Transforming Big Data into Smart Data

NUS National University of Singapore | RMI Advancing Risk Management for Singapore and Beyond

Weekly Credit Brief

Mar 25 - Mar 31 2014

Stories of the week

Shipbuilder China Rongsheng's loss widened

On March 31, China's largest private shipbuilder, China Rongsheng Heavy Industries Group Holdings Ltd, reported a CNY 8.9bn annual loss as revenue dropped 83% from a year earlier. The company said that the loss was a result of a market downturn and financial difficulties faced by the Group's customers. Current liabilities at the end of 2013 exceeded its current assets by CNY 6.68bn while total borrowings and leasing liabilities amounted to CNY 22.40bn, out of which CNY 13.71bn will be due in 12 months. After the reported loss, the company secured loans and other financing from banks worth CNY 10bn until 2015.

The extension of loans is part of the group's strategy to improve its financial performance. In December 2013, Mr Zhang Zhi Rong, a major shareholder of the company, agreed to provide an interest free revolving facility of up to CNY 3bn to the firm. In January 2014, China Rongsheng issued a CNY 786mn convertible bond which is scheduled for repayment in July 2016. The group also plans to issue another CNY 786mn convertible bond in April 2014, which will mature in October 2016. The company is taking immediate measures to improve collection of outstanding receivables from customers, cut capital expenditure, reduce long term costs and restructure the remuneration of senior management.

The RMI 1-year probability of default (RMI PD) for China Rongsheng has remained above the aggregate RMI PD for Chinese shipbuilders between September 2011 and March 2014, as shown in Figure A1. Sales at the conglomerate declined to CNY 7.2bn in December 2011 from CNY 8.70bn in June 2011. Lower shipping dry bulk, container and tanker rates were hurting the order books for the shipbuilder. In September 2011, the company received a CNY 35bn loan from China Development Bank, therefore increasing the firm's leverage. The firm went on to take on more loans from creditors. The ratio of total debt to equity subsequently increased from 145% in June 2011 to 209% in June 2012. Through this period, the RMI PD for China Rongsheng increased 5.83X to 106bps. By the end of July 2012, RMI PD reached a zenith of 237.4bps following a 38.86% drop in market capitalization during the month.

Figure A1: RMI PD for Chinese shipbuilders. *Source: The Risk Management Institute*

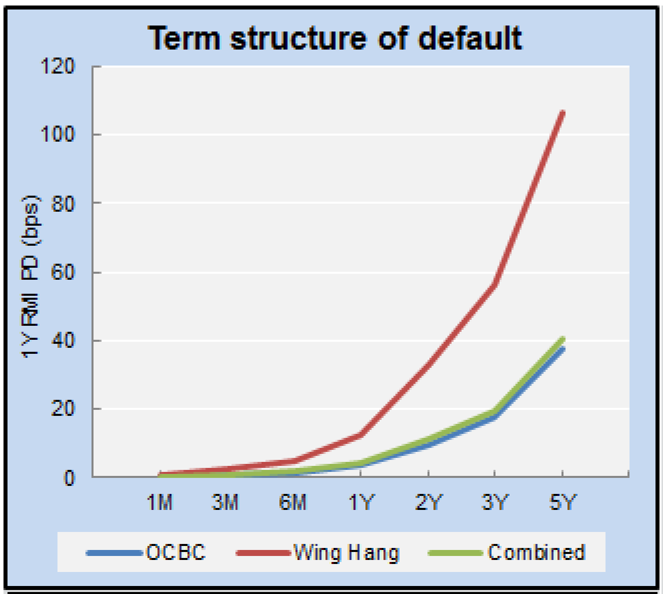
The aggregate RMI PD for Chinese shipbuilders increased to a record high in March 2014. China Rongsheng has been struggling to remain a going concern in an industry plagued by overcapacity. Unlike neighboring countries which have 10 and 15 active shipyards in South Korea and Japan respectively, China had 1647 shipyards in 2012. Customers are not ordering new ships at the same rate as that before the 2008 financial crisis. The Shanghai export containerized freight index has fallen 38.1% between April 2012 and March 2014, while figures from the Lloyd's Register of Shipping highlight that idle container ships in the world have a total idling capacity of 547,834 twenty-feet equivalent units (TEUs) in February 2014, which is the highest level since April 2013.

