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Buyout rumors swirl around heavily indebted GNC Holdings

By Dexter Tan

GNC Holdings Inc, the largest global dietary supplement retailer is facing headwinds from a competitive industry. Last week, GNC Holdings Inc.'s 2020 1.5% convertible note lost 201bps over two days after rumors surfaced that KKR and SinoPharm could acquire the ailing firm. The yield to maturity on the convertible note declined to 15.63% on Mar 3 after rising to 23.22% on Feb 16. Despite the slight rise in bond price, GNC's convertible note last traded at 63.5 cents on the dollar - more than 37% below its issuance price of 100.75.

GNC's bond price drop is a partial reflection of deteriorating credit performance over 2016. GNC's EBITDA interest coverage ratio plunged to 5.86X in Q4 from 9.62X a year ago; the firm's retained cash flows (cash from operations adjusted by dividend payouts) to debt ratio dropped by half to 9.92% from Q4 2015. The level of debt over total assets increased to 74.47% in the most recent quarter, more than 4 times the level of its closest competitor - Vitamin Shoppe Inc (VSI).

Credit measures as of Dec 31, 2016	Debt to total assets (%)	T12M EBITDA to net interest expense (X)	T12M Retained cash flow to total debt (%)	RMI-CRI 3-year Actuarial Par Spread with 40% recovery rate (bps)[1]
GNC Holdings Inc.	74.47	5.86	9.92	180.49
Vitamin Shoppe Inc.	17.96	13.83	70.80	23.52

Table 1: Credit metrics for GNC Holdings Inc. and Vitamin Shoppe Inc. *Source: RMI-CRI, Bloomberg*

Vitamin Shoppe Inc. is also a specialty retailer of health products. In 2015, GNC and VSI each issued a 5-year convertible note. Last week, the convertible notes of VSI (VSI 2.25% 12/01/2020) and GNC traded at 475bps and 1404bps over equivalent US Treasury notes, respectively. The 3-year RMI-CRI Actuarial Par Spreads (AS) arguably captures the credit risk components of the yield spreads[2]. As seen in Table 1, the RMI-CRI 3-year AS and traditional credit metrics highlight GNC's weak financial conditions.

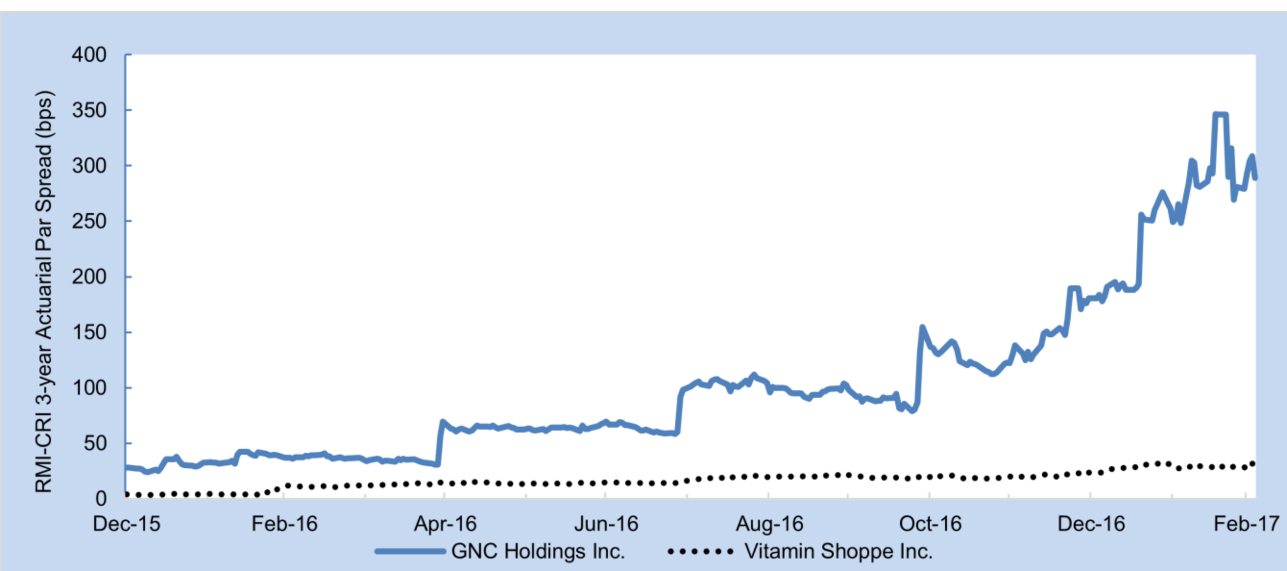

Figure 1: RMI-CRI 3-year Actuarial Par Spreads for GNC Holdings Inc and Vitamin Shoppe Inc, assuming a 40% recovery rate. *Source: RMI-CRI*

[1] We follow the ISDA standard recovery rate for senior unsecured bonds of 40%.

[2] Although the comparison of RMI-CRI AS to yield spreads may not be entirely comparable, RMI-CRI AS provide a form of guidance to the firms' credit profiles. The RMI-CRI AS is an alternative measure of credit risk using the RMI-CRI Probabilities of Default. RMI-CRI 3-year Actuarial Par Spreads measures the credit risk of a 3-year option free bond with quarterly payouts, discounted at the USD Libor and swap rates. Unlike credit default swaps, the RMI-CRI AS is not influenced by risk premium and market liquidity.

Despite USD 1.417bn of debt maturing in three years, the retailer's retained cash flow of USD 152mn in 2016 and a three-year average of USD 239mn is insufficient to pay the bonds' principal requirement. GNC could raise more capital or dispose assets to boost its liquidity profile. However, the covenants in the revolving credit facility and convertible note restrict the company's funding options.

