Weekly Credit Brief
Nov 26 - Dec 02 2013

Story of the Week

Qantas RMI PD remains high as Australian government rebuffs state support

Australian Prime Minister Tony Abbott yesterday fended off suggestions that Sydney-based Qantas Airways Ltd (Qantas) needed an official debt guarantee from the Australian government. This followed reported private discussions between the government and Qantas about a potential debt guarantee or equity stake. The company is also seeking changes to the Qantas Sale Act, which limits foreign ownership of the company to 49%, which company executives believe is hampering Qantas' ability to compete domestically with a largely foreign-backed Virgin Australia Holdings (Virgin).

The RMI probability of default (RMI PD) for Qantas has declined significantly since Q3 2012 (see Figure 1), when we touched upon [Qantas' tie up with Dubai-based Emirates](). The partnership arrangement has helped stem losses in Qantas' international unit, and combined with growth in the discount airline Jetstar in Asia, helped the company report an AUD 6mn profit for the twelve months ended June 2013, up from an AUD 244mn loss for the same period in 2012. However, Qantas has come under increasing pressure from a resurgent Virgin, with market concerns reflected in RMI PD data. A larger share of the domestic market and well-funded foreign owners has led to a fall in the RMI PD for Virgin, with the company's RMI PD sitting below that of Qantas for most of 2013.

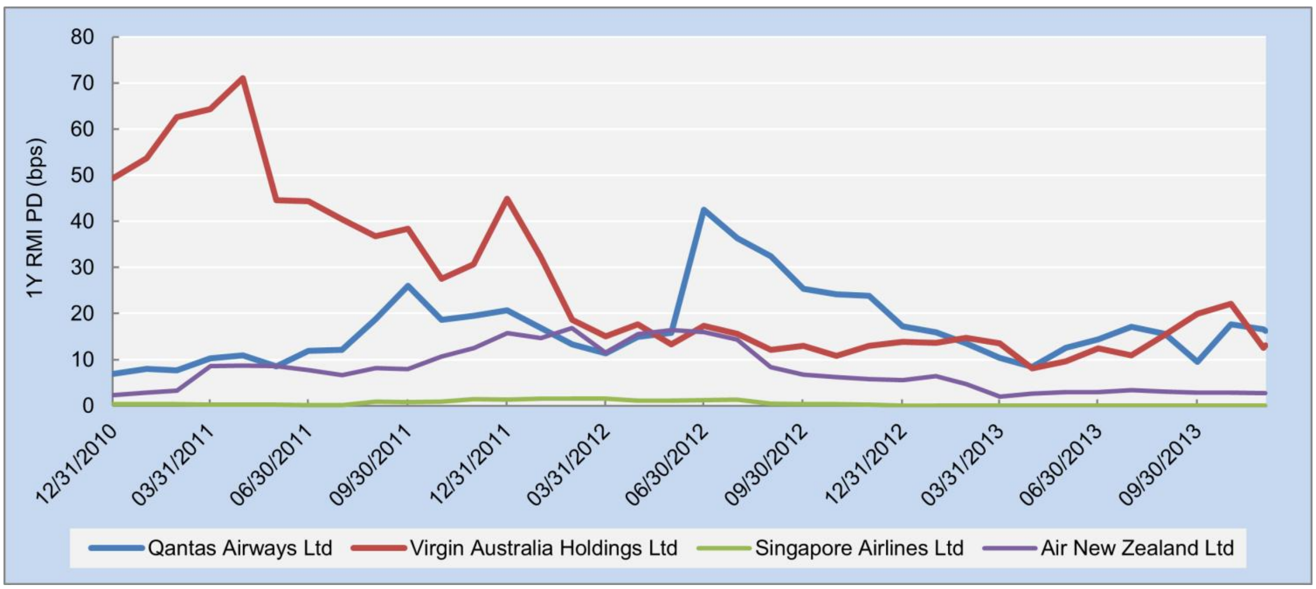

Figure 1: 1Y RMI PDs for Qantas Airways Ltd and domestic/regional competitors.

Qantas is currently rated Baa3 by Moody's and BBB- by S&P, one notch above junk at both rating agencies. Qantas fears that a rating downgrade could increase its borrowing costs, a primary reason the airline was seeking a government debt guarantee. After pouring cold water on a potential debt guarantee or shareholding, Mr Abbott also suggested that Qantas should make clear what it wants from the government. This could include changes to the Qantas Sale Act, to remove the 49% cap on foreign ownership of the airline. However, Qantas is yet to make a formal proposal to the government to address what it calls an "unlevel playing field."

