Transforming Big Data into Smart Data

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

Weekly Credit Brief

May 06 - May 12 2014

Story of the week

Alibaba plans for an IPO when credit quality for US-listed Chinese internet firms is at its highest in 3 years

The RMI 1-year aggregate probability of default (RMI PD) for Chinese internet US listed firms declined to 9.8bps in March, the lowest level since December 2010, before rising marginally to 26bps in May. In the past 3 years, the aggregate RMI PD has remained below 100bps which is significantly lower compared to the default benchmark for other Chinese companies listed in the US. The aggregate PD for Chinese firms listed in the US and excluding the internet sector climbed to 328bps in August 2012 following a slowdown in the Chinese economy and a rise in PDs for Chinese energy and chemical companies.

A low aggregate RMI PD for the Chinese internet sector precedes the initial public offering plan of Alibaba Group Holding Limited, which would be one of the world's largest online and mobile commerce companies (according to 2013 gross merchandise volume) with an estimated value between USD 150bn and USD 200bn. Alibaba is one of the three Chinese Internet giants known as BAT (Baidu, Alibaba and Tencent). Chinese companies have reached market capitalization numbers comparable (or larger) with US companies as the IPO is said to raise between USD 15bn to USD 20bn which would make it the largest IPO in the US since Facebook's USD 16bn offering in May 2012. The company released more details in its initial public offering filing on May 6, including information about its recent financial performance and largest shareholders. Principal stakeholders Softbank (34.4%) and Yahoo (22.6%) held larger stakes in the firm than its founder Mr Jack Ma, who owns 8.9% of the group. Accordingly, Ma could become one of the richest persons in China depending on the company's IPO outcome.

Alibaba's stock sale comes at a time at which equity underwriting has been robust and increasing. In the first four months of the year, more than 180 companies announced initial public offerings in the US, while 317 listed firms intend to issue more shares. This exceeds the 120 US IPOs in the first four months of 2013. Last year, 222 US companies went public led by technology and biotechnology focused firms, making 2013 the strongest year in IPO activity since 2000.

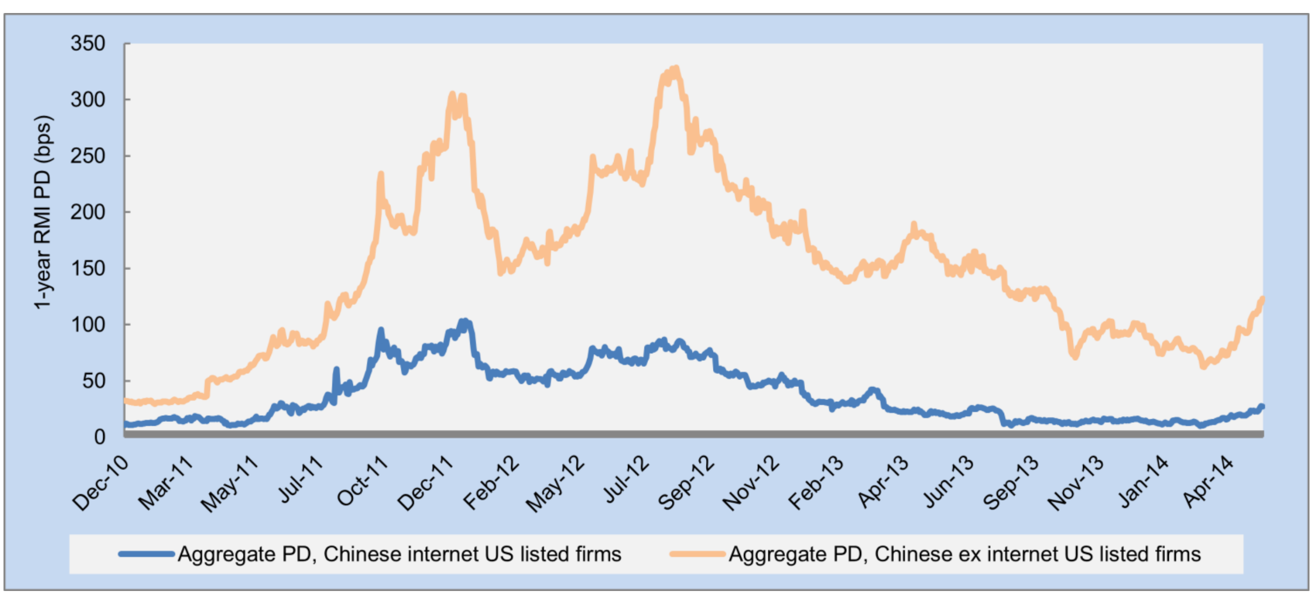

Figure 1: 1-year aggregate RMI probabilities of default for Chinese companies listed in the US. *Source: Risk Management Institute*

	Alibaba					Sector Average				
Period ending	Operating Margin	Net income margin	Current Ratio	Cash Ratio	Total Debt to Equity	Operating Margin	Net income margin	Current Ratio	Cash Ratio	Total Debt to Equity
31/03/2012	26%	21%	2.37	1.9	4%	8%	24%	2.88	1.80	13%
31/03/2013	42%	25%	1.8	1.39	300%	7%	24%	2.43	1.74	23%
31/12/2013	49%	44%	1.73	1.24	118%	13%	21%	2.96	2.23	35%

Figure 2: Financial performance metrics for Alibaba Group and Chinese internet companies. *Source: Risk Management Institute, Bloomberg, company reports.*

As shown in Figure 2, the financial performance of the Chinese internet sector has largely improved between March 2012 and December 2013. Operating margins have increased while net income margins remained above 20%. Liquidity ratios have also increased as the average cash ratio grew to 2.23% in December from 1.74% in March last year. Financial leverage for the industry as measured by the proportion of total debt to equity has also climbed through the months from 13% to 35%. Comparatively, Alibaba appeared to have a higher leverage ratio while possessing higher profitability measures. The group's current and cash ratios were also lower than the sector's average. According to the company's filing, the group increased their total liabilities between March 2012 and March 2013 from USD 2.03bn to USD 8.49bn and reduced their total equity from USD 5.46bn to USD 1.78bn.