According to the terms in the revolver facility, GNC cannot exceed a senior secured debt to EBITDA ratio of 4.25X. Unfavorable covenants in the convertible bond restrict the firm from selling assets or merging with another entity until the borrower satisfies all debt obligations to the convertible note holders. Additionally, the cross default provision compounds the default liabilities if the firm fails to pay the term loan or revolver credit facility.

If a company acquires GNC with an all cash offer, convertible note holders may receive its principal and interest payments. In an all equity deal, the seniority and covenant structure of the bond may require the acquirers to pay off existing debt or find ways to negotiate terms with the note holders.

Credit News

Gordmans Stores is said to prepare for bankruptcy filing

Mar 7. Gordmans Stores Inc., a Midwestern department-store chain, is preparing to file for bankruptcy. In a retail industry suffering from sluggish mall traffic and a move by apparel shoppers to the internet, Gordmans has struggled in recent years. Losses began to mount as its growth slowed in 2014. Much of the firm's USD 85mn debt will be due in 2020. Same-stores sales fell more than 9% in the latest reported quarter. Citing "sluggish retail environment", the company also announced job cuts in January. (Bloomberg)

GM to take on USD 3bn in debt to fund pensions moved to Peugeot

Mar 6. General Motors, the US auto maker, expects to raise about USD 3bn in debt to fund pension obligations it plans to transfer to Peugeot SA as part of the sales of its European business, which had been agreed on March 6. The company has European pension liabilities of USD 9.8bn on its balance sheet, of which USD 6.5bn is underfunded. There will be an annual cash requirement of about USD 300mn to fund the UK and German pensions. GM will pay Peugeot USD 3.2bn, which offsets the pensions' current USD 2.8bn deficit and includes a premium of USD 400mn for eliminating risk at the plans. (Bloomberg)

China overtakes Eurozone as world's biggest bank system

Mar 5. Chinese bank assets reached USD 33tn at the end of 2016 as compared to Eurozone's USD 31tn and USD 16tn for the US. At USD 33tn, China's bank assets is more than 3.1 times the size of the country's annual economic output. It not only signifies China's growing influence in world finance but it also highlighted its reliance on debt to drive growth. An economist from the IMF commented that the huge size of China's banking system is a cause for worry due to the sector's potential inefficient resource allocation and heightened credit risks. Shadow banking and off-balance-sheet are also issues that continue to plague commercial banks in China. As a result, the top leaders has shifted its policy focus from stimulus towards risk management. Economists have noted that a more developed capital market will help China's financial system by being less reliant on banks and thus control debt growth. (FT)

New risks loom for China local debt, this time in dollars

Mar 2. As China's Local Government Financing Vehicles (LGFVs), which had ballooned under the previous Communist leadership as it pursues all-out growth, is being addressed through a Beijing-led bond swap program, units set up by local authorities are currently selling debt outside of China, in dollar denomination. However, the funding vehicles do not have dollar revenue to draw on for debt servicing, exposing repayment dangers in foreign exchange risks if China's yuan continues to depreciate. According to Hong Kong-based managing director of corporate ratings at S&P Global Ratings, "the funding window could close any time if the market volatility rises, or dollar rates surge, or there are unexpected credit events." (Bloomberg)

Ezra's joint venture files for bankruptcy

Feb 28. Emas Chiyoda Subsea, a joint venture between Singapore's Ezra Holding Ltd. and Japan's Chiyoda Corporation has filed for Chapter 11 bankruptcy in the United States. The move came on the same day as Ezra's request for a trading halt on the Singapore Exchange – citing the need to facilitate the company's restructuring financially and operationally. Court documents revealed that DBS Bank and OCBC had unsecured claims of around USD 84.6mn and USD 13.1mn respectively. Keppel Shipyard also has claims amounting to USD 2.8mn. Emas AMC, a wholly-owned unit of Emas Chiyoda also filed for bankruptcy in Norway on the same day. (Straits Times)

Italy's Stefanel files for debt restructuring plan extension (Reuters)

International Shipholding Corp's reorganization plan confirmed by bankruptcy court (Reuters)

Zivo Bioscience executes debt restructuring (Reuters)

Regulatory Updates

China bank regulator's new chief announces debt-containment measures

Mar 2. Measures to contain financial risk, inclusive of expanding debt-for-equity swaps, were announced during the first speech from the new chair of the China Banking Regulatory Commission Guo Shuqing. The measures were announced in the face of China's growing corporate debt pile and includes the agreement among China's banks to exchange a further CNY 400bn of corporate debt for equity stakes in those companies this year, with CNY 400bn of swaps already completing this year. The program, launched in 2016, was aimed at paring down China's roughly USD 19tn pile of corporate debt. (FT)

Updating corporate insolvency laws to help ailing firms

Mar 1. Lawmakers in the Singapore Parliament tabled amendments to corporate debt restructuring legislation as part of government efforts to position the city-state as a debt restructuring hub and global financial center. The Companies (Amendment) Bill is expected to be passed into law to enhance Singapore's corporate rescue laws, as higher amounts of debt restructuring work is expected amidst weak global growth. Debt restructuring in Singapore is currently a two stage process – scheme of arrangement followed by judicial management. The amendments will introduce elements of US law, in particular the processes under Chapter 11, into the scheme of arrangement framework. The Ministry of Law also tabled amendments to the Trustees Act, requiring trustees to maintain beneficial ownership information and proper accounting records – aimed to strengthen Singapore's trusts regime. (Straits Times)

UAE Central Bank issues capital adequacy regulations in line with Basel III (Emirates 247)

New Zealand central bank to review bank capital requirements (Nasdaq)

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