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Weekly Credit Brief Feb 23 - Feb 29

World's largest container shipper stumbles amid trade slowdown

by [Xia Xinyao]

The Baltic Dry Index (BDI), a measurement of the demand for shipping capacity versus the supply of dry bulk carriers, has witnessed its all-time low at the beginning of 2016 - only one third of the last five-year average. As world economic growth has moderated and as international trade has slumped, the container shipping industry found itself saddled with massive overcapacity at a time of weak demand.

As shown in Figure 1, the average of RMI-CRI 1-year Probabilities of Default (PD) for the top 10 container shipping firms, which control around 61% of all shipping capacity, increased from around 5bps at the beginning of 2015 to 34bps now, indicating the worsening credit quality of the overall industry. Even A.P. Moller – Maersk Group (Maersk), the biggest container shipping company in the world with a market capitalization of USD 27bn, could not escape from this credit deterioration. The RMI-CRI 1-year PD for Maersk has increased from 5.26bps at the beginning of 2015 to 20bps now.

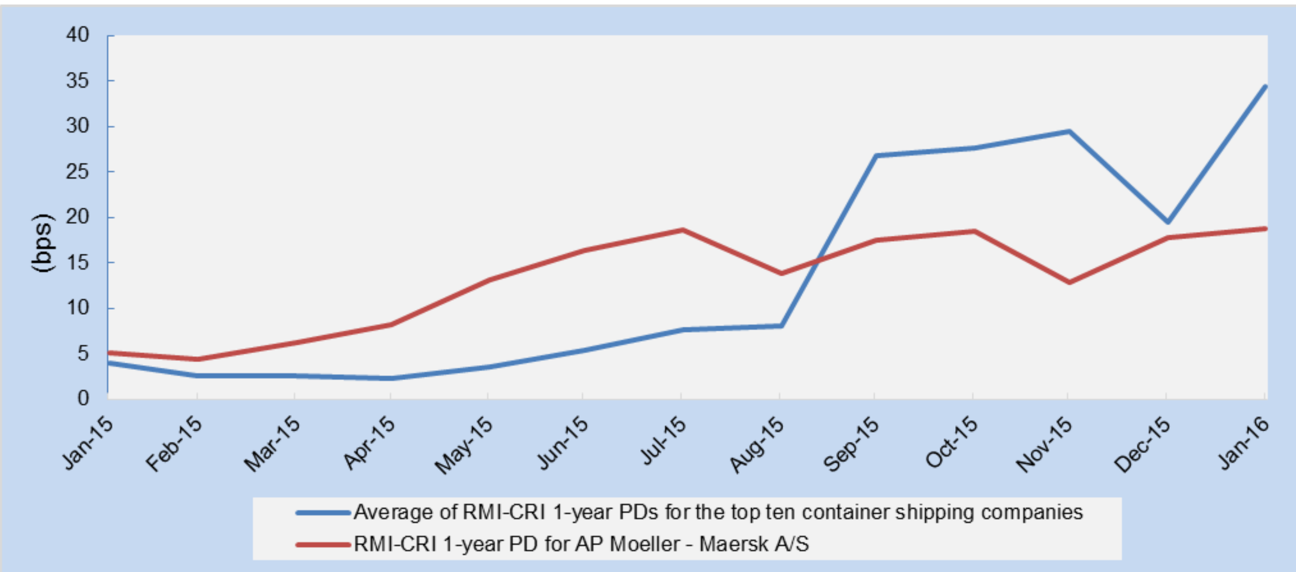

Figure 1. The average of RMI-CRI 1-year PDs for the top 10 container shipping companies and RMI-CRI 1-year PD for Maersk. *Source: RMI-CRI*

As the growth of the global economy slowed down from a high of 5.35% in 2007 to 2.50% in 2015 and as total world trade growth YoY slowed from 15.3% to 2.8% in the same period, the order book for containers declined considerably from 79.7mn dwt (dead-weight ton) in 2008 to 38mn dwt in 2015. Meanwhile, the capacity of container-liner is increasing and excessive compared to the demand. The aggregate fleet capacity for global containership has continued to increase relentlessly from 159mn dwt in 2008 to 243mn dwt in 2015 (see left panel of Figure 2). The weak demand and oversupply has severely damaged the pricing power of the marine shippers and has led to a record low BDI. And rates of Maersk, the largest player with the biggest pricing power, have declined significantly from USD/FFE (USD/forty-foot equivalent unit) 2,800 in Q1 2013 to USD/FFE 1,900 in Q4 2015.

