THE VIRAL INFECTION IS NOT GOING TO BE CURED OVERNIGHT: THE (FINANCIAL) PHLEGM WILL STAY IN INVESTORS' THROATS FOR SOME TIME, YET

Many desperate bankers and the *'experts'* of equity markets are singing similar words of the same old song: *'As key indices fall on major equity markets, it is a wonderful opportunity to pick up stocks and shares on the cheap'*.

Don't believe a word of it because stock and shares prices can fall much further: Just wait and see.

As with any viral infection, the financial problems, confronting the world, today, will not go away in a hurry: They will linger for some time, perhaps another year or so.

Last Monday, it was reported that the senior management of a smallish Canadian bank, Coventree Incorporated, had stated that the commercial paper market was in dire need of being refinanced with massive amounts of cash.

Clearly, this little bank is correct.

Then, on Tuesday, it was announced that at least 2 Canadian trusts had been unable to issue new commercial paper in order to repay commercial paper that is about to mature.

Further, the traditional Canadian banks of the trusts were reported to have turned down requests for more funding to the trusts.

From Tokyo, Japan, it was announced that Azabu Buildings Company, a large, real-estate company of the second-largest economy of the world, announced that it was hopelessly insolvent, with debts of about 564.80 billion yen (about $HK4.79 billion).

The company has filed for protection from creditors under the Corporate Rehabilitation Law in the Tokyo District Court.

The virus, which had its roots in the US, had spread to Japan.

Just yesterday, the extent of the exportation of the problems in the US subprime, mortgage-lending industry was exemplified when 2 of the world's biggest banks, both domiciled in Japan, announced their problems.

Mitsubishi UFJ Financial Group Incorporated announced, openly, that it had unrealised losses of about ¥5 billion (about $HK331 million) with regard to its exposure to US subprime mortgages, up to the end of July.

Sumitomo Mitsui Financial Group Incorporated, another big bank in The Land of The Rising Sun, announced, also, that it had recorded *'several billion yen'* in losses for the 3 months, ended June 30, 2007.

This bank had unloaded about ¥350-billion-worth (about $HK2.97 billion) of US, mortgage-backed securities, during the month of June.

The above 2 banks, it is noted, only gave scant statistics in respect of the months of June and July.

For certain, more losses will be made known in the fullness of time.

Central Banks from Tokyo to New York have been pumping hundreds of billions of US dollars into the money markets of the world in order to assure investors that these institutions are quite willing and able to stand up and be counted.

Unfortunately, all that is happening by such tardy and, now, platitudinous gestures is confirming that which most people already know: The economies of the world are in deep trouble.

How Did It All Happen … And So Quickly?

To begin with, the present situation did not happen quickly: It has been festering for the best part of 3 years – at least.

This medium stated, definitively, more than 2 years ago, that the writing was on the wall; and, that the problems in the US housing market were quite likely to affect many parts of the largest and most-important economy of the world.

And that is just what has happened.

The US housing market, buoyed by the 2004-2005, runaway US equity market and a near-unprecedented boom in the US housing market, both of which were galloping at a red-hot pace, caused financial institutions to be hot to trot to jump up and to offer money to just about anybody who appeared to be a good a fairly good bet, using the then market value of the applicant's bricks and mortar as collateral.

And many of these institutions took terrible chances with some of those borrowers who were not even good bets, leading up to the advent of the chaos in the sub-prime, mortgage-lending industry.

Obviously, as history has proved, due to inadequate due diligence on the part of many a financial institution in the US, quite a number of the people who received cash, based on the then market value of their new homes, should never have been financed in the first instance.

If anything, the financial institutions did them a disservice by affording them mortgage loans.

Today, a great number of these homeowners is unable to pay the interest factor on their loans, let alone that part of the principal that is due.

The number of delinquencies is mounting, daily, and, as they do, so it puts the strain on lending institutions, builders, suppliers, and, eventually, the traders in the High Street.

