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Transforming Big Data into Smart Data
Weekly Credit Brief Jan 28 - Feb 03 2014

Stories of the Week

RMI PDs for British banks increase before earning releases

By Dexter Tan

The 1-year RMI probabilities of default (RMI PD) for some of the UK banks have increased ahead of their 2013 year-end earnings which will be released in a few weeks. RMI PDs for HSBC Holdings, Standard Chartered and Barclays have climbed 3.10bps, 3.86bps and 0.86bps respectively year-to-date. During 2013, RMI PDs for Barclays and Standard Chartered decreased by 19.32bps and 9.05bps respectively but the default risk for HSBC rose marginally by 3.3bps. In 2012, RMI PDs for HSBC and Barclays registered significant declines of 45.81bps and 95.76bps respectively while a similar measure for Standard Chartered rose slightly by 0.63bps. The change in RMI PD for the banks is shown in Figure A1.

Figure A2 displays the banks' annual earnings from 2010, together with net income estimates for FY 2013. According to Bloomberg, all three banks are expected to report higher profits in 2013 compared to 2012. HSBC is expected to report revenues in excess of USD 18.07bn for FY2013 while Barclays is projected to report a profit in FY2013 from a loss of 980mn in FY2012. Standard Chartered meanwhile has managed to generate net profits close to USD 5bn in recent years.

Despite producing healthier profits for shareholders, the growth trend for bank revenues has largely been on the decline, as highlighted in Figure A2. HSBC's revenue topped USD 72.45bn in 2011 but declined to USD 69.35bn in FY2012. Revenues also fell at Barclays, as the bank reported revenues of USD 50.30bn in 2010 and USD 49.19bn in 2012. On the contrary, Standard Chartered, which derives most of its income from emerging markets, has seen revenues increase steadily through the years, albeit earnings may fall slightly in FY2013.

Barclays and Standard Chartered recently attracted a fair amount of publicity but the banks refuted rumors about the state of their businesses. On January 29, UK-listed Barclays responded to speculation suggesting that the bank would be closing 400 branches in the next 5 years as the bank looks to rely on technology to replace jobs. The bank said that they have no plans to announce significant reductions to their UK branch network and the increasing use of technology creates opportunities for the lender to offer better services to customers. Meanwhile, Standard Chartered CEO quashed speculations of being a possible takeover target. The statement came after a report surfaced that the bank could be bought over by an Australian lender.

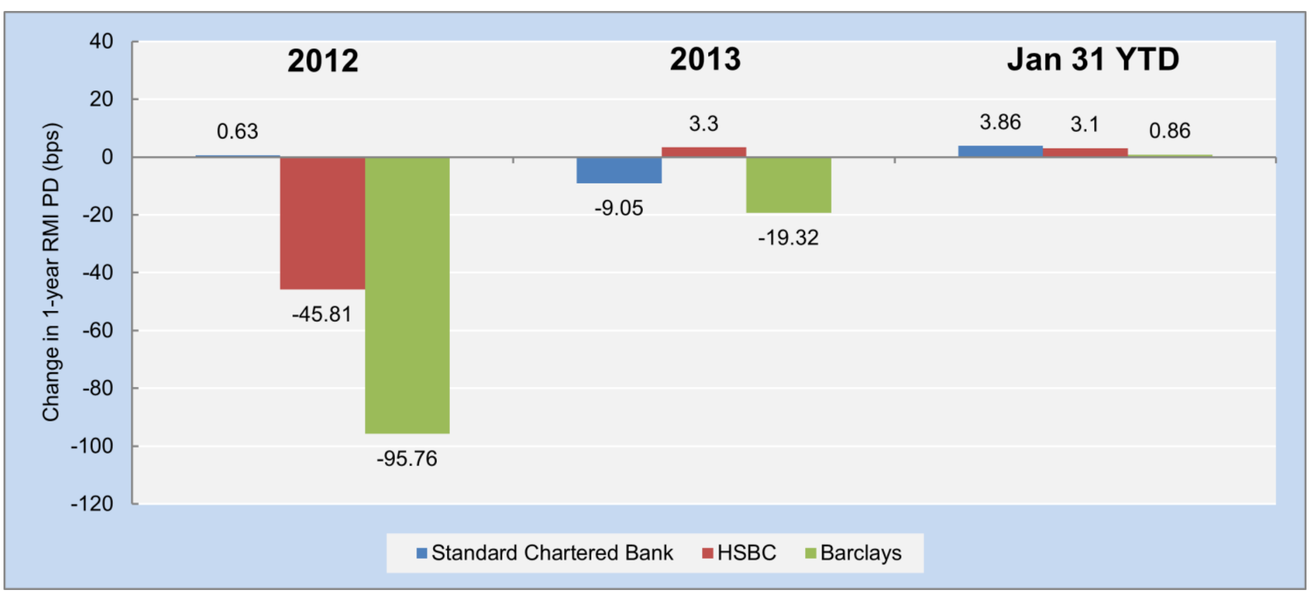

Figure A1: Change in 1-year RMI PD for UK-listed banks. *Source: The Risk Management Institute*

