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Gannett wrestles with the age of digitization

by Yong Kit Siong

In the new age of global digitization, organizations worldwide have to adapt to changing consumer behavior and the newspaper business is no exception. Gannett Co Inc., the largest US newspaper publisher by total daily circulation is facing headwinds as readers and advertisers increasingly migrate to digital platforms. Since 2005, total US newspaper advertising revenue has steadily declined from its peak of USD 48bn to USD 14bn in 2015 (see Figure 1, left).

Against the backdrop of this technological change, Garnett completed two acquisition deals this year to diversify beyond traditional print media and drive towards a digital future. The USA Today Network, a plan by Gannett to unite its local and national brands under one group, serves as a selling point to advertisers its ability to spread messages. Under the plan, the companies bought over were Journal Media Group (for USD 250mn) with its affiliated digital assets and ReachLocal (for USD 175mn), which is an online marketing company. With the acquisitions, Gannett hopes to revamp itself by capturing more digital advertising revenue, instead of solely relying on old-fashioned print advertising. Unfortunately, Gannett's effort for business diversification has not been smooth sailing.

In November 2016, the company terminated plans to buy Tronc, which owns the Chicago Tribune and the Los Angeles Times. The completed transaction would have added big-city newspaper brands with a national reach to Gannett's portfolio. The negotiation of the deal, however collapsed when bankers financing the deal made unexpected withdrawals as the proposed valuation, a 149% premium to Tronc's share price in April 2016 was too high. Gannett's core business metrics could not justify the post-transaction leverage either.

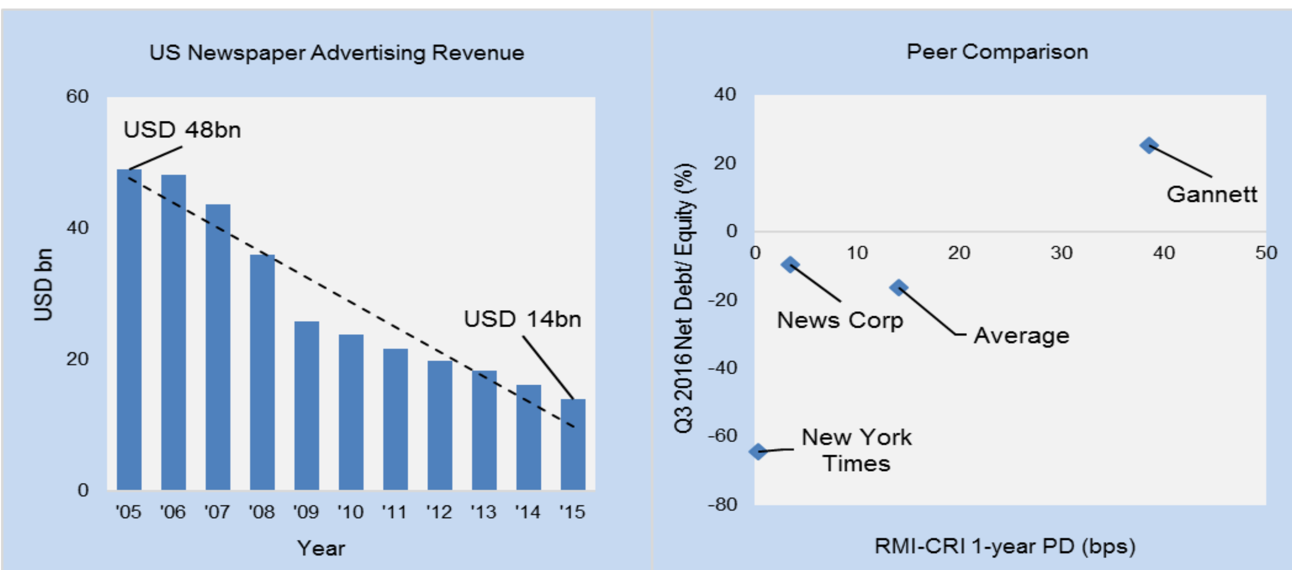

Figure 1: US newspaper advertising revenue (left); Comparison of Gannett against key industrial peers: PD data (as of 30 Dec 2016), leverage data (Q3 2016) (right). *Source: Bloomberg, RMI-CRI*

When compared with other listed newspaper publishers such as News Corp and the New York Times (see Figure 1, right), Gannett's credit risk is significantly higher. According to the RMI-CRI 1-year Probabilities of Default (PDs) on Dec 30, 2016, Gannett is eight times more likely to default than its peers in 12 months. In addition, Gannett's net debt to equity ratio, a measure of a company's leverage, is considerably higher based on results released in the latest quarter. The reason for such high leverage is because Gannett took on USD 425mn of loan for the completed acquisitions, while its cash position is merely USD 117mn in Q3 2016. On the contrary, News Corp and New York Times had negative net debts at the end of September 2016, meaning that their cash balances exceeded their debt obligations.

Even as Gannett has been expanding its portfolio with a string of M&A deals, the publisher's core business suffered losses in Q3 as advertising revenue fell 11.7% and circulation dropped 6.4%. Gannett reported a net loss of USD 24.2mn as the newspaper company recorded millions of dollars in new expenses amid recent acquisitions. The restructuring and severance costs related to these deals were reported to have hurt the company's bottom line in the latest quarter. Similarly, the company's EBITDA margin, decreased significantly both on a QoQ and YoY basis in the latest quarter.

