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Macy's, Inc. joins the swelling ranks of troubled US departmental stores

By Ernest SIM

American departmental stores operator Macy's, Inc, merchandises a variety of products encompassing fashion apparels, cosmetics, and household products through its namesake Macy's departmental stores, Bluemercury specialty beauty retail chain and upscale Bloomingdale stores. With its expansive fleet of 880 retail stores across the US, Macy's has grown to be the largest departmental chain in the US by sales. However, over the last two years, Macy's had posted shrinking margins attributed to a confluence of factors such as lower tourist spending at its Macy's and Bloomingdale stores, a warm winter resulting in tepid demand for winter clothing and shifting consumer preferences away from traditional brick-and-mortar retailers, shaving Macy's topline figures.

While the drop in tourist spending and warm winters had chipped away at Macy's earnings, the change in consumer preference is more pervasive. With the retail environment continuously shaped by changing consumer expectations of their retail experience, Macy's ailing performance reflects its difficulties in grappling with the threat posed by e-commerce as consumers pursue convenience. This shift in consumer preference disproportionately weighs down on retailers that rely on brick-and-mortar stores as its main channel to merchandise products and Macy's, despite its omnichannel efforts, is not insulated from such trends. Same store sales, which is an indicator of the performance of a retail chain's sales by comparing quarterly sales of established stores on a year-on-year basis, slid from 2% in Q4 2014 to -3.3% in Q3 2016 as volume of foot traffic to retail stores fell (see Figure 1). The weak foot traffic in Macy's departmental stores had crimped the departmental chain operator's profits, resulting in a decline in trailing 12-month EBITDA margin across the period from 13.65% in Q4 2014 to 9.54% in Q3 2016, suggesting a decline in operational efficiency.

More recently, Macy's had revised its November/December 2016 guidance downwards upon dismal sales volume despite an uptick in the index of consumer sentiment, a gauge of consumer confidence (see right panel of Figure 1). Macy's tapering sales volume during the holiday season is not unique to its own with online e-commerce giant Amazon credited to have drawn sales away from other departmental store chains as well.

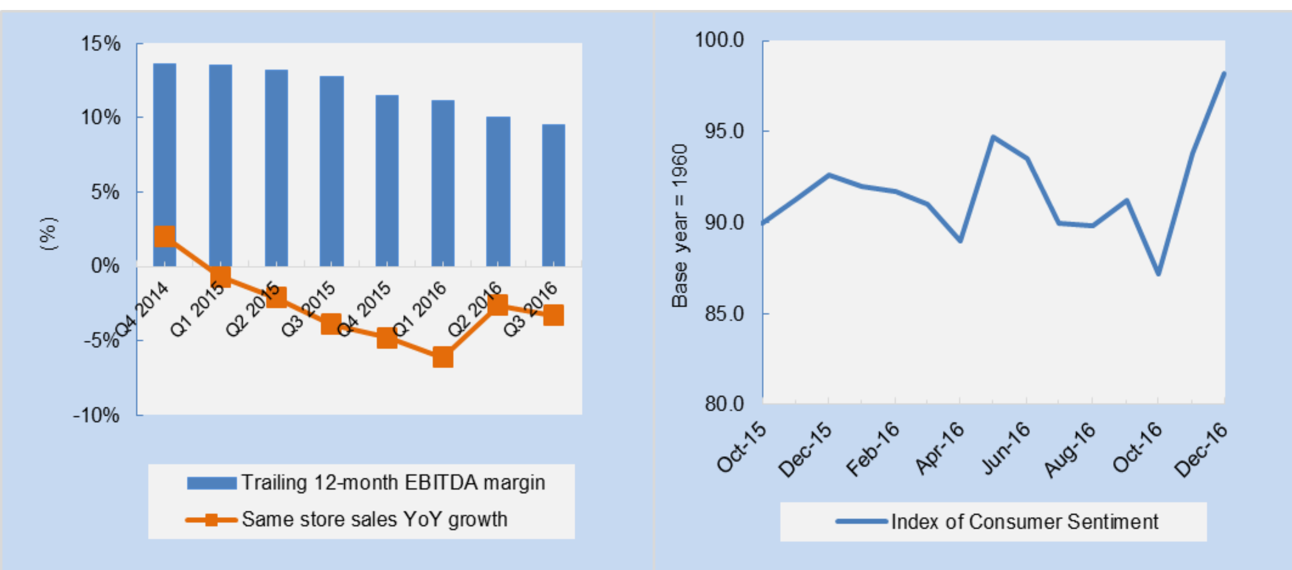

Figure 1: Financial data for Macy's, Inc. (LHS) and University of Michigan Index of Consumer Sentiment, monthly (RHS). *Source: Bloomberg, University of Michigan*

As Macy's faces pressure to align with current consumer preferences, diminishing margins could wear down its ability to deal with debt obligations, weakening the company's credit and liquidity profile. The departmental chain incumbent had already posted an increase in debt relative to its earnings, with total debt to EBITDA rising from 2.25x in Q3 2015 to 3.01x in Q3 2016, while the interest coverage ratio had decreased substantially from 3.23x in Q3 2015 to 1.30x in Q3 2016 (see Table 1). Collectively, these figures indicate a dwindling ability to repay debt and interest on debt.

