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Mothercare's turnaround plan hangs by a thread

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According to Company Watch, UK high street chains could be facing a financial distress greater than the 2008 crisis. Online competition, intense rivalry among retailers, rising interest rates, and wage declines played profound roles in significant sales deterioration, leading to poor results in December 2017. Maplin Electronics and the UK arm of Toys R Us have filed for bankruptcy administration early this month while Debenhams, Marks&Spencer, and the House of Fraser have ditched expansion plans, and speed up store closures to turn round their troubled brands. Meanwhile, the global retail leader for expectant mothers and children, Mothercare PLC is trying to complete its turnaround plan to offset its current negative outlook.

Mothercare's shares dived to a 14-year low after reporting significant half-year losses. The company's market value continued to fall after the company lowered its profit guidance in December and offered to waive its financial covenant in January. Sales during the December holiday season fell as the company chose not to cut prices in the run during Christmas. Amidst the softening UK and Middle East market, Mothercare is tapping on existing debt facilities up to their limits to complete its digital transformation turnaround plan.

The 5-years turnaround plan was initiated in 2015 with being a global digitally led business and higher income margin as the goal. This transformation program involved debt fueled investment in IT and digital, as well as stores refurbishment to generate meaningful sales growth in the future. In 2017, Mothercare renovated 214 stores to a new club format that provides specialty services to increase its brand value. Mothercare also grew its online presence to account for 42% of sales in the last twelve months. Closing the underperforming stores, which nearly halved its UK stores, was also part of the plan in Mothercare's digital age.

Financial Year	2013Y	2014Y	2015Y	2016Y	2017Y	2018H1 LTM
Revenue (GBP mn)	749.4	724.9	413.9	682.3	667.4	659.2
Net Income (GBP mn)	-23.8	-27.5	-15.4	6.4	8.2	-6.7
Change YoY like-for-like Sales (%)	-3.6	-1.9	2	3.6	1.1	2.5
Online % of Sales (%)	18	19	33	37	41	42

Table 1: Income statement data for Mothercare PLC. *Source: Bloomberg, Mothercare's annual report*

In the last two years, the business turned a profit for the first time in five years following the turnaround strategy. Furthermore, the positive growth in its like-for-like British division appears to be an indication of the company's successful recovery plan. In the last half year, UK like-for-like sales increased 2.5% with online sales gaining 5.3%. Mothercare currently generates around 42% of its turnover online, compared to just 19% three years ago, implying digital sales could exceed sales in physical stores in the future. Other than boosting online sales, the company's management is producing exclusive and specialty products, collaborating with celebrities and designers, and offering in-store consultations to win over competitors.

Fiscal Year	2013Y	2014Y	2015Y	2016Y	2017Y	2018H1 LTM
Cash from Operations (GBP mn)	4.0	1.3	-3.8	20.7	14.4	8.4
Current Ratio (%)	1.31	1.08	1.48	1.4	1.31	1.37
Cash & Short Investment (GBP mn)	17.6	17.3	31.5	13.5	0	1.3

Table 2: Financial Data for Mothercare PLC. *Source: Bloomberg*

Mothercare's 1.37 current ratio implies that the company has maintained a safe level of current assets to meet its short term liabilities. Over the last half year, Mothercare has increased its debt level by GBP 21.9mn, while its short term debt decreased by GBP 0.9mn. The company's cash and short investment stands at GBP 1.3mn and may be adequate to sustain its short-term operation. Despite GBP 15mn of its long-term debt maturing this November, Mothercare generated GBP 14.4mn of cash from operation in its last financial year, exceeding 96% of its maturing debt. This means, if Mothercare's turnaround plan hurdles the challenging market and increases sales with else remains the same, the company could cover its debt obligation. Considering the significant increase of cash through operations since Mothercare embarked on the turnaround plan in late 2015, Mothercare has a potential to overcome its weakening business.

