



## Slowdown in PC market pushes No. 1 PC maker Lenovo to diversify

by [Samuel Lim Kok Hong](#)

On Sep 18, 2015, the Federal Reserve decided to keep interest rates unchanged, citing concerns stemming from the weak global economy. Indeed, global growth in 2015 has been weaker than expected – creating strong headwinds for many cyclical sectors. Against this backdrop, global PC makers are bracing themselves for further slowdowns in the industry, even as modern, mobile devices erode their share of the market in recent years. Already, global PC shipments have fallen by 6.7% YoY in Q1 2015 and 12.8% YoY in Q2 2015. For the year ending 2015, research firm International Data Corp (IDC) expects PC shipments to fall by about [8.7%](#). The firm had previously forecasted a decline of 6.2% for the year. Additionally, IDC also expects 2016 shipments to be adversely affected by issues in the global economy and the lack of new models being introduced into the market.

Lenovo, which is the world's biggest PC maker, held [18.8%](#) of the global market share in 2014. The Fortune 500 company hires over 33,000 employees, with operations spanning across over 60 countries. Its products are sold in more than 160 countries. With more than 72% of its revenue coming from the PC business in FY 2014/15, the impact of the slowdown in the industry is material. The company cut [3,200 jobs](#) in Aug 2015, claiming that it was facing the toughest market condition in years. It also reported lower sales in the PC business line. Lenovo's decision echoed those made by its peers. Hewlett-Packard, the second biggest PC maker in the world, has already outlined its plan to cut jobs in the coming years to reduce costs.

Given the bleak prospects, Lenovo's management has taken steps to diversify its business away from the PC sector. The company spent [USD 5bn](#) last year in acquisitions to expand into the smartphone and server markets. In Oct 2014, it acquired Motorola Mobility from Google Inc. and low-end server business, System X from IBM. The acquisitions were funded by a five-year USD 1.5bn note, which was issued in May 2014. With the final closure of the System X purchase in Mar 2015, Lenovo also assumed the liabilities of the acquired businesses. Furthermore, the company issued another batch of notes in Jun 2015, totaling RMB 4bn, to cover its work capital needs. As a result, Lenovo's capital structure has weakened significantly over the past one year.

As of Jun 2014, Lenovo's net debt to equity was -106.77%. The metric turned positive during the first quarter of 2015, primarily due to increased liabilities. Similarly, its current ratio fell from 1.10 on Jun 30, 2014 to 0.92 as of Jun 30, 2015. Beyond numbers, these additional liabilities would shrink Lenovo's cash channels. The capability of the company to service debts, measured by the EBITDA to interest expense ratio, has dropped to 7.8 in the latest reporting quarter, from 15.15 just a year ago. While the interest burden is not expected to cause financial difficulties for the company, the current business climate may call for greater prudence going forward – especially when the industry is expected to shrink during the near term. Revenues are expected to continue to decline going into 2016 and the measure of its debt servicing capability may yet worsen further.

3 Months Ending	Q1 FY2015 Jun 30, 2014	Q2 FY2015 Sep 30, 2014	Q3 FY2015 Dec 31, 2014	Q4 FY2015 Mar 31, 2015	Q1 FY2016 Jun 30, 2015
<b>Current Ratio</b>	1.10	1.11	0.93	0.90	0.92
<b>Net Debt / Equity (%)</b>	-106.77	-82.73	-14.61	16.76	15.84
<b>EBITA / Interest Expense</b>	15.15	20.63	14.94	9.52	7.80

Table 1: Financial data for Lenovo. Source: Bloomberg

Consistent with the increased leverage in the company's capital structure, the RMI-CRI 1-year Probability of Default (PD) for Lenovo has increased from 11.8bps on Jan 1, 2015 to 63.6bps on Sep 18, 2015 (see Figure 1). Aside from the weaker fundamentals, volatile markets in the second quarter of the year, in particular the stock market sell-off in Hong Kong, resulted in further deterioration in the credit profile of the company during that period.

