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Weekly Credit Brief Apr 21 - Apr 27 2020

The traditional media and entertainment sector's credit quality further deteriorated amid the COVID-19 headwinds

by Li Mengyan

The global economy is now suffering from headwinds due to the COVID-19 outbreak. The traditional media and entertainment sector[1], which was already vulnerable before the pandemic due to the competition from the internet-based new media industry, has seen its credit quality further deteriorated amid the weak consumer spending, stagnant economy and low market confidence since the beginning of the COVID -19 outbreak. Nearly every segment in the traditional media and entertainment sector has been upended by the pandemic: businesses such as casinos, theatres and clubs, which rely heavily on out-of-home venues, social gatherings and in-person staffing, have been shut down, while televisions, radio providers and newspapers-publishers have reported a slippery advertising revenue. According to NUS-CRI Probability of Default Implied Ratings (PDiR[2]), over 52% of firms in the traditional media and entertainment sector have PDiR lower than or equal to BB+ as of April 2020.

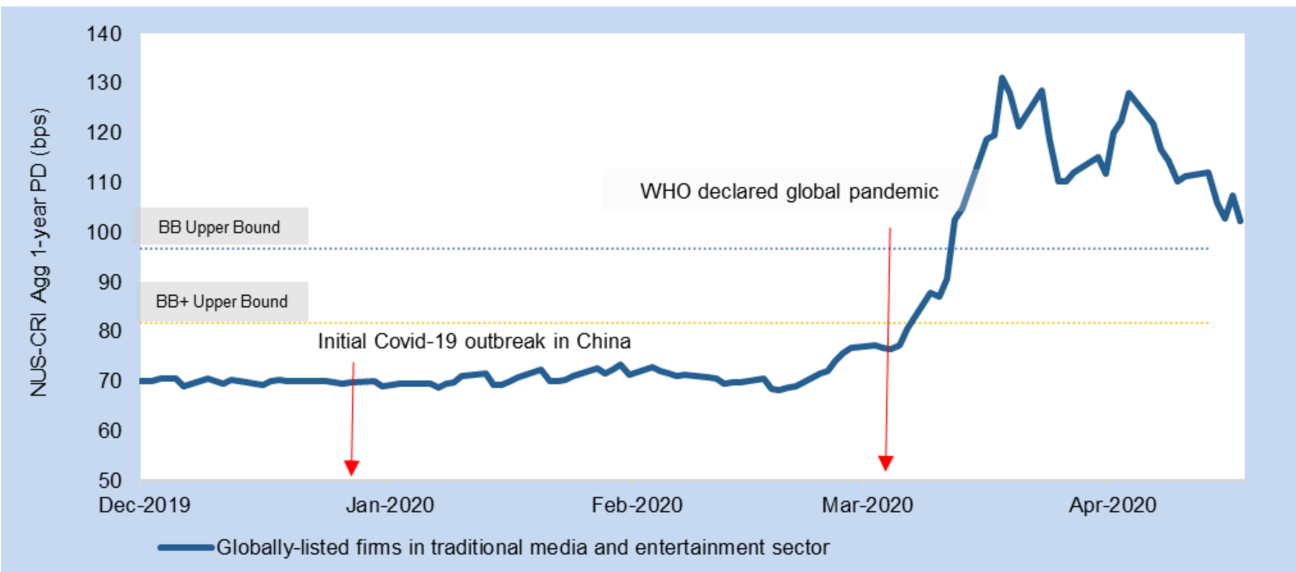

Figure 1: NUS-CRI Aggregate 1-year PD for globally listed firms in the traditional media and entertainment sector from Dec 2019. *Source: NUS-CRI.*

As indicated by the NUS-CRI Aggregate (mean) 1-year Probability of Default (Agg PD) shown in Figure 1, the Agg PD of the traditional media and entertainment industry has remained stable in Jan and Feb 2020, when the COVID-19 spread was mainly limited within China. In the initial phase of the COVID-19 outbreak, firms in the traditional media entertainment sector located outside China were merely affected through supply chain disruption due to the factories close-down in China, which did not affect their credit profile significantly in the short run. Starting from late Feb, the rapid spread of the coronavirus in Europe and the US then made the traditional media and entertainment firms suffering from a sharp decline in domestic consumption. The sector is heavily affected by the worldwide cancellation and postponement of events or projects. Correspondingly, the Agg PD has increased significantly since late Feb 2020,

[1] The traditional media and entertainment sector is composed of subsectors includes theatres, music, gambling, lottery services, casino services, professional sports, night clubs, television, cable TV, publishing-books, publishing-newspapers, publishing-periodicals, radio, broadcast services and multimedia. Internet-based media and entertainment firms are not included.

