

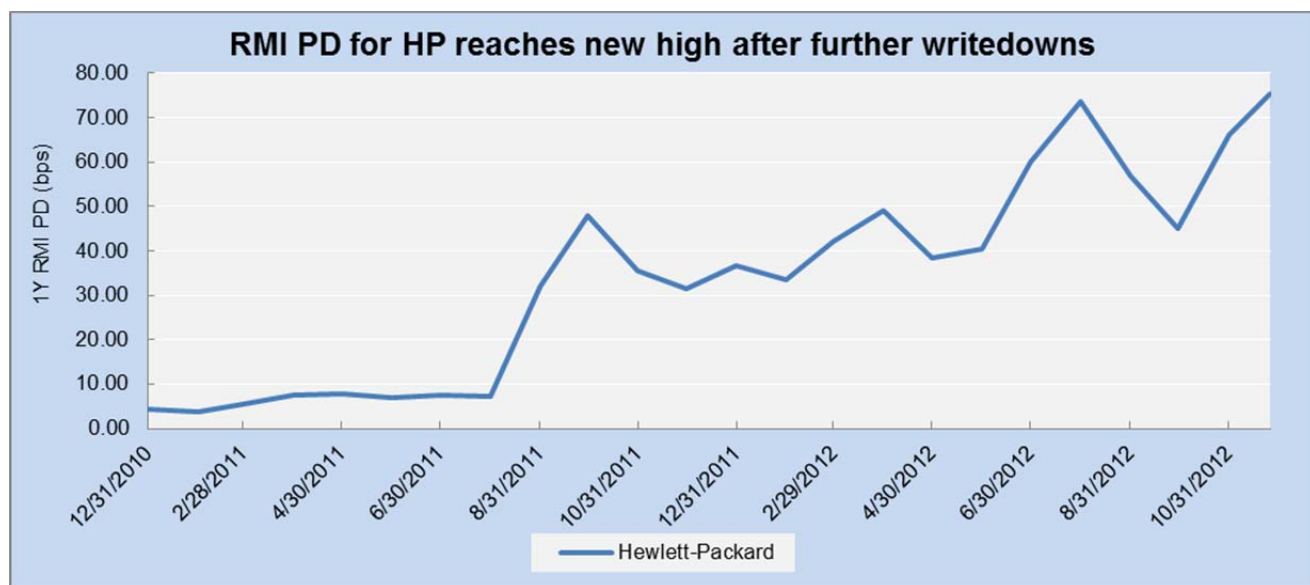


Story of the Week

Hewlett-Packard credit outlook deteriorates

By Jun Jie Ne Win Jonathan

The 1-year RMI probability of default (RMI PD) for US-based Hewlett-Packard (HP) rose to a new high on November 26 as the company reported a massive writedown from another failed acquisition. The near term credit outlook remains uncertain as HP is still struggling to find its footing in new business lines through its acquisitions while current lines falter. RMI has [previously noted](#) HP's difficulties in weakening demand for hardware.



Accounting writedowns: The current issue HP faces is the massive writedown of British software maker, Autonomy Corp which was acquired in 2011 for USD 12bn. This writedown has put an immediate downward pressure on HP's stock price and will negatively impact the firm's future earnings and increase its leverage. On November 21, HP accused Autonomy of an array of financial improprieties resulting in a USD 8.8bn writedown. HP claims that more than USD 5bn relates to aggressive earnings management, including improperly categorized hardware. This writedown comes as HP is attempting a multiyear business restructuring.

Mistakes in acquisitions: The missteps with Autonomy are not a one-off event but signs of a broader problem; a poorly conceived acquisition strategy. In August, HP wrote down its 2008 USD 13.9bn purchase of Electronic Data Systems (EDS) by USD 8bn. EDS was known for servicing large scale outsourcing needs such as accounting and client management. This model of making large upfront investments and then committing clients to large, long-term contracts became severely challenged as customers increasingly shifted to cloud computing for parts of their operations. At the same time, competition from other developing economies has also driven down prices, further eroding EDS's margins. As of last week, HP has recorded a total of USD 18bn of writedowns during 2012.

HP's intention in buying Autonomy and EDS was to diversify away from hardware and expand into the more profitable space of enterprise services. However, entry into new business lines came at a cost as HP paid a premium of 64% to acquire Autonomy. Despite outward signs of growth, an overly-ambitious acquisition spree has had negative credit implications for HP.

Sources:

[Dell, HP Earnings Expected to Herald the End of PC Era](#) (Bloomberg)

[HP due diligence thrust into spotlight](#) (FT)

[Hewlett-Packard: Down in the valley](#) (FT)

In the News**Chinese consumption damped by smaller wage gains**

Nov 26. Chinese consumer spending has fallen due to slower wage growth this year, undermining the nation's efforts to move away from an export driven growth model. Chinese labor statistics reported smaller pay increases as the economy grew at the slowest pace in Q3 compared to the previous three years. Meanwhile, manufacturing companies' earnings decreased from levels seen last year while household spending, measured as a percentage of GDP, dropped to its lowest level since the start of China's reforms in 1978. ([Bloomberg](#))

Europe set to delay bank capital rules as U.S. row simmers

Nov 26. European regulators may delay the introduction of Basel III capital rules by six months or more, from the originally planned implementation date of January 1, 2013. US regulators recently said they did not expect the new regulations to take effect until 2014. EU lawmakers are struggling to agree on many aspects of the new rules. Moreover, European banks have expressed concern that earlier adoption of the new capital rules, combined with new oversight from a central EU supervisory authority would place them at a competitive disadvantage to US banks. Meanwhile, US banks have started to shore up their capital base by issuing USD 10bn in noncumulative preferred shares since June. Basel III requires banks to hold 7% common equity to risk-weighted assets (RWA), along with an additional 1.5 percentage points of Tier 1 capital, which includes preferred shares. ([Reuters](#), [FT](#))

Indian entrepreneurs curb expansion plans as loans plunge

Nov 21. Indian entrepreneurs are avoiding syndicated loans as a means of funding due to higher borrowing costs. With the Reserve Bank of India increasing the required cash buffer ratio, lending will be further constrained as banks will have to put aside higher amounts of capital. ([Bloomberg](#))

US ratings agencies face Chinese challenge

Nov 19. Chinese credit rating agency (CRA) Dagong Global Credit, Russian CRA RusRating and US based CRA Egan-Jones Rating announced their new joint venture would be called The Universal Credit Rating Group. This new CRA was created with the intent to speed up the reform of the global credit rating system by issuing independent ratings. Since 2008, the three largest US CRAs continue to account for 95% of the global ratings market and have faced increased criticisms over their monopolistic positions. The industry's over reliance on the largest CRAs led to the launch of rating institutions in other regions. For example, the RMI Credit Research Initiative pioneered the public good approach to credit ratings in 2009. Europe based Roland Berger will create its own ratings in 2013 while the Bertelsmann Foundation of Germany has initiated an international non-profit CRA named INCRA that released ratings for several sovereign nations earlier in November. ([DW](#), [RMI](#))