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Micron Technology: Aided by favorable market conditions

By Yong Kit Siong

Micron Technology Inc., one of the largest US makers of memory chips, has surprised the market by posting stellar financial results for the latest quarter. That is in stark contrast with last year, when oversupply in the chip market troubled Micron's financial performance. The company's bottom line suffered and sailed into the negative region (see Table 1). Its RMI-CRI 1-year Probability of Default (PD) rose significantly, implying higher credit risk. However, since its nadir last year, Micron's market capitalization has been on an upward trend, rebounding by almost 195% within a year as investors regain confidence.

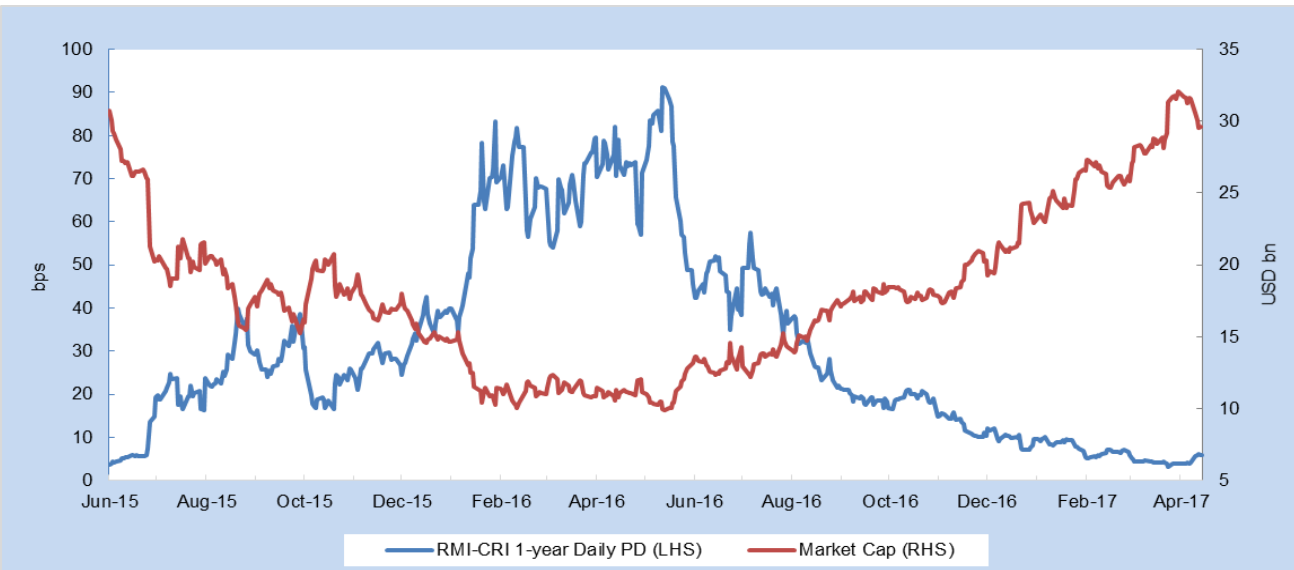

Figure 1: RMI-CRI 1-year PD (LHS) and market capitalization (RHS) for Micron Technology Inc. *Source: RMI-CRI, Bloomberg*

In the latest quarter, Micron's sales increased as a result of tight supply-demand conditions in the memory market. This increased sales come along with favorable Dynamic Random Access Memory (DRAM) prices. Revenue breakdown of Micron (see Figure 2) shows that DRAM and NAND flash (a type of non-volatile storage technology) are major segments of the company's business, contributing 63.7% and 33.8% respectively, to the company's business revenue. The numbers imply that prices of the DRAM and NAND flash memory chips could play a vital role to Micron's profitability.

Along with falling 1-year PD, Micron's operating margin has improved over the past three quarters. Micron attributed the better margins to improved sales performance. Particularly, in the most recent quarter, the firm saw a 21% QoQ increase in DRAM (its main product) average selling price and also a 1% QoQ increase in DRAM sales. As for NAND, Micron unfortunately saw a decrease in average selling price despite its volume increasing by 1%.

