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Sharp's restructuring is still far from a revival plan

by Justin Hsiao

Sharp Corp. (Sharp), a century-old Japanese electronics company known for its display panels for iPhone and liquid crystal display (LCD) TVs, saw its share price drop 27% on May 11 before it filed a net loss of JPY 222.35bn (USD 1.9bn) for the financial year ended in March on May 14. The company has experienced the third net loss in four years due to poor sales, stiff competition, and unfavorable domestic monetary policy. And it has pledged a turnaround plan on May 14 ranging from job cuts and cost reduction to the possible sales of its headquarter in Osaka. However, its mid-term plan was deemed to be too mild to solve the firm's devastating situation.

As shown in the left panel of Figure 1, the RMI 1-year Probability of Default (PD) of Sharp has been hovering around 40 to 70bps, which is at a really high level given its big size and as compared to its peers, Sony Corp. and Panasonic Corp., which had PDs of 5.16bps and 1.57bps respectively on May 15. The difference can be easily seen by examining the PD term structures of these three firms (shown in the right panel of Figure 1). Sharp's RMI 1-year PD recently had a surge on May 11 corresponding to its market plunge and a drop in its DTD, which is a volatility-adjusted leverage and a key variable in the RMI PD model.

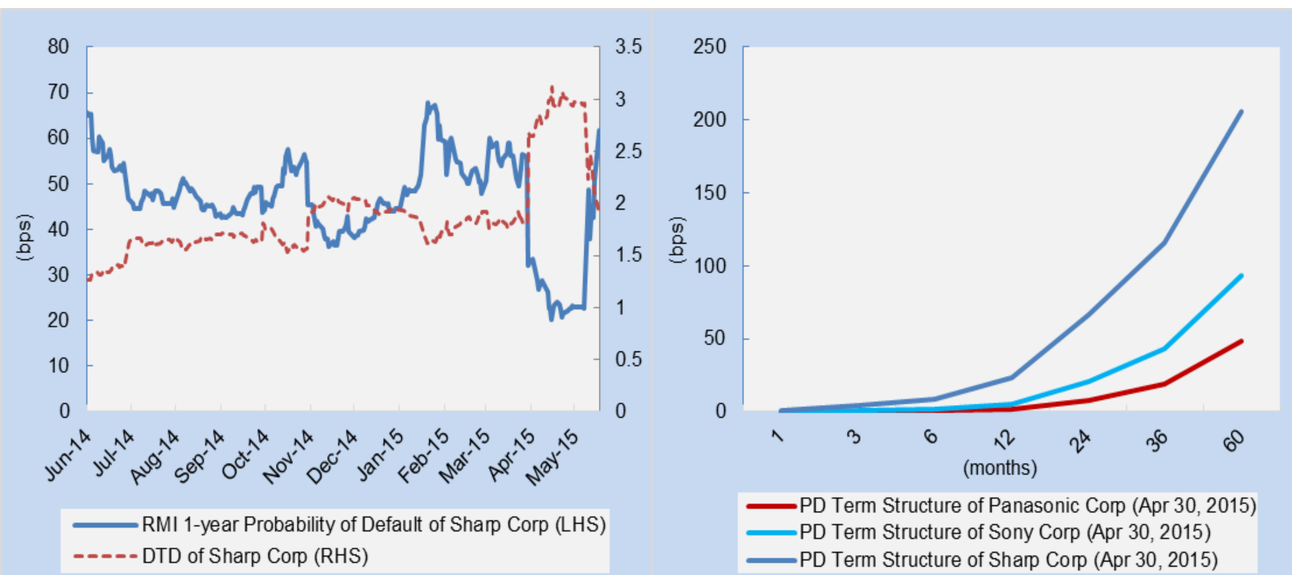

Figure 1: RMI 1-year PD and DTD of Sharp Corp and PD term structures on Apr 30, 2015 of Sharp and its peers. *Source: Risk Management Institute*

