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Weekly Credit Brief September 09 - September 15

Radioshack ponders bankruptcy

By Dexter Tan

Despite an increase in US consumer confidence in August, Radioshack Corporation, the largest US listed consumer electronics store may not be able to wait for its cash register to start ringing. The retailer announced that it is actively seeking capital as the company is running out of cash and may file for a Chapter 11 bankruptcy soon. Radioshack has been losing market share to low-cost retailers and online rivals like Amazon for years. The firm's quarterly filing showed the struggling retailer is running precariously low on cash. The company held USD 30.5mn in cash and cash equivalents in August, compared with USD 432mn a year ago. Total long term debt climbed to USD 656mn, which is significantly higher than USD 499mn in Q2 2013. The increase in debt and decline in cash would be credit negative for Radioshack as it could elevate the firm's current default risk as measured by the RMI 1-year probability of default (RMI PD).

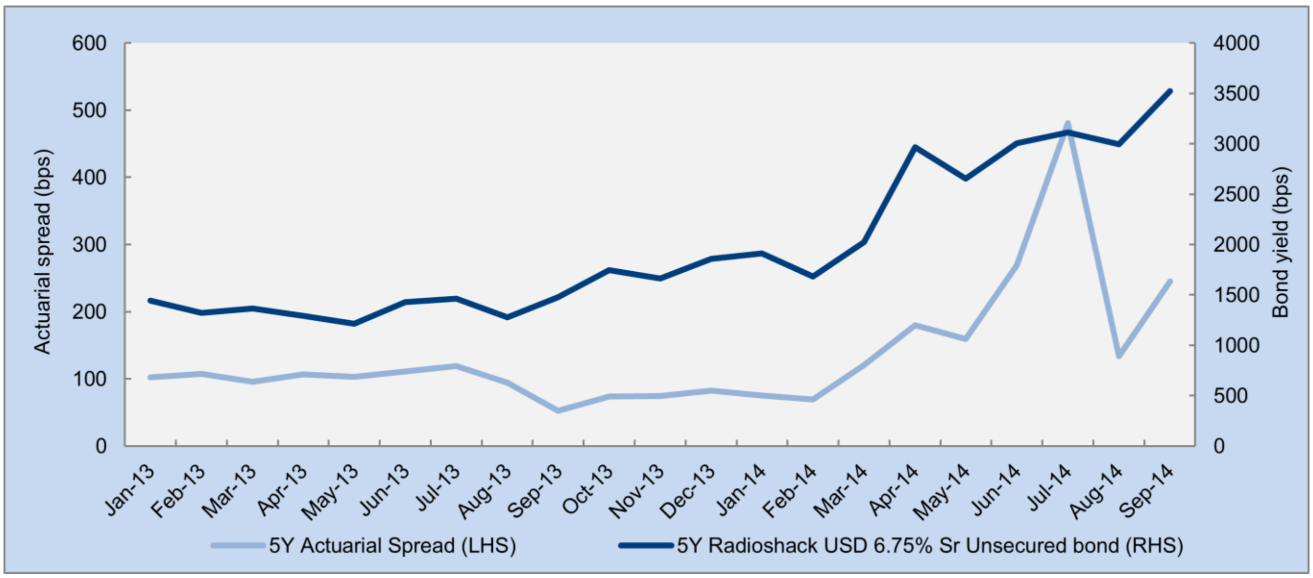

Figure 1: 5 year USD denominated bond yield and RMI 5 year Actuarial Spread for Radioshack (based on a recovery rate of 40%). Source: *Bloomberg, Risk Management Institute*

RadioShack's weak financial standing has been reflected in its RMI 1-year PD, which has risen from 52.5bps a year ago to a high of 1897bps in August before falling to 774bps on September 12. This was due to a recovery of 56% in market capitalization (Figure 2). The 5-year RMI Actuarial Spread (RMI AS) for the company increased from 52.5bps to 245bps (based on a recovery rate of 40%) in the same period. The RMI 5-year AS is a pure measure of default risk, and is not influenced by risk premium and liquidity. Yields on Radioshack's 5 year USD senior unsecured bond also climbed more than 2000bps. The company reported consecutive negative earnings since Q1 2012 which has damaged its ability to repay its creditors. The electronics retailer has plans to close 1,100 stores as it attempts to survive to substantial market losses in the wireless business and the electronics retail arena.

