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Weekly Credit Brief Jan 23 - Jan 29

Sprint Corp faces challenging outlook amid failed merger talks

by Toh Yong Hui Desmond

Sprint Corp offers a comprehensive range of wireless and wireline communications products and services, and served 54 million connections as of September 30, 2017. Over the past 6 months, the market capitalization of Sprint Corp has plunged by about 37.1%, and correspondingly, the RMI-CRI 1-year PD rose from about 26bps to about 103bps in the same period (see Figure 1).

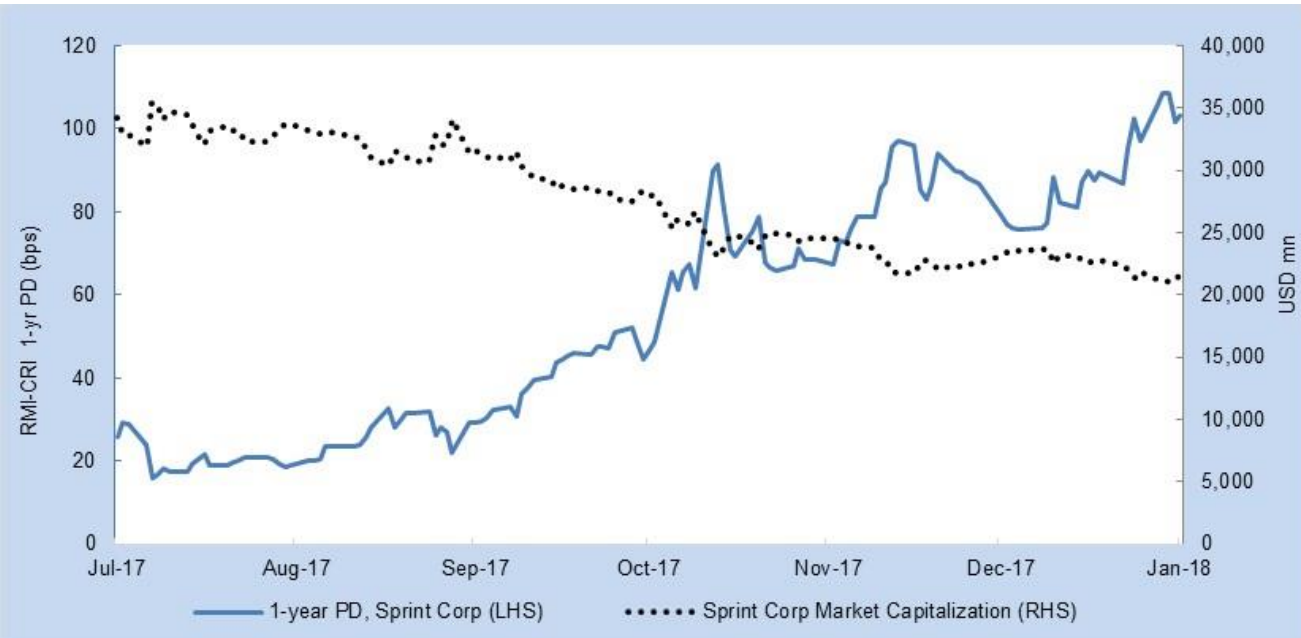

Figure 1: RMI-CRI 1-year PD for Sprint Corp (LHS) & Market Capitalization for Sprint Corp (RHS). *Source: RMI-CRI, Bloomberg*

Notably, Sprint Corp's share price tumbled by 13% in a single day on November 4, 2017 after merger talks with T-Mobile were called off. This compounded concerns that Sprint Corp would continue to lose market share in the face of steep competition from its rivals in the US telecommunications industry. Indeed, after peaking at about 18% in Q1 2013, its market share has been declining in recent years (see Figure 2), levelling 12.7% in Q3 2017. Conversely, Sprint Corp's competitors have been gaining market share, with T-Mobile's market share exceeding that of Sprint Corp for the first time in Q4 2015. Given that the telecommunications industry is characterized by high capital expenditures, such loss in market share could adversely affect Sprint Corp's ability to reap economies of scale and compete with its larger rivals, hence weakening its profitability. The deterioration in profitability has in turn caused Sprint Corp to have the lowest EBITDA/Interest Expense ratio as compared to its industry peers (see Table 1), indicating a weaker credit profile.

