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Weekly Credit Brief Dec 19 - Dec 25

Toys R Us' bankruptcy aggravates Mattel's struggle amid a competitive toymaker market

By Lin Li

Mattel Inc (Mattel), the largest toy maker in the United States, saw its stock price plunge 25% from July 25 to December 22, 2017 followed by a series of weak outlook announcements and disappointing financial reports. Correspondingly, the RMI-CRI 1-year Probability of Default (PD) for Mattel increased to 42.4bps from 7.2bps during the same period, exhibiting a deteriorating credit profile. The weak performance of Mattel was mainly due to the bankruptcy of Toys R Us, the debtor and second-biggest customer of Mattel, and its underperforming brands amid a competitive market in US toymakers.

	Q1 2017	Q2 2017	Q3 2017
Current Ratio (X)	1.7	1.4	1.3
Net Income (USD mn)	-109.5	-53.7	-592.1
Net Debt (USD mn)	1933.1	2367.1	2687.7
Net Debt/EBITDA (X)	2.8	3.6	6.2
Cash & Equivalents (USD mn)	381.9	275.4	181.3
Inventory to Cash (days)	146	172	227

Table 1: Financial Data for Mattel. *Source: Bloomberg*

The Toys R Us bankruptcy in September 2017 could be one of the main reasons of Mattel's poor performance. As the main customer of Mattel, Toys R Us' failure leads to Mattel's weaker Q3 profile. Mattel reversed USD 43mn of net sales attributable to the North America segment in Q3 2017. The inventory-to-cash days, which indicates the length of time in days that a company uses to sell inventory and collect receivables into cash, increased to 227 in Q3 from 172 in Q2 2017 (see Table 1). The bankruptcy aggravated matters and forced the company to write down the value of its inventory and offer discounts to retailers to clear out unsold products. These losses without a corresponding effective reduction in the costs associated with the sales, resulted in the 10% decrease on profit margins YoY.

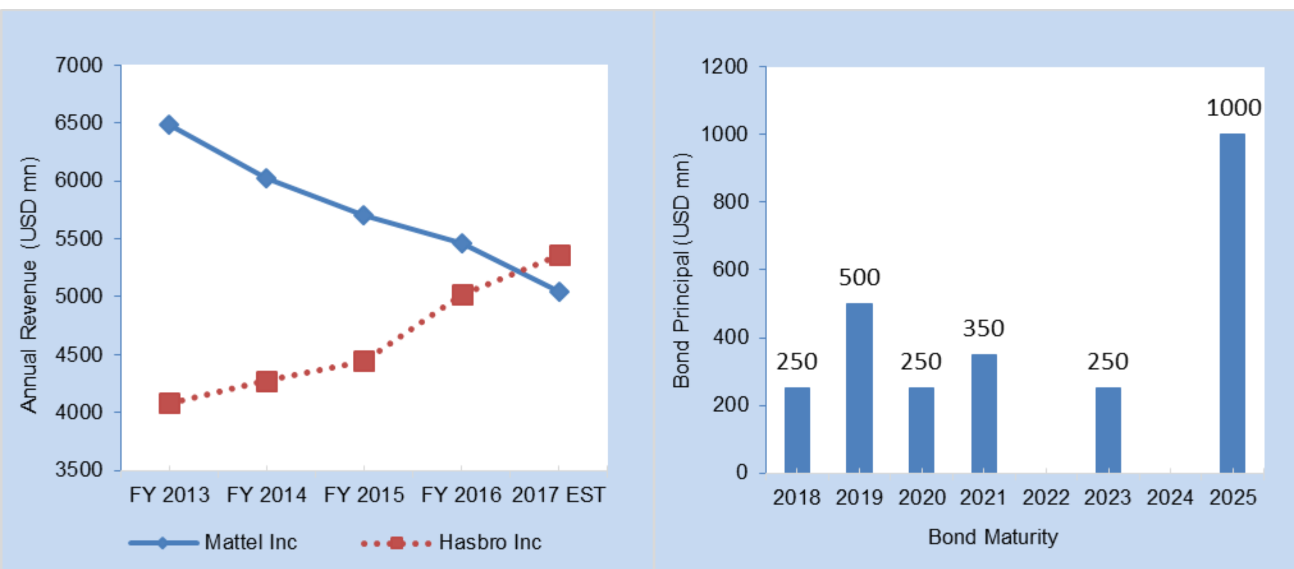

Figure 1: Annual revenue of the top 2 toymakers in US.(LHS) & Bond principal distribution of Mattel Inc. (RHS) *Source: Bloomberg*

Besides the bankruptcy of its main customer, the business environment has been disadvantageous to Mattel in recent years. For most of the children today tend to opt for games on devices like iPads and tablets, Mattel finds itself harder and harder to attract customers. Although efforts has been made to overhaul existing brands they still failed to gain enough traction. Furthermore, [Mattel even lost its important license for Disney Princess and Frozen dolls to Hasbro Inc (Hasbro)], the biggest competitor who has long played second fiddle to Mattel. The annual revenue of Mattel is decreasing YoY (see Figure 1). According to Bloomberg, Hasbro is on track to surpass Mattel's annual sales for the first time since 1993 as the sales growth of Mattel is -9.19% while Hasbro's is 8.00% (see Figure 1).