	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016
Revenue (USD mn)	701.2	739.3	659.4	748.8	772.3
Operating Expense (USD mn)	184.9	163.8	189.6	218.6	238.6
Net Profit/ Loss (USD mn)	39.2	20.4	31.3	12.3	-24.2
EBITDA Margin (%)	11.48	8.42	11.03	7.34	0.91

Figure 2: Financial metrics for Gannett Co. Inc. *Source: Bloomberg*

As consumers turn to digital platforms for information, traditional forms of newspapers may become obsolete one day. Fast changing innovation in the industry has disrupted the journalism model of the past and incorporated changes along the technology and marketing areas of the publishing value chain. A willingness to experiment with new digital print methods and flexibility to adapt to changing consumer behavior, will likely be the drivers that determine whether a publisher survives or falters. If Gannett can monetize its acquisitions and keep operating costs down, perhaps Gannett can get out of its current predicament.

Credit News

RBI's warning as Indian banks' bad loans hit 14-year high

Dec 29. India's banking industry, especially those in the dominant state-run sector, have hit a 14-year high for its gross bad-loan ratio causing a strain on their capital buffers and profitability. The biggest culprits are the state-run lenders as they have the lowest ratio of capital to risk-weighted assets among bank groups with negative returns on their assets. Weakness in the banking sector would be a roadblock for Prime Minister Narendra Modi, who is looking to revive credit growth in order to ensure continuous growth in India's economy. According to the International Monetary Fund earlier this year, India's banking system was among the most vulnerable as loan growth slowed and bad debts rose. (Bloomberg)

Troubled Chinese nuclear project illustrates Toshiba's challenges

Dec 29. Toshiba's ambition to make nuclear power a focus of its future has stumbled into a road block, as the company announced that it could book a loss of up to USD 4.3bn on its Westinghouse Electric Co. subsidiary. Its AP1000 reactor, built in Sanmen, a town south of Shanghai has been beleaguered with many design and structural issues, resulting in delays. The nuclear reactor is currently at least three years behind schedule. The Japanese conglomerate's stock has fallen over 40% this week, with this disclosure coming as the company aims to move past a 2015 accounting scandal. State Nuclear Power Technology, which is partnering Westinghouse to build 4 AP1000 reactors, has said it was committed to working to resolve the issues. (WSJ)

Corporates lead surge to record USD 6.6tn debt issuance

Dec 28. Global debt sales reached a record high in 2016, led by companies gorging on cheap borrowing rates. More than USD 6.6tn of bonds were issued in the first half of the year with company debt accounting for more than half of total issuance. The prospect of higher interest rates instigated fears that debt burdens will be harder to bear in 2017. Moreover, there are question marks growing over the future of bond-buying programs from the BoJ and the ECB. (FT)

Singapore defaults seen as bellwether for Asia distress in 2017

Dec 28. According to restructuring specialist Hogan Lovells Lee & Lee, "Singapore is a bellwether for the larger ASEAN and Asian region." He added that "some of the fundamental problems those industries face won't go away" with "many of the companies in the commodities sector have high levels of debt and depressed revenues." In 2016, five companies, which includes oil services firms Swiber Holdings Ltd. And Swissco Holdings Ltd., defaulted on nearly SGD 1bn worth of bonds. KPMG stated that defaults could widen to include Singapore's developers after a plunge in home prices. Furthermore, China's overheated housing market cooled in November following renewed buying curbs rolled out by authorities. (Bloomberg)

Brazil's Temer to veto bill easing states' debt: official

Dec 28. The Brazilian president's chief of staff office stated that Brazillian President Michel Temer will go against a bill that grants distressed states a temporary relief of their debts to the federal government. The veto follows the scrapping of a clause in the bill that forced states to adopt tough austerity measures for debt relief. According to a presidential aide, the Brazilian government aims to work on a new bill to re-establish austerity measures, which includes a freeze on wages and an increase in pension contributions. (Reuters)

Bankruptcy becomes an option for some borrowers burdened by student loans (WSJ)

Peabody extends debt deadline amid creditor support (Reuters)

Peer-to-peer lenders morph into traditional banking (FT)

Regulatory Updates

Compliance costs a new, growing worry: Poll

Dec 29. Operating costs and manpower-related issues are the top worries for companies but companies are also becoming increasingly worried about compliance costs according to the Singapore Business Federation survey. Government regulations is cited as a key challenge ahead of issues like access to finance, technological change and disruption. Businesses are hoping for more government assistance and short-to medium-term support to tide over the slowing economic growth. (Straits Times)

Deutsche Bank 2017 capital requirements lowered in ECB review

Dec 27. The European Central Bank's (ECB) Supervisory Review and Evaluation Process (SREP) has lowered Deutsche Bank's minimum phase-in common equity tier 1 (CET1) ratio for 2017. The German lender must now maintain a ratio of only 9.51%, down from the current requirement of 10.76%, and the bank's last reported ratio of 12.58%. The announcement will likely alleviate concerns about the bank's capital, which peaked last week when it reached a USD 7.2bn settlement to end US investigations into its practices of underwriting and issuing mortgage-backed securities from 2005 to 2008. Banks in the euro zone have also seen their minimum CET1 ratios fall, as the ECB replaced a portion of its binding requirements with non-binding guidance in dictating the ratios. (Bloomberg)

Trump's financial deregulation might be bad news for banks after all (WSJ)

Chinese M&A boom faces regulatory checks (FT)

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Contributing Editor: Victor Liu