	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016
EBIT to interest expense (X)	3.23	9.96	2.79	1.19	1.30
Total debt to EBITDA (X)	2.25	2.46	2.57	2.88	3.01

Table 1: Credit and liquidity metrics for Macy's, Inc. *Source: Bloomberg*

Correspondingly, the RMI-CRI 1-year Probability of Default (PD) for Macy's had been on a general uptrend since the start of Oct 1, 2015, rising from under 10 bps to 48 bps on Jan 13, 2017 (see Figure 2). The PD for Macy's tracks the aggregate 1-year PD, a simple median for US departmental store operators, with the aggregate PD rising from 16.5bps to 81bps across the same period.

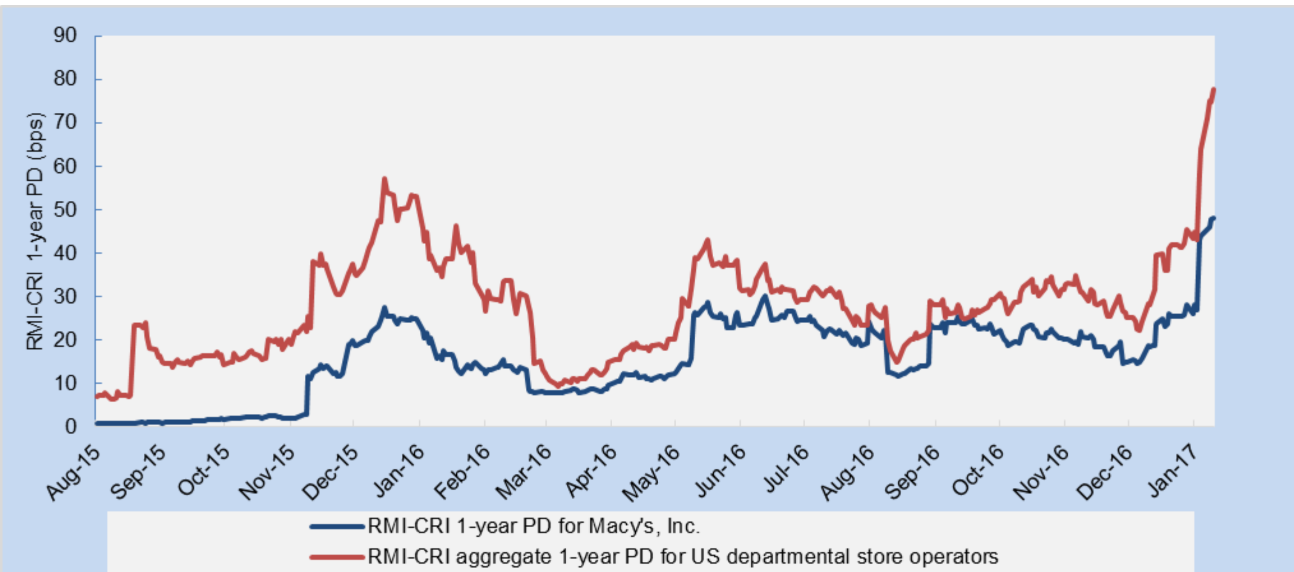

Figure 2: RMI-CRI 1-year PD for Macy's, Inc and aggregate RMI-CRI 1-year PD for US departmental store operators. *Source: RMI-CRI, Bloomberg*

While Macy's situation is not as dire as its departmental store counterpart Sears, which was once the largest US retailer, with lackluster growth on its horizon, Macy's had already sought to shutter 68 out of its planned closures of 100 stores. These closures were aimed at cutting back on expenses, focusing on its remaining high productivity stores and channeling USD 250mn out of its estimated USD 550mn expense savings towards the development of its better-performing online retail sites. However, at the beginning of 2016, Macy's had outlined similar measures of store shutdowns, restructuring and streamlining of back-office processes leading to job cuts. Other measures revolve unlocking and driving value from its real estate portfolio.

Looking ahead, while diverting resources towards websites to enhance online shoppers' experience might alleviate earnings pressures placed on departmental store operators such as Macy's and other brick-and-mortar retailers by online retailers, leveraging on technology to improve in-store experience for shoppers could also be a solution to drive top-line growth. Amazon Go, e-commerce giant Amazon's venture, albeit being a smart supermarket, has granted a futuristic glimpse of shopping at physical stores with its hassle-free checkout.

