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Weekly Credit Brief January 06 - January 12

Small-sized teen apparel retailers become vulnerable

by Jiang Zhengyi

While the US economy is doing well, teen clothing retailers in the US is undergoing hardships. Two clothing chains, Deb Stores Holding LLC and Delia's Inc, filed for bankruptcy during last month. Another two teen retailers, Wet Seal Inc and Aeropostale Inc, have recently made known the difficulties it faces in operating. Wet Seal Inc said on Jan 7 that it is shutting down 338 stores, roughly 2/3 of its locations, to shore up cash and keep liquidity. It also received a default notice of USD 27mn from a lender on some of the company's senior convertible notes and is facing bankruptcy if it fails to meet its obligations by Jan 12. Before this, Wet Seal Inc has experienced losses in 8 out of past 10 quarters and comparable sales drops 11 out of past 13 quarters. Aeropostale Inc lost USD 141.8mn in the latest fiscal year, and it is also planning to slash its store bases in 2015 due to shortages of liquidity.

Table 1 presents the 8 US listed companies in the Teen & Young Adult Cloth Stores industry. As tabulated, most of the companies have experienced decreases of CFO / Average Current Liability Ratio and Common Equity / Total Assets Ratio from Q2 FY2015 to Q3 FY2015, indicating the decreasing abilities to repay current liabilities from operations and worsening credit profiles. Only Urban Outfitters Inc and Abercrombie & Fitch Co, the two large market cap companies, have seen their CFO / Average Current Liability Ratios increased. Moreover, if we classify those with market cap above USD 1bn as large market cap companies, we may find that only the two small market cap companies, Wet Seal Inc and Aeropostale Inc, present negative CFO / Average Current Liability Ratio, indicating their severe shortages of cash from operation. Additionally, they show larger absolute value decreases in both ratios than other companies with large market caps, and the lower is the market cap, the more the ratios decrease. The smaller market cap companies are performing the worst.

Company Name	Market Cap (USD mn)	CFO/Avg Current Liab		Common Equity/Total Assets (%)	
		Q3 FY2015	Q2 FY2015	Q3 FY2015	Q2 FY2015
Urban Outfitters Inc	4,657.55	1.17	0.93	69.29	70.17
American Eagle Outfitters Inc	2,845.40	0.54	0.59	63.22	67.49
Buckle Inc	2,553.96	1.72	1.89	71.02	71.37
Abercrombie & Fitch Co	2,033.62	0.78	0.63	54.18	58.18
Ascena Retail Group Inc	1,982.11	0.54	0.59	55.58	55.63
Zumiez Inc	1,177.14	0.81	0.86	68.9	67.05
Aeropostale Inc	178.82	-0.19	-0.08	17.96	24.02
Wet Seal Inc	10.71	-0.88	-0.73	-11.34	18.53

Table 1: Companies of Teen & Young Adult Cloth Stores industry in the US and their Market Caps, CFO / Average Current Liability Ratio and Common Equity / Total Assets Ratio. (CFO means Cash Flow from Operation) *Source: Bloomberg*

As shown in Figure 1, the average of the RMI 1-year Probabilities of Default (RMI 1-year PDs) of all 8 companies has sharply increased from about 126bps to over 800bps since Nov 2014, while the average of the RMI 1-year PDs of large market cap companies remains almost stable at a relative low level, though it also rose moderately to above 3.5bps since Aug 2014. Therefore, the dramatic increase of the average of PDs is mainly driven by the two small market cap companies.

