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Market troubles compel Toshiba to restructure

by Samuel LIM Kok Hong

In the past year, the Japanese conglomerate Toshiba has been wrestling with the consequences of an accounting scandal and losses in its businesses. The scandal-plagued company has seen its share price nosedive by about 40% since April — when news of profit overstatement started to surface. On Christmas Day in 2015, the scandal came to a close when the Japanese Financial Service Agency imposed a record JPY 7.37bn fine on Toshiba. Apart from its accounting problems, the company's lacklustre business performance was reflected in their latest earnings report as the company reported a loss of JPY 90.5bn for the latest six-month period. The two significant loss-making divisions are the lifestyle division, which deals with consumer electronics and the community solutions division, which deals with retail information systems and office equipment. While the loss in the community solutions division was mainly due to the impairment of goodwill and intangible fixed assets, the outlook for the lifestyle division remains poor because Toshiba has not been able to effectively differentiate its products in the consumer electronics sector. In the television business, Toshiba faces competition from Chinese firms at the lower end of the market and Korean firms, at the higher end. Additionally, the slowing demand in the PC sector has hurt its PC sales.

Against the backdrop of poor outlook in the consumer electronics sector, the company announced on Dec 21, 2015 that it would undergo restructuring. The overhaul will result in 7,800 job cuts, mostly from the consumer electronics business, as the company intends to streamline its business to focus on memory chips and nuclear energy. These cuts make up about 30% of the workforce in the consumer electronics business and about 3% of total employees in Toshiba. Moreover, Toshiba also intends to sell its TV manufacturing plant in Indonesia and is considering to consolidate its PC and large electrical goods business with those of the other companies. Analysts speculate that the company is trying to generate funds for its memory chip business, which is its most profitable division but requires continuous investment, by selling off or restructuring several businesses. Due to the restructuring, Toshiba expects a net loss of JPY 550bn in the current fiscal year ending March 2016.

3 months ending	Q4 2015 Mar 31, 2015	Q1 2016 Jun 30, 2015	Q2 2016 Sep 30, 2015
Operating Income (JPY bn)	-31.34	-10.96	-79.54
Total D/E (%)	87.70	90.02	105.52

Table 1: Financial data for Toshiba Corp. *Source: Bloomberg*

Toshiba has been making operating losses since Q4 2015 (ending Mar 31, 2015) and the credit risk of the company has also increased over the past year, as shown in Table 1. Toshiba's debt to equity ratio has grown quarter-over-quarter for the latest two reporting cycles, fuelled by declining equity value and increasing debt. Following a credit rating downgrade in Dec 2015, the spread on Toshiba's bonds due in 2020 surged to more than 300bps, suggesting that capital markets financing has become costlier for the company. On Dec 29, Toshiba sought for a second credit line from banks to pay off the accounting scandal fine, as well as the restructuring costs. The size of the debt, as well as the higher borrowing costs, would create a drag on its profitability and limit the possibility of a quick turnaround in the financial health of the firm.

The accounting scandal and the poor business performance have driven the RMI-CRI 1-year Probability of Default (PD) for Toshiba Corp from 7.08bps on Apr 30, 2015 to 53.74bps on Jan 4, 2016 (see Figure 1). Toshiba's market capitalization was significantly impacted by the probe into its accounting scandal in May 2015 and the restructuring plans that were announced later in December 2015.

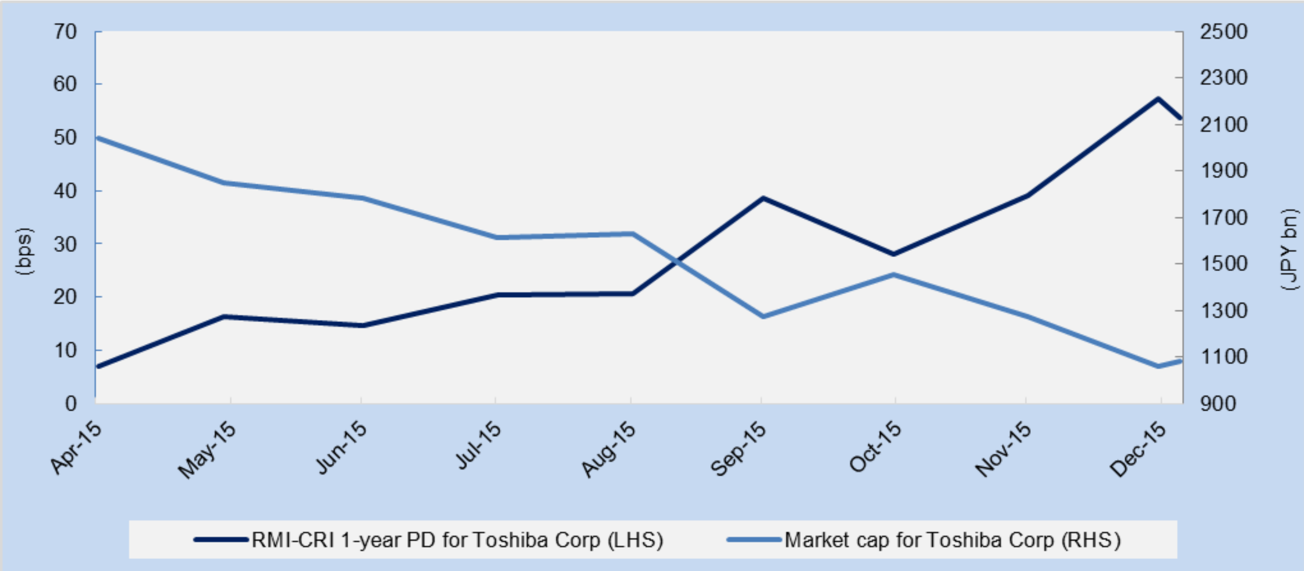

Figure 1. RMI-CRI 1-year PD and market cap for Toshiba Corp. *Source: RMI-CRI, Bloomberg*