In its 2012 restructuring, Sharp had switched its focus from television and solar panels to small and medium-sized LCD. Right now, the LCD segment accounts for more than 30% of Sharp's sales and is its core business. Yet, Sharp's LCD segment, focusing on panels for smartphones and tablet computers is under pressure due to the falling price of panels as competition heats up and as low-cost Asian rivals gain a growing market share. According to IHS, a research firm, the average selling price of a 5-inch full high definition smartphone panel has fallen to below USD 30 from around USD 50 in 2013. In addition, Sharp's solar panels segment was hit by a global slump in demand amid cheap oil prices. According to the company's report, its net loss was partly caused by an impairment loss of JPY 103.5bn for LCD plants and a solar cell plant. Sharp also has had some trouble in its consumer electronics business. As the business has been hurt by the recent weakness of the Japanese currency. Sharp has a big share of the consumer appliance business in the domestic market, but makes many of those products overseas. It has difficulties to raise the prices at home to make up for the higher manufacturing costs abroad.

Table 1 tabulates some financial figures of Sharp. The company's market cap has been shrinking severely in FY 2014 and reached JPY 280.51bn on May 18. And its net income came into negative territory in three out of four quarters. Thus, the company's operating efficiency worsened substantially as its operating margin landed at -14.27% in the latest quarter, which was mainly driven by a decline in sales and the costs of restructuring according to the company. Besides, the company has accumulated a huge debt burden through the years. Its total debt to total equity ratio reached 2,286.14% in Q4 FY2014. According to the company's report, excluding its subsidiaries, total liabilities of JPY 1.57tn were more than total assets of JPY 1.56tn.

	Jun 30, 2014	Sep 30, 2014	Dec 31, 2014	Mar 31, 2015
Market Cap (JPY bn)	552.90	530.78	455.93	399.79
Net Income (JPY bn)	-1.79	6.53	-11.90	-215.19
Operating Margin (%)	0.75	3.47	2.89	-14.27
Total Debt / Total Equity (%)	512.31	404.74	387.90	2,286.14

Table 1: Credit metrics of Sharp Corp. *Source: Bloomberg*

The panel maker is trying to make its business stay afloat. Its latest restructuring plan incorporates axing 10% of its global workforce and the sale of its head office. Moreover, it will issue preferred shares to two Japanese banks, Mizuho Financial Group Inc. and Mitsubishi UFJ Financial Group Inc., which are its main lenders to reduce its debt stress. The banks already hold more than JPY 600bn loans of Sharp and will provide an additional JPY 200bn in financial support by buying preferred shares. Moreover, the firm will get additional assistance of JPY 25bn from Japan Industrial Solutions Ltd., a private equity fund that specializes in turning around troubled companies.

Although the injection of capital and cost reduction will buy some time for the troubled technology firm, most of the analysts think that the plan still falls short of required fundamental overhaul and is not enough to revive the firm's business. Like Sony Corp. and Panasonic Corp., which have sold off money-losing businesses and focused on more profitable niches, if Sharp wants to have a recovery and a sustainable growth, it still needs to make further structural reforms.

Sources:
Sharp shares plunge ahead of restructuring (WSJ)
End of the road for Sharp (CNBC)
Sharp warns on ability to stay afloat after USD 1.9bn loss (FT)
As smartphone panel prices fall, panel makers focus on cost reduction, IHS says (IHS)
Company's presentation on May 14, 2015 (Sharp)

Note: underlined text highlight revisions made on May 20, 2015

Credit News

Foreign creditors face bankruptcy riddle amid China slowdown

May 17. China's corporate bankruptcy law, finalized in 2007, is still evolving, and foreign creditors are uncertain about how the legal system treats their claims in the face of insolvency. According to lawyers based in Hong Kong, the courts are able to decide the priority of payouts to bondholders which often put foreign investors at a lower priority over onshore investors. It is unclear when the government is able to interfere in the payment priorities although the law does place onshore and offshore creditors on the same ground. Some investors who were burnt by the failure of FerroChina were paid back as much as 60 cents to the dollar while other investors did not receive a cent. China is slowing down and the number of bankruptcy cases is expected to increase, but the outcome of the legal proceedings would continue to be marred by political motivations. (Reuters)