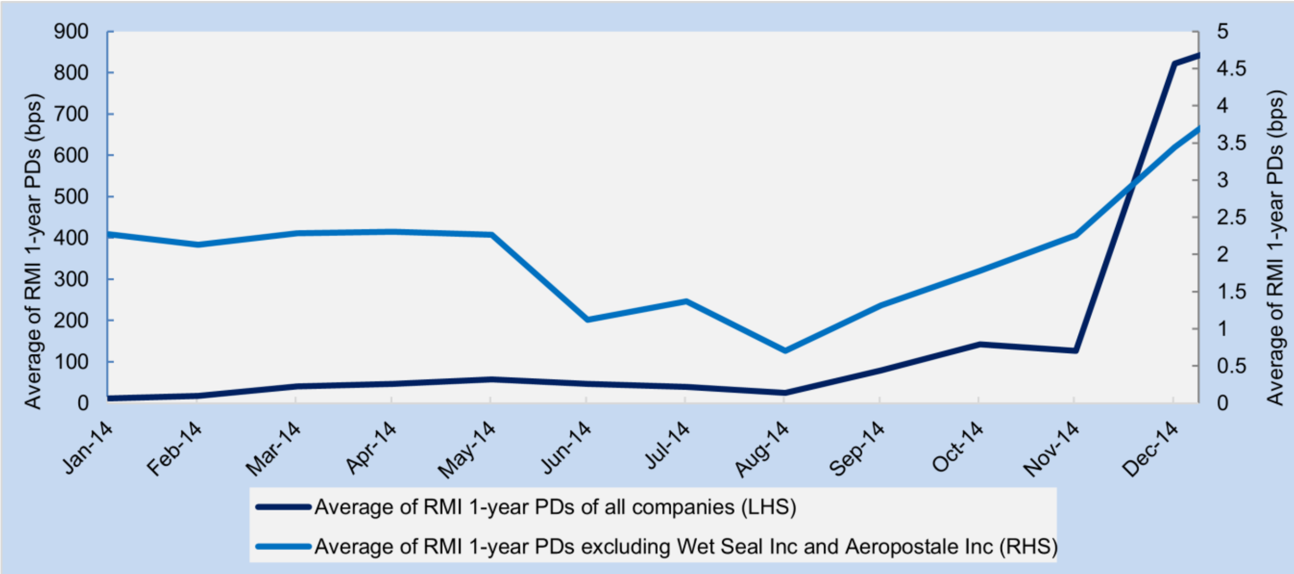

Figure 1: Average of RMI 1-year PDs (LHS) of all companies in the Teen & Young Adult Cloth Stores industry in US and Average of RMI 1-year PDs (RHS) of the companies with market cap greater than USD 1bn. *Source: Risk Management Institute*

Further, looking at the RMI 1-year PDs of the two excluded companies in Figure 2, we may find that Wet Seal Inc, with the lowest market cap, has the highest absolute value of PDs and climbed fiercely since Nov 2014 and Aeropostale Inc, with the second-lowest market cap, shows a relative stable PD trend at a lower level but higher than large market cap companies and has a similar pattern of rising PD since Nov 2014.

Competitions from online and fast-fashion retailers and shifts in household spending to electronics or other items of fashion are driving customers away from the traditional retailers, pushing them close more stores as they try to cope with economic shifts. As put by Craig Johnson, president of consulting firm Customer Growth Partners L.L.C., in 2000, spending on clothing accounted for 5% of a typical US household's budget, while now it's about 2.8%. Based on the current performances of teen clothing retailers in the US, those with small market cap are more vulnerable than the rest.

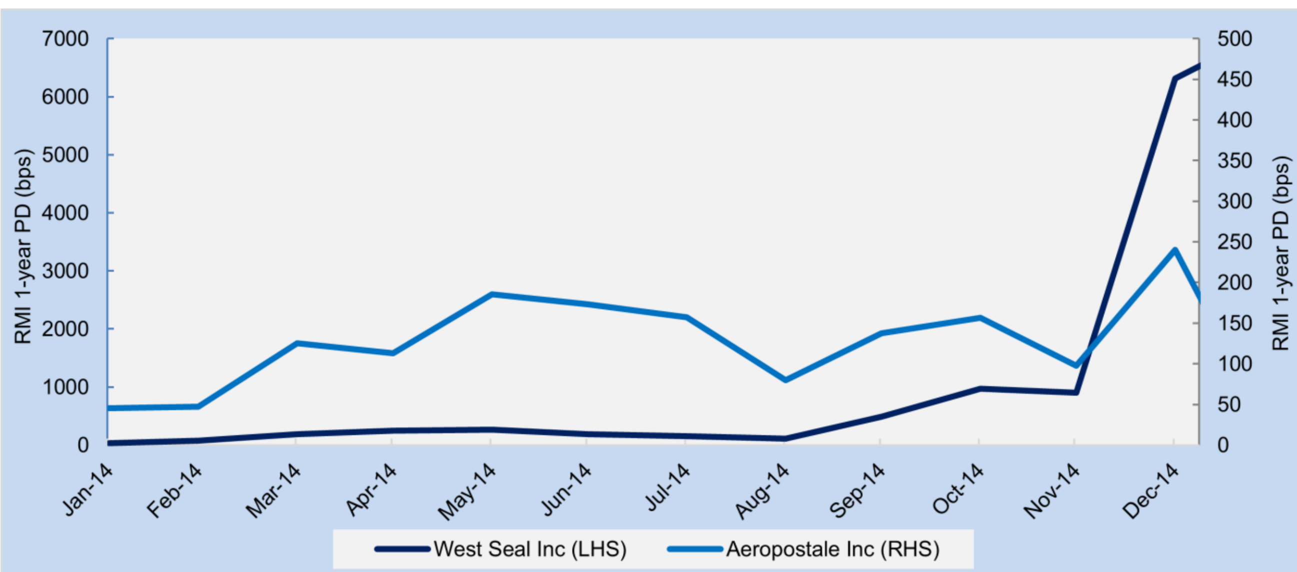

Figure 2: RMI 1-year PDs of Wet Seal Inc (LHS) and Aeropostale Inc (RHS) with small market caps below USD 1bn. *Source: Risk Management Institute*