	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017
Net Income (USD mn)	-97.00	-215.00	-170.00	180.00	894.00
Operating Margin (%)	-0.17	-0.93	-0.99	9.04	22.46

Table 1: Financial metrics for Micron Technology Inc. *Source: Bloomberg*

Subsequently, as part of the company's cost reduction effort, the cost-per-bit of both DRAM and NAND have also gone down significantly in the latest quarter, recording a 6% and 15% reduction on a QoQ basis. The company claims 3D NAND (an innovative technology of Micron) advancement and smaller DRAM transistor migrations to be the critical operational factors that led to the lower costs. The reduced cost-per-bit increased Micron's gross margins for DRAM and NAND by 44% and 31% QoQ, respectively.

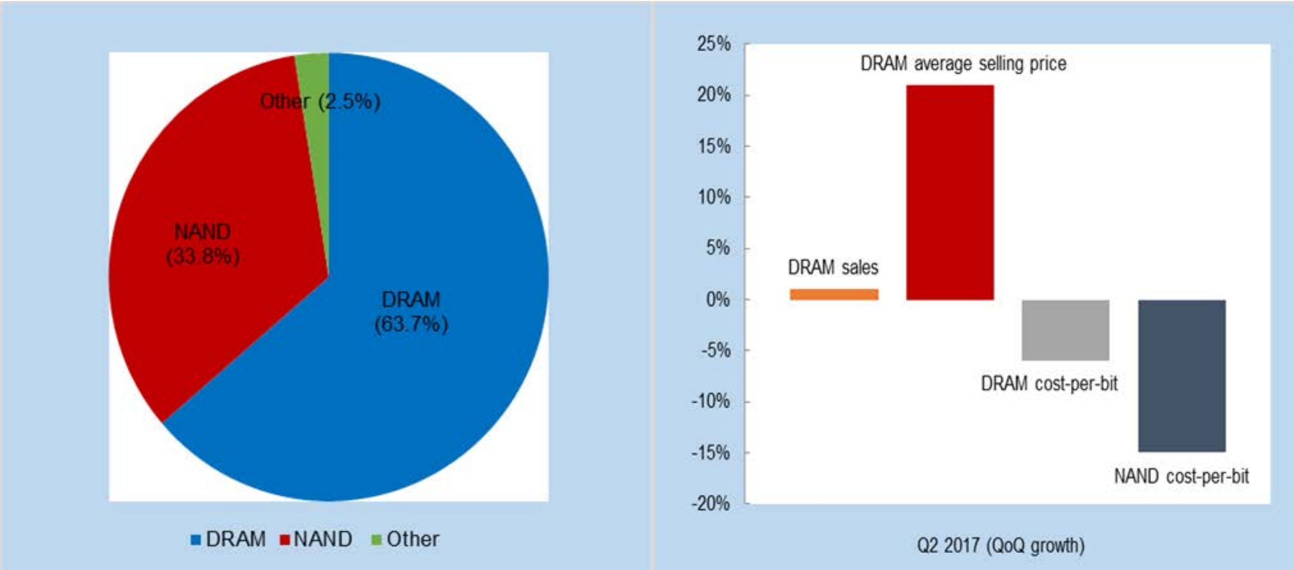

Figure 2: Micron's revenue breakdown and QoQ growth for various statistics, Q2 2017. *Source: Bloomberg, company report*

Looking forward, the firm expects the pricing environment to remain benign through the next quarter and continue to drive margin improvement. However, as the chip market is highly competitive, any significant market downturn can have an adverse impact on the company's bottom line. If its competitors such as Samsung Electronics decide to increase supply of memory chips, the price of memory chips will suffer a downturn. Therefore, despite recovering from its poor showing last year, Micron will still need to maintain prudent management policies to ensure long-term business stability.

Credit News

In South Korea, world's biggest shipbuilder gets bond rescue by pension fund

Apr 17. The world's largest shipbuilder, Daewoo Shipbuilding and Marine Engineering, managed to come to an agreement with South Korea's National Pension Service on the restructuring of its bonds. This decision comes after the Korea Development Bank and Export-Import Bank of Korea agree to convert 80% of their loans to Daewoo into shares and extend the maturity of the remaining loans by as much as 5 years. Daewoo owes the pension fund KRW 390bn and had a total debt of KRW 14.4tn as of December. Daewoo also posted its fourth consecutive annual loss in 2016 due to reduced demand for oil tankers and rigs. Daewoo would be meeting bondholders over the next few days and failure to win final approval would mean that the firm will be subject to mandatory court receivership and debt restructuring. (Straits Times)

