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Diebold Nixdorf struggles amid slowing ATM market and high leverage

by Liu Hanlei

The automated teller machine (ATM) may have celebrated its 51st anniversary since the first ATM operated in London, but questions about its future have been raised given the increasing use of cashless transactions through digital banking and card payments. According to data from a banking and payment system consulting company, RBR, the number of operating ATMs in the US grew by just 1.4% from 2010 to 2016. In Europe, the number of installed ATMs has actually been declining by 6% per year since 2010. ATMs around the UK are shutting down at a rate of 300 each month as contactless payments for small transactions increase. The banking industry body, UK Finance, said that debit card payments had overtaken cash as the most popular form of payment in UK as the number of cash transactions fell by 15% YoY to 13.1bn transactions in 2017.

In the global ATM industry, Diebold Nixdorf Inc and NCR Corp are the top two manufacturers with a 32% and 27% market share respectively. The slower deployment in Europe and the US is in line with slow revenue growth by Diebold Nixdorf and NCR (see Table 1 below). According to RBR, the growth of ATMs is mainly from Asia Pacific with a 6% growth rate in 2016 and it is expected to grow in the coming years especially from China. However, competition in Asia is keen as evidenced by a drop in Diebold Nixdorf's product business from Asia. The lucrative China ATM market is also dominated by local manufacturers such as GRG Banking and Cashway due to regulations implemented in 2016 which require foreign companies to form joint ventures with local partner in order to operate in China. Given that Diebold Nixdorf and NCR have limited market exposure to Asia, only 12% of Diebold Nixdorf's revenue and 14.5% of NCR's revenue comes from Asia, and with the regulation in place in China, these two market leaders' growth prospects may be limited.

Diebold Nixdorf	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018
Revenue (USD mn)	1133.9	1122.7	1249.9	1064.2	1105.6
Net Income (USD mn)	-30.6	-35.4	-108.3	-70.9	-138.5
Operating margin (%)	3.53	7.84	5.05	1.4	0.53
Net Debt/Equity (%)	204.59	223.84	225.02	281.86	564.8

Table 1. Financial figures of Diebold Nixdorf Inc. *Source: Bloomberg.*

NCR Corp	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018
Revenue (USD mn)	1593	1663	1782	1517	1537
Net Income (USD mn)	90	106	-56	8	-157
Operating margin (%)	11.74	12.39	12.01	8.24	9.37
Net Debt/Equity (%)	200.76	179.46	158.63	189.17	226.97

Table 2: Financial figures of NCR Corp. *Source: Bloomberg.*

Adding to Diebold Nixdorf's woes of sluggish revenue growth were the increasing operating and restructuring expenses after the companies' strategic expansion in 2016. Diebold Nixdorf was formed after Diebold acquired Wincor Nixdorf in Aug 2016 with a market premium of 35% financed mainly by debt. However the combined entity with a bigger market share did not perform well as it generated losses for the past quarters. In the latest Q2 2018 earnings, it reported a loss of USD 1.82 per share as compared to analysts' expectation of a gain of USD 0.01 per share. The company attributed the loss to the higher service and delivery cost due to supply chains delay. Diebold Nixdorf also revised its 2018 guidance from a loss of USD 75-95mn to USD 325-365mn due to a higher than expected restructuring expense. Restructuring expense to streamline operations in 2018 is projected to increase by USD 70mn to USD 100mn. In fact, 2017's projected cost savings USD 100mn due to the merger was eroded by acquisition related expenses. Diebold Nixdorf's share price plunged as much as 36% when it released its Q2 2018 earnings.

Diebold Nixdorf's revenue is mainly from Europe, Middle East and Africa (EMEA) with 56% of revenue as of Q2 2018 while NCR derives 26.9% of revenue from EMEA and a majority of 59% from America as of Q1 2018. Both these markets are experiencing a slowdown of ATM deployment. With a slowdown in revenue growth and a simultaneous increase in costs, operating margins were affected with Diebold Nixdorf in a worse shape, obtaining a 0.53% operating margin in the latest quarter.