	EBITDA/Interest Expense (X)	Postpaid ARPU (USD)	Postpaid Churn Rate (%)
Sprint Corp	4.53	46.00	1.72
Verizon Communications Inc	9.86	136.31	0.97
AT&T Inc	7.38	58.29	1.07
T-Mobile US Inc	6.52	46.93	1.23

Table 1: Financial Data for Sprint Corp and its Competitors in Q3 2017. *Source: Bloomberg*

Moreover, the decline in average revenue per user (ARPU) has put further downward pressure on Sprint Corp's profitability. For instance, postpaid ARPU declined to USD 46.00 in Q3 2017 from USD 50.54 a year ago (see Table 2). Sprint Corp attributed this decline in ARPU to the ongoing shift of customers to lower-priced service plans and increased promotional activities. Such promotional activities include the company's "half-off" promotion offering to trim rival bills by 50%, and an "unlimited freedom" offer with five lines of "unlimited" data, talk and text for about USD 20 per line per month.

	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017
Revenue (USD mn)	8247	8549	8539	8157	7927
Postpaid ARPU (USD)	50.54	49.70	47.34	47.30	46.00
Postpaid Churn Rate (%)	1.52	1.67	1.75	1.65	1.72

Table 2: Financial Data for Sprint Corp. *Source: Bloomberg*

Despite such promotional activities, the postpaid total churn rate, which is the percentage of postpaid subscribers who discontinue their subscriptions within a given time period, has been on an upward trend (see Table 2). For instance, the postpaid total churn was 1.72% in Q3 2017 as compared to 1.52% a year ago, and Sprint Corp has reported a YoY increase in churn rate for the past 3 quarters, even as its competitors reported lower churn rates (see Table 1). According to analysts at BTIG, a brokerage firm, the increase in churn rate could be due to years of underinvestment in Sprint Corp's network that rendered its network less competitive than that of its rivals. Such increase in churn rate, coupled with the aforementioned decline in ARPU, has caused Sprint Corp's revenues to decline to USD 7.93bn in Q3 2017 from USD 8.25bn a year ago (see Table 2). Worse still, the churn rate is set to increase in year 2018, as some of the carrier's promotional offers are set to end. For instance, the price of the company's "unlimited freedom" offer as mentioned earlier was set to increase by USD 30 per month after January 31, 2018. Thus, the outlook for the company's profitability and credit profile is bleak.

Figure 2: Wireless Subscriptions Market Share of Sprint Corp and its Competitors. *Source: Statista*

Due to its lackluster financial performance in the past few quarters, Sprint Corp is expected to generate less than USD 500mn of free cash flow for the fiscal year 2017. In addition, capital expenditures related to its wireless network is expected to be about USD 3.75bn in 2017, which casts doubt on its ability to service its debt, given that USD 19bn are due over the next four years.

In view of the challenging outlook for Sprint Corp, its management has pledged to continue with its cost-cutting initiatives in order to reduce operating expenses and improve operating cash flows. While such moves are warranted, there remain other challenges, such as the growth in churn rate and decline in ARPU, which Sprint Corp needs to overcome in order to achieve a material improvement in its financial standing.

Credit News

China faces refinancing crunch with USD 2.7tn of bonds bearing down

Jan 29. As more than half of the outstanding debt matures, China's USD 4tn bond market faces a refinancing challenge over the next five years. Companies, state-owned enterprises, financial institutions and sovereign borrowers have USD 409bn of bonds maturing in 2018, followed by USD 619bn in 2019 and USD 664bn in 2020. Given a higher interest rate environment, new debt will be more expensive, heightening concerns over default risk by some borrowers. However, some market commentators believe the refinancing does not pose a significant risk. Analysts at Moody's commented that "the debt maturity and refinancing needs" this year will "be manageable". (FT)