	2013-06-30	2013-09-30	2013-12-31	2014-05-03	2014-08-02
RMI 1-year PD (bps) (Sep 12: 774.3)	198.7	52.5	108.1	570	1897.4
Revenue	844.5	805.4	935.4	736.7	673.8
Net income	-53.1	-112.4	-191.4	-98.3	-137.4
Short term liquidity (Quick ratio, %)	-18.1	-21.1	-22.7	-9.5	-10.1
Long term debt	499.2	498.3	613.0	613.4	656.9
Cash from operations / Net debt (%)	16.4	61.6	-32.2	-7.0	-13.8

Table 1: Financial metrics for Radioshack. Figures in USD mn, unless otherwise indicated. Figures related to income statements are based on the prior 3 months. Source: *Bloomberg*

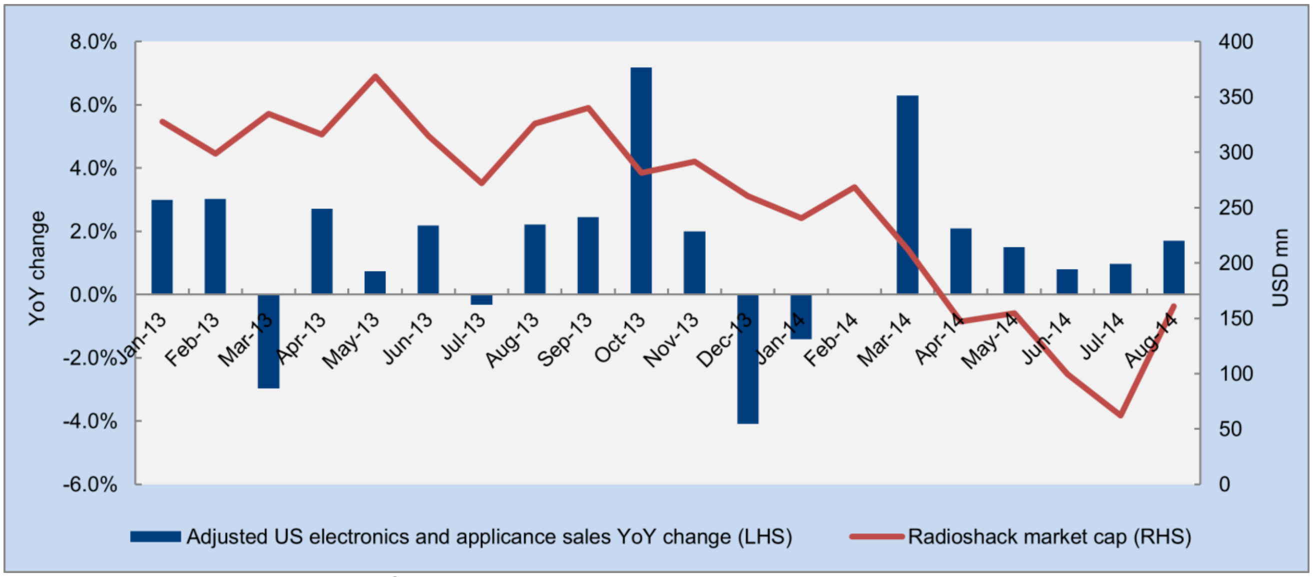

Figure 2: Radioshack's market cap vs US electronics YoY sales growth. Source: *Bloomberg*

The company's new corporate strategy has not improved revenue in recent quarters. The firm remains challenged by continued weakness in declining consumer electronics and soft mobile sales. Consumers displayed low interest in the postpaid and prepaid handset offerings. An aggressively priced handset market meant that customers could easily find lower priced products in Radioshack's competitors. Wireless carriers heavily promoted significant cash incentives for customers to switch mobile plans and led them away from Radioshack's retail stores. Revenue declined from USD 844mn to USD 673mn between Q2 2013 and August this year while the ratio of cost of goods sold (COGS) to revenue remained around 64%. This ratio is considerably high given that Conn's Inc has a similar ratio of 48%.

Unless the company reaches an acceptable sale or partnership or substantial restructuring plan, the company is expected to file for Chapter 11 bankruptcy, which would cause a default with current lenders and wipe out all shareholder value. In such a situation, first lien and second lien lenders would likely to receive higher rate of recovery compared to bondholders of the firm's senior unsecured bonds. The company has USD 93mn and USD 250mn of first and second lien notes outstanding, which mature in December 2018. The deals were financed by a consortium of lenders including GE Capital and CIT Corporate Finance.

The loans from GE Capital may be replaced by a USD 585mn financing package from UBS and Standard General LP (Radio shack's second largest equity holder). GE Capital's loan has placed a number of negative covenants in its loan to Radioshack which restricts the company in a number of areas including acquisitions, business operations, disposal of assets, investments and dividend payments. The new deal would give the firm more flexibility in pursuing restructuring options but is unlikely to change its current financial status as the amount of debt in its balance sheet is not going to decrease. Under these assumptions and as a result, RMI 1-year PD for Radio shack would continue to stay at an elevated level.