Chesapeake digs deep to overcome its weaknesses

Apr 16. Chesapeake Energy established itself to become US's most active driller and second-largest gas producer by spending on drilling and completing new wells. Its growth was financed by banks and investors and it amassed a debt burden of USD 20bn as of Q4 2012. Chesapeake's prospects look bleak when gas prices crashed in 2011-2012. Doug Lawler signed up to be the chief executive in May 2013 to steer the company out of trouble. Mr. Lawler improved performance to make Chesapeake's operations more profitable and it is now one of the lower-cost operators in US shale industry. Net debt has also been cut to USD 10.3bn as of Q3 2016 and share price has almost quadrupled since February 2016. Despite this, Chesapeake still has a highly leveraged capital structure and is dependent on favorable commodity prices. A renewed slump in prices would likely affect Chesapeake's operation as it plans for its oil output to grow. (FT)

Takata rescue talks extended, even as bankruptcy risk looms

Apr 15. Potential bidders for Takata Corp – car-parts maker Key Safety Systems Inc (KSS) and Bain Capital LLC, have extended talks to purchase the company. Current negotiations for the company are already in their 14th month and are likely to run on until end May, sources said, after an informal, self-imposed end of March deadline to come up with a deal was missed. Recent talks have involved discussing an indemnity agreement to cover reimbursement costs for Takata's air bag recalls, believed to be as high as USD 10bn. However, automakers which have been sharing costs for the recalls dating back to 2008 want Takata restructured through a transparent court-ordered process, such as bankruptcy, which will effectively wipe out the firm's shareholder value. Takata has denied that it will seek some form of bankruptcy to protect itself from creditors. (Channel NewsAsia)

India's cash machines run dry again

Apr 14. After a demonetization move last November that caused a severely liquidity crunch, India's ATM machines are running out of banknotes again. Despite constant claims from the government that cash supply is back to normal, analysts say that the Reserve Bank of India, India's central bank, is slowing its currency printing too soon, with the number of banknotes in circulation being only two-thirds of what they were before demonetization. The rate of increase in money supply was 5.9% in the week to January 13, while it slowed to 2.8% in the week to February 24. ATM operators have also noted that bank branches are hoarding notes to serve their own customers, rather than distributing them across the country. Since ATM withdrawal limits were removed in March, people also started withdrawing more cash, while supply has not moved much. (FT)

China credit growth accelerates as shadow banking gauge picks up

Apr 14. China's new credit increased more than estimated in March especially in shadow banking. New loans slowed for a second month to RMB 1.02tn while the money supply increased 10.6%, the most sluggish pace since July. The acceleration implied there is a long way for Chinese policy makers to ease financial and property risks after big cities rolled out home purchase curbs. The central bank's tightening has slowed the increase of aggregate financing although at a pace slower than the market expected due to the strong demand for financing. (Bloomberg)

IMF more upbeat about global economy this year than in 2016 (Straits Times)

China's economy grows 6.9% in Q1, slightly faster than expected (Straits Times)

Regulatory Updates

European banks may face USD 128bn capital cap as Basel bites

Apr 13. The Basel Committee on Banking Supervision is putting the final touches to the Basel III post-crisis capital rules which is setting stricter standards for how lenders estimate the riskiness of their assets. With the new regulations, banks need to raise more capital. According to McKinsey & Co. the new regulations may force European banks to plug a capital shortfall of USD 128bn and banks in Sweden, Denmark, Belgium, the Netherlands and Ireland will be impacted the most. (Bloomberg)

Indonesia bailout fund too small for bank restructuring mandate

Apr 12. Indonesia's bank deposit insurance agency, LPS, is thinking of ways to bolster its IDR 75tn war chest as there are talks that its current funds are insufficient for its new mandate of restructuring banks in addition to bailing out depositors. Plans are being proposed for LPS to implement a new premium on top of current fees paid by Indonesian banks to the agency. The premiums paid may be dependent on the riskiness of the banks. LPS's new mandate include the ability to restructure troubled banks by transferring their good assets to other institutions and focusing on resolving the bad assets. It can also issue bonds to the central bank in the event of a crisis. (Business Times)

Fears mount over US construction boom (FT)

Detention of China regulator heralds clampdown on insurers (FT)

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