Despite cash offer for Wing Hang, OCBC's credit risk remains low compared to peers

By James Weston

Singapore-based Oversea-Chinese Banking Corporation (OCBC) announced a conditional general cash offer to acquire 100% of Hong Kong-based Wing Hang Bank Ltd (Wing Hang) on April 1. The offer comes three months after the banks first entered exclusive talks in January. At that point in time, OCBC was expected to make an all-equity offer of around 1.8x Wing Hang's book value, which RMI probability of default (PD) data showed was credit positive for both institutions. The new general cash offer of SGD 6234mn is 1.77x Wing Hang's consolidated net book value, according to OCBC, and will be financed using cash reserves and/or committed loan financing. After making changes to reflect details of the general offer, RMI PD data shows the move is slightly credit negative for the consolidated institution, but comparing our new estimate to OCBC's peers shows OCBC will remain one of the strongest banks in Developed Asia (Figure B1, right).

As we have previously mentioned, the acquisition will give OCBC access to Wing Hang's rapidly growing cross border CNY lending business, which stretches from Hong Kong into southern China's Pearl Delta heartland. As illustrated in Figure B1 (top left), the move remains credit positive for Wing Hang. The merger will also allow OCBC to capture growing trade, investment, capital and wealth flows between its South East Asian base and North Asia, and build out the capabilities of its CNY lending business amid the ongoing internationalization of the CNY. It will also give OCBC greater access to stable and liquid USD and HKD funding markets in Hong Kong, and the largest offshore CNY deposit base in the world.



OCBC / Wing Hang Combined Entity	Cash and Debt	All-Cash	Previous estimate	OCBC Q4 FY13
1Y RMI PD (bps)	4.38	4.39	1.22	1.63
DTD	4.25	4.28	6.23	6.01
Cash/Total Assets	16.2%	15.3%	15.2%	15.5%
CE Tier 1 CAR	11.0%		-	14.5%
Total CAR	12.5%		-	16.3%

Financial Institution	Economy	RMI PD (bps)
Hang Seng Bank	HK	0.69
Oversea-Chinese Banking Corp	SG	1.44
Commonwealth Bank of Australia	AU	1.59
BOC Hong Kong Holdings	HK	2.32
Bank of East Asia	HK	2.86
United Overseas Bank	SG	3.59
ANZ Banking Group	AU	3.76
OCBC / Wing Hang Combined	**SG**	**4.38**
Cathay Financial Holding Co	TW	4.73
Westpac Banking Corp	AU	5.18
DBS Group Holdings	SG	5.34
Taishin Financial Holding Co	TW	5.69
Taiwan Co-op Financial Holding Co	TW	7.07
National Australia Bank	AU	8.18
Fubon Financial Holding Co	TW	9.50
Shinhan Financial Group	KR	10.56
Wing Hang Bank	HK	10.73
Mitsubishi UFJ Financial Group	JP	32.62
Sumitomo Mitsui Financial Group	JP	36.33
KB Financial Group	KR	50.17
Woori Finance Holdings	KR	85.16
Hana Financial Group	KR	105.04
Mizuho Financial Group	JP	125.85

Figure B1: Term structure of default for OCBC, Wing Hang and the combined entity, assuming a cash and debt offering totaling SGD 6234mn (top left); risk metrics for the combined entity and OCBC historically and under various scenarios (bottom left); and trailing six-month 1-year RMI PDs for the largest banks in Developed Asia (right). *Source: The Risk Management Institute, OCBC*

The higher RMI PD estimate for the combined entity arises from an increase in the expected debt of the consolidated entity. We assume OCBC will aim to maintain cash and near cash assets at the trailing five year average level of 4.7% of total assets, which means OCBC would have to finance SGD 3.5bn of the purchase price with intermediate term loan financing. The higher debt level leads to lower distance-to-default (DTD) for the combined entity. DTD is a volatility adjusted measure of leverage; RMI PDs are inversely proportional to DTD. Assuming an all-cash offer leads to similar RMI PD levels for the combined entity, with slightly higher DTD offset by a decline in overall liquidity (Figure B1, bottom left).