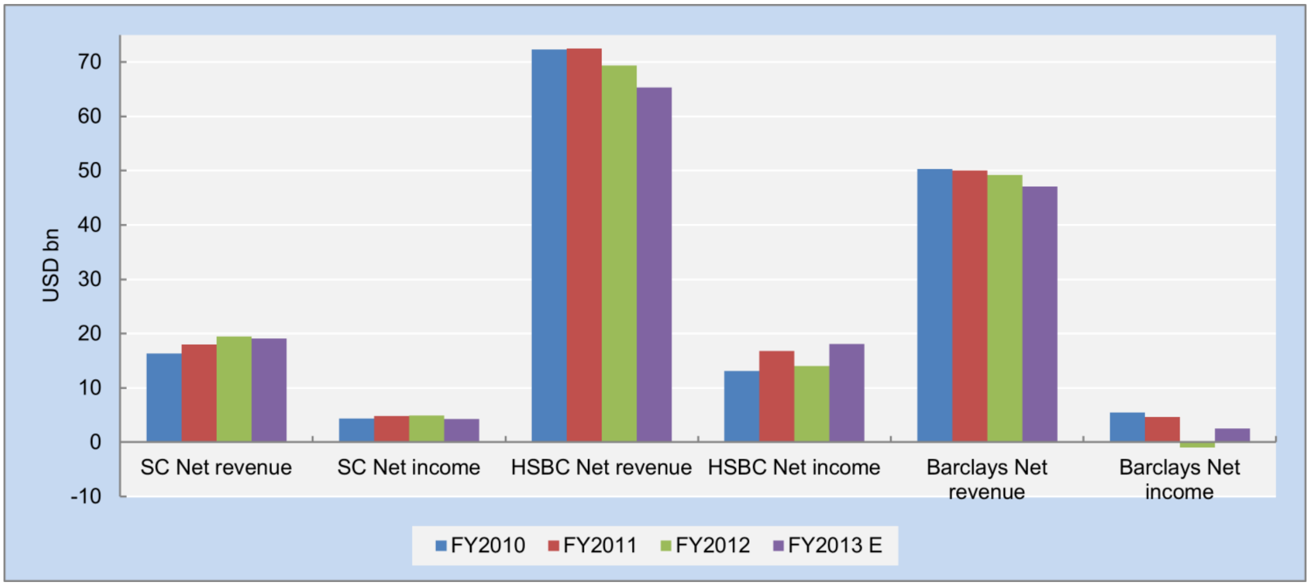

Figure A2: Annual bank revenue and earnings, according to Bloomberg estimates. Net revenue is the sum of interest income, trading account profits/losses, investment income/losses, commissions and fees earned and other operating income, minus interest expense. Net income is profits after all expenses. *Source: Bloomberg compilations*

US FAA downgrade further hurts Jet Airways India

By Chiranjiv Sawhney

For the past few years, India's aviation sector has been plagued by mismanagement, bankruptcies and closures. It is thus unsurprising that India's second largest airline, Jet Airways, currently has an elevated 1-year RMI PD –at 301bps.

The increase in just over a month however, has not just been because of legacy mismanagement issues, but also because of new developments in India's aviation sector that have rubbed salt in the wounds of the airlines. Jet Airways' 1-year RMI PD climbed 68bps from 233bps at the end of 2013 to 301bps on February 3, 2014. Over the same period, Jet's market capitalization, plunged from INR 33.16bn to INR 25.15bn (see Figure B1). Its distance-to-default (DTD) also deteriorated from 0.21 at the end of last year to -0.02 currently. DTD is a volatility-adjusted measure of a firm's leverage, with numbers close to or below zero suggesting potential insolvency.

