Feature of the Week

US apparel manufacturers gain growth momentum, PD improves

By Justin Hsiao

Apparel manufacturers in the US have positive growing outlook, meanwhile, their credit profile is better than the aggregate US market. In terms of industry revenue and market capitalization, the top three apparel design and brand licensing companies in the world, VF Corp (VF), Ralph Lauren Corp (RL), and PVH Corp (PVH), are all well-known owners of global apparel brands. VF owns brands like The North Face and Timberland; Ralph Lauren specializes in offering American lifestyle clothing; PVH's major brands are Calvin Klein and Tommy Hilfiger. Even though, they are international brands, the domicile sales still remain the main strength to the companies. In 2013, domicile sales accounted for 62.4% to VF's revenue, 66.9% to RL, and 59.7% to PVH.

Figure 1 (LHS) shows that the annual revenue in 2009 (the year after the 2008 financial crisis) slightly dropped for all three companies. After that, they enjoyed a stable revenue growth every year. By the end of 2013, VF and RL's annual revenue had grown 34% and 39% in the last five years. PVH experienced an exceptional 98% annual revenue growth compared to 2008.

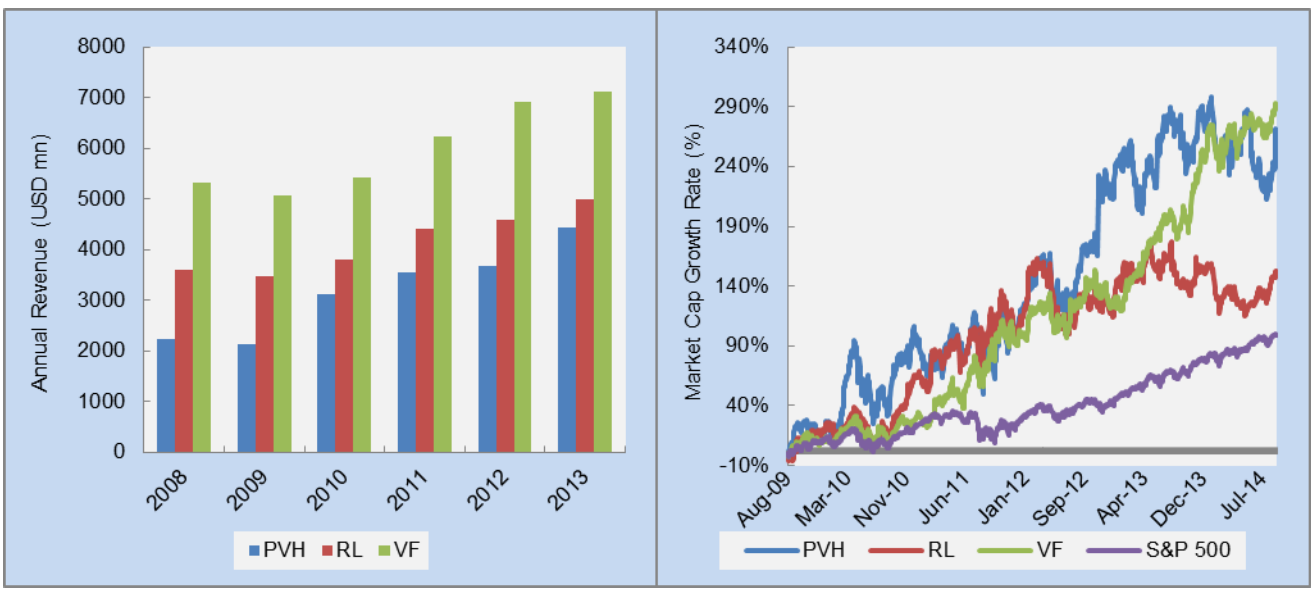

Figure 1: Annual revenue from North America and Canada for VF, RL, and PVH (LHS); Market capitalization growth rate of S&P500, PVH, RL, and VF since five years ago (RHS) Source: *Bloomberg*

US stock market provides strength for apparel makers to grow as well, illustrated in Figure 1 (RHS). The stock price growth of three main apparel companies has outperformed S&P 500 since Aug 2009. Until now, S&P 500 has a near 100% growth, and it just stands at the record high of 2,000 recently. However, the three biggest market cap stocks, VF, PVH, and RL, have grown even more- VF by 292%, PVH by 270%, and RL by 152%. The revenue and capital market momenta give US apparel companies advantage to expand through issuing capital or engaging in M&A activities, i.e., VF had an all-cash takeover of Timberland Co. on Sep 14, 2013; RL PVH bought Tommy Hilfiger Corp for EUR 2,300mn on Mar 15, 2010 and unified the Calvin Klein under one umbrella on Feb 13, 2012.

