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Toshiba plunges into meltdown

by Crystopaz ANGGA

Shares in Toshiba Corp lost almost half of its value as concerns on multi-billion write-downs continue to weigh on the company's financials. The Japanese electronics giant dismayed investors in December when it reported potential multi-billion write-downs on its newly acquired Stone and Webster (S&W)'s nuclear operation in the US. Triggered by cost overruns at US power projects, the write-downs, estimated between USD 1bn and USD 8bn, have wiped out most of the equity's gains since the recovery from the accounting scandal in 2015 (see Figure 1).

The recent write-downs suggest a bigger corporate governance issue of Toshiba. In December 2015, the company reported falsifying profits by nearly USD 1.3bn, being slapped with a record fine of JPY 7.3bn. Also, the company wrote down USD 2.3bn goodwill of its US subsidiary, Westinghouse, last year after long denying the deterioration of its nuclear operation following the Fukushima's nuclear disaster in 2011. In addition, the recent write-downs on S&W's goodwill turned out to be another shock as the company only predicted USD 87mn of write-downs.

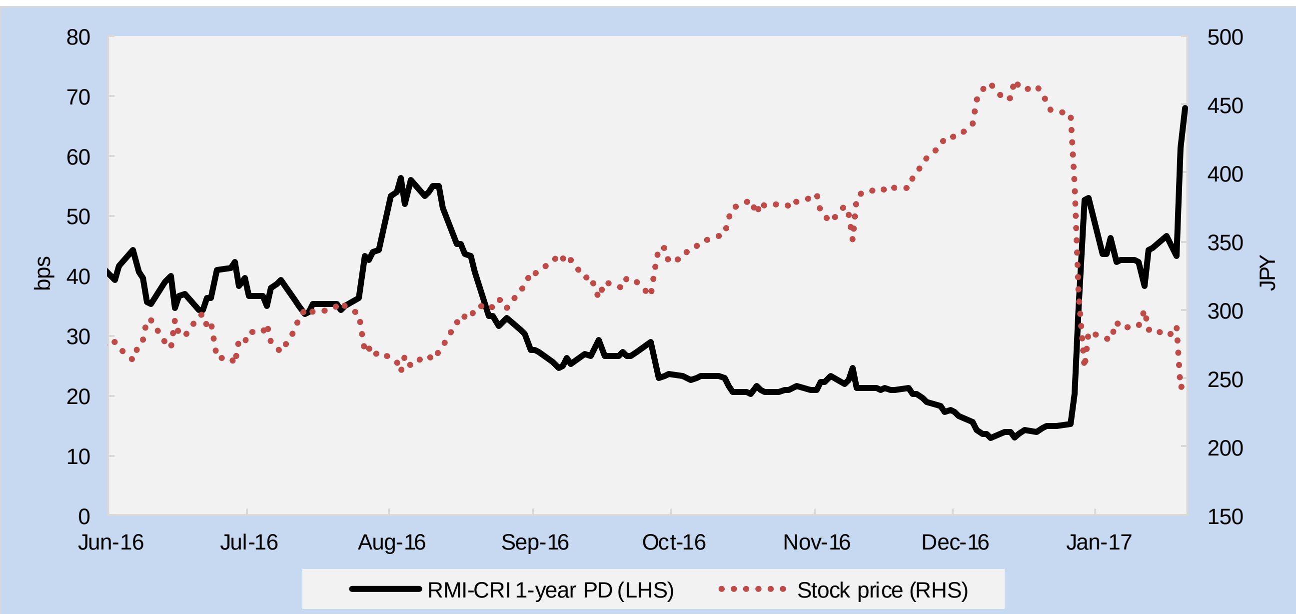

Figure 1: RMI-CRI 1-year PD (LHS) and stock price (RHS) for Toshiba Corp. *Source: RMI-CRI*

Following the write-downs warning in December, the RMI-CRI 1-year Probability of Default (PD) for Toshiba has jumped to 68bps on January 20, indicating a heightened credit risk. Moody's also downgraded Toshiba's corporate family rating by three notches from B3 to Caa3 while reviewing the ratings for another downgrade. The credit rating agency cited problems with the Toshiba's short-term liquidity and the rapid erosion of its shareholder's equity. In the face of billion dollars write-downs, Toshiba's equity, which stood at JPY 363.2bn (USD 3.58bn) at the end of September, is at risk of being wiped out as it has already suffered a marked decrease since 2015 (see Table 1).