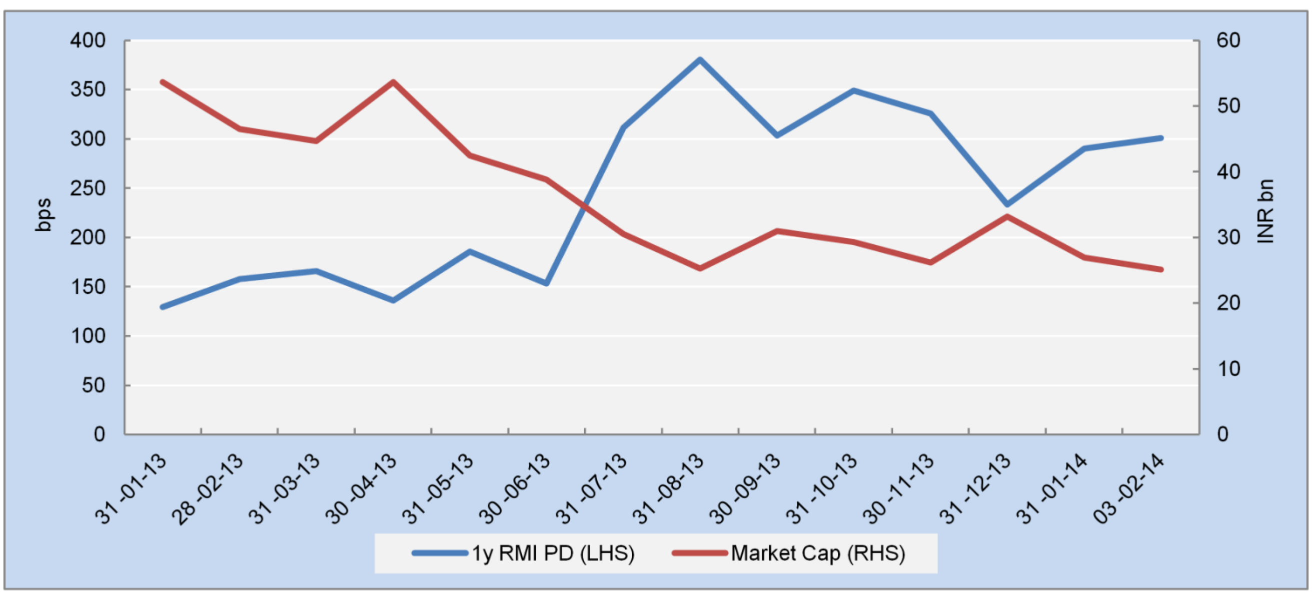

Figure B1: 1-year RMI PD for Jet Airways vs Market Cap. *Source: Bloomberg, The Risk Management Institute*

FAA downgrade

Late last week, the US Federal Aviation Administration (FAA) downgraded India aviation's safety ranking to Category 2 from Category 1. This bars Indian carriers from starting new services to the US and lines up their planes for additional security inspections when in the US. In addition, since reciprocal code-shared arrangements between Category 2 nations and US airlines aren't supported by the FAA, United Airlines and American Airlines have both pared their tie-ups with Jet Airways.

Jet, which currently runs 7 flights to the US and earns 5% revenue from the US route, had announced re-launching its New York service in May since being shelved in September 2012, and expanding its route coverage to Chicago in the winter schedule. Both of these expansion plans will now have to be curtailed by the downgrade. Moreover, experts argue that in the past, an FAA action has had a domino effect with other nations following suit in downgrading the safety status of a nation downgraded by the FAA.

Increasing competition

To stop the bleeding balance sheets of Indian airlines, the Indian government decided last year to allow up to 49% of foreign direct investment in the aviation sector. Following this move, international airlines have begun collaborating with local partners to set up domestic operations.

In the same vein, Etihad infused USD600mn into Jet Airways for a 24% stake in the company. While the opening up of the Indian aviation sector has provided much needed balance sheet strength to Jet, it has also increased competition which is likely to eat into Jet's profitability and market share. Tata Sons has joined hands with two big players of Southeast Asia – Singapore Airlines and AirAsia to launch two ventures. Both of these are expected to be operational later this year. Tata-SIA Airlines will fly the full service segment while the AirAsia-Tata venture will participate in the low-cost market.

Coal Miner finds itself mired in a pit

By Sam Foo

On 23 January, New World Resources PLC (NWR), an Amsterdam-registered coal miner with activities in Central Europe, announced that they had engaged Blackstone Group LP to help reorganize its capital structure, following the deterioration of market conditions. According to the company's forecast, the average price it receives for coke (cooking coal), used in steelmaking, will plunge 7% QoQ in the first quarter of the 2014, as a result of falling demand from steelmakers. The company's announcement sent its bonds into a tailspin as investors took it to portend an impending default. Its market capitalization also took a sharp tumble after equity analysts highlighted the possibility of a heavily discounted rights issue by NWR to curb its debt.