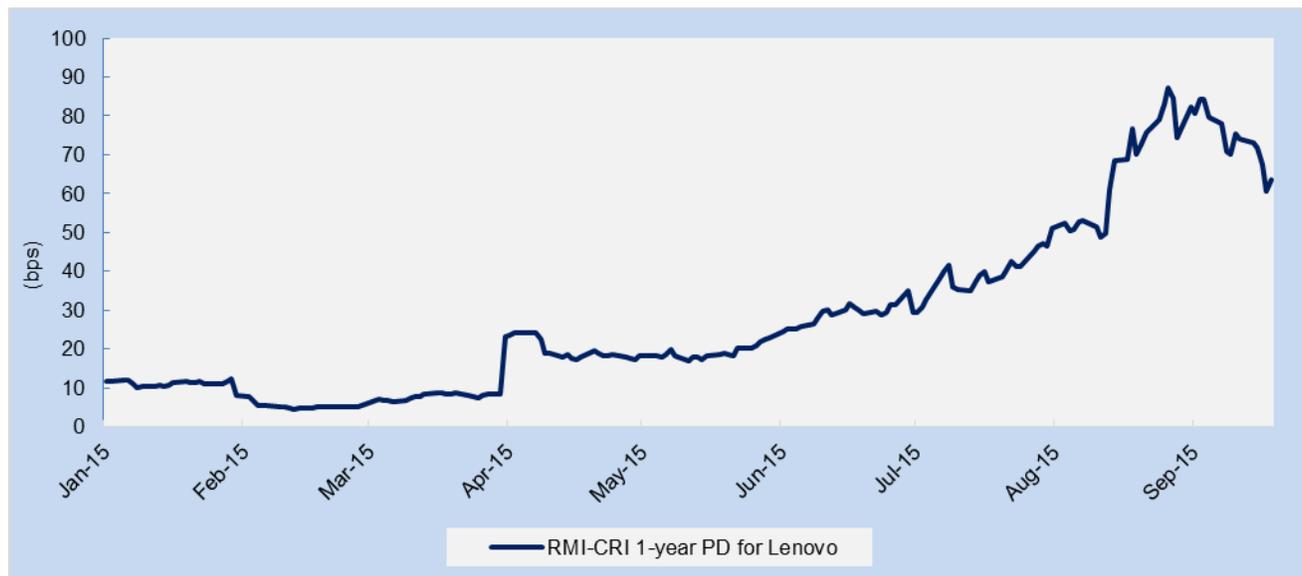


Figure 1: RMI-CRI 1-year Probability of Default for Lenovo. Source: RMI-CRI

While the outlook of the PC sector seems bleak in the short term, IDC expects PC shipments to start growing again in 2017 driven by the next refresh cycle in the commercial markets; companies are expected to replace their existing PCs in 2017, thereby driving up sales of PCs. Amidst the headwinds faced by Lenovo in 2015 so far, the company can find a silver lining in the gains that it made in the PC market share, which grew from 18.8% in 2014 to [20.6%](#) in Aug 2015. The diversification of Lenovo's business might put a short term strain on its financial health but if one were to look beyond the horizon, these risks may well pay off as the firm can reduce its reliance on the PC sector.

## Credit News

### Citic Securities placed on S&P credit watch list after probe

**Sep 17.** Citic Securities, China's largest brokerage firm, was placed on a credit watch list after the firm's employees were being probed for alleged insider trading. Standard & Poor's is deciding whether to cut the company's "BBB+" rating as extended investigations may pose significant challenges for Citic Securities' businesses over the longer run. S&P also said that the firm would be negatively affected if its executives were found to be partially responsible for the illegal activities. ([Bloomberg](#))

### Defaults mount in beleaguered energy industry

**Sep 17.** The well is running dry for deeply indebted energy companies. Samson Resources Corp. became the latest and largest victim of an industry downturn, as it filed for chapter 11 protection on Sep 17. Industry experts say more oil-and-gas companies are poised to follow Tulsa into bankruptcy as oil prices remain low following a steep drop that began last year. According to Fitch Ratings, compared with a 2.9% corporate default rate in the US, the default rate among US energy companies has accelerated in recent months to 4.8%, the highest level since 1999, while the exploration and production companies witnessed an even higher default rate at 8.5%. ([WSJ](#))

