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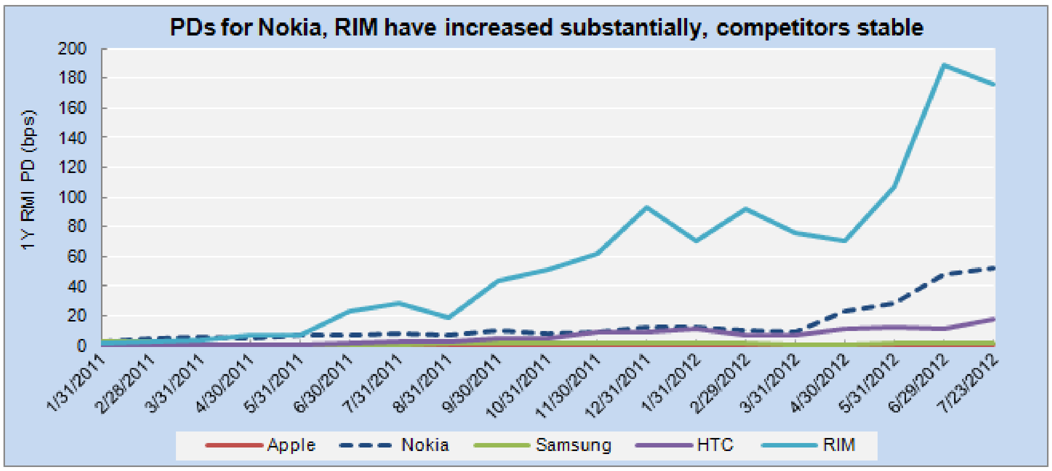
Weekly Credit Brief

Jul 17 - Jul 23 2012

Story of the Week

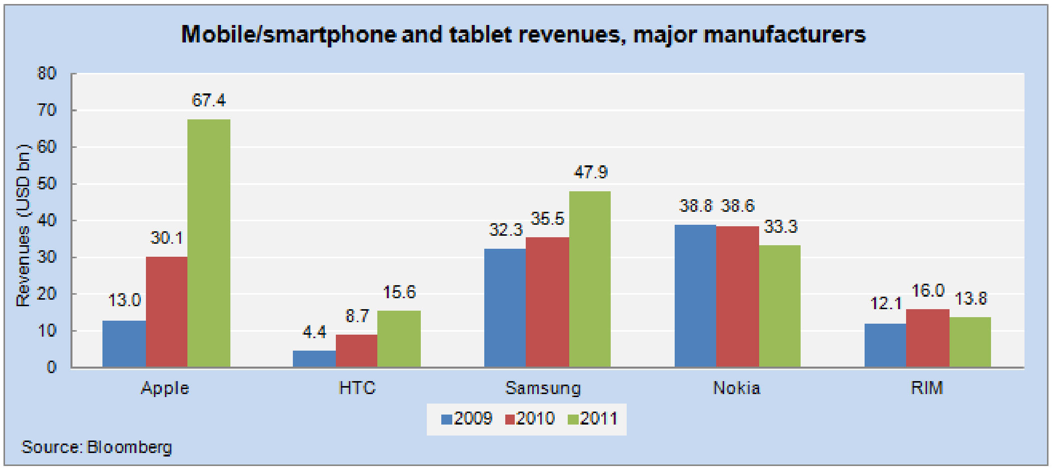
Intensified competition, consumer preferences likely to have a negative impact on Nokia, RIM

The 1-year RMI probability of default (RMI PD) for both Nokia and Research In Motion (RIM), the Canadian-based BlackBerry maker, have reached record highs in recent weeks, as concerns about the attractiveness of their product lines increased, following poor product reviews and widening losses during Q2. Increased competition in the mobile device market has weighed upon the credit profiles of both Nokia and RIM, with both companies bleeding cash as sales declined. The RMI PD for Nokia first started to increase in mid-April, before S&P downgraded the company to BB+ on April 23, and well before both Moody's and Fitch downgraded the company to Ba3 and BB- respectively in the last week. RIM does not have a credit rating from any major rating agency, illustrating the broad coverage and utility of RMI's PD model.



