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Lane Bryant parent Ascena considers mass store closures

by Xu Zijun, Lisa

America's iconic retailers are shutting hundreds of stores and implementing cost-cutting measures in the face of rising competition. Ascena Retail Group (Ascena) could close 250 retail locations by July 2019 and possibly shut another 400 stores if they fail to obtain rent concessions from mall operators. Macy's Inc. announced 68 store closures and 10,000 job layoffs early this year while J.C Penney is shutting down 138 stores by August. Sears Holdings unveiled restructuring plans in May this year. The US brick and mortar retail industry is facing challenges from rising labor costs and cutthroat competition from online retailers.

Ascena is the largest US-based specialty retailer of women's clothing with a long history dating back to 1962. The company was once included in the S&P400 index and managed seven brands: Ann Taylor, Loft, Lane Bryant, Maurices, Dressbarn, Cacique and Justice in about 4,900 stores.

In 2015, Ascena tried to expand its leadership position in the women's apparel market by acquiring high end mall brands, but the purchase of the Ann Taylor and Loft brands (under Ann Inc.) seemingly added more problems for the firm. Under the terms of the acquisition, Ascena paid USD 1.7bn in cash and financed the deal with a USD 1.8bn senior secured term loan due in 2022. The acquisition was supposed to generate significant cash flow and realize USD 150mn in annual run rate synergies by 2018. However, the company started to report deteriorating performances across its brands since October last year. Ascena's operating and EBITDA margins went to negative in April this year and its Total Debt/Equity ratio surged to over 200% (see Table 1). As shown in Table 2, all the sectors under the company's portfolio showed a decrease in comparable sales.

Three months ending	7/30/2016	10/29/2016	1/28/2017	4/29/2017
Operating Margin (%)	3.60	3.05	-2.56	-83.82
EBITDA Margin (%)	8.94	8.65	2.95	-77.66
Total Debt/Equity (%)	109.25	105.21	102.24	235.98

Table 1: Financial Data for Ascena Retail Group Inc. *Source: Bloomberg & Ascena Retail Group Inc.*

Quarterly net sales ending (USD mn)	4/23/2016	4/29/2017
Premium Fashion (Ann Taylor, Loft)	575.1	535.8
Value Fashion (Maurices, Dressbarn)	510.9	485.1
Plus Fashion (Lane Bryant, Catherines)	354.4	328.6
Kids Fashion (Justice)	228.9	215.6
Total Company Sales	1,669.3	1,565.1

Table 2: Comparable Net Sales of Ascena Retail Group Inc. *Source: Ascena Retail Group Inc.*

With the deterioration in earnings and high financial leverage, Moody's downgraded Ascena to Ba3 from Ba2 in April 28 this year. In June, Moody's downgraded the firm's outlook to negative from stable. The weak financial results also disappointed its investors. In May 2017 its market capitalization shrunk to the lowest level in over a decade of USD 335.29mn compared to USD 1.7bn in August last year. Reflecting the worsening creditworthiness of the company, the RMI-CRI 1-year Probability of Default (PD) for Ascena surged from 200 bps to above 1400bps in May 2017 (see Figure 1).