The current ratio of Mattel shows a negative trend since Q1, 2017 and the net debt increased by 40% in the past 3 quarters. The nine-month period EBITDA ended September 30, 2017 is USD 106mn versus USD 438mn in 2016. There is a heavy burden for Mattel to pay back bond principals from 2018 to 2021 (see Figure 2) as Mattel's cash balance and profitability deteriorates. As a result, Mattel issued USD 1bn of bonds due in 2025 to refinance those short-term debt in this December, with coupon rate up of 6.75%, more than 200bps above similarly rated bonds. The deteriorating profitability performance and high leverage made the three rating agencies, Fitch, Moody's and S&P Global Ratings, all downgrade Mattel on December 2017.

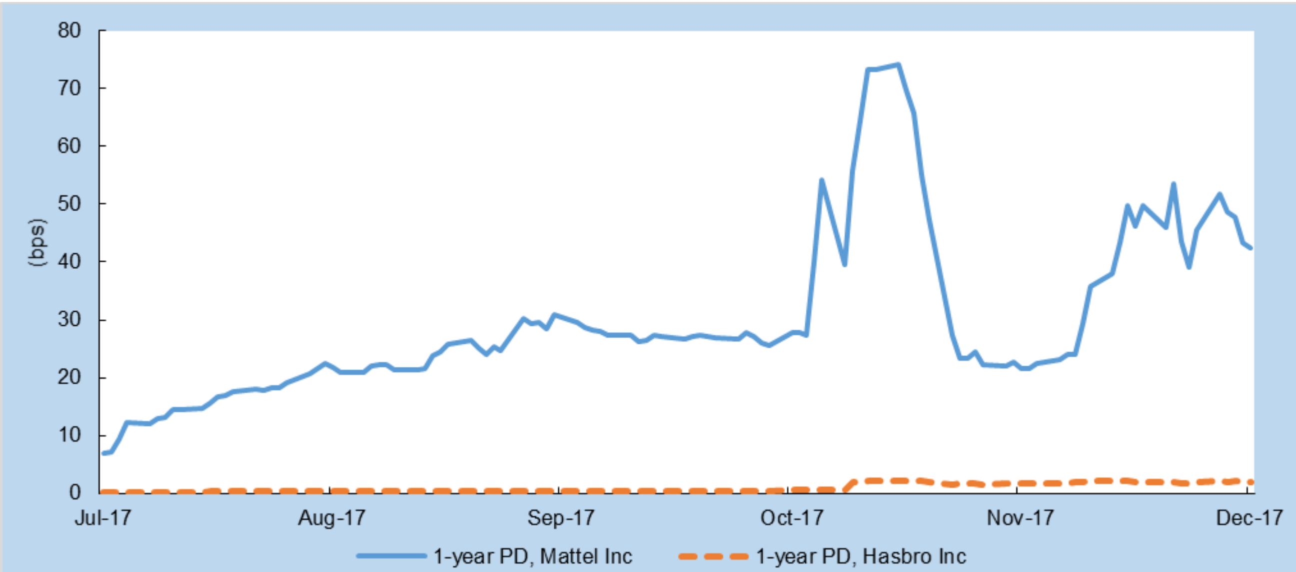

Figure 2: RMI-CRI 1-year PD for Top 2 toymakers in US on December 22, 2017. *Source: RMI-CRI*

On December 11, Mattel published a bleak trading outlook, citing that it may be unable to realize the anticipated cost saving plans and warned that sales in the holiday season will continue to be negatively impacted by tighter inventory at key retailers and its underperforming brands. The PD for Mattel shows an upward trend in general and lies high above Hasbro's PD, suggesting that Mattel has a higher credit risk than Hasbro due to its worsening financial performance amid the competitive market (see Figure 2). In all, Mattel may face more headwinds in the intermediate future as it struggles to get back on track.

