CRI Credit Research Initiative
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Weekly Credit Brief
Apr 12 - Apr 18

# PC sector shows signs of distress

by LEE Yanru

The PC sector has been losing its luster. Based on two major international research firms, Gartner and International Data Corporation (IDC) definition of PC which broadly includes desktop, notebooks, as well as ultra-premium, they have reported a significant decline in PC shipments over the past few years. Gartner pointed out that global PC shipments were estimated to be 64.8mn units in Q1 2016, down by 9.6% YoY, while IDC claimed that global PC shipments could have fallen by 11.5% YoY in the same period.

Based on Gartner analyst reports, this decline could be attributed to a few factors. First and foremost, the sluggish global economy has soured consumer sentiment. All major regions, such as the US, Asia-Pacific, and Europe, Middle East and Africa (EMEA), have mostly experienced a falling demand for PCs. Latin America, in particular, has reflected the most significant drop in PC shipments, down by 32.4% YoY, due to the current economic woes and political instability in Brazil.

Additionally, the rising popularity of PC substitutes, tablets and smartphones, has contributed to the loss of interest in PC over the past few years. The left panel of Figure 1 shows the downward trend of PC shipments and the corresponding rise in tablet and smartphone shipments.

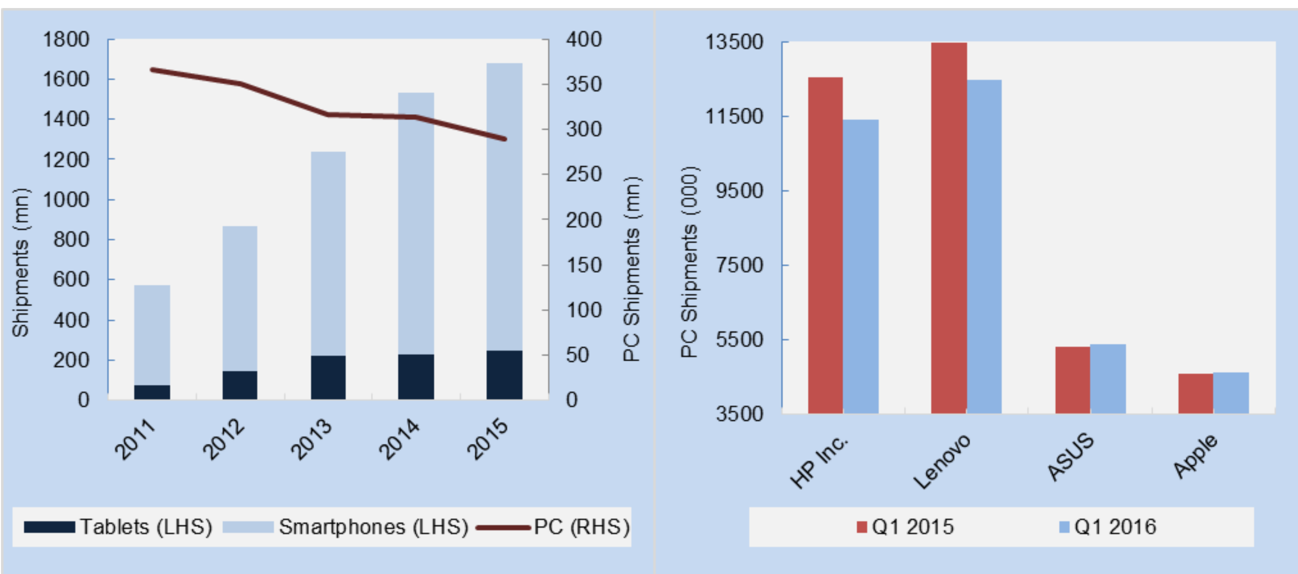


Figure 1: Global shipments by product (left panel); global PC shipments for the 4 largest-listed PC companies (right panel). *Source: Statista, Gartner*

Despite the overall downward trend for the industry, not every individual firm has performed poorly. While PC shipments for Lenovo and HP, the top 2 players in the industry, declined by 7.2% and 9% YoY, respectively, the PC shipments for ASUS and Apple were relatively stable (Figure 1). Notably, Apple is less affected by the downturn in the PC sector, as PCs only accounts for less than 10% of its total revenues compared with about 70% for Lenovo and 30% for HP. Asus was less affected by this downward trend because it realized good sales from its high-end products.

The RMI-CRI 1-year PD reflects the poor performance for Lenovo and HP (see Figure 2). Lenovo's PD increased from around 10bps at the beginning of 2015 to a high point of 58.8bps on Apr 15, 2016. Likewise, HP's PD surged to 403.6 bps on Apr 15, 2016, from a low point around 1-2 bps at the start of last year. In contrast, the RMI-CRI 1-year PD for Apple has hovered at a level lower than 1bps, while the PD for ASUS remained stable at 2-3bps in the same time period.