The company has come under significant pressure from its highly profitable core domestic Australia market from Virgin. Founded as a low-cost carrier, Virgin has added full-service tickets, business class seats and rural services since 2010 to compete more directly with Qantas. Over the past year, Qantas' key international competitors, including Abu Dhabi-based Etihad Airways PJSC, Air New Zealand Ltd and Singapore Airlines Ltd have increased their equity investments in Virgin Australia, and strengthened code-sharing agreements at the same time to help disrupt efforts by Qantas to gain market share in Asia, the Middle East and Europe. This is believed to be a strategic response to Qantas' partnership with Emirates, and the success of its Jetstar brand in Asia.

All three of the airlines with stakes in Virgin are either fully state-owned or have a sovereign state as a controlling shareholder, allowing them to easily provide support in the form of new equity. An AUD 350mn rights issue by Virgin in November illustrated this, with Etihad Airways, Air New Zealand and Singapore Airlines all looking to increase their stakes in Virgin. The move angered Qantas management, who labeled have it a stealth takeover. It also showed how Virgin can easily raise money from foreign investors which the Qantas Sale Act prevents Qantas from doing.

Qantas has ruled out raising additional capital itself. Qantas is relatively cash rich with AUD 2.8bn of cash, or 3.39x short-term debt (see Figure 2). Qantas management is more concerned about the support that Virgin's largely state-owned shareholders can provide. Qantas has accused Virgin of starting a domestic capacity war, and running at a loss in order to damage Qantas on domestic and international routes, especially in Asia. Qantas has increasingly looked to Asia for revenue, and announced a code-share deal with Asia's largest airline China Southern yesterday.

Qantas Airways Ltd	SA Jun-132	SA Dec-12	SA Jun-12	SA Dec-11	SA Jun-11		FY 2013	FY 2012
Net Revenues	7,660	8,242	7,676	8,048	7,303		15,902	15,724
Fuel Expense	2,019	2,135	2,103	2,117	1,913		4,154	4,220
Non-Fuel Expense	4,951	5,143	5,098	5,195	4,675		10,094	10,293
EBITDA	**690**	**964**	**475**	**736**	**715**		**1,654**	**1,211**
Depreciation Expense	731	719	705	679	643		1,450	1,384
Financial Expense/(Income)	93	94	97	79	71		187	176
Income Tax Expense/(Benefit)	(29)	40	(121)	16	(9)		11	(105)
Net Income	**(105)**	**111**	**(206)**	**(38)**	**10**		**6**	**(244)**
Working Capital Needs	(3,119)	(3,257)	(3,937)	(3,425)	(3,513)		(3,119)	(3,937)
Capital Expenditure	417	721	480	1,391	1,363		1,138	1,871
ST Debt	835	1,135	1,119	654	577		835	1,119
LT Debt	5,245	5,058	5,430	6,064	5,454		5,245	5,430
Cash / Near Cash	2,829	3,058	3,398	3,342	3,496		2,829	3,398
Net Debt	3,251	3,135	3,151	3,376	2,535		3,251	3,151
EBITDA Margin	9.01%	11.70%	6.19%	9.15%	9.79%		10.40%	7.70%
Cash / ST Debt	3.39x	2.69x	3.04x	5.11x	6.06x		3.39x	3.04x

Figure 2: Pro forma financial statements, Qantas Airways Ltd. Financial year ends June 30. All figures are AUD mn, except where indicated.

Sources

Tony Abbott closes door on guaranteeing Qantas debt (The Australian)
Virgin Australia Luring Buyers to Weaken Qantas (Bloomberg)
Capital raising off Qantas agenda (The Australian)
Qantas, China Southern forge code-share deal (SMH)

In the News

Kookmin bank to close 55 branches as Korean margins narrow

Dec 02. Due to lending margins sinking to the lowest in four years, Kookmin Bank, South Korea's largest by assets, plans to close 55 branches in January. Kookmin Bank said the closures will cut operational costs, as the bank focuses on its Internet banking operations. The lender also advised that employees at the shuttered branches will be moved to other outlets, without providing an estimate for cost savings. Kookmin Bank, which has 1,205 branches across South Korea, joins Standard Chartered and Citigroup, in trimming outlets in the country as profits decline and lending margins narrow amid central bank interest-rate cuts to stimulate economic growth. (Bloomberg)