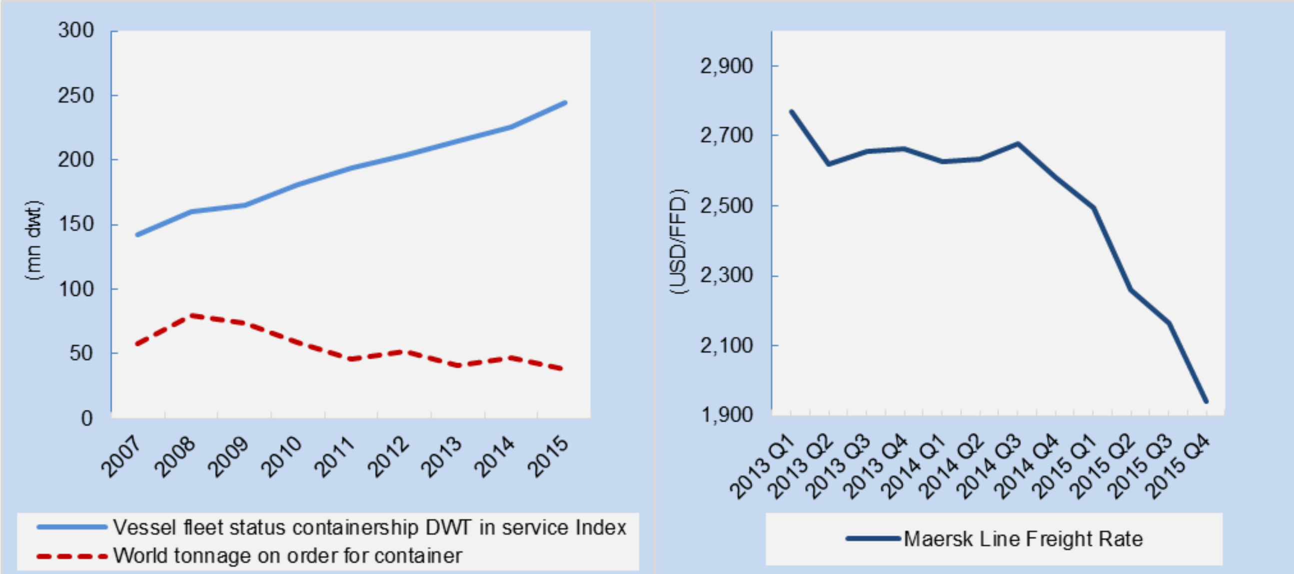

Figure 2. The world tonnage on order for container and global container fleet capacity (left panel) and the freight rate of Maersk (right panel). *Source: UNCTAD, Bloomberg*

Even amid the supply glut, leading container shippers are still deploying more vessels in order to increase their market share by offering the lowest rate. In 2015, Maersk ordered 11 Triple-E vessels, the world's largest vessel with a capacity of carrying 19,000 containers. This strategy heavily weighed on the company's margin (see Table 1). Its operating margin had decreased to -29.99% in the last quarter of 2015 from 16.54% in Q1 2015, resulting in an increase in net debt/EBITDA from 0.79x to 1.11x during the same period, reflecting its deteriorating debt covering ability. Maersk's shipping business, which accounted for around 60% of the total revenue in 2015, reported an underlying profit of negative USD 165mn in Q4 2015, compared to USD 631mn in Q3 2015.

	Q1 2015	Q2 2015	Q3 2015	Q4 2015
Operating margin (%)	16.54	14.02	11.13	-29.99
EBITDA (USD mn)	2,825	2,619	2,363	-1,424
Net debt/EBITDA	0.79	0.81	0.82	1.11

Table 1. Financial figures of Maersk. *Source: Bloomberg*

The container shipping industry is searching for other solutions, such as cooperation within the industry and enhancement in operational efficiency. Maersk announced in November that it will cut costs by cutting 4,000 jobs by the end of 2017 and cancelling options to buy new vessels. Although the lower fuel prices can benefit shipping companies and might potentially stimulate economic and trade growth, we have yet to see that happen.

