Credit Research Initiative

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Weekly Credit Brief July 29 - August 04

Tiger Airways flies into regional turbulence

By Justin Hsiao

Tiger Airways Holdings Ltd (TGR), 40% owned by Singapore Airlines Ltd, has been struggling with negative operating margins and falling yields per passenger mile. The low-cost carrier reported a loss of USD 52.1mn in the quarter ended in June, widening from a USD 26.1mn loss a year earlier. Overall, the business posted losses for the last three quarters. As shown in Chart 1, the RMI 1-year probability of default (RMI PD) for TGR displayed a distinct increasing trend since the middle of last year from 2.86bps to the current 35.14bps, rising above the aggregate PD for 4 listed low-cost airlines in the Southeast Asian region.

Chart 1: 1-year RMI PD for Tiger Airways vs Aggregate PD for listed budget carriers in Southeast Asia. (includes RMI PDs for AirAsia BHD, Asia Aviation PCL, Cebu Air Inc and Nok Airlines PCL) *Source: Risk Management Institute*

Tiger Airways most recent quarterly net loss is the largest of all Southeast Asian budget carriers. According to the CEO Lee Lik Hsin, the low frills airline industry is facing a challenging operating environment due to a persistent oversupply of flight capacity. Recent aviation disasters in Malaysian Airlines and the Taiwan air accident may affect passenger flight revenue but the carrier plans to focus on filling its planes with passengers, and then improving yields through partnerships to increase earnings.

In order to gain overseas revenue, TGR has affiliate companies, subsidiary companies, and joint ventures across Southeast Asian region, including Indonesia, Australia, Philippines, South Korea, Thailand, and Taiwan. However, this strategy has not brought promising results to TGR. It suffered losses from its Australian operations and closed its loss-making Indonesian venture on July 1, 2014.

Lower passenger yield

According to Table 1, the company's operating income had a five-fold drop and the net loss doubled from SGD 32.8mn to SGD 65.2mn compared to the second quarter last year. Even though TGR claimed that net income and the load factor[1] (from 75.1% to 84.7%) have improved during Q2, the yield per passenger mile has continued to fall, from 7.46 in Q2 2013 to 6.24 in Q2 2014. Which means the company is decreasing in profit efficiency.

[1] Load factor is the ratio of passenger-kilometers travelled to seat-kilometers available.

Reporting period	Q2-2013	Q3-2013	Q4-2013	Q1- 2014	Q2-2014
Operating Income	-2.7	-12.8	-12	-23	-13
Net Income	-32.8	23.8	-118.5	-95.5	-65.2
Yield per Passenger Mile	7.46	6.65	6.88	6.38	6.24

Table 1: Figures in SGD mn. *Source: Bloomberg*

Increasing competition

The decrease in yield can be viewed as the result of stiffer competition within the Southeast Asia region. Other low-cost flights are very competitively priced in the market and it is difficult for TGR to stand out without cheaper prices or better services. Yet both goals are hard to achieve considering the company's current profile. Tiger, now, is short on free cash flow (a measure of financial performance, which takes the difference between operating cash flow and capital expenditure). At the end of June in 2014, its free cash flow was -$233.5mn. At the same time, the airline faces heightened aircraft lease costs and expensive regional route licensing fees.

Lower demand in Southeast Asian Region

TGR provides cheap airline alternatives to customers across Southeast Asia, but with the 2 accidents with Malaysia Airlines and troubles in Thailand, tourists are avoiding travelling to the Southeast Asia regions as travel demand has declined significantly compared to previous years. Especially with TGR's regional centric strategy, the current situation looks challenging as the region suffers a drop in tourist numbers.

Credit News

Portugal in EUR 4.9bn rescue of Banco Espirito Santo (BES)

Aug 04. Portugal will spend EUR 4.9bn to rescue its largest listed bank after a frenzied weekend discussion between Portuguese and EU officials. Three weeks ago, RMI had highlighted the potential systemic problems surrounding BES, which will be split into a "good bank" (renamed Novo Banco) and a "bad bank", which will house all its troubled assets. The Espirito Santo family, shareholders and junior debt holders will bear the losses of the bad bank, meaning that all senior bondholders and depositors will be protected. Novo Banco will be recapitalized by a special bank resolution fund created in 2012. The Bank of Portugal expects the state to be reimbursed when Novo Banco is eventually sold to private investors. (Bloomberg)

Bumi Resources sweetens debt-exchange offer as default looms

Aug 01. PT Bumi Resources is trying to avert default by offering new terms to existing bondholders ahead of its repayment deadline. After failing to reach a deal agreement on June 5, Bumi is offering convertible bondholders new terms that include repaying the debt in April 2018, which is 3 years sooner than its previous proposal. The company plans to split the 9.25% debt into convertible and straight debentures with a 8.5% coupon. The new offer may help Bumi secure a default waiver. However, the latest proposal is still subject to discussion as no agreement has been reached. (Bloomberg)

Argentine bonds crash after ISDA declares Argentina in default

Jul 31. The International Swaps and Derivatives Association (ISDA) declared that Argentina has defaulted on its bonds, which has triggered payments of up to USD 1bn on credit default swaps. Argentine bonds posted their largest two-day loss since 2012 after ISDA's decision. Benchmark notes due in 2033 declined 2.75 cents to the dollar to 86 cents on Friday. The ISDA Committee will conduct an auction to settle the outstanding swap transactions. Argentina's second default is likely to affect the already struggling economy drastically and result in a weaker currency and a rising inflation rate which is now close to 40%. (United Press International, CNBC)

Erste bank reports massive EUR 1bn loss (The China Post)

EU warns about CoCo bond risks in banks (Bloomberg)

Regulatory Updates

EU warns of CoCo risk as banks build buffers on new rules

Aug 01. The European Union's banking, markets and insurance authorities have alerted banks and insurance companies about the risks of selling complex debt and hybrid securities – products such as contingent-convertible debt, known as CoCo bonds, to retail clients as they seek ways to boost capital to pass stress tests and comply with new rules. CoCo structures are highly complex and are non-homogeneous in terms of trigger levels, necessary capital buffer levels and loss absorption mechanisms. Banks could be guilty of violating the Markets in Financial Instruments Directive, where customers have been given the impression that the CoCo bond is safe as a deposit or is protected by a deposit guaranteed scheme, neither of which is true. (Bloomberg)

MAS proposes legislation for a regulatory framework for financial benchmarks

Jul 29. The Monetary Authority of Singapore introduced a regulatory framework to deter manipulation of financial benchmarks, following the policy proposals in 2013. The legislation comprises 2 key thrusts. The first thrust applies to acts of manipulation occurring in Singapore or financial benchmarks administered in Singapore, indicating that the manipulation of any financial benchmark in Singapore will be made liable to criminal and civil sanctions under the Securities and Futures Act. The other thrust requires administrators and submitters of financial benchmarks designated by MAS to be subject to regulations. Currently, MAS plans to designate the Singapore Interbank Offered Rates (SIBOR) and Swap Offered Rates (SOP as key benchmarks. (MAS)

Austrian president signs Hypo debt haircut law (Reuters)

Banks burdened with compliance costs outsource home loans (Bloomberg)

Hong Kong banks face global tax woes (FinanceAsia)

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