In the near term, however, tax policies under the Trump administration could spell higher costs for Macy's and the wider retail industry as costs are raised if import tariffs are adjusted upwards. With Trump's impending inauguration, Macy's current focus on alignment towards its online business segment would place it in a better position to capture revenue and drive earnings.

Credit News

Peabody Energy gets USD 1.5bn in financing to exit bankruptcy

Jan 13. Bankers including Goldman Sachs and JP Morgan are providing USD 1.5bn in loans to help Peabody Energy Corp exit bankruptcy by the end of this year. The company had been in business for 133 years before it filed for bankruptcy protection last year. Peabody's market capitalization was nearly USD 20bn in 2011 but has since declined to USD 91mn following the decline in coal prices. The company began bankruptcy proceedings with more than USD 7bn in debt but it plans to cut more than USD 5bn of debt through a new private placement and rights offering. (AFR)

China's Dalian Machine Tool Group cross-defaults on short-term bills

Jan 13. China's state-owned Dalian Machine Tool Group Corp announced that it had cross-defaulted on short-term bills issued last October, after failing to remedy defaults on another debt obligation. The company had not raised enough money to remedy the defaults for its short-term bills issued in 2015 after a grace period of 10 working days was given. This marks the latest in a series of defaults by Chinese companies struggling with weaker demand and overcapacity. (Reuters)

Turkey's Central Bank said to tighten liquidity to prop up Lira

Jan 12. Turkey's Lira surged the most in more than a year after its Central Bank increased borrowing cost to 10% from 8% through the late liquidity window. This move by policy makers show that they are getting creative in arresting the decline in the lira after the Central Bank lifted its interest rates in November last year but to little avail partly due to Turkey's weak economy hurt by terrorist attacks and political instability. The Central Bank may also intervene in lira's decline to protect price and financial stability by putting a floor under the lira with higher interest rates but did not state any plan to alter borrowing costs. (Bloomberg)

Electric plant operator Homer City files for bankruptcy

Jan 11. Homer City Generation LP has filed for Chapter 11 bankruptcy protection as it seeks to implement a restructuring plan that aims to clear USD 600mn in secured debt. The company operates one facility that has three electric power-generating units in Indiana county, Pennsylvania, staffed by NRG Energy Services, which will remain in place as the plant operator. Homer City was in the midst of rounding up votes to a restructuring agreement with its secured creditors when it filed for Chapter 11 in the US bankruptcy court. The plant is run as a limited partnership by EFS HC GP, LLC – which is an entity indirectly owned by General Electric Co. Other indirectly owned GE affiliates own most of the partnership. (WSJ)

Strapped-for-cash Chinese companies find new ways to borrow

Jan 11. Chinese companies, facing record delays in collecting payments from customers as a result of the worst economic slowdown in a quarter of a century, are ramping up sales of asset-backed securities to fund their operations. In 2016, structured sales notes backed by assets, such as receivables, jumped 130% to RMB 455.2bn (USD 65.7bn) – accounting for 54% of all asset-backed securities issued in China – up from 33% in 2015. Notes backed mainly by bank loans, which used to constitute the largest proportion of ABS issuance, fell 4.6% in 2016. Government measures to control risk have reduced companies' credit access – also leading to a 20% rise in bankruptcies in 2016. In 2014, it took an average of 76 days for companies to collect cash on completed sales. That figure is now 94 days.(Bloomberg)

US corporate bankruptcies expected to rise in 2017 and beyond (Reuters)

Fitch downgrades outlook on Australian bank sector to negative (FT)

Regulatory Updates

Officials planned to prioritize debt payments as 2011 debt-ceiling deadline loomed

Jan 12. Treasury meeting transcripts, released after a customary 5-year lag reveal a privately formalized plan in August 2011 by Federal Reserve and Treasury Department officials. The plan would have seen one-off payments on Treasury debt and delayed payments of other government obligations if the federal borrowing limit failed to be increased. The minutes revealed that the Fed was prepared to make interest and coupon payments on US government securities – a major linchpin in global financial markets. The suspension on the federal borrowing limit is set to expire in mid-March 2017. (WSJ)

Bitcoin plummets in value as PBOC announces formal investigation into virtual currency

Jan 11. The price of Bitcoin has plunged after regulators announced that major Bitcoin platforms might have breached existing anti money laundering and trading exchange rules. Representatives of the PBOC and the Beijing Financial Bureau have urged the trading platform companies to enforce strict risk controls and consider the possibility of setting up third party custodians for the Bitcoin market. Soon after the regulator's announcement, the platforms' users were unable to log on to their accounts as large volumes of sell orders had caused the trading systems to seize up. (SCMP)

UK regulator doubles meetings with industry (FT)

Rabobank to raise EUR 1bn to meet stricter capital requirements (Reuters)

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