Greece avoids default but still remains desperate for cash

May 15. Greece narrowly averted a default last week but continues to battle to keep itself solvent. Greece faces a punishing debt schedule in coming weeks as it owes another EUR 1.5bn to the IMF in June. The government ordered more than 1,000 municipalities, embassies and consulates to transfer their excess cash to the central bank but many have refused to obey the order, stating that it defies the fiduciary duty and the country's constitutional law. Some analysts said that the country's economic recession is likely to worsen as the payment liabilities will curb the government's spending on the economy. (Telegraph)

Rising bond yields challenge US equity valuations

May 14. The long-run US equity bull market has benefited from a long period of slumbering bond yields. However, the growth momentum is obviously slowing down. While the S&P 500 enjoyed a record closing level on Thursday, it stands 3% higher for the year. As equities have spun their wheels, attention in recent weeks has concentrated on rising US Treasury bond yields. Last week, Fed chairwoman Janet Yellen made two statements that valuations in the stock market were "quite high" and she warned that there was a risk of a "sharp jump" in longer term bond yields when the Federal Reserve raises short-term rates. Some see a link between bonds and equities and worry that lofty share prices look vulnerable. (FT)

Moody's compares Singapore's big three banks: DBS, OCBC and UOB

May 13. Credit rating agency Moody's said a number of differences among Singapore's three biggest lenders could lead to their different credit ratings over time. According to its report, the Big Three exhibit similarly strong financial fundamentals; namely robust asset quality, good capital adequacy levels, and healthy funding and liquidity profiles. Nevertheless, there are also differences among the three banks, such as: (1) their geographic mix; (2) their varying appetites for capital market activities; (3) their funding structures; and (4) challenges related to the introduction of Basel III rules. (Strait Times)

Major banks to delete records for some borrowers who filed for bankruptcy

May 13. Two top US banks are preparing to delete negative credit reporting records for some borrowers who filed for bankruptcy, after facing accusations of letting poor marks for unpaid debt haunt borrowers' credit even after the debt was canceled. In several lawsuits filed in the US Bankruptcy Court, banks are required to "promptly notify credit reporting agencies of any corrections" to their information. Mr. Carpinello, a lawyer who represents borrowers, said the banks' move could help people who got a bankruptcy discharge but didn't realize that their credit reports are being affected by older notices from a bank. Neither bank admitted wrongdoing, since the bank's reporting is "consistent with credit reporting agency policies". (WSJ)

JCB hit by slowdown in emerging markets (FT)

Moody's cuts Chicago's debt to junk (WSJ)

India confident of overtaking China's growth rate (FT)

Regulatory Updates

Fannie-Freddie overseer offers update on single-security plan

May 15. The federal overseer of Fannie Mae and Freddie Mac offered an update on an initiative that could transform a bond market powering the US housing. The Federal Housing Finance Agency released information on May 15 about how it is viewing feedback on its push to facilitate interchangeable trading of mortgage securities guaranteed by each of the taxpayer-backed companies. Some market participants have expressed concern that the effort could make a key type of mortgage-bond trading less liquid, exposing investors to new risks or unleash a difficult adjustment period. (Bloomberg)

Shelby's bill could free 25 midsize US banks from stress test

May 15. A bill introduced this week by Senate Banking Committee Chairman Richard Shelby, which would raise the minimum amount of assets for a bank to be designated systemically important to USD 500bn from USD 50bn. The Alabama Republican's bill could spare 25 mid-size lenders from annual stress tests and having to prepare living wills, exercises that cost banks millions of dollars a year. Wherever the bar is set, the bill would allow regulators to designate banks below that level as systemically important after an elaborate process that gives firms a right to appeal. (Bloomberg)

SEC finds more regulatory lapses in private equity exams

May 15. The US Securities and Exchange Commission is finding more regulatory lapses among private equity firms five years after gaining oversight of the industry under the Dodd-Frank Act. Only 6 large US banks have reached the bar now. Wherever the bar is set, the bill would allow regulators to designate banks below that level as systemically important after an elaborate process that gives firms a right to appeal. Moving the threshold won't necessarily mean all banks that fall under it will get relief, according to Brian Gardner, an analyst at Keefe, Bruyette & Woods. (Bloomberg)

Fake Avon filing puts spotlight on SEC (CNBC)

Basel guidance may burden credit unions (Credit Union Times)

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