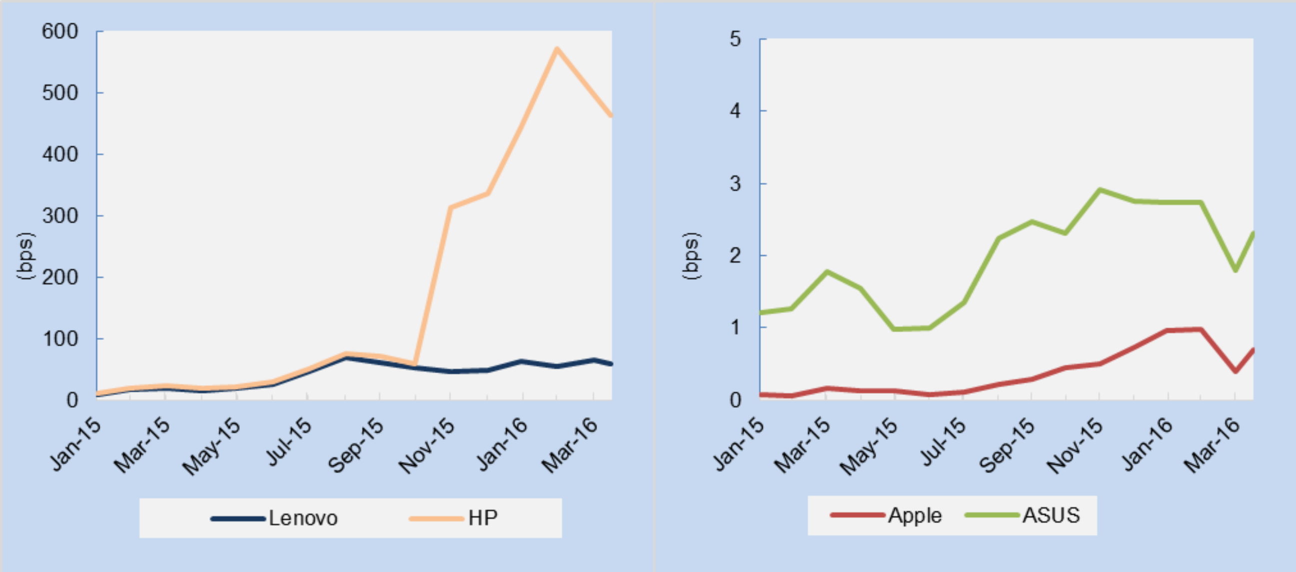


Figure 2: RMI-CRI 1-year Probability of Default (PD) for top 4-listed PC companies. *Source: RMI-CRI*

The difficulties faced by Lenovo and HP are also revealed by their financial performance. The total debt to EBIT ratio for both companies has increased over the past year. The rising total debt to equity ratio also indicates increased financial risks for Lenovo and HP.

| | | FY 2014 | FY 2015 |
|---|---|---|---|
| **Lenovo** | Total Debt to EBIT | 0.97 | 3.36 |
| **HP** | | 2.72 | 4.51 |
| **Lenovo** | Total Debt to Equity (%) | 35.99 | 90.47 |
| **HP** | | 71.98 | 87.62 |

Table 1: Financial data for Lenovo and HP. *Source: Bloomberg*

Gartner forecasts that global PC shipments for 2016 will fall below the 2015 level, suggesting even tougher financial challenges for PC companies in the upcoming quarters. Nevertheless, the research firm still looked bullish on the PC shipments from 2017 onwards. If the PC firms can take advantage of the increasing future demand for ultra-premium devices as Windows 10 becomes more popular, the PC industry prospect will be brighter.

## Credit News

### State fund dispute puts 1MDB at risk of default

**Apr 18.** A worsening dispute between the state funds of Malaysia and Abu Dhabi over a complex billion-dollar transaction is threatening to trigger a major financial crisis in Malaysia. Last week, International Petroleum Investment Company (IPIC) informed 1Malaysia Development Berhad (1MDB) that the KL entity was in default of a complex bond agreement between the two. The monies are part of payments under a May 2012 agreement, where the London-listed IPIC guaranteed 1MDB bonds valued at USD 3.5bn. In return, 1MDB agreed to make payments as collateral to IPIC's subsidiary Aabar. The complications at 1MDB could also adversely impact Malaysia's efforts to raise much-needed funding in international bond markets, and hurt its credit ratings. (Straits Times)