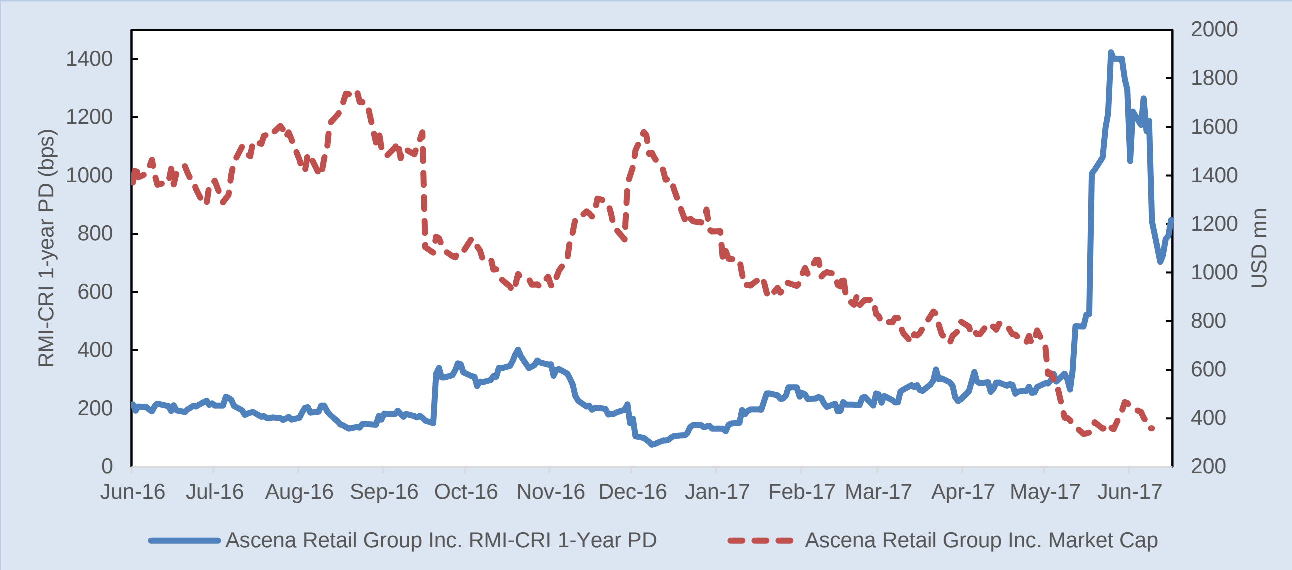

Figure 1: RMI-CRI 1-year PD for Ancena Retail Group Inc (left axis) and market capitalization (right axis) *Source: RMI-CRI, Bloomberg*

In an official statement made by Ascena the management team recognized the tough environment for retail stores. The waning demand across the sector, rising labor cost and increasing competition from digital retailers are the main challenges for the company. Ecommerce stores are likely capturing market share from conventional stores in malls. Traditional retailers may need to find better solutions to survive rather than competing on price such as dangling discounts and promotions to attract consumers. Fast-fashion retailers such as Inditex's Zara are examples of companies that have captured current fashion trends and produce products in a cost-efficient manner to respond to fast-changing consumer tastes.

Although Ascena caters to a wide range of women's fashion, the company's sales have been falling. In addition to a more efficient cost structure, Ascena needs to be more connected to customers' need in order to adapt to the hypercompetitive retail sector. For now, it may find itself between a rock and a hard place as its shopper traffic is still decreasing.

Credit News

Heady markets belie lingering uncertainty

Jun 23. According to the Monetary Authority of Singapore (MAS), financial markets are likely underestimating tail risks that include elevated political uncertainty, even as the global economy recovers. This post-crisis phenomenon is characterized by investors' voracious appetite for risk-taking in financial assets despite sluggish investment in the real economy. MAS also added that although economic growth is on a positive momentum and is increasingly broad-based across both advanced and emerging economy, key factors supporting sustained growth – capital investment and productivity – remain weak in most parts of the world. Besides that, differing expectations after the Fed's interest rate hike, and risks from trade protectionism and Brexit casted doubts on the global economic growth. However, Asia remains committed to openness and is positioned for sustained growth through various investment opportunities, such as private equity. (Business Times)

Big China companies targeted over 'systemic risk'

Jun 23. Concerned with rapid capital outflows and the risk associated with the use of unconventional financing tactics for acquisitions, China's bank regulator ordered domestic lenders to examine on the credit exposures of large Chinese companies. Even though the regulator did not specify which companies were being checked on, several firms experienced a fall in their stock prices, including Dalian Wanda, Fosun International and HNA. This move is touted as a game changer to the Chinese mergers and acquisitions situation. (FT)