In addition to mounting losses and slowing demand for ATMs, Diebold Nixdorf's net debt/equity ratio rose to a new high at 564.8% as of Q2 2018 while NCR's net debt/equity ratio stands at 226%. While Diebold Nixdorf is currently in compliance with its credit covenants, its revised 2018 guidance indicates that there is a potential that the company may not meet its net debt to trailing 12-month EBITDA covenant as defined by its credit facility agreement with its lenders. Diebold Nixdorf is planning to discuss with its lenders about amending its credit agreement. The RMI-CRI 1-year Probability of Default (PD) for Diebold Nixdorf rose to 1000bps, which is equivalent to a PD implied rating of CCC (see Figure 1 below). Comparing to NCR's PD, Diebold Nixdorf is in a worse credit position due to its lower margins, consecutive quarters of losses, higher leverage and projected challenges at achieving synergies from the past acquisition.

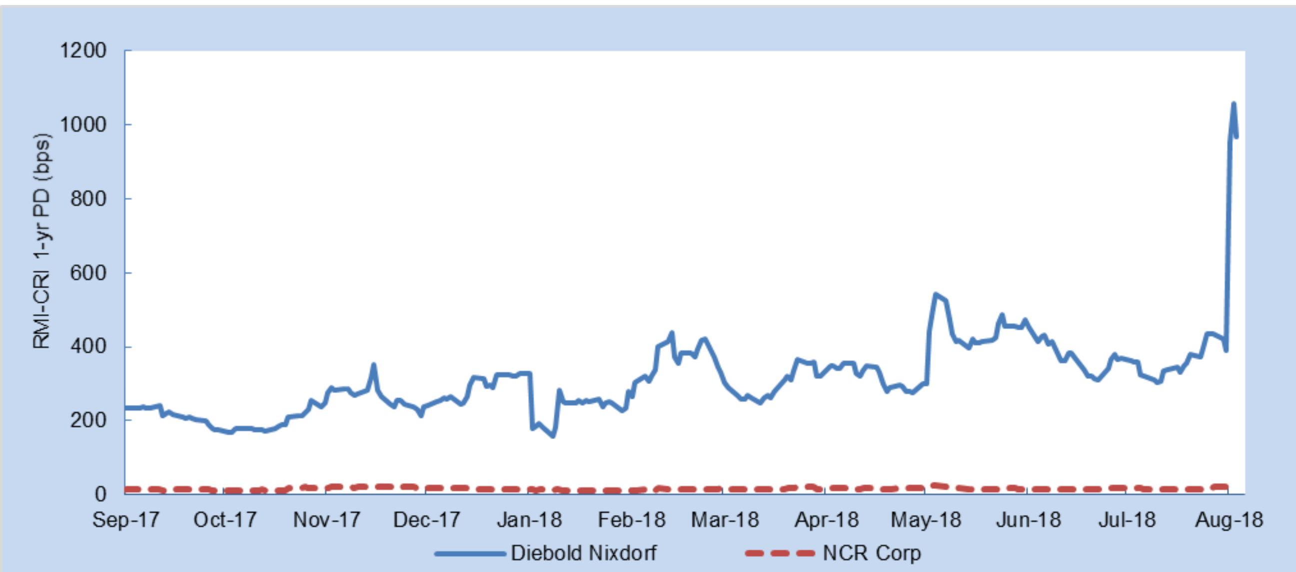

Figure 1: RMI-CRI 1-year PD for Diebold Nixdorf Inc and NCR Corp. *Source: RMI-CRI*

To keep up with times and relevance, ATMs have evolved to more than just dispensing cash and manufacturers have to keep up with innovation and features. Contactless and Near Field Communications (NFC) may lead the new wave of self-service interactions in replacing the traditional card and PIN combination. A more personalized interaction has also been a key goal by banks and both market leaders have developed in this aspect. The new ATM initiatives are termed as Interactive Teller Machine by NCR and In-lobby Teller by Diebold Nixdorf which both serves to combine the convenience and accuracy of a machine together with the personal interaction of a human. The capability to overcome these technological and societal changes may determine the future survival of the two leaders in the ATM market.