### Corporate borrowers default on USD 50bn debt so far this year

**Apr 17.** Corporate borrowers across the world have defaulted on USD 50bn debt so far this year as the number of delinquent companies accelerated at its fastest pace since the US emerged from the financial crisis in 2009. The sharp decline in commodity prices, spurred by slowing global growth, and lackluster demand for base metals and crude, have weighed on oil and gas producers and miners. Nearly half of the defaults have occurred in these two industries. (FT)

**Linc Energy enters into voluntary administration**

**Apr 15.** Linc Energy shares have been suspended since March 30 as it sought more time to continue discussions on its debt restructuring and recapitalisation efforts. The firm, which was de-listed from the Australian Stock Exchange to float on the SGX in late 2013, had promised huge returns from an innovative technology to extract fuel from coal deposits but failed to generate any meaningful revenue from a string of much-heralded projects. It posted a net loss of USD 100.6mn for its second quarter as oil prices plummeted. (Straits Times)

**Peabody, world's top private coal miner, files for bankruptcy**

**Apr 13.** Peabody Energy Corp filed for US bankruptcy protection on Wednesday after a sharp drop in coal prices left it unable to service debt of USD 10.1bn, much of it incurred from an expansion into Australia. Debt troubles for Peabody date back to its USD 5.1bn leveraged buyout of Macarthur Coal in 2011, just when prices peaked for the metallurgical coal that the Australian company supplies to Asian steel mills. As demand for metallurgical coal fell, particularly in China, Peabody's financial woes intensified. The company took a USD 700mn writedown on its Australian metallurgical coal assets last year. (Channel NewsAsia)

**Saudi rating cut for first time at Fitch on lower oil prices**

**Apr 12.** Saudi Arabia's credit worthiness was downgraded at Fitch Ratings after the plunge in oil prices. The kingdom's rating was lowered one level to AA-, the fourth-highest investment grade, and its outlook maintained to be negative. The Saudi stock exchange's market capitalization has fallen by almost USD 50bn since the kingdom's credit rating was first cut at the end of October, with the benchmark Tadawul All Share Index down 10%. (Bloomberg)

**Moody's upgrades Argentine credit rating** (FT)

**Energy XXI files for bankruptcy in debt-for-equity swap** (WSJ)

**Regulatory Updates**

**Singapore adopts 2008 crisis policy as growth grinds to halt**

**Apr 14.** Singapore's central bank unexpectedly eased its monetary stance, adopting a policy last used during the 2008 global financial crisis, as economic growth in the trade-dependent city-state ground to a halt. The Monetary Authority of Singapore moved to a neutral policy of zero percent appreciation in the exchange rate, causing the local dollar to slide and dragging down currencies across Asia-Pacific. The surprise announcement came two days after the International Monetary Fund warned of the risk of negative shocks to the global economy. Monetary easing followed an expansionary budget announced by Finance Minister Heng Swee Keat last month, indicating how severe authorities view the slowdown as businesses shut and growth in bank loans contracts. (Bloomberg)

**Five big banks' living wills are rejected by US regulators**

**Apr 13.** JPMorgan Chase & Co., Bank of America Corp. and three other major US banks failed to persuade regulators they could go bankrupt without disrupting the broader financial system and could now face a tighter leash from Washington after government agencies used one of the most significant post-crisis powers bestowed under the Dodd-Frank Act. The banks – including Well Fargo & Co., Bank of New York Mellon Corp. and State Street Corp. – must scrap their resolution plans after the Federal Reserve and the Federal Deposit Insurance Corp. said versions submitted last year filed to satisfy their requirements. The lender will have until Oct 1 to rewrite the plans – but under the pressure that another failure would give regulators power to subject them to more capital or liquidity constraints on their businesses. (Bloomberg)

**Basel bites again as rules push Aussie banks toward longer bonds**

**Apr 12.** Australia banks may need to sell a lot more longer-dated bonds to get into the kind of shape regulators will be happy with. The country's major lenders, fresh from raising USD 15.4bn in equity capital last year, face the prospect of ramping up their longer-term debt funding to comply with stricter rules under the global Basel III framework. While Commonwealth Bank of Australia is poised to meet NSFR requirements, the next biggest lenders could need to raise a combined AUD 41bn in additional term-debt by 2018, according to an estimate from Macquarie Group Ltd. With credit costs already increasing and net interest margin being squeezed, that could add to pressures for National Australia Bank Ltd and some of its peers. (Bloomberg)

**China's finance minister accuses credit-rating companies of bias** (Bloomberg)

**Italy bank plan sets up fight on bankruptcy reforms** (FT)

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