[2] The NUS-CRI Probability of Default Implied Rating (PDiR) provides a more conventional interpretation of PDs – it translates NUS-CRI 1-year PDs to letter ratings by taking reference from the historically observed default rates of S&P's rating categories.

rising from 70bps to 130bps in Mar. While the Agg PD has shown a downward trend since the beginning of April, it still remains at a level far higher than the pre-pandemic period.

Even before the COVID-19 outbreak, the traditional media and entertainment industry were already vulnerable. It had the highest downgrades by credit rating agencies in 2019 among all other sectors. The traditional media and entertainment sector has been facing increased competition and audience fragmentation from those internet-based firms providing media services. Firms in the traditional media and entertainment sector have invested significantly to differentiate services and increase subscribers, further weighing on margins. The recent pandemic exacerbated the weaknesses in this sector. Specifically, the global film industry is estimated to lose USD 5bn this year as films are retracted and cinemas remain closed. Ticket sales in Q1 2020 fall 45%, USD 4.7bn down on the Q1 average for the past three years. Televisions, radios and broadcasting services providers are suffering from a drop in advertising revenue, which is their primary revenue source. Despite more indoor audiences after the lockdown of business, people do not spend much money and advertisers have slashed budgets or blocked their promotions.

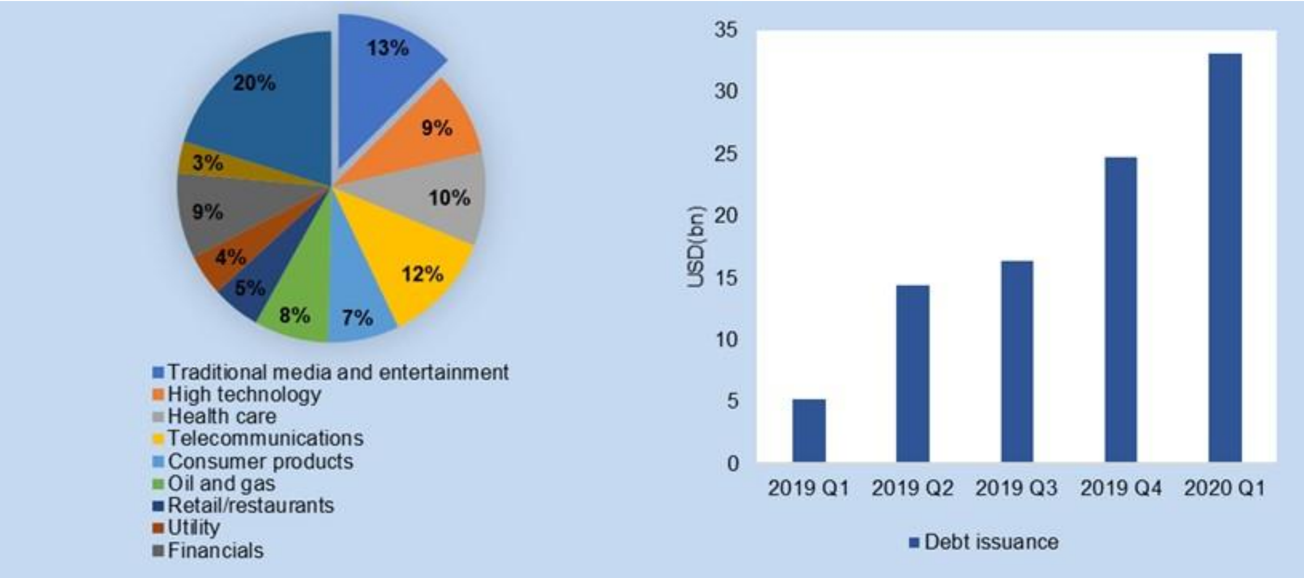

Figure 2a&b: The outstanding amount of junk bond issued by the globally domiciled firms in the traditional media and entertainment sector as of 2019 (LHS); the amount of debt issuance of the traditional media and entertainment sector by quarter (RHS). *Source: Bloomberg*