Just before 2015 came to a close, Japan's industry ministry and a government-affiliated investment fund offered their assistance to revamp the home electronics division and other operations in Toshiba. These rescue plans are part of a larger effort to restore Japan's dominance in the electronics industry. The efforts would help to inject a certain degree of confidence back in Toshiba and pave the way for further financial stability. However, it is rather unlikely for Toshiba to emerge from the accounting scandal unscathed. The streamlining of Toshiba's operations will result in the company morphing into a smaller entity with lower profitability in the foreseeable future. It could be a long while before it returns to its previous stature in the market, if at all.

Credit News

Singapore home prices post longest losing streak in 17 years

Jan 4. Singapore home prices dropped for a ninth quarter, posting the longest losing streak in 17 years, as tighter mortgage curbs cooled demand in Asia's second-most expensive housing market. The government began introducing residential property curbs in 2009 as low interest rates and demand from foreign buyers raised concerns that the market was overheating. The data shows that prices slid 2.6% in prime areas and 3.7% in the suburbs in 2015. Prices for stand-alone homes mainly reserved for local buyers dropped 4.4% last year. (Bloomberg)

Shipowners rocked by sinking charter rate

Jan 3. Earnings for vessels carrying dry bulk commodities have been adversely hurt by the slowdown in Chinese economy, oversupply of shipping services, as well as low oil price. Short-term charter rates for Capesize ships, the largest kind, were as low as USD 4,897 a day on Dec 23, down from USD 20,000 a day in August. Presently, this charter fees are not even sufficient for covering vessel's operating costs, let alone their financing. Operating and financial costs for vessels generally cost about USD 13,000 per day. Ship owners were so badly hurt by their decline in earnings that most of them were required to undertake forced sales, emergency capital raisings, and face possible bankruptcy. (FT)

South Korea's factory output unexpectedly falls on export decline

Dec 30. South Korea's factory output missed estimates in November as poor exports due to weak global demand continue to weigh on production in Asia's fourth-largest economy. While the economy is growing due to improving domestic demand, the softness in global demand is constraining manufacturers, and low oil prices are hurting Korean refiners. Growth in China, Korea's largest trading partner, is forecast to slow again in 2016, adding to headwinds for the export-dependent nation. (Bloomberg)

Noble Group cut to junk by Moody's over liquidity concerns

Dec 30. Moody's has downgraded the Noble Group's credit rating to "junk" due to concerns of the company's liquidity amid the persistent downturn in the commodity sector, despite its recent announcement of a sale of its remaining stake in Noble Agri to China's Cofco Corp for SGD 1.05bn. Following this news, the company's stock faced a selloff on Wednesday amid heavy trading. Shares eventually closed down 9.1% at a more than two-week low of SGD 0.40. Noble is currently rated BBB- by Standard & Poor's who declared that its sale of Noble Agri will reduce Noble's business position, even though the sales would improve the Hong Kong-based firms financial leverage and liquidity position. (Bloomberg)

Biggest Korea brokerage sees 10% won drop to stave off deflation

Dec 30. South Korea's largest brokerage forecasts that the won is going to depreciate as much as 10% in 2016, its steepest decline in 8 years as the government favours currency depreciation to revive exports and stave off deflation. At present, South Korea has undertaken interest rates cut to unprecedented levels to keep the economy expanding, in the face of declining exports and greater capital outflows. Additionally, the won is under further pressure from depreciation in the yuan as the Chinese economy has slowed down with minimal signs of improvement. The Bank of Korea has set the new inflation target at 2% for the coming 3 years, down from a range of 2.5% to 3.5% for the 2013-2015 period which was not achieved. The monetary authority pledged to end the current period of low inflation that threatens to hurt the country's economic growth. (Bloomberg)

Bank of China sells USD 1.3bn stake in Huaneng Power Company (Bloomberg)

KaloBios Pharmaceuticals files for bankruptcy in wake of Shkreli arrest (Channel NewAsia)

Singapore economy grew 2.1% in 2015, beating expectations (Channel NewsAsia)

Regulatory Updates

Solvency II rules set to spark M&A surge in insurance sector

Jan 3. The Solvency II capital regime came into force on January 1, bringing reforms to the European insurance business and paving the way for merger and acquisition activities in the sector. The new rules reward well-diversified insurers with lower capital requirements. As a result, both large insurers and smaller players with specialized businesses are incentivized to consolidate, the latter being driven by the additional capacity needed to meet Solvency II analysis and reporting standards. (FT)

Sebi to tighten disclosure norms for rating agencies

Jan 3. Markets regulator Securities and Exchange Board of India (Sebi) is set to tighten disclosure norms for rating agencies as well as the companies being rated, as it seeks to check the menace of 'rating shopping' and a 'pick-and-choose' approach in disclosing rating actions. This proposed regulatory move follow due to the Amtek Auto fiasco and an increasing amount of loan defaults, which trigger downgrade or suspension of ratings without the same being properly communicated to investors. (Economic Times)

China fires a warning shot at Yuan speculators with bank bans (Bloomberg)

UK financial regulator drops review of banking culture (Bloomberg)

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