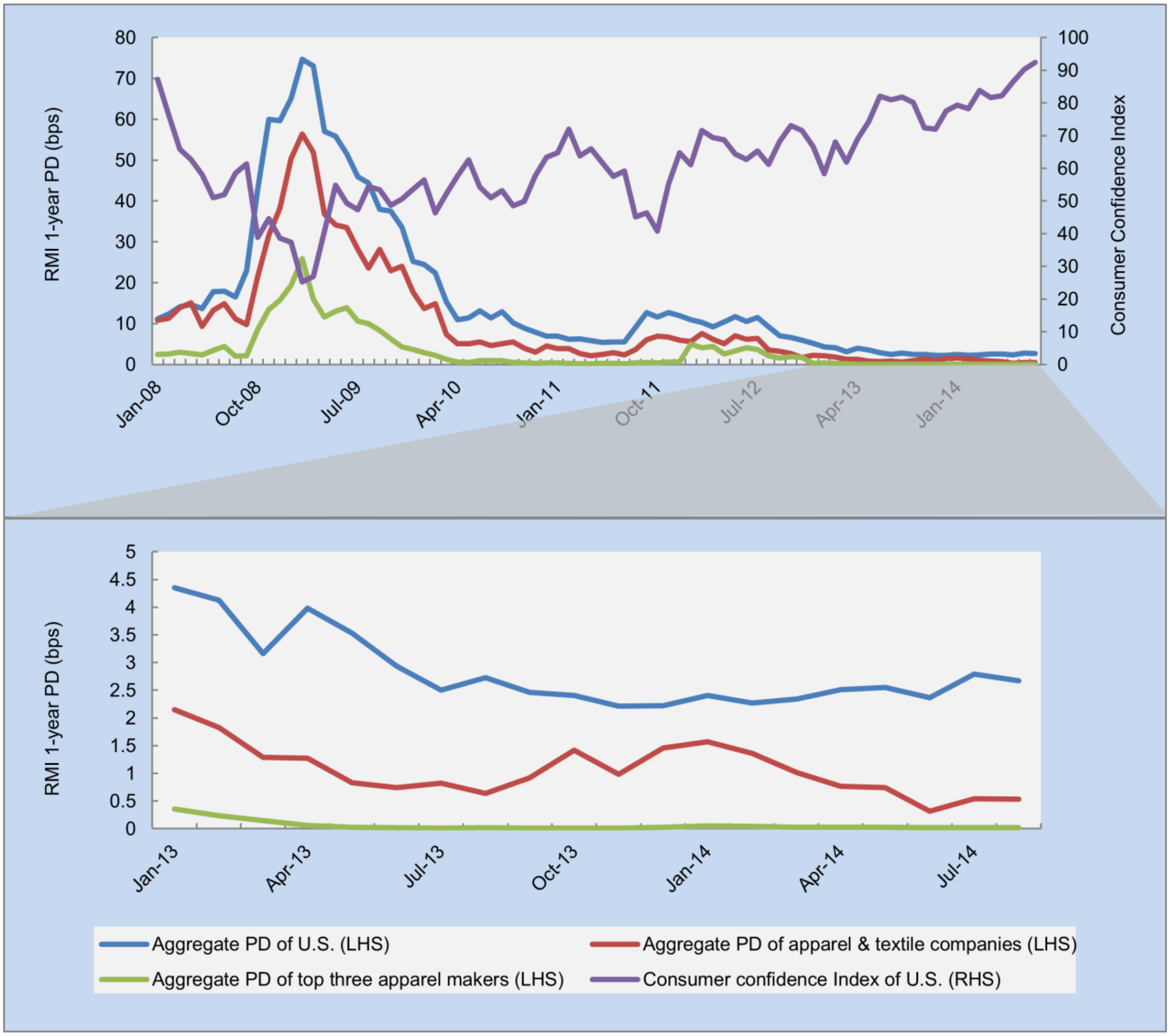

Figure 2: Aggregate PD for US, 56 apparel & textile companies in US and main three apparel companies in US Source: *Risk Management Institute, Bloomberg*

RMI 1-year Probability of Default (RMI 1-year PD), which tracks 60,000 listed firms globally, is a forward-looking view of the probability of default over the next year, based upon market and fundamental data. According to Figure 2, the RMI 1-year PD of the big 3 apparel manufacturers in the US demonstrates upside trends at the beginning of the 2008 due to the financial crisis. At the same time, during that period, the consumer confidence index of US dropped from 87.32 to 25.3. After a slew of economy boosting stimulus, i.e. three rounds of quantitative easing, the consumer confidence has since risen to 92.4 on Sep 4, 2014 from its low of 2008 and inversely the RMI CRI noticed that their 1-year PDs have decreased. Another interesting fact is that, during this period, the PD for US top 3 apparel companies is better than the median PDs for 56 US apparel and textile companies and the overall US listed companies- PD flat for the US apparel makers since 2013 at close to 0.