OCBC said it is likely to complete new equity financing going forward, in order to maintain capital ratios at prudent levels. This could replace intimidate debt financing for the Wing Hang acquisition, and help offset a predicted decline in capital adequacy levels. OCBC expects the transaction will reduce its Common Equity Tier 1 capital adequacy ratio (CAR) as of December 31, 2013, to 11.0% from 14.5%, and its total CAR to 12.5% from 16.3%. We would expect new equity issuance to be credit positive for the combined entity, as shown in previous coverage where we expected an all equity financing for the transaction.

Credit News

RBA holds cash rate at 2.5%

Apr 01. The Reserve Bank of Australia (RBA) left the official cash rate on hold, and reaffirmed that the most prudent course would be a period of stable rates. The official cash rate remains at a record low 2.5%, where it has been since August 2013. The RBA said that resources sector investment spending is set to decline significantly, and there were currently only tentative signs of improvement in investment intentions in non-resource sectors. The RBA said that despite a depreciation of the AUD, the currency remains high by historical standards. The AUD has declined from as high as USD 1.0556 per AUD to USD 0.9265 per AUD at the end of Q1 2014. (The Australian)

Bad loan write downs soar at China banks

Mar 30. CNY 59bn of loans were written down by the five biggest Chinese banks in 2013, up 127% from 2012, a sign of mounting economic stress. Large reserves were set aside over the last decade against possible losses and hence the five biggest Chinese banks were able to increase their write-offs without diminishing their profitability or capital cushions. Return on equity for the five biggest banks rose 7% to 15% in 2013, slower than the rate in 2012. The banking sector's non-performing loan ratio increased slightly to 1% from 0.95%. However analysts are concerned that banks were using write-off to keep their bad loan ratio artificially low. (FT)

Philippines raises reserve ratio as rate increase seen nearing

Mar 27. In a bid to curb liquidity and guard against potential asset bubbles arising from rapid credit expansion, the central bank of the Philippines (Bangko Sentral ng Pilipinas) raised the reserve requirement for universal and commercial banks by 1 percentage point to 19%, effective April 4. Money supply growth had been in excess of 30% every month from last July to January this year. With pressure for accommodative monetary policy easing, the central bank is also expected to increase its benchmark interest rate in the coming months, from the current record low of 3.5%. (Bloomberg)

Argentina sells ARS 5.5bn bonds in return to local debt market

Mar 27. Argentinian government sold ARS 5.5bn of three-year bonds on March 27, returning to the local bond market for the first time in many years. Argentina has been locked out of the international debt markets since its default in 2001. This has caused the government to rely on central bank money printing to fund spending, pay creditors and finance natural gas imports. This bond sale thus marks a shift in the government's funding strategy. (WSJ)

Li warns of risks as yields drop most since Lehman (Bloomberg)

Finnish hopes for fragile growth hit by Ukraine crisis (Reuters)

Vietnam's Q1 GDP growth slows as lending hobbled (Businessweek)

Regulatory Updates

EU turns to asset-backed debt to beat business-funding drought

Mar 27. Last week, the European Commission (EC) called for international agreements on how "high quality" securitizations are defined, pushing for such securitizations to be given preferential treatment in regulations. The move is part of the EU's continuing effort to revive the market for asset-backed debt and improve access to funding for businesses. Other measures introduced by the EC to boost business funding included guidelines on regulating crowd-funding websites, and a draft law that overhauls EU rules on company pensions. (Reuters)

Citigroup fails the Fed's examination, 25 banks pass

Mar 26. The Federal Reserve released the Comprehensive Capital Analysis and Review (CCAR) results for 30 bank holding companies on March 26, which hold a combined USD 13.5tn of assets on their balance sheets, and represent nearly 80% of all US bank holding institutions. The Fed objected to the capital plans of 5 banks including Citigroup Inc, HSBC North America Holdings, RBS Citizens Financial Group Inc, Santander Holdings USA and Zions Bancorporation. The capital plans for the first four banks were rejected based on qualitative concerns while Zions Bancorporation did not meet the minimum post stress tier 1 common ratio of 5%. According to the Fed's assessment, US firms have increased their capital since the first set of stress tests in 2009. Between this period, the aggregate tier 1 common equity ratio of the 30 banks has reached 11.6% in Q4 2013 from Q1 2009. In response to the CCAR results, Citigroup CEO said that the bank would work with regulators to understand their concerns so that they may meet the Fed's future expectation on capital planning on a qualitative basis. (US Federal Reserve, Citigroup press statement)

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