The term structure of the RMI-CRI Forward 1-year Probability of Default (Forward PD) for Mothercare suggests that, based on the market information on March 16, the credit profile for Mothercare could improve gradually within the next few years. With Mothercare's turnaround plan ending in two years' time, the company could report higher profit and a smaller debt burden, although the firm's 1-year default probability is higher than the median for 10 UK fashion retailers. (See Figure 1) The Forward PD computes the credit risk of a company in a future period, which is interpreted similarly to a forward interest rate. For example, the 6-month Forward 1-year PD is the probability that the firm defaults during the period from 6 months onwards to 1 year plus 6 months, conditional on the firm's survival in the next 6 months.

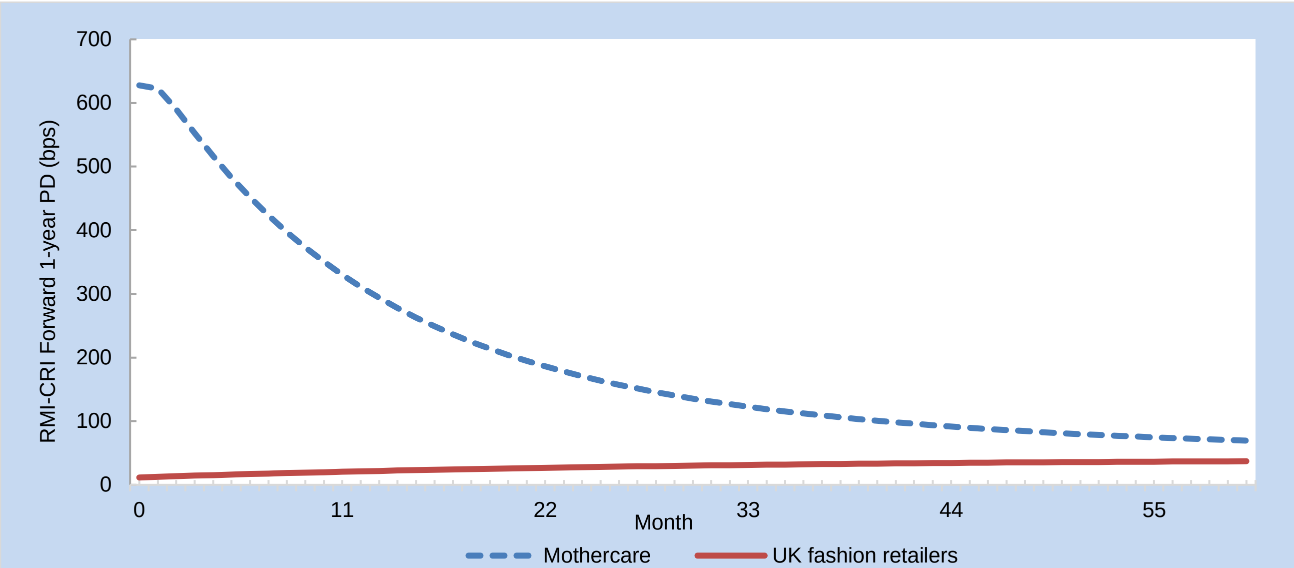

Figure 1: RMI-CRI Forward 1-year PD term structures for 10 UK fashion retailers and Mothercare on 16 Mar 2018. *Source: RMI-CRI*

Mothercare is seeking new financing to continue with its revamp program to improve sales. The retailer may need to regain market trust and build loyalty among consumers across all its platforms to generate more profit and liquidity. The turnaround plan that involves initiatives to appeal more customers and achieve higher brand value may help the company to escape from the current profit headwinds and improves its credit outlook.

Credit News

Egypt's debt loses the edge that attracted USD 20bn

Mar 19. Egypt's sovereign bonds are losing its investment appeal as the central bank considers cutting interest rates. Regulators have cut benchmark rates in February and observers say rates may fall further by another 400bps. The country's sovereign yields could fall to levels on par with other sovereign notes in Turkey, Argentina or Nigeria. Fund managers interviewed by Bloomberg say that the government could lower the 20 percent tax on foreign T-bill investors to prevent bond yields from falling in tandem with the benchmark rate cuts. (Bloomberg)

