Hopes dim for Sharp amid Japan's TV industry sunset

Tim Kelly, Reuters

Sharp Corp shares tumbled nearly 30 percent to their lowest closing level since 1976 on Friday as investors questioned whether Japan's last major maker of television panels will survive the sunset of the country's TV industry.

A day after the century-old company warned of an operating loss of 100 billion yen ($1.28 billion) for this fiscal year, Moody's and Standard & Poor's cut their credit ratings and rival Fitch warned that Sharp could lose investment-grade status unless a planned restructuring succeeds.

Sharp's mounting losses, a symptom of Japanese TV makers' increasing uncompetitiveness against rivals from South Korea and elsewhere, leave it scrambling for a fresh cash injection.

Analysts say its future may hinge on whether Hon Hai Precision Industries, the flagship of Taiwan's Foxconn Group, is willing to increase its investment in the ailing firm. S&P in its report cited that relationship as one of the factors it will consider when deciding whether to cut its BBB rating another notch to the last rung of investment grade.

"Sharp has been helped by Hon Hai, they may need more help," said Yuuki Sakurai, CEO of Fukoku Capital Management, the asset management unit of Japan's Fukoku Mutual Life Insurance. "Japan's TV makers are just relying on their past legacies. As long as they depend on TV they will face tough competition."

Revealing expectations for an operating loss this business year of 100 billion yen and announcing 5,000 job cuts, its first in six decades, the maker of Aquos TVs on Thursday insisted it retained the backing of its main banks, Mizuho Financial Group and Mitsubishi UFJ Financial Group.

Investors were unconvinced and dumped the stock, which slid 28 percent on Friday to 192 yen, its lowest level in 36 years and cutting the company's market capitalization by more than $1 billion to $2.72 billion.

Share collapse

Sharp, which got its start 100 years ago making mechanical ever-sharp pencils from which it derived its name, declined to comment on the share collapse.

Adding to Sharp's woe and handicapping its ability to raise fresh funds, Moody's Investors Service on Friday cut the company's short-term debt rating from Prime-2 to Prime-3, the lowest investment grade.

Moody's cited "concern that the company's operating performance and additional restructuring costs will continue to pressure its cash flow downwards, thereby increasing its dependence on external sources for liquidity".

Those external sources so far include Hon Hai, which in March agreed to buy into the ailing TV maker.

S&P's decision to cut its rating came after the Japanese company on Thursday expanded its annual net loss forecast to 250 billion yen from 30 billion yen.

The net loss of 138 billion yen in the three months ended June 30 has already taken a big chunk out of Sharp's capital. Its shareholders' equity ratio slumped to 18.7 percent from 23.9 percent at the end of March, falling below the 20 percent threshold generally considered to be healthy.

"With Sharp's losses growing to this level, there's barely going to be any net capital left," said Makoto Kikuchi, CEO of Myojo Asset Management in Tokyo.

Waning demand

Like rivals Sony Corp and Panasonic Corp, Sharp has been hammered by waning global TV demand and aggressive overseas competitors led by Samsung Electronics that are grabbing a bigger slice of a shrinking pie. Sony's stock fell 7 percent on Friday to 897 yen, its lowest since 1980, while Panasonic was off 3.8 percent.

Combined, the three Japanese TV makers this business year expect to sell around 10 million fewer TVs than they did the previous year.

While Sony has movie studios, an insurance business and a gaming unit, and Panasonic builds batteries and automotive devices that can offset TV losses, Sharp, which invented transistor calculators and pioneered LCD TVs, has fewer options to retool.

Underlining a looming cash crunch, Sharp's credit default swap spreads - the cost of insuring its debt against default - have been widening since February, with the 5-year contract currently at an all-time high of 833.3/1000.

In the past month the CDS curve has shown a dramatic inversion, which means it is now more expensive to buy insurance against default for shorter maturities than longer maturities.

Such an inversion is usually seen in small, fragile companies.

"The availability and cost of credit will be affected if lenders continue to be concerned about the company's prospects," Fitch said in a report Friday.

Sharp's next financing hurdle is a 200 billion yen convertible bond that matures in September next year. It was issued in October 2006 when the stock was trading above 2,000 yen at a conversion price of 2,531 yen.

"They'll get support from the banks and get through their immediate funding concerns... but they're going to have to do some equity financing to strengthen their capital base," Myojo's Kikuchi said.

Hon Hai help?

One option for Sharp could be to seek more investment from fellow Apple Inc supplier Hon Hai.

In March it agreed to buy a 46.48 percent stake in Sharp's LCD plant in Sakai in western Japan. Much of the company's losses stem from the underutilized facility.

Hon Hai also agreed to purchase new Sharp shares worth 66.9 billion yen, giving it an 11 percent stake in the Japanese company. Hon Hai has yet to stump up the money for that deal, in which it agreed to pay 550 yen for each new share.

Speculation has swirled that the Taiwanese company may renegotiate given the fall in Sharp's share price, and it said in a statement on Friday that Sharp had agreed it did not need to honor the deal.

"Due to the volatility of Sharp Corporation's share price, Sharp Corporation agrees our company does not need to honor the share purchase agreement signed on March 27, but Sharp Corporation will still reserve the right for our company to purchase the same percentage of shares," Hon Hai's statement said.

Sharp's president, Takashi Okuda, had said on Thursday that Hon Hai would honor the deal at the agreed price.

In June, when Sharp's shares were trading above 400 yen, Hon Hai Chairman Terry Gou told an annual general meeting the firm was in talks with Sharp about increasing its stake. Local media later reported that Hon Hai hoped to seek a board membership in Sharp.

Although saddle with ballooning losses, Sharp remains an attractive partner for Hon Hai because of its research into new technologies such as next generation ultra thin high definition screens and advanced manufacturing processes it has honed at Sakai, the world's most advanced LCD plant.

Sharp, however, may not be easy to woo despite its ballooning losses. Okuda told his company's shareholders at their annual gathering in June that there would be no more capital coming from Hon Hai and that there was no plan to invite Gou or any of his executives to join Sharp's board.

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