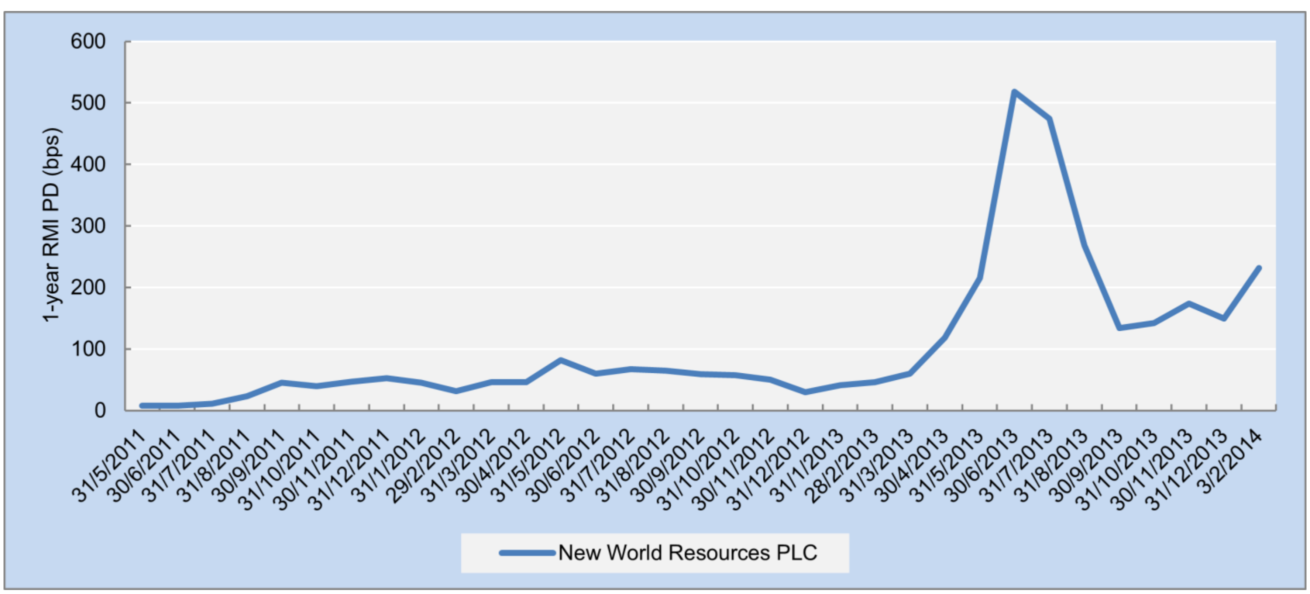

Figure C1: 1-year RMI PD (in bps) for New World Resources. *Source: The Risk Management Institute*

Consequently, a spike can be seen in the company's RMI probability of default (RMI PD) in January, increasing again after a significant increase in mid-2013. The latter was driven by the company's increasing losses and a drastic decline in its RMI distance-to-default (DTD) over 2013. DTD is a volatility adjusted leverage measure; NWR's DTD fell to 0.13 on February 3. The company's RMI PD fell in September 2013 after the company announced a number of asset sales, which led to an increase in the company's market cap, and positive changes to the company's size relative to the FTSE and market to book ratio.

However, continued poor financial performance over Q3, and a worsening liquidity position (refer to Table C1), led to further declines in the company's market capitalization and its DTD. Moreover, losses in the first nine months of FY2013 standing at EUR 444.2mn - a stark contrast to its EUR129.9mn profit in FY2011. NWR however, may look forward to a potential lifeline thrown by its parent company BXR Group Ltd in the form of fresh equity capital injection.