Australian banks' risky loans fueling house price gains

Dec 02. Australia's largest banks, whose lending standards helped the country avoid a property cash during the global credit crisis, are raising concerns with home loans helping to fuel record house prices. The proportion of mortgages with a loan-to-value ratio over 90% rose in Q3 to the highest since Q2 2009, according to data from the Australian Prudential Regulation Authority. The proportion of interest-only loans also increased to the highest in at least five years. (Bloomberg)

Rising NPAs, greater scrutiny hurt infrastructure funding: Naina Lal Kidwai

Nov 30. The Planning Commission of India has set up a robust target of attracting USD 1tn investment in the infrastructure sector during the so-called 12th Plan Period (2012-17). However, rising non-performing assets and greater scrutiny hinder lenders' ability to finance the ambitious program. "The basic blocks for financing the scale of infrastructure projects in India are not in place," said Naina Lal Kidwai, president of the Ficci industry grouping and country head of HSBC India. (Indiatimes)

Price growth and jobless fall eases pressure on ECB to act

Nov 29. Economic data for the eurozone released in the week ended December 1 shows rising inflation and the first unemployment decline in almost three years, suggesting a pickup in economic recovery across the region. Consumer price inflation rose by 0.9% in November, while the jobless rate fell to 12.1% in October from 12.2% recorded in September. The encouraging data may ease pressure on the ECB, which meets this Thursday, to take stronger measures in stimulating the eurozone. ECB data released on November 28 showed total loans to the private sector contracted by 2.1% in October ahead of the ECB's main refinancing rate cut in early November. (Reuters, Reuters)

Record USD 1tn cash haul to spur Euro growth

Nov 28. European companies have accumulated USD 1tn in cash as companies retained earnings and sold bonds during the recent recession. A survey by Ernst and Young revealed that company executives in European firms expect merger and acquisition activity to increase in the next 12 months. Takeovers announced by European companies have increased 6% to USD 716bn this year compared to the same period a year ago. This is less than half the record USD 1.5tn of deals completed in 2007. A separate survey by Fitch Ratings also said showed that European investors expect mergers and acquisitions to rise in 2014 as the European economy recovers and companies become more willing to use their cash reserves. Moving forward, Fitch anticipates more bond issuances as companies take the opportunity to raise low cost debt. (Bloomberg)

Brazil's central bank raises interest rate to 10%

Nov 27. Brazil has raised the Selic rate on November 27 by 50bps to 10%, pushing the benchmark interest rate to its highest level since March of 2012. The central bank's monetary policy committee unanimously voted to raise the Selic rate for a sixth consecutive time, extending what has become the world's biggest tightening cycle. However, the monetary authority omitted a previous reference to inflation trends from its decision statement, triggering speculation that the central bank is about to slow the pace of future rate hikes. (Reuters)

Vale treated like junk as default risk reaches 2008 highs

Nov 27. The cost to insure Vale SA's bonds against default for five years has climbed 52bps to 236bps since touching a four-month low on October 16. The contracts are now more expensive than the average for global commodity companies for the first time since 2008, as default swaps traders treat the mining company's debt, which is rated A- by S&P, like that of companies ranked five levels lower at BB. The world's largest iron-ore producer is being dragged down by the rising prospects of a sovereign downgrade of Brazil in over a decade next year. (Bloomberg)

S&P cuts outlook on Malaysia banks on household debt concern

Nov 27. Standard & Poor's downgraded the credit outlook for four Malaysian banks on concern that rising property prices and household debt are leading to economic imbalances in the country. The credit rating agency cut its outlook to negative from stable for CIMB Group Holdings Bhd, AmBank Bhd, RHB Bank Bhd and sister company RHB Investment Bank BHD. S&P cited the potential for deterioration in the lenders' asset quality and financial profile in an unfavorable economic scenario as the rating rationale. (Bloomberg)

Moody's raises Greek rating to Caa3 (Reuters)

S&P raises Cyprus to B- as risks to economy recede (Reuters)

Europe covered bond sales hit decade low (FT)

China spurs rebound in issuance of dim sum bonds (WSJ)

Aussie seen tumbling amid RBA talk of intervention (Bloomberg)

Australia bond risk rises, credit-default swaps show (Bloomberg)

RBI may allow up to 74% FDI in credit info companies (Indiatimes)

World Bank GIF structure for infrastructure financing to be finalized by April (Indiatimes)

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Contributing Editor: James Weston