The traditional media and entertainment sector is the largest sector that issues junk bond, and it has witnessed 67 downgrades of issuers by S&P ratings in the first quarter of 2020, which is the highest among all sectors. It has seen its total debt pile up and there is in all USD 8bn of bonds issued by the traditional media and entertainment sector maturing by the end of this year. Figure 2b shows the increasing amount of debt issued by the traditional media and entertainment industry over the previous few quarters, with the latest quarter seeing the highest debt issuance since last year. Among all the bonds issued by the traditional media and entertainment industry, over 61.8% of them are rated as junk bonds according to S&P Global. In the midst of the current business difficulties, the traditional media and entertainment firms are seeking to raise funds to shore up their balance sheet. For example, ViacomeCBS, an entertainment giant, has offered USD 1.25bn worth of debt securities on the market in order to repay existing debt and fulfill liquidity needs in March. However, since investors embrace risk aversion in fear of the uncertain oil price and virus transmission, there was a massive sell-off of risky bonds in March, which led to significantly widened yield spreads of high-yield bonds as shown in Figure 3.

Responding to the crisis, governments around the world have taken actions to support the bond market and inject liquidity. In the US, the Fed has announced an unprecedented decision to purchase exchange traded funds that own high-yield debt in April, sparking the biggest rally in junk bonds in more than a decade. US also approved a USD 2tn coronavirus stimulus package, which relieved the traditional media and entertainment industry to some extent. This might contribute to the recent decline of the industry's Agg PD as shown in Figure 1. In April, AMC Entertainment, the world's biggest cinema chain operator, has successfully raised USD 500mn of cash by issuing junk bond with 11% yield. However, most of the Fed's junk-bond intervention is limited to companies that were rated investment grade on March 22 when the program was introduced. Since most of the companies in the traditional media and entertainment sector were already rated below investment-grade, they would still have problem in raising fund. Investors are still staying in risk off mode, as the option adjusted spread (OAS) of the Bloomberg Barclay's US High Yield Index – Media and Entertainment over US Treasury still remains elevated, despite dwindling from the peak.

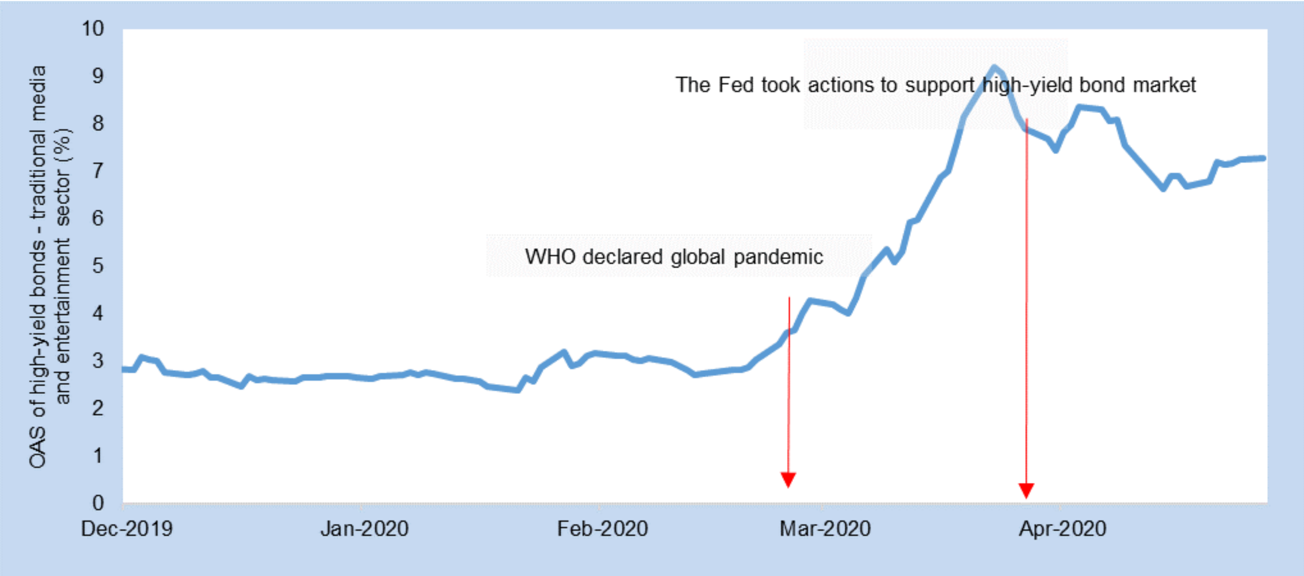

Figure 3: The OAS of the Bloomberg Barclay's US High Yield Index – Media and Entertainment from Dec 2019. *Source: Bloomberg*