Toshiba's cash position, in particular, looks worrying. Free cash flow has remained negative in the past six quarters as the company continues to burn cash amid massive restructuring (see Table 1). The memory chips division, its most profitable business, put strain on the cash flow, as it requires continuous capital injection to keep up with the technological demand. Amid cash burn, Toshiba's net debt has increased by one third in the past three quarters (see Table 1).

3 Months Ending	Sep-2015	Dec-2015	Mar-2016	Jun-2016	Sep-2016
Operating Income (JPY bn)	-82.6	-139	-479.2	20.1	76.7
Operating Margin (%)	-5.64	-9.59	-38.4	1.66	5.59
Free Cash Flow (JPY bn)	-108.5	-40.0	-7.6	-88.7	-64.9
Net debt (JPY bn)	1,158.1	1,223.5	481.2	601.5	655.6
Total Common Equity (JPY bn)	1,021.8	527.5	328.9	336.1	363.2

Table 1: Financial data for Toshiba Corp. *Source: Bloomberg*

In times of distress, Toshiba seems to have limited options to raise cash. The company has been prohibited from issuing shares in the stock market due to its profit-saddling accounting scandal in 2015. It has fewer assets to sell after a slew of divestitures in 2016. In March, the company sold its medical unit to Canon Inc. for USD 6.2bn and the home appliance division to China's Midea Group for undisclosed amount. Cash-strapped with few assets to sell, Toshiba considered spinning off its highly profitable memory chip businesses, which may fetch for USD 2.7bn in exchange of 20% stake.

Prior to the S&W's write-downs, Toshiba is poised to post a strong performance due to strong demand for memory chips. Weaker yen, in particular, is expected to boost Toshiba's NAND flash memory chip sales and improve its operating margin. Thanks to growing demand for memory chips and hard disks, the company swang back to profit in June (see Table 1) after reporting losses for six consecutive quarters. The company even raised its annual operating profit forecast by 50% in November after upgrading its profit forecast in August last year. As the storage and device solutions segment generates approximately 70% of the firm's operating profit, Toshiba's last-ditch effort to spin off its highly profitable memory chip segment might turn disadvantageous.

Despite waning demand for nuclear plants and cost overruns on its nuclear operations, Toshiba's nuclear division remains central to its survival. The government's dependency on Toshiba to clean up nuclear plants in Fukushima provides a steady stream of revenue and a state lifeline that would prevent Toshiba's collapse. Even in the face of insolvency, the company could expect to receive a state bailout from the government. In fact, Toshiba's main creditors have recently affirmed their support for the company, which also requested financial aid from state-backed Development Bank of Japan.

While Toshiba attributed the massive write-owns to cost overruns and delays, Toshiba's problems could actually lie in its poor internal control. Mired with troubles and scandals, Toshiba Corp might have already lost its standing as Japan's corporate darling.

Credit News

Good times seen coming to end for China's real estate bonds

Jan 23. Fund managers and investors, who have piled into the USD 65bn market for dollar-denominated bonds issued by Chinese developers, could be seeing a reversal in their good fortunes. With analysts being increasingly pessimistic about prices and sales in the Chinese property market, the falling yield premiums associated with these bonds may not be big enough to mitigate its potential credit risks. Chinese regulators who enacted regulations to restrict buying and increase down-payment requirements contributed to falling home prices in Beijing, Shanghai and Shenzhen in December 2016. The number of cities that reported housing price growth has fallen to its lowest level since January 2015. Onshore bond offerings by the property sector shrank by 94% YoY to RMB 2.3bn this month. (Bloomberg)

