitsui warns of first loss since 1947 (FT)

Regulatory Updates

MAS welcomes move to allow cross-border RMB flows from Chongqing

Mar 25. The move by the People's Bank of China Chongqing Operations Office will allow eligible corporates and individuals in the Chinese city to conduct cross-border Renminbi transactions with financial institutions and corporates in Singapore. The initiative will facilitate greater use of RMB in the region and contribute to the growth of the offshore RMB market in Singapore. It will also strengthen financial connectivity between Chongqing and Singapore. (Channel NewsAsia)

Banks' leeway on credit risk narrows as Basel tightens rules

Mar 24. The Basel Committee on Banking Supervision suggested a standardized method for lenders to follow in determining the amount of capital needed to fund exposures to financial firms, equity and large corporations. The Basel Committee's Chairman stated that addressing the issue of excessive variability in risk-weighted assets is important in regaining market confidence in the usage of risk-based capital ratios. The new plan would still allow internal models to be used in certain cases, and the measures imposed would help to promote a healthy level of capital and fairer comparability across the banks. (Bloomberg)

Singapore Reits set to consolidate to cope with rising regulatory costs

Mar 23. According to Cambridge Industrial Trust, Singapore's real estate investment trust market is set to consolidate as smaller vehicles merge in the face of rising regulatory costs. Although Singapore Reits have grown into the sixth-largest globally by market cap, more than half of the 35 Reits listed in Singapore have a market cap of less than USD 1bn. The new rules put in place last year by MAS required higher levels of disclosures, entailing higher compliance costs and lower revenue potential for Reit managers. As the new rules are especially punitive for smaller-scale Reits, a trend of consolidation could be expected. (Straits Times)

EU mulls easing bank-failure rules to align with global standard (Bloomberg)

Senior ECB official tells banks to stop whining (FT)

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Contributing Editor: Khaw Ker Wei