Credit News

Qantas returns from junk-bond purgatory with upgrade by Moody's

Feb 29. The ratings of Qantas Airways, the Sydney-based airline, was raised one level to Baa3 by Moody's, which had stripped it of investment-grade status back in Jan 2014. It follows a similar decision by S&P in November, which lifted its score to BBB- with a stable outlook. Qantas last week posted a record first-half profit, helped by a plunge in fuel prices, and announced its second capital return in less than six months. Its situation has been bolstered by a cost-cutting initiative that's so far saved about USD 1bn, a collapse in global energy prices and a dialling back of competition with Virgin Australia Holdings. The cost of insuring Qantas debt with credit default swaps was 230bps at the end of last week, having declined from as much as 350bps in March 2014. (Bloomberg)

Republic Airways files for bankruptcy after pilot shortage

Feb 26. Republic Airways Holdings filed for bankruptcy on Feb 25, blaming a lack of pilots for its failure to succeed when other major airlines are enjoying record profits. Republic Airways operates a fleet of smaller planes that provide flights for larger airlines including American Airlines, Delta Air Lines and United Continental. According to the chairman of Republic, although it landed a three-year union contract with its pilots in 2015, the company still had to ground aircraft just as it attempted to renegotiate agreements with the larger carriers, an unnecessary waste of the company's valuable resources. (Bloomberg)

Standard Chartered credit ratings on watch for downgrade by S&P

Feb 26. On Feb 23, Standard Chartered reported its first annual loss since 1989 and warned that earnings would remain subdued this year as it overhauls its operations. Due to heavy reliance on Asia and commodities for returns, the bank saw bad loans nearly double in 2015, pushing it to a USD 2.36bn net loss. Hence, S&P may downgrade the bank's current "A-" credit rating once again after the last downgrade in Feb 2015. According to S&P, the business uncertainty of Standard Chartered has been elevating due to its ongoing transformation and the challenging macro environment. (Bloomberg)

Singapore GDP grew more last quarter than earlier estimated

Feb 24. Singapore's gross domestic product grew at an annualized rate of 6.2% in the last quarter of 2015, beating expectations for a 5.7% gain. The construction and service sectors expanded by 7.7% and 6% respectively, while the manufacturing sector dropped by 4.9%. The service sector has been contributing to GDP growth but slow growth in China, Singapore's largest export destination, has been hurting the manufacturing sector. Singapore's monetary authority eased its exchange rate based monetary policy twice last year, citing weak global growth as a headwind to the Singapore economy. (Bloomberg)

US banks to cut credit lines for energy firms, more bankruptcies expected

Feb 24. The head of JP Morgan's commercial bank said that banks could cut their credit lines to energy firms by 15-20% this year, a move that could lead to more bankruptcies in the oil and gas sector. A plunge in the price of oil below USD 30 per barrel has forced a number of oil firms into financial distress. Deloitte estimates that 175 companies, or nearly a third of the oil and gas industry, could file for bankruptcy this year. During its latest quarterly report, JP Morgan increased their loan loss provisions to the energy sector by 60% as more firms have been trying to restructure debt payment terms with lenders. Others have tried raising capital by cutting staff and selling key assets. (Straits Times)

Royal Bank of Canada suffers fresh hit from oil collapse (FT)

S&P downgrades Singpost with stable outlook (Straits Times)

Vale looks to sell core assets to reduce debt (WSJ)

Regulatory Updates

China halts overseas investment schemes

Feb 28. China appears to have mothballed two pioneering outbound investment schemes, which were created to facilitate overseas investment in China. Seven global asset managers were issued with the license for the Qualified Domestic Limited Partner scheme in July 2015 but none of them have been allotted with the quota necessary to launch. Similarly, domestic asset managers have also reported that the issuance of new quota under the Qualified Domestic Institutional Investor license has stopped. (FT)

PBOC researcher suggests single regulator for financial markets

Feb 23. A researcher from the People's Bank of China (PBOC) has called for the assimilation of the agencies that oversee securities, insurance, banking and foreign exchange in China into the central bank. The creation of a single financial markets regulator will help coordinate monetary policy with financial and currency regulations and enhance the government's ability to identify systemic risks. (Bloomberg)

Israel's largest lender warns Kahlon plan will boost easy credit (Bloomberg)

Fund managers in talks with regulator over clarity on fees (FT)

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