Note: underlined text highlight revisions made on September 17, 2014

Credit News

Venezuela heads to a default reckoning

Sep 14. The yield on Venezuelan bonds due 2022 hit a six-month high of 15.8% in September as fears of a Venezuelan government default grow. Key issues with the economy remain inefficiencies arising from nationalization of companies and rampant corruption. The central bank has increased money supply (M2) by 70% in the past 12 months and 63% in the 12 months before but limited the quantity of dollars at higher rates, severely hurting the companies that import and produce finished products. (WSJ)

Chinese bank on hook for CNY 4bn shadow banking default

Sep 12. Small Chinese bank Evergrowing Bank is on the hook for CNY 4bn (USD 652.3mn) due to defaults in the off-balance-sheet credit products, the latest default to hit China's shadow banking sector. The off-balance-sheet products have been increasingly popular in recent years, as high-yielding alternatives to bank deposits. Evergrowing Bank guaranteed the repayment of CNY 3.7bn of principal and CNY 300mn of interest payments under off-balance sheet products issued by one of its shareholders and an affiliated company. However it is unclear where the CNY 3.7bn, due to be repaid by the shareholder and the affiliated company at the end of August, has gone. China's shadow banking sector to be around CNY 33tn by mid-2014, equivalent to 58% of 2013 GDP or 20% of total bank assets and presents a rising risk of default as the economy slows. (The Straits Times)

Argentina passes new debt bill with eye on next payment

Sep 12. Argentina's Congress passed a new bill to issue USD 200mn (GBP 123.05mn) coupon payment on an estimated USD 29bn foreign-held bonds by Sep 30, in defiance of a U.S. court ruling which tipped the country back into default. This is a race against time because investors will call for immediate payment on the principal value of their bonds if Argentina fails to complete payment and the default spreads across bond series. As a response, investors began to move their Argentine debt from the United States and other foreign jurisdictions to either Argentina or France via an exchange of debt. (Reuters)

NII Holdings files for Chapter 11 bankruptcy protection (WSJ)

AB Inbev explores financing to buy SABMiller (WSJ)

HCBC aims to raise EUR 1.5bn in convertible bonds (SCMP) (Subscription required)

Regulatory Updates

Austria won't accept fig-leaf financial-transaction tax

Sep 14. According to Austria's Finance Minister Hans Joerg Schelling, the country will not participate in a planned financial-transaction tax unless the revenue generated outweighs the cost to the industry stating that it is unreasonable to accept the tax in the case that the overhead of banks, companies and stock buyers is bigger than the outcome. Though many European countries have been designing the transaction tax that may start in 2016, participants still negotiate on how it could work, especially for the criteria to differentiate between speculative and non-speculative derivatives. (Bloomberg)

Danish bank collateral set to drop on new mortgage rules

Sep 12. Banks in Denmark will probably need to hold less collateral to secure their bonds after new mortgage rules are implemented. The new rules will limit sales of interest-only and adjustable-rate mortgages, restrict the amount banks can refinance each year, as well as put less pressure on banks to hold excess collateral against mortgage-backed bonds. According to Danske Bank, the longer funding and fewer interest-only loans under the new rules should have a positive impact and the new mortgage rules will likely improve credit ratings. As for the time table, banks have until 2018 and 2020 to meet the new requirements. The deadline accounts for sufficient time to restructure balance sheets where customers have commitments of 30 years. (The Chicago Tribune)

Basel Committee updates Basel III implementations for 227 banks

Sep 11. On Sep 11, the Bank for International Settlements observed that most large internationally active banks meet the Basel III risk-based capital minimum requirements. Meanwhile, the capital shortfalls relative to target has further narrowed, with EUR 15.1bn aggregate shortfall for Group 1 banks at the CET1 target level of 7.0% and EUR 2.0bn and EUR 9.4bn capital shortfall for Group 2 banks at CET target level of 4.5% and 7.0% respectively. Besides, the weighted average LCR for Group 1 bank was 119%, up from 114% six months earlier, but this was unchanged for Group 2 banks. Moreover, the average NSFR for Group 1 was 112% while for Group 2 banks the average NSFR was 112%. (BIS)

How do the largest U.S. banks fare in terms of Basel III compliance

Sep 11. The Federal Reserve has proposed to set stricter capital requirements than those indicated in the Basel III norms. The higher common equity tier 1 (CET1) ratio required by the new regulation would force the banks to shrink their balance sheet, cut down their capital return plans and to issue more shares to make up for capital shortfall. (Forbes)

Termination rights protocol due by end of September

Sep 09. Dealers and regulators will agree on a protocol that temporarily restricts banks' OTC derivative termination rights by the end of Sep 2014, and the adherence to this protocol could be expected from early Nov 2014. Even if all global systemically important financial institutions (G-SIBS) are willing to give up their termination rights, the buy-side entities will not do so due to their fiduciary duty to clients. And regulations banning G-SIBS from trading with entities that haven't surrendered their termination rights will only be enforced by the end of 2015, but this time-lag has raised concerns about dealers' disadvantage position and their potential risks. Besides, how the stay of termination rights interacts with the margin period of risk (MPOR) calculation under Basel II is still unresolved. (Risk.net)

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