Sources: Wet Seal may be too late to stave off bankruptcy (Marketwatch)
Teen-Apparel Chains Poised for Pain as Malls Lose Luster (Bloomberg)

Credit News

China's automobile sales to slow further in 2015

Jan 13. China's auto industry faces a second straight year of weaker growth after a sharp 2014 slowdown, according to an industry association and analysts, as car makers continue to grapple with a cooling economy and rising inventories. Analysts expect China's slowing growth will weigh on auto sales over the course of the year. China's gross domestic product is widely expected to rise 7.3% in 2014, the weakest since 1990, and further deceleration is likely, said economists. The latest data from the China Automobile Dealers Association show that stockpiles at China's more than 22,000 dealerships jumped to 55 days in November, up from 44 days in October and the highest level since June 2012. (WSJ)

Singapore rate spike to weigh on property prices

Jan 13. A sudden new-year jump in Singapore interest rates threatens to push up mortgage costs and steepen a slide in home prices. The three-month Singapore interbank offered rate, against which most home loans are benchmarked, has risen 18 basis points to 0.6392% this year to the highest since April 2010, driven by a stronger US dollar and new liquidity requirements for Singapore banks. Head of research at Maybank said that interest rates will rise slowly from current levels. He expects three-month SIBOR to increase to 1% by the end of this year and 2% by the end of 2016. (Bloomberg)

New capital goals and Santander share sale heap pressure on Europe's banks

Jan 13. The biggest eurozone banks have come under renewed pressure to raise extra capital after the European Central Bank set new individual targets and Spain's Santander responded by selling EUR 7.5bn of shares last week. The ECB, which took over regulation of the eurozone's 130 biggest banks from national supervisors in November, has given lenders until the end of this week to appeal against the capital ratios it believes they need. The ECB capital requirements are undisclosed, though some individual institutions have made their ratios public. (Strait Times)

Malaysian state fund 1MDb fails to repay RM 2bn loan, chief executive replaced

Jan 6. 1Malaysia Development Bhd (1MDb), a state investment company in heavy debts, has for the second time failed to pay the loan to local lenders. The loan amounts to RM 2bn (SGD 750mn) and was due on December 31, 2014. Attentions of Bank Negara Malaysia have been drawn to this and a meeting was held by top executives from 1MDb to settle the debt issue. (Straits Times)

Caesars receives more support for restructuring plan (WSJ)

Energy bondholders could lose out in refinance deals (FT)

Standard Chartered to shut equities business (WSJ)

Regulatory Updates

New PBOC bank deposit rules unlikely to increase lending

Jan 13. The People's Bank of China (PBOC)'s new rules requiring banks to count in their interbank deposits from non-bank financial institutions have enlarged the banks' deposit base. This change has more effects of squeezing shadow banking than of monetary easing. The 75% loan-to-deposit ratio (LDR) for banks can make deposits larger. Many see the rules as a stimulus of bank lending, while others do not expect there will be much impact. (SCMP)

Stricter dark pool rules said to be under consideration at SEC

Jan 13. The Securities and Exchange Commission is developing rules that will force dark pools to comply with some of the same requirements exchanges face and will address two key areas of concern including the disclosure of the types of orders available on the platforms and the source of pricing data. The SEC is also weighing whether to require dark-pool operators to tell investors who else trades on their systems and whether they route unfilled orders to other platforms used by more aggressive traders, according to a person with knowledge of the matter. As the SEC considers new rules, others have weighed in with proposals to alter how dark pools operate. (Bloomberg)

US banks call for action on clearing houses

Jan 12. US banks have urged the US Treasury secretary to shore up clearing house, arguing the likes of fail of clearing house such as CME Group and LCH. Clearnet could cause the next financial crisis instead of preventing it. Big banks' concern is the lack of resolution plan from regulators towards clearing houses' collapsing. Despite the clearing houses have resisted banks' calls, the European legislation likely to publish in the coming year will put US authorities under pressure to follow the suit. (FT)

Government stake dilution is not enough for Basel III: RBI (FT)

Derivatives markets brace for Basel III margin crunch in 2015 (Banking Technology)

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