Noble Group braces for first bond default as pressure mounts

Mar 19. Noble Group (Noble) decided to default on a USD 379mn bond in a bid to preserve assets for the benefit of all stakeholders during the implementation its proposed restructuring plan. As a result of long-term trading losses and massive write-downs, Noble is now working on a USD 3.5bn restructuring deal to ensure survival. If the Trustee pursues insolvency proceedings against the commodity trader, its debt restructuring plan will be significantly affected. Meanwhile, Noble is racing against time to garner enough votes to support this plan. Furthermore, Noble also stated that it would not be paying the upcoming coupon for the USD 750mn tranche of bonds that matures in March 2022. (Business Times)

Largest US radio company iHeartMedia files for bankruptcy

Mar 15. IHeartMedia Inc (IHM) filed for Chapter 11 bankruptcy on March 20 in the midst of overwhelming debts and falling revenue. The company said it had reached an in-principle agreement with creditors to restructure a debt of more than USD 10bn, allowing the company to repair its capital structure. The reorganization would give lenders about USD 5.6bn in new debt and 94% of the equity in the resulting IHM structure. They would also receive IHM's 89.5% stake in its unit, Clear Channel Outdoor Holdings. IHM also specified that its subsidiary would not file bankruptcy and the cash available is sufficient to fund the bankruptcy process. Shares of IHM lost three-quarters of their value in the second half of 2015 and have never recovered since then. (CNBC)

Some holders of Etihad-linked USD 1.2bn bonds brace for default

Mar 15. Some holders of Etihad-linked USD 1.2bn bonds, which called Equity Alliance Partners (EAP) and issued in 2015 and 2016 through an Amsterdam-based special purpose, are seeking legal advisers to evaluate their options with respect to a potential default of the notes. In particular, the creditors are evaluating what actions they could take if the remarketing of the Alitalia and Air Berlin fails. Meanwhile, Etihad contemplates over these issued bonds, which lost over 25 cents on the dollar after troubles hit the two airline companies it partially owned. Regarding the debt repayment, some believe that a refinancing of the entire structure could occur while others think Etihad may buy the defaulted loans at par during the remarketing, given its previous commitment to cover Alitalia's debt portion. (Reuters)

Higher UK car-finance defaults add to consumer-credit risk

Mar 15. Default rates in UK car-finance market are rising, mainly driven by buyers with elevated credit risk, adding to regulators' concerns over the consumer-credit risks. British regulators are grappling with a surge in consumer credit, with dealership car finance growing at an average rate of about 20% a year since 2012, leading to an increase of more than GBP 30bn. The surge in car finance was a result of the popularity of personal contract purchase deals, where consumers pay a deposit and make monthly payments over an agreed period. There is a risk of complacency in the market with a small shock being easily absorbed but also holding a potential to cause a dire situation. However, the Financial Conduct Authority (FCA) said the firms are adequately managing these risks and the financial impact of such a fall would not materially affect their overall financial soundness. (Bloomberg)

EV Energy to file for bankruptcy to swap debt for equity (Reuters)

Yes Bank acquires 17.3% in Fortis Healthcare after credit default (Bloomberg)

IMF bailouts in Africa gain only marginal success (FT)

Regulatory Updates

UK's biggest banks face higher capital hurdles in stress test

Mar 16. Andrea Enria, the chief executive of the European Banking Authority has pushed back calls to regulate cryptocurrencies, stating that it would be more effective to prohibit financial institutions from holding and selling cryptocurrencies. Regulating fintech cryptocurrency firms would risk excessively constraining financial innovation as start-ups do not have the resources to shoulder the compliance burden. Fintech regulation in Europe should keep pace with laws in the US and China and be restricted to companies that are performing the same functions as banks. (Bloomberg)

Hedge funds seek fixes to credit default swaps after being stung by loopholes

Mar 13. According to the Bank for International Settlements (BIS), the recent volatility in global financial markets should not deter top central banks from increasing interest rates or ending years of unprecedented stimulus. BIS's latest report said that after such a long period of calm, there were bound to be more market wobbles, but policymakers need not have to fear such volatility along the normalization path. Even though the recent market correction wiped trillions of dollars off the value of global stocks, the turbulence has not alerted the broader economic and financial picture. Financial conditions remain unusually accommodative and credit markets have hardly budged. (Bloomberg)

Chinese Central Bank's Departing Chief Leaves a Legacy of Reform – and Debt (Bloomberg)

Euro zone bailout fund could play role in future debt restructuring: ESM head (Reuters)

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