Looking forward, the credit outlook of global traditional media and entertainment firms shows a gradual improvement. The near-term credit outlook still remains gloomy and default risk is high, while the long-term credit outlook improves considerably, as tracked by the NUS-CRI Aggregate (mean) Forward 1-year Probability of Default (Forward PD)[3] in Figure 4. In the short run, the slumped economy and stagnant revenue are still pressuring the traditional media and entertainment sector. While in the long run, the Forward PD will drop back to the pre-pandemic level, since they will have had survived from the recent tough times and the market would regain confidence amidst the gradual opening-up of outdoor activities and businesses. However, even after the coronavirus pandemic, the intense competition from new media firms would still exist, and some internet-based media giants might swallow up firms in the traditional media and entertainment sector, which imposes threat to the traditional firms. These continuous threats of existence might necessitate the traditional media and entertainment sector to find new ways to survive in the midst of internet transformation.

[3] The Forward PD estimates the credit risk of a company in a future period, which can be interpreted similar to a forward interest rate. For example, the 12-month Forward 1-year PD is the probability that the firm defaults during the period from 12 months onwards to 1 year plus 12 months, conditional on the firm's survival in the next 12 months.

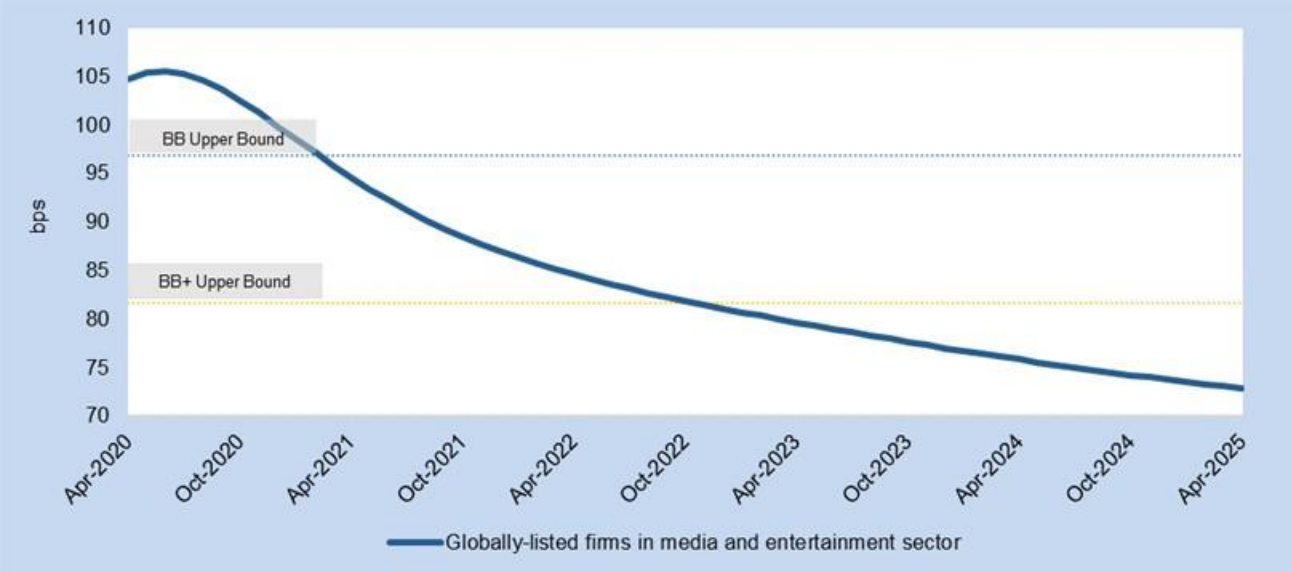

Figure 4: NUS-CRI Aggregate Forward 1-year PD of globally listed firms in the traditional media and entertainment sector based on information available in Apr 2020. *Source: NUS-CRI*

Credit News

Contagion risks build in India's credit market after fund freeze

Apr 27. India's credit markets were jolted late last week as Franklin Templeton decided to wind up USD 4.1bn of Indian debt funds, which immediately sent corporate borrowing costs soaring and the spread on one benchmark index rising to a seven-year high. According to a former chairman of the Securities and Exchange Board of India, other mutual funds are also facing huge redemption requests like Franklin Templeton. The problem of the mutual fund industry could swiftly migrate to the entire financial services industry and might then soon spread to the real economy. (Bloomberg)