Issuer Name	Offer Size (USD mn)	Offer Price	Change in Market cap from IPO to date (%)	1st trading day price premium over offer (%)	Trade Date (US)
Tuniu Corp	72.00	9.00	11.89	0.00	09/05/2014
Weibo Corp	328.44	17.00	5.06	-4.29	16/04/2014
Leju Holdings Ltd	100.00	10.00	0.40	8.00	16/04/2014
Autohome Inc	152.88	17.00	72.82	77.41	10/12/2013
58.com Inc	215.05	17.00	117.18	24.71	30/10/2013
LightInTheBox Holding Co Ltd	90.68	9.50	-47.47	17.47	06/06/2013
YY Inc	94.19	10.50	403.33	0.00	20/11/2012
Vipshop Holdings Ltd	71.53	6.50	2002.77	-7.69	23/03/2012
Tudou Holdings Ltd	174	29.00	0.00	-13.41	16/08/2011
Taomee Holdings Ltd	64.69	9.00	-44.44	-5.67	08/06/2011

Figure 3: Recent Chinese internet US listed IPO statistics. *Source: Bloomberg*

The ability of Chinese internet companies to raise capital through IPOs on the US exchanges has been positive on average as displayed in Figure 3, studying the most recent 10 issues. Most of the issuers have recorded a higher share price premium on the first day of trading at the market open due to the oversubscription of the IPO. In addition, many of the Chinese firms have witnessed a substantial increase in market cap after their IPO debuts. Vipshop Holdings, a small cap company has registered a twenty fold gain in market capitalization since its IPO in 2012. US investor sentiment surrounding Chinese internet companies has been encouraging, creating a strong appetite for the Alibaba IPO.

Credit News

Rising bad loans threaten India's gradual economic recovery

May 06. According to the OECD, India could witness an upturn in capital investment after the national elections. Coupled with a boost in consumption driven by slowing inflation, economic growth could increase to 4.9%in 2014 from 4.5% in 2013. However, rising bad banking assets caused by high interest rate at Indian lenders threaten to choke the recovery. Currently, stressed loans in India totalled USD 100 bn, and Fitch Ratings expects the amount of non-performing assets to reach 14% of loans by March 2015. Failure to halt the increase in bad loans will probably derail the pick-up in investment in the future. (Reuters)

Portuguese yields dip as Lisbon pledges "clean" bailout exit

May 06. Portugal's 10 year bond dropped to 3.62%, the lowest level since 2006 after the country announced that it would exit from the international bailout on May 17 without a back-up loan. The nation's borrowing costs have been declining sharply since 2012, driven by signs of an economic recovery within the country and the euro zone. It is expected that Portugal's credit ratings will be upgraded from its current junk ratings at all three rating agencies. (Reuters)

EU cuts growth outlook as inflation seen slower

May 06. The European Commission warned that low inflation would remain a threat to the euro zone for at least another two years. The predicted inflation is 0.8% for this year and 1.2% for 2015, both lower than the ECB's target of 2%. The prolonged low inflation may lead to a fall in consumer demand and give borrowers a difficult time in repaying debt, thereby hindering the economic recovery of the region. The ECB may introduce quantitative easing or negative interest rates so as to mitigate the risk of deflation. (Bloomberg)

Wells Fargo mortgage pain proves salve for bond market (Bloomberg)

Regulators must act on CoCo bond risks (FT)

Regulatory Updates

US Fed proposes rule to limit size of merged banks

May 08. The Federal Reserve is seeking the public's comment to implement a Dodd Frank Act mandate that would restrict industry concentration in the financial sector. The proposed law would prevent a bank merger if the new company's liabilities exceed 10 percent of the aggregate consolidated liabilities of all financial companies. The rule would apply to a number of financial institutions including bank holding companies and systemic non-financial companies classified by the Financial Stability Board. Industry participants have until July 8 to respond to the draft regulation. (Reuters)

SEC finds illegal or bogus fees in majority of buyout firms

May 06. Many private equity firms have been placed under regulatory scrutiny for the first time after the Dodd Frank Act authorized a greater oversight of money managers to the SEC. US regulators found that more than half of the firms under review have been collecting illegal fees or had severe compliance shortfalls, which could signal higher future compliance costs for the industry. A unit set up by the SEC has repeatedly found problems with how firms compensate their executives, who are paid with investor funds or money from portfolio companies rather than from the buyout firm. (Bloomberg)

EU ministers eye 11-nation transaction tax to start 2016

May 06. 11 nations within the European Union are planning to impose a tax on equity and derivative transactions which are being opposed by the UK, Sweden and the Netherlands. Work on the transaction tax started more than a year ago, after failing to implement it across all countries in the EU. Participants have remained committed to the cause without agreeing on how it could be executed. Countries calling for the levy have been undecided over which specific trades to tax and who should collect the revenue. Smaller countries are asking for a large scale tax which would potentially raise more revenue while larger nations are only willing to begin on a small scale. (Bloomberg)

Standard Chartered bank reprimanded for violating accounting rules (The Korea Herald)

Australia's central bank braces for government's austerity budget (WSJ)

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