Credit News

China's big five banks will likely raise USD 20bn in preparation for Basel III

Sep 08. For the implementation of Basel III norms, the five biggest Chinese state-owned banks will need to raise up to USD 20bn in additional capital by the end of 2014. China's banking sector is struggling with a slowing growth in profitability, heightened concerns about a vulnerable property market and rising non-performing loans. Raising additional capital in the current challenging environment could prove difficult for the banks. (China Money Network)

Citigroup sees trading revenue slump easing

Sep 08. Trading revenues from equity and fixed income for Citigroup and other banks is expected to be flat in Q3 2014 as against last year when the investor sentiment was hurt with expectations that the Federal Reserve would move to raise interest rates sooner than expected. The bank says that the third quarter may show the first signs that trading revenues may be improving. It is also expected that the quarterly revenue from investment-banking would to be stronger than a year earlier. (The Wall Street Journal) (Subscription)

CoCo market seen swelling to USD 80bn on banks' review

Sep 04. The CoCo market is likely to increase by 50% to USD 80bn by this year as a result of the stress tests and asset quality review in the coming weeks. The contingent capital bonds, which include additional Tier 1 securities, are created to push the burden of policing the banks on to investors by forcing bondholders to pay for collapses. Although the CoCo bonds are risky for investors, their eagerness for the coupon offered by the additional Tier1 securities mean that they do not care too much about the risks. Banks can include additional Tier 1 bonds as capital when they calculate their regulatory leverage ratio, which is used by regulators to prevent lenders gaming capital as a percentage of risk-weighted assets. (Bloomberg)

Regulatory Updates

Islamic banks face challenge from Basel III deposit regulations

Sep 08. Banks all over the world are gearing up to meet tough Basel III regulations, Islamic lenders face uncertainties as to how regulators will treat their deposits. Islamic banks seem to be able to cope with these tough rules in most aspects except for the deposit bases as Islamic banks obtain most of their deposits from the more volatile profit-sharing investment accounts (PSIAs). Islamic banks would be required to offset that volatility by increasing the amount of high-quality liquid assets (HQLAs) which are in short supply. Thus, many Islamic banks will depend on the weights or "run-off rates" to meet this challenge. The treatment of PSIAs also depends on factors specific to the Islamic banking industry in each country. (SCMP) (Subscription)

US regulators tweak final liquidity rule for large banks

Sep 03. In a new rule adopted by the US regulators on Sep 3, more than 30 of the biggest US banks will be required to add an aggregate USD 100bn more in cash or cash-like assets than they currently hold. As a first amongst more such measures planned, regulators in US want to ensure that banks are capitalized enough to cover 100% of their net cash outflows for 30 days during periods of economic stress. On the flip side, during normal times increased capital reserves will likely depress the banks' ability to lend or invest and potentially drag down bank earnings and even the broader economic growth prospects. (The Wall Street Journal) (Subscription)

RBI revises Basel III capital requirements

Sep 02. The Reserve Bank of India (RBI) has made amendments on non-equity regulatory capital instruments under Basel III, allowing banks to issue tier II capital instruments to retail investors and halving the minimum maturity of Tier II capital instruments to at least 5 years. Additional Tier 1 capital instrument is also allowed with the principal loss absorption through either conversion into common shares or write-down mechanism. However, there is now a provision which requires these instruments to be either written off permanently or converted into common shares upon reaching the point of non-viability (PONV) and ensures the eligibility of non-common equity capital instruments before issuance. (Business Today)

Banks to get ECB test results a month early

Sep 01. The European Central Bank (ECB) intends to release the preliminary results of its assessment on the banking industry, which will force banks to acknowledge their weaknesses, adjust their capital buffers and write off soured loans to regain investors' trust. This would allow banks to plan any necessary measures. After the release of the preliminary results, banks will have up to 48 hours to submit questions and raise issues with the ECB. (Reuters)

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