US economy grows 2.6% in last quarter of 2017

Jan 27. According to the Bureau of Economic Analysis, the US economy grew by an annualized 2.6% in the fourth quarter of 2017. Although inventories and trade are the drags on growth, the picture among consumers was far more positive. US households spending has been increased 3.8% during the last quarter of 2017, stimulated by a rising stock market as well as signs of firming wages. Government spending also climbed at 3% pace. However, economists are divided over the sustainability of the expansion as the risk of economic overheating is increasing. (FT)

Carillion ran up debts and sold assets to fill GBP 217mn dividend gap

Jan 26. Carillion, a collapsed construction company liquidated in January 2018 with just GBP 29mn cash and more than GBP 1.5bn of debt, sold assets worth GBP 217mn to continue paying dividends to shareholders between 2012 and 2016. While Carillion paid out dividends of GBP 376mn over the five-year period, it generated just GBP 159mn of net cash from operations. The continued rising dividend with evaporated cash flow raised questions about whether the company paid dividends out of capital, which is illegal in accordance to UK company law without prior court approval. Although Carillion reported profits that exceeded the dividends paid by a wide margin, there are doubts about these numbers given the wide variance of cash flow and the GBP 1.3bn writedown the group took in the first half year of 2017. (FT)

US investors load up on Russian debt despite looming sanctions: Phosagro

Jan 26. According to the head of Russian fertilizer giant Phosagro, US and European investors are loading up on Russian debt despite a looming threat of new US sanctions on Moscow amid a renewed commodity boom. Phosagro placed a USD 500mn eurobond this week at a coupon rate of 3.949%, its lowest ever. Andrei Guryev, CEO of Phosagro, indicated that his bond was five times oversubscribed with 92% of investors from Western countries, including 41% from the United States. He said the appetite for the Russian debt shows that US and European investors believe the Russian corporate story. The outlook for the fertilizers market is positive as China was closing more loss-masking facilities amidst its fight on pollution. (Reuters)

Malaysia's central bank raises key rate for first time in 3.5 years

Jan 25. On January 25, Malaysia's central bank raised its key interest rate for the first time since July 2014, becoming the first in Southeast Asia to raise its rate in years and the first Asian nation to hike them in 2018. The overnight policy rate increased by 25bps to 3.25% with Bank Negara Malaysia backing their decision to normalize the degree of monetary accommodation as the economy remains firmly on a steady growth path. The ringgit gained nearly 11% against dollar in 2017, well reflecting the country's strong economic fundamentals. According to the central bank, the stance of monetary policy should be appropriate to prevent the build-up of risks that could arise from interest rates being too low for a prolonged period of time. Inflation is predicted to average lower in 2018, on expectations of a smaller effect from global cost factors. (Channel NewsAsia)

Iceberg urges Noble's creditors to reject debt-for-equity swap (Straits Times)

Carillion's Canadian branch files for bankruptcy protection (Globe and Mail)

Nine West plans a bankruptcy filing with asset sales (Bloomberg)

Regulatory Updates

Egypt's parliament finally approves bankruptcy law

Jan 28. Egypt's parliament approved a new bankruptcy law on January 2018 which is a move that is positive for the investment environment. The new law abolishes prison sentences in bankruptcy cases, limits punishments to a monetary fine and allows any business that is close to bankruptcy to have the option of conciliation with its creditors or restructuring its financial position. The laws aimed to minimize the need for companies or individuals to resort to the courts and to simplify post-bankruptcy procedures. The new law is expected to improve Egypt's rating in global indices as the ease of exiting the market are currently the main obstacles for the business environment. (Egypt Today)

China opens up debt-to-equity swaps, tightens rules on insurers' investments

Jan 26. China will allow banks to set up private equity funds to raise capital for the country's debt-for-equity swap scheme, which was set up to ease the debt burden of many state-owned enterprises. Firms involved are mostly in industries facing oversupply, such as steel and coal. The state planner said it would allow qualified listed and non-listed companies to issue common shares, preference shares or convertible bonds to the subsidiaries of banks for financing swaps. Separately, China has been trying to curb risk in the insurance sector. China's insurance regulator said that the new rules governing insurers' investments will come into force on April 1. The new rules will focus on governing the way of funds invested by insurers and improving risk control. (Reuters)

Resolution plans under IBC may need approval of fewer lenders (Economic Times)

Massive cryptocurrency heist spurs call for more regulation (Bloomberg)

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