China bad debt prices up 30% as new gold rush gets under way

Jun 22. As domestic and foreign investors rush into China's bad loans market, prices of non-performing loans have been on the rise. NPL prices surged more than 30% this year with a large number of buyers seizing up a limited supply of NPLs in the market. The Chinese authorities are supportive of this form of distressed investment as they provide a market-oriented solution to the growing NPL problem in China. NPLs increased by 61% in the past two year and stands at USD 231bn currently. With better prospects of debt recovery due to higher real estate valuations, foreign investors like Bain Capital and PAG are quick to snatch up NPL portfolios. At the same time, local investors are willing to pay higher prices for NPLs due to increased liquidity of NPLs as more asset management companies are given the right to deal with NPLs. (Bloomberg)

Intesa in talks over parts of Italy's Veneto banks

Jun 21. Intesa Sanpaolo is in talks with the Italian government and the EU regulators about taking control over the goods assets of both Popolare di Vicenza and Veneto Banca. To prevent its dividend policy and capital position from being affected, Intesa demands for the stripping out of the Veneto banks' bad loans and the state's payment of at least 4000 redundancies and any legal risks associated with a mis-selling scandal. Insiders think that the deal is unlikely to happen and that the EU authorities might view Intesa's demand as a form of state aid. Intesa is expected to make a decision by the end of the week. (FT)

Crisis-hit Noble to skip bond coupon payment

Jun 21. Noble Group confirmed that its USD 2bn revolving credit facility would be extended by 120 days starting from Jun 20 and is currently in talks to find strategic investors. The crisis-hit trader also pushed back coupon payment of its USD 400mn perpetual bond. Analysts added that the decision to skip coupon payment would further hurt investors' confidence on the company. Under the perpetual bonds' terms, Noble can defer payments without triggering a default. Meanwhile, coupon payments on other bonds are due in July and September. In addition, Noble has bonds worth USD 379mn and USD 1.1bn due in March and May 2018 respectively. (Straits Times)

Sears Canada seeks reinvention as it falls to insolvency (The Globe and Mail)

Poland scales back debt plans after tax crackdown (FT)

Regulatory Updates

Biggest banks clear their first hurdle in Fed's stress tests

Jun 23. All 34 banks subjected to the first phase of annual stress test managed to exceed minimum thresholds set by the Fed. The purpose of the stress test is to ensure that banks remain well capitalized even in a severe recession. Since the implementation after the 2008 financial crisis, stress testing has prompted banks to increase their common equity capital by more than USD 750mn. With a supplementary leverage ratio of 3.8%, Morgan Stanley fared the weakest in this round of review even though it still met the minimum requirement of 3%. As banks get healthier financially, there have been calls to reduce the frequency of stress testing and to scrap one of the toughest requirements. However, the Fed remains cautious on this as banks can position their portfolios to pass tests without necessarily having their risks under control. (Bloomberg)

PBOC 'won't shrink balance sheet'

Jun 23. China's central bank, the People's Bank of China (PBOC), decided to adopt a neutral monetary policy despite the US Fed's action to trim its holding of Treasury bonds and mortgage-backed securities worth USD 4.2tn. Relying on PBOC's use of different policy tools and the distinct Chinese balance sheet structure, PBOC is poised to retain its balance sheet level due to the absence of huge portfolio of securities assets which need to be dealt with, unlike the US. China's portfolio of assets, which are mainly foreign exchange-based, also does not trigger worries as PBOC can always hedge its foreign exchange accounts by adjusted other subjects. China depends on big state-controlled banks and increased government spending to stimulate its economy, making it relatively easier to control credit across the country. (Straits Times)

ECB to shed more light on corporate bond purchases (FT)

US could ease Volcker Rule, exempt small banks: regulators (Reuters)

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Contributing Editor: Dexter Tan