New World Resources PLC	Q3 FY13	Q2 FY13	Q1 FY13	Q4 FY12	Q3 FY12	FY 2012	FY 2011
Turnover	200.6	252.8	240.1	286.6	291.0	1,299.4	1,632.5
Cost of Sales	169.3	210.4	214.6	102.6	173.3	315.7	375.3
Admin & Other Expenses	47.4	368.7	49.6	180.7	54.8	753.6	804.8
EBITDA	**(16.1)**	**(326.2)**	**(24.0)**	**3.3**	**62.9**	**230.1**	**452.5**
Depreciation Expense	27.6	41.3	41.8	44.0	36.8	174.0	176.4
Financial Expense/(Income)	13.5	16.3	27.8	18.1	6.2	47.4	89.1
Income Tax Expense/(Benefit)	(8.7)	(68.5)	(13.3)	(10.2)	5.8	9.9	57.1
Net Income	(48.5)	(315.4)	(80.3)	(48.6)	14.1	(1.2)	129.8
Working Capital Needs	37.5	14.9	72.8	57.3	87.3	57.3	9.3
CFO	(7.7)	16.4	(21.6)	2.4	47.4	2.4	50.1
CL	219.1	216.4	215.7	238.7	360.3	238.7	406.5
Cash / Near Cash	148.5	175.7	192.9	267.0	443.6	267.0	536.9
TA	1,511.9	1,649.0	2,059.4	2,201.3	2,372.8	2,201.3	2,374.1
RMI DTD (Feb 3: 0.13)	**0.67**	**0.47**	**1.89**	**2.58**	**1.87**	**2.58**	**2.42**
Net Debt	681.1	653.2	642.7	551.0	480.6	551.0	391.5
Cash / TA (RMI Adjusted)	9.82%	10.66%	9.37%	12.13%	18.69%	12.13%	22.62%
Cash / CL	0.68x	0.81x	0.89x	1.12x	1.23x	1.12x	1.32x

Table C1: Pro-forma financials for New World Resources PLC. Figures are in EUR mn, except for RMI DTD and where otherwise indicated. New World Resources' financial year ends December 31st. Source: *Company financial reports, The Risk Management Institute*

In the News

Puerto Rico seeking $2 billion debt offering

Feb 02. Puerto Rico is organizing a debt offering of approximately USD 2bn in the coming weeks amid increasing pressure from credit-rating agencies and investors to bolster its finances, The offer will be the first by a Puerto Rico entity since August 2013. In 2013, investors in municipal bonds, those issued by state and local governments and related entities, suffered their biggest annual losses in 19 years, driven by financial setbacks in Puerto Rico and Detroit's record-setting bankruptcy filing in July. (WSJ)

Top investors cut emerging Asia debts; favor developed stocks

Jan 31. A Reuters' poll on Jan 31 showed that the world's top investors have cut emerging Asian bond holdings to a 2.5 year low while keeping relatively high weightings in euro zone stocks. This survey of 51 leading investment houses in the US, Japan and Europe also indicated that investors were at their most optimistic on equities since December 2010, highlighting their confidence in the recovery led by developed economies. The poll was taken amid a sharp sell-off in emerging currencies following US Fed tapering that forced central banks in Turkey, South Africa and India to raise interest rates. (Reuters)

New NPA norms: RBI offers a breather

Jan 31. The Reserve Bank of India, under the 'Framework for Revitalizing Distressed Assets in the Economy', has offered some reliefs to banks in relation to early detection and resolution of non-performing assets. The central bank has also revised rules for provisioning for non-performing accounts. Lenders will be required to make 25 % provision for unsecured loans that remain unpaid for six months. The provision was initially at 30%. For loans that have remained unpaid for two years, banks would only have to set aside 40%, instead of 50%. Additionally, the new framework also defines guidelines for early formation of a lenders' committee with the timeline to agree to a plan for resolution of bad loans. (Business Standard)

Treasury's 4 note auctions attract highest demand since 2012

Jan 31. The US Treasury sold USD 111bn in 4 note offerings on January 30, attracting the highest demand since 2012. Investors submitted bids of 3.23 times the amount of debt sold, as the US government offered to sell USD 29bn of 7-year notes and USD 35bn of 5-year securities. Uncertainty over the US government's ability to pay its bondholders remains. The US Congress is set to debate over the debt ceiling before February 7. If the limit is not raised or suspended again on that day, regulators will have to exercise special measures to extend its borrowing authority. (Bloomberg)

Malaysia's Ringgit drops to weakest since May 2010 on Fed taper

Jan 30. The MYR depreciated to its lowest level in more than 3.5 years after the US Federal Reserve signaled the continuation of its gradual stimulus withdrawal. Following the Fed's announcement that it will trim monthly bond purchases to USD 65bn, demand for emerging market assets continued to weaken. Meanwhile, the MYR hit 3.3485 per USD, marking the ringgit's 1-week drop of 0.4% and a 2.1% decline in the month of January against the greenback. Last week, Bank Negara Malaysia maintained its benchmark interest rate for the 16th successive time at 3% as inflation quickened to a two-year high. (Bloomberg)

Ukraine credit rating cut at S&P as political turmoil escalates (Bloomberg)

RBI hikes key lending rate by 0.25 per cent to 8 per cent (Deccan Herald)

Turkish overnight lending rate 12.00% vs. 10.00% forecast (Investing**)**

Japan's Mizuho ups dividend, but Basel may dim megabank shareholder hopes (Reuters)

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Contributing Editor: Chiranjiv Sawhney