Credit News

China's bill for debt binge coming due

Aug 6. China's corporate debt has surged towards 170% of GDP from 101% of GDP in 2008 with many bonds due for redemptions this year. Companies are facing USD 365bn of bond payments from August until the end of this year. There are at least 20 corporate defaults in the first seven months, matching the total number of defaults for the whole of 2017. The financial situation may worsen due to a depreciating Chinese yuan and escalating trade tension from the US. The yuan has depreciated 5.2% against the US dollar, which increases the risk for companies with large amounts of overseas debts. The government has cut taxes, loosened lending restrictions and increased infrastructure spending to stimulate the economy. (Nikkei)

Money managers are seeking shelter in the riskiest parts of CLOs

Aug 6. The amount of outstanding collaterised loan obligations (CLOs) increased 80 percent to more than USD 540mn this year as credit fund managers invest more in the equity tranches of collateralized loan obligations. During the credit recovery after the 2008 Global Financial Crisis, the tail end of many CLOs outperformed investment grade corporate bonds, junk bonds and other US asset classes. Fund managers expect the strong performance of CLOs to continue and are investing in CLOs as a way to ride out the next downturn. (Business Times)

House of Fraser's Chinese owner struggles with liquidity pressures

Aug 2. Sanpower Group Co, the Chinese real estate and department store conglomerate and parent company of UK department store House of Fraser, is facing liquidity pressures after a debt-fueled global acquisition spree. Sanpower Group has been trying to sell its stake in House of Fraser since 2016, but did not find a buyer. The Chinese conglomerate may have difficulty raising funds and meeting operational expenses. The failed attempts to sell House of Fraser and declining sales in the British retail sector has left the UK department store in struggling for survival. (FT)

PG&E slumps on prospect of wildfire-induced debt restructure

Aug 1. PG&E is said to be exploring debt restructuring options as the firm may incur wildfire-related liabilities reaching as high as USD 17.3bn. Financial damages from last years' Northern California wild fires may force the company to file for bankruptcy as investigators from the California Department of Forestry & Fire Protection found that equipment belonging to the company ignited 16 of the wildfires. The company is lobbying to change the inverse-condemnation provision which holds companies fully responsible for fire damages regardless of negligence. (Bloomberg)

Turkish banks propose rules to accelerate loan restructuring

Aug 1. The Banks Association of Turkey is proposing new rules to allow lenders to speed up the restructuring of company debt and avoid booking the problematic debt as non-performing loans. More than TRY 50mn of bad loans would benefit from the banking group's proposal, a move that would likely help borrowers with their debt obligations. A 23% slide in the Turkish Lira and high interest rates have affected the companies' ability to repay foreign debts and increased local borrowing costs to the highest level. The Association suggests a loan to be restructured if lenders with at least 75% of the total debt agreed to do so. According to the document, a committee of lenders could then order measures like changes to shareholder structure and management, asset sales, spin-offs and capital injections. Restructurings would be resolved within 150 days of an agreement being reached. (Bloomberg)

S&P and Moody's are about to be joined by a Nordic game changer (Bloomberg)

Israeli markets to get short-term boost from improved credit ratings (Reuters)

Mozambique bondholders are said to eye gas in restructuring (Bloomberg)

Regulatory Updates

Bank lobbyists seek to neutralize accounting shake-up

Aug 6. The Financial Accounting Standards Board (FASB) is proposing to change accounting rules, asking banks to recognize expected loan losses in a timely fashion. Banks say that the new rules would increase existing capital requirements and have asked bank lobbyists to call on regulators to limit the new reforms by the FASB. Proponents argue that the new rule would prevent typical risky lending practices before the crisis and require lenders to book potential losses when loans are originated using forward looking models. (FT)

China's central bank steps up effort to boost lending

Aug 1. After taking stimulus steps to boost economic growth, the People's Bank of China has loosened lending restrictions for banks in anticipation of a potential slowdown and US tariffs imposed on Chinese goods. Less than two years after a government initiative to curb risky lending practices and reduce the countrywide debt burden, regulators are making it easier for businesses to obtain bank funding. Lenders may have more capacity to lend but it is unclear if the measures would lower the record corporate default rate, which is at the highest level in three years. (Business Times)

Regulators probe options market's major clearinghouse (WSJ)

EBA publishes technical standards on risk retention for securitization transactions (EBA)

China crackdown on bad debt forces wave of loans on the market (FT)

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Contributing Editor: Dexter Tan