On Monday, August 6, 2007, contained in **TARGET** Intelligence Report, Volume IX, Number 146, this medium reported the matter of IKB Deutsche Industriebank AG and how, because this cash-strapped bank was having terminal problems, the German Government had to come to its aid with a bailout plan that will cost the German taxpayers the best part of $US11 billion.

That report followed **TARGET** (), warning its Subscribers that the situation, around the world, had the makings of a perfect financial storm.

Please Refer To:

TARGET Intelligence Report, Volume IX, Number 143,
Published On Wednesday, August 1, 2007

IKB, as it is commonly referred to in Germany, is a classic example of how the US housing virus has spread.

And the medicine to kill this virus has not yet been found, **TARGET** hastens to add.

As struggling homeowners in the US have to admit to their local lending institutions that they are unable to meet their financial commitments as they fall due, so European lending institutions are caught up in this international web of defaulters.

This is because quite a number of European lenders jumped aboard the fast-moving, US subprime, mortgage *'train'*, a couple of years ago, and, today, they are feeling the strain … and the pain.

Ask IKB about its New Jersey and Delaware- registered affiliate, Rhineland Funding Capital Corporation, which is, today, insolvent.

Many European lenders issued bonds, backed up by these subprime mortgages, in order to finance themselves.

This was one of the things that Rhineland Funding Capital Corporation did with a great deal of gusto.

It looked good, at the time, but, clearly, many people forgot to think of the probable scenario should there be a spate of delinquencies on the part of US homeowners.

Which is, exactly, the situation, today.

That state of affairs, then, cascaded down to investors who, rightly so, began to question the validity and veracity of certain statements, made by the heads of certain financial institutions.

People who buy bonds usually expect to cash in those bonds in time and the issuers are supposed to be able to live up to their financial obligations.

The bona fides of many bond issuers are in doubt, today – and rightly so, also.

This was seen when, on Tuesday, August 14, 2007, **TARGET** reported the matter of CBRE Realty Finance Incorporated, a US-based company whose senior management admitted that it had been hurt by the failure of 2 Maryland condominium projects.

The share price of CBRE Realty Finance Incorporated fell by 32 percent on the news.

On the same day, this medium reported that Luminent Mortgage Capital Incorporated had suspended payment of its quarterly dividend while it hunted for some cash.

(Watch this space for more about this company)

And so the list of companies with major financial problems, listed on The New York Stock Exchange or on The NASDAQ, the biggest equity markets of the world, continued to grow.

It was hardly any wonder that, eventually, the penny had to drop.

Little has changed since August 1, 2007 – except that things have become even worse as more and more admissions of financial failures are being made by the heads of companies, companies which, only a few years ago, were above suspicion.

Even the mighty BNP Paribas SA of France had to suspend withdrawals from 3 of its funds due to the volatility in the US asset-backed, securities market.

BNP Paribas, as with many other banks, had been financing long-term investments with short-term borrowings, issuing commercial paper.

The Hongkong Land Company Ltd did something similar in Hongkong, some years ago, when Mr Trevor Bedford, the then Managing Director of this company, had this massive property company bite off more than it could possibly chew, using short-term borrowings to finance long-term, property projects.

The problem with issuing commercial paper – bonds and the like – is that they will be redeemed in due course and, as such, it is incumbent that the issuer either has the cash to redeem the commercial paper or, alternatively, can find the wherewithal to be able to issue more bonds in order to roll over his financial obligations.

This is, of course, an over-simplification, but, in a nutshell, that is the situation.

However, once bitten twice shy: Few people are willing to take the risk in respect of the new commercial paper.

In short, these people doubt the bona fides of the issuer of new commercial paper.

The present situation is not limited to financial institutions, however: It goes much deeper.

One wonders whether or not some of the highly geared companies, some operating cruise ships, some operating relatively newly established airlines, some having committed tens of millions of dollars in the construction of building projects and so on will be able to live up to their financial commitments.

Certainly, if financial institutions are feeling the heat in their *'kitchens'*, it is a guarantee that they will be scrutinising every aspect of a borrower's application for funds.

Any company that is considered cash-poor will become a victim, or be considered suspect of the current situation, whether or not that company deserves such a nomenclature.