US banks pull back from lending to European companies

Apr 24. It has been observed that American lenders are hesitant in underwriting bilateral and syndicated loans to European clients in recent weeks. JPMorgan, Bank of America, Goldman Sachs have withdrawn and reduced loans to borrowers from the region- in the first quarter, the combined market share in syndicated loans in Germany by the five largest US banks fell more than a third. In difficult times, many banks begin showing home bias to reduce risk and regional exposure, but this comes at the expense of foreign borrowers. Although some German companies are seeking alternatives such as government-backed loans from state-owned development bank KfW, such arrangements also require the support of their existing lending groups, which consists of American banks. Thus, this puts these German companies in a tough position. (FT)

China to step up reform of banks hit by coronavirus

Apr 22. Small and medium-sized Chinese banks, which already struggled with high levels of bad debt before this crisis, are especially suffering in the aftermath of the Covid-19 outbreak. The economic shock can lead to worsened credit quality problems as borrowers cannot repay their loans. Therefore, financial regulators announced reforms to restructure China's banking system and root out unfit shareholders by vetting bank shareholders to identify those that did not meet regulatory requirements. The regulator's announcement came after Bank of Gansu, whose Hong Kong-listed shares collapsed by more than 40 percent on April 1, seemed to be in need of a state-backed-bailout. (FT)

Investors adapt to 'new normal' on corporate bond trading

Apr 22. Captured by the bid-ask spread on dollar-denominated investment-grade corporate bonds, the costs of trading corporate debt in the US high-grade bond market remain at 7.3bps, which is about three times the average in the weeks before the Covid-19 crisis. Spreads in other fixed-income sectors such as European investment-grade debt and emerging-market dollar debt also remain elevated. However, the intervention of central banks helped to narrow the bid-ask spread from their highest levels in March. For example, the US Federal Reserve announced to buy investment-grade as well as high-yield corporate bonds for the first time. (FT)

Banks tighten credit on Asia oil traders as Hin Leong losses add to woes

Apr 21. Several banks are tightening credit and stepping up scrutiny on existing loans to oil trading companies following the crash in global oil prices and the news of financial problems faced by major traders. One of Asia's largest oil trader, Hin Leong Trading Pte Ltd (HLT) recently revealed the loss of hundreds of millions of dollars and this sparked many banks to review all existing and new credit lines to commodities traders in Asia for fear that the oil plunge could bring further defaults in the region. Meanwhile, traders have also scaled back their activities as credit and liquidity tightens affecting the smooth flow of commodities. In addition, the pandemic also reduced fuel demand causing a double whammy in the oil industry. As such, the oil industry will shrink and trading firms must be prepared for a credit squeeze. (Reuters)

BoE warns bank loan reserves risk choking business funding (FT)

Japan insurers go big on credit abroad as Fed revives market (Bloomberg)

Junk bond market gushing with deals despite historic oil drop (Bloomberg)

Regulatory Updates

ECB loosens collateral rules to accept 'fallen angel' bonds

Apr 23. To limit the financial turmoil that might be caused by a wave of credit rating downgrades, the European Central Bank has changed its rules to accept "fallen angel" bonds that lose their investment-grade credit ratings to maintain banks' access to its ultra-cheap liquidity during the coronavirus crisis. It had decided to also temporarily exempt bonds that are downgraded to junk status from its requirement that any collateral it accepts has an investment grade rating. Its loosened collateral rules will remain until September 2021. (FT)

Bank of Japan flags coronavirus risks to financial stability

Apr 21. In its semi-annual Financial System Report, the Bank of Japan identified three significant risks to the Japanese financial system: higher credit costs during the protracted downturn, losses on security investments and foreign currency funding problems. However, the central bank also stated that the country's financial system is and will also remain to be stable. In the short term, the Bank of Japan's priority is to make sure banks keep lending so that the surge in demand for working capital can be met. Furthermore, the Japanese government extended an emergency state to the country and pledged to give every citizen a one-time payment of JPY 100,000 (USD 930). (FT)

BOJ removes cap on Japanese government bond purchases (Nikkei Asian Review)

ECB predicted to beef up asset purchases with shift into 'junk' bonds (FT)

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