Telecommunications company Avaya files for bankruptcy

Jan 23. Avaya, a telecommunications company, filed for Chapter 11 bankruptcy to pare back its debt load of USD 6.3mn. However, the company has decided against selling its call center business despite its attempts to do so previously. According to the company, the sale of the call center would not maximize value for its customers or creditors and the company is currently negotiating deals to sell parts of its business. Furthermore, Avaya mentioned that an affiliate of Citigroup Inc. would provide a USD 725mn loan for operations funding while the company undergo reorganization to reassure jittery vendors who had shortened payment periods and reduced credit terms in recent months. (Reuters)

Angolan banks appeal for bailout as oil slump crimps liquidity

Jan 23. A bailout package by the government was requested by Angolan banks as banks are adversely impacted from low oil prices that contribute to a majority of the nation's foreign–exchange earnings. In an interview, the Chairman of the Association of Angolan Banks Amilcar Silva said that financial support could come from President Jose Eduardo dos Santos's administration or shared by all of the country's lenders. However, he did not indicate if banks were calling for a liquidity boost for the industry or cash injections aimed at struggling companies. (Bloomberg)

Shipping crisis puts German banks under pressure

Jan 22. According to a report published by German public broadcaster ARD, it was hinted that Hamburg and Schleswig-Holstein may have to offer up to EUR 20bn in credit guarantees to aid banks with bad investments in container shipping. Reporter Heinz-Roger Dohms wrote that German shipping companies could hardly stand against the new mega-shipping firms in Asia and with over-capacity, German shipping firms could not afford to send their container ships out. As German banks maintain approximately USD 100bn in shipping loans, covering a quarter of the world's total, banks that underwrite German shipping companies would be adversely affected. (Deutsche Welle)

Women's apparel retailer Limited Stores files for bankruptcy

Jan 17. US women's apparel chain The Limited last week filed for Chapter 11 bankruptcy protection after closing all of its 250 stores. The chain is the latest in a slew of brick-and-mortar retailers who have seen their business driven to the ground by changing consumer tastes and online competition. However, the company's brand name may continue to be used, as private equity firm Sycamore Partners has agreed to bid USD 25.75mn for the company's intellectual property, which includes its trademarks, website address and social media accounts. Sun Capital, which wholly acquired The Limited in 2010, said it earned nearly double its initial USD 50mn investment in the retailer. The company's asset sales are subject to approval from the US Bankruptcy Court in Wilmington, Delaware. (Reuters)

Chinese banks to issue more bad loan-backed securities in 2017: Fitch (SCMP)

Moody's: Singapore local banks expected to manage credit quality issues (Straits Times)

Regulatory Updates

China clamps down on banks moving currency overseas

Jan 22. Chinese regulators, concerned with the RMB's rapid depreciation against the dollar are imposing yet another new set of capital controls to stamp out remittances of RMB out of the country. Under the new ruling, banks in Shanghai must bring in RMB 100 for every RMB 100 remitted overseas by their clients, ensuring no net outflows of Chinese currency. Currently, Shanghai-based banks are allowed to remit RMB 160 for every RMB 100 brought back into the country. In Beijing, the new rules mandate banks to import RMB 100 for every RMB 80 remitted overseas on behalf of clients. Foreign banks, which derive a higher percentage of revenues from cross-border business, are highly susceptible to the new rules. The rules are one of few remaining to preserve China's forex stockpile, which stood at just over USD 3tn at the end of 2016. (FT)

Danish central bank proposes stricter mortgage bank capital rules

Jan 18. Denmark's central bank may impose the Minimum Required Eligible Liabilities (MREL) requirement on banks to increase the lenders' loss absorbing capability in the event of a bank resolution. Introduced in 2014, the MREL was set up so that banks have sufficient liabilities to prevent taxpayers from bearing the burden of any bank bailout. The implementation of the MREL could cost homeowners between 200 and 1100 crowns per one million crowns borrowed. Last year, Denmark's largest lender, Nykredit said that it would raise homeowner fees and file an initial public offering to cope with the increased cost of capital. (Reuters)

Brussels races to amend rules that hurt pensions industry (FT)

ECB steps up warning on UK euro clearing after Brexit (FT)

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