In the case of a number of international cruise lines, many of them have committed to buy many billions of US dollars' worth of new luxury vessels, those vessels to be delivered next year.

If people start to tighten belts and the existing vessels are not sufficiently full of well-heeled passengers, there could be trouble in store in trying to borrow from Peter in order to pay Paul.

Star Cruises Ltd

Star Cruises Ltd () (Code: 678, Main Board, The Stock Exchange of Hongkong Ltd) brought out its Interim Report for the 3 months, ended March 31, 2007, showing that it had suffered a Loss Attributable to Shareholders of about $US79.39 million (about $HK619.24 million) for the first quarter.

That result compared with the like period in 2006 when the company reported a Loss Attributable to Shareholders of about $US35.05 million (about $HK373.39 million).

The losses for the first quarter of 2007 were despite Passenger Cruise Days, rising to 2,794,561, compared with the like period in 2006 when Passenger Cruise Days were 2,381,418.

The occupancy level of the company's ships was maintained at about 99 percent, but, still, there was not a profit in sight.

In fact, according to **TOLFIN ()** (The Computerised, Online Financial Intelligence Service and Web-Based, Credit-Checking Provider), in the past 5 Financial Years, this company has, really, not done very well, at all.

The following is lifted from the database of **TOLFIN**, by permission:

	Financial Year, Ended December 31				
	2002	2003	2004	2005	2006
	All Figures Are Denominated In $US'000				
Turnover	1,573,588	1,618,208	1,699,007	1,967,353	2,343,055
Operating Profit Before	160,842	79,049	134,827	145,937	95,452

Impairment Loss					
Impairment Loss	Nil	(99,545)	(14,500)	(1,400)	(30,600)
Operating Profit/(Loss)	160,842	(20,496)	120,327	144,537	64,852
Interest Income	3,325	2,613	2,985	8,484	6,670
Financing Costs	(99,326)	(94,227)	(110,005)	(155,930)	(200,944)
Net Profit(Loss) Attributable To Shareholders	50,931	(124,896)	(11,584)	17,906	(156,196)

In summary, Star Cruises Ltd lost money for 3 Financial Years out of 5 Financial Years and the sum total of the situation was a Loss Attributable to Shareholders of about $US223,839,000 (about $HK1.75 billion).

As at March 31, 2007, the company had about $US139.83 million (about $HK1.09 billion) in cash and cash equivalents, which was a decided decrease, compared with the like period in 2006 when the company had cash and cash equivalents of about $US468.83 million (about $HK3.66 billion).

Long-Term Borrowings stood at about $US3,154,194,000 (about $HK24.60 billion), which was not too dissimilar from the like 2006 quarter.

Financing costs, during the first quarter of this Financial Year, stood at about $US55.88 million ($HK435.86 million), which compared with the like period in 2006 when financing costs were $US46.36 million (about $HK361.61 million).

Clearly, financing costs are eating away at this company's Bottom Line and it is, also, clear that the company is financing its operations by very material, long-term loans – which is, of course, the nature of this kind of operation.

Turning to airlines, there is Oasis Hongkong Airlines Ltd (), the HKSAR, start-up airline which took off in October of 2006 – after a number of hiccoughs – and which is owned by the Minister of a Methodist Church of the HKSAR.

It is losing huge amounts of money and one wonders how long the religious faithful will continue to fund this loss-maker.

It is said that if one wants to create a millionaire out of a billionaire, have that person invest in a start-up airline.

Whether or not Oasis Hongkong Airlines will continue to fly, only Heaven knows, but, for the rest of us, it would appear to be prudent to keep the purse strings, tied tightly, at least for the time being.

It appears that many investors of the HKSAR have, already, taken the hint and one notes that property sales are on the wane – already.

And this has taken place in just one week as it was noted that property transactions for the week, ended August 10, 2007, had dropped by about 31 percent, compared with the number of transactions for the week, ended August 3, 2007 – 303 transactions versus 438 transactions.

This is just the beginning …

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