Credit News

Indonesia wins Fitch ratings upgrade

Dec 22. The rating on the nation's long-term, foreign currency-denominated debt was raised one level to BBB with a stable outlook. This is the second sovereign rating upgrade this year, months after S&P lifted the nation out of junk status. The upgrade puts Indonesia on par with Philippines and Portugal, which also received upgrades this month. Indonesia's resilience to external shocks is among the key rating drivers as policymakers focus on stability. Rising foreign exchange reserves and strong economic growth also justify the upgrade. These endorsements of the nation's economic stability are likely to help President Joko Widodo as he embarks on a USD 62bn borrowing plan next year. (Straits Times)

HNA pledges USD 362mn of Postal Savings Bank shares for loan

Dec 22. HNA Group has pledged USD 362mn of shares in a Chinese bank as collateral, as part of the conglomerate's efforts to access liquidity. The shares were lent to institutional investors for a loan of undisclosed size. HNA has drawn global attention in the past three years through a USD 40bn spending spree to snap up companies from different industries, while a squeeze on liquidity in recent weeks has prompted the group to look for fresh funding. Liquidity concerns are just part of the HNA's worries. The group has also been scrutinized for providing, as regulators from a number of countries said, false or incomplete information regarding its ownership structure, leading to the collapse of some deals. (FT)

Subprime auto defaults are soaring, and PE firms have no way out

Dec 22. Private-equity firms are finding hard to exit their investments in the auto finance industry, with margins of these subprime lenders shrinking due to spikes in delinquencies and weakening car demand. For instance, Exeter Finance was unprofitable from 2011 through 2015 even after Blackstone Group LP invested USD 471mn to help Exeter expand and cycled through three CEOs at the lender. Bad loans remained an issue, together with events of delinquencies in bonds this year. As such, Blackstone may look to unload Exeter next year. A similar situation is also applicable to Parella Weinberg Partners-backed Flagship Credit Acceptance, concerns are raised as to whether the company can earn a satisfactory return, especially when losses are still projected for this year. Mergers of auto finance firms are expected and whilst nobody is willing to pay more than book value for them, PE firms have begun lowering their expectations of a big profit on exit. (Bloomberg)

Norway paper company Norske Skog files for bankruptcy

Dec 20. Norway's pulp-and-paper company Norske Skogindustrier ASA field for bankruptcy in Oslo on December 19 2017 after it failed to restructure its heavy debt load. At the end of third quarter, the company's net-interest-bearing debt stood at USD 842mn, reflecting negative cash flow and unpaid interest costs related to the recapitalization process. Norske Skog As, the unlisted parent, will be the new operating parent company of the Norske Skog group, allowing its operations to continue to run as normal. Trading in Norske Skog, shares has been halted since December 19 and they had fallen 91% in the year before the suspension. (WSJ)

South Korean crypto exchange files for bankruptcy after hack

Dec 20. Youbit, a Seoul-based cryptocurrency exchange, will enter bankruptcy proceedings after it lost 17% of its total assets caused by a cyber-attack on December 19. This came eight months after the previous cyber-attack cost 40% of its total assets stolen. Yapian, owner of Youbit, stated that clients could safely withdraw 75% of assets as some coins were in the cold wallet – physical devices disconnected from the web can be plugged into computers when needed. South Korea has emerged as a hotbed for cryptocurrencies as bitcoin is trading at a premium over the prevailing international rates. South Korea hosts some of the world's busiest virtual currency exchange and accounts for 15% to 25% of the world's bitcoin trading. (Straits Times)

Noble Group creditors allow more time on debt restructure (FT)

Reliance Communications bondholders organize after default (Bloomberg)

Credit Suisse risks 3rd straight loss on trump tax overhaul (Bloomberg)

Regulatory Updates

China Central Bank official says bankruptcy may benefit the country

Dec 25. The head of research bureau at the People's Bank of China gives of the opinion that local governments should be allowed to go bankrupt in order to curb excessive borrowing by regional authorities. A case of bankruptcy like Detroit can serve to dispel beliefs that the central government provides an implicit guarantee for local authorities. China's central government has been active in limiting local borrowings to effectively control leverage and prevent any major risks from occurring. Due to a lack of support for local funding units, issuance of local governments' debts fell by 23% in 2017. Chinese authorities believe that addressing the problem of hidden debts in local governments and state-owned companies is crucial in the prevention of systematic financial risks. (Bloomberg)

Sebi to revisit default diktat

Dec 25. At its board meeting on December 28, the Securities and Exchange Board of India (Sebi) is set to look at several issues, one of which is a review of its earlier directive that made it mandatory for listed companies to inform stock exchanges in the event of loan default. The Sebi's directive was viewed as tough, as a technical default could happen even in the case of a standard asset, hence some relaxation in the Sebi directive is possible. Furthermore, the Sebi board may consider modifying insider trading norms, in response to recent information leaks. The Sebi board may also modify the regulatory framework for credit rating agencies (CRAs), and such modifications could include a hike in the minimum net worth of CRAs and a stipulation that certain categories of promoters of CRAs must have a sound track record for at least five years. (The Telegraph)

Lithuania raises banks' capital requirement from end-2018 (Reuters)

Qatar banks need to prepare for upcoming Basel IV (The Peninsula Qatar)

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