Intensified competition: Until recently, Nokia phones have remained popular in emerging markets due to low-price points, and BlackBerry services continued to be popular with corporate customers. However, the two firms have seen their respective market shares in these key segments fall recently. Competitors, including Apple and manufacturers using Google's Android operating system such as Samsung and HTC, have increased offerings of devices with greater functionality and leaner pricing.

Lower demand for products: Despite their dominance in the mid-2000s, an inability to develop better operating platforms or lower cost smartphones decreased the competiveness of Nokia and RIM. A lack of content and features has led to weaker demand for both companies' product offerings. Coupled with an increasing demand for greater personalization, consumers preferred the functionality of Apple and Android mobile devices. Despite large investments aimed at revitalizing flailing product lines, new products such as RIM's BlackBerry Storm and BlackBerry PlayBook, and Nokia's Lumia devices, have received poor reviews. This is one of the primary reasons why both firms continue to bleed cash, with Nokia halving the price of its flagship Lumia 900 Windows smartphone in the US on July 16



In contrast, Apple's success in the mobile device market has been marked by a string of well-received hits, with industry leading profit margins, while a diversified range of Android-based offerings from Samsung and HTC have attracted a wide range of customers. Between 2009 and 2011, Apple and Android manufacturers enjoyed significant revenue increases, while RIM and Nokia suffered revenue declines.

Ill-suited to current technology cycle: The provision of high quality development kits and a huge platform to market finished products have attracted developers to Apple's iOS and Google's Android platforms. Over 650,000 apps are available for Apple's iOS, and almost 500,000 are available on the Google Play store. A shrinking user base and a clunky development platform have seen developers largely abandon the Blackberry platform. RIM has only 80,000 apps in its store, and only 15,000 are compatible with its PlayBook tablet. A partnership between Nokia and Microsoft has given users of Nokia's latest offerings access to over 100,000 apps. However, Microsoft announced in early July that Windows Phone 8 will not be compatible with current Nokia handsets, a key reason why Nokia decided to slash the price of its flagship phone last week.

Sources:
Nokia junk debt rating cut by Moody's as losses mount (Bloomberg)
Nokia debt rating cut to junk at Fitch (Bloomberg)
Nokia's bad call on smartphones (WSJ)
RIM updates developer tools ahead of BlackBerry 10 launch (Reuters)
Nokia drops on Microsoft system decision (Bloomberg)

In the News

Singapore investigates rate setting, Aussie mechanism a potential rate model
Jul 18. The Monetary Authority of Singapore (MAS) last week said it and other global regulators were examining the setting of key interest rates determined through daily bank submissions. MAS is examining the submission process for Sibor, Singapore's Libor equivalent, a practice which both Bank of America and RBS ceased participation in last week. In related news, market commentators have suggested Australia's Bank Bill Swap (BBSW) Reference Rates could provide an improved model to Libor, as rates are set based on commercial paper trades. However, replicating the homogenous treatment of prime bank paper would be difficult in other markets. USD Euribor or an overnight rate such as Eonia are also being mulled as alternatives, but suffer from a lack of wide adoption. (WSJ, Reuters, IFR Asia)

Potentially more CRAs on the horizon as Kroll market share increases
Jul 19. The Securities and Exchange Commission (SEC) said that more CRAs could soon apply to register with the SEC as NRSROs. The news came as newcomer Kroll Bond Ratings eclipsed more established S&P in the commercial mortgage backed security (CMBS) sphere, claiming third place in the rating of CMBS transactions behind Moody's and Fitch Ratings, only a year after its first deal. Founder Jules Kroll attributed this a focus on due diligence, surveillance and insightful analysis. In related news, former Home Secretary of India Gopal Krishna Pillai suggested that Brazil, Russia, India, China, and South Africa should establish a joint international CRA to counter the suspected bias of the Big Three global ratings agencies. (Reuters, Reuters, News Track India)

Unrealised losses could create bank capital volatility

Jun 21. To address the issue of bank capital being reduced during periods of market illiquidity, US bank regulators have proposed new rules on unrealized gains and losses on available-for-sale (AFS) securities. The rule would deduct unrealized losses and add unrealized gains to the Tier 1 capital of banks, with the exception of AFS cash flow hedges. However, the changes may affect bank liquidity and make it more difficult to hedge interest rate risk. In related news, six of the largest US banks have taken steps to shut down their proprietary trading desks in anticipation of the incoming Volcker Rule. (Fitch Ratings, Bloomberg)

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