**S&P downgrades Japan**

**Sep 16.** Standard & Poor's on Sep 16 lowered Japan's sovereign debt rating in the latest sign of concern about Japan's economic prospects nearly three years after Prime Minister Abe took power. The downgrade to "A+" from "AA-" was because the government is unlikely to quickly improve the nation's fiscal health due to weak economic growth from S&P's viewpoint. Moody's Investors Service and Fitch Ratings have also lowered Japan's credit rating in the past year. All three rating agencies cited Japan's huge government debt of more than 200% GDP, which is the largest among developed nations. ([WSJ](#))

**China braces for second onshore bond default by state firm**

**Sep 15.** China National Erzhong Group could become the second state-owned company to default on its interest in the onshore bond market. The smelting-equipment maker might not pay its 5.65% note due 2017 because of difficult business conditions, causing the bond's yields to rise to 28.8% last week. Earlier in April, Boading Tianwei became the first state-owned corporation to default in the onshore market. Payment uncertainties over deflation risks, overcapacity and spiraling corporate debt have marred the outlook for the Chinese economy, which is forecasted to grow at the slowest pace since 1990 this year. ([Bloomberg](#))

**Weak growth leads Moody's to cut France's credit rating**

**Sep 15.** Moody's has lowered France's government bond rating because of the country's weak growth outlook. It cut France's rating to "Aa2", changing its outlook to "stable" from "negative". Moody's said that its decision was prompted by the continuing weakness in France's medium-term growth outlook, which it expects to extend through the remainder of this decade. Although France's new rating still indicates high credit worthiness, the agency highlights that low growth, coupled with institutional and political constraints would make it challenging for the French government to reduce its high debt burden. ([FT](#))

**Fed officials still see 2015 lift-off despite September delay** ([Bloomberg](#))

**A&P insiders took home millions in year before bankruptcy** ([WSJ](#))

**Upgrade happy China raters say S&P lacks local knowledge in cuts** ([Bloomberg](#))

**Regulatory Updates****US SEC removes credit-rating references from money fund rules**

**Sep 18.** US securities regulators adopted rules on Sep. 16 that strip out references to credit ratings from their rule book governing money market funds, as part of an ongoing effort to reduce the industry's reliance on credit-rating agencies after the financial crisis. It removed the current rules that money funds are only allowed to invest in securities that have received one of the two highest short-term credit ratings, and that they must invest at least 97% of their assets in securities that received the highest short-term rating. ([Reuters](#))

**Japan regulator urges banks to meet pledge to cut shareholdings**

**Sep 18.** Japan's financial regulator urges the nation's largest banks to follow through on their commitments to reduce stakes in other companies. Japanese top three banks have pledged to reduce their shareholdings, though they omitted providing specific quantitative targets. This move follows a corporate governance code, which aims to ensure that companies use capital effectively, by encouraging companies to either sell their stakes or justify their decisions to hold them. Given that strategic shareholding make up a higher ratio of the capital base of Japan's largest banks compared to their peers in the US and Europe, Japan's financial regulator expressed concern about the potential impact of any stock market decline on their capital. ([Bloomberg](#))

**Canada to boost corporate bond market transparency by 2017**

**Sep 17.** Canadian securities regulators are making moves to improve transparency in the CAD 500bn corporate bond market, long perceived by investors to be opaque and unfair to smaller participants. The Canadian Securities Administrators is proposing for trading data on all corporate-debt securities to be made public by 2017, replacing a system that provides public data on less than half of the Canadian corporate securities. This move follows the trend of Canada's peers internationally to bring greater openness to the market, as well as aiming to better protect investor interests by placing them in a better position to assess the quality of their execution, through greater transparency. The market reforms, which the regulators propose to implement over the next two years, are open for comment until Nov 1. ([Bloomberg](#))

**Kara Stein urges SEC to act over cyber-attacks** ([FT](#))

**US regulator halts bitcoin derivatives** ([FT](#))

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