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AMC Entertainment Holdings' precarious route to beat competition

By Liu Hanlei

AMC Entertainment Holdings (AMC) stormed from being the second-largest in the US to be the world's largest movie theater chain after its year-long USD 3bn acquisition binge of Carmike Cinemas in the US, Odeon and UCI Cinema Holdings in Europe, and Nordic Cinemas in the Nordic region. The acquisitions are a result of Wang Jianlin's ambition, who owns 58% of AMC through Dalian Wanda Group, to increase his conglomerate's share of global market cinema to 20% by 2020. AMC's share performance suffered, down 35% from its peak in Mar 2017, from a slow summer box office in the US and a potential move by Hollywood studios to make their new movies available in homes sooner.

AMC derives 65% of its total revenue from the US market and the summer season typically generates the highest grossing receipts across the year. However, in recent two years, the US box office revenue witnessed a consecutive summer slump as it dropped 7.7% between May and mid Jul 2017 as compared to last summer. It has only posted two positive weekend-to-weekend receipts so far this summer, mainly due to less impressive movie sequels. In addition to the summer slump, Hollywood studios are eyeing to release movies to home users 10 days after its debut on the big screen. As the home entertainment business declined 7% in 2016 to USD 12bn followed by a 6% drop in 2015, Hollywood studios are desperate to find new revenue streams. Analysts are expecting this move by Hollywood studios to release movies quicker after its theatrical debut to affect 15-25% of movie theaters' earnings.

Netflix, a subscription-based video streaming service company, is also expected to shake up the movie industry just like what it has done for the TV industry, thus putting pressure on movie theaters. Netflix achieved strong subscription growth over the past quarters and had reached 100mn subscribers by Apr 2017. The strong growth pace of Netflix highlights the threat of disruption to the business environment of movie studios and theaters.

Aside from the bleak industry prospect, AMC's acquisition binge has made it higher levered, as its net debt to equity ratio increased from 121.4% in Q3 2016 to 176.2% in Q1 2017. The EBITDA/interest expense also dropped from 4.8x to 2.9x in the same period. The effect of its acquisition also affected its bottom line. In its Q1 2017 earnings release, AMC reported a net income of USD 8.4mn in Q1 2017, much lower than USD 29mn in Q4 2016 due to a USD 40.3mn of M&A expenses. Given the tough business environment and the resultant disappointing financial results, the RMI-CRI 1-year Probability of Default (PD) for AMC rose from single digit in the beginning of this year to 178bps in late July 2017, exhibiting a deteriorating credit profile.

	Q1 2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017
Net Income (USD mn)	28.3	24.0	30.4	29.0	8.4
Net Debt/Equity (%)	119.8	118.4	121.4	210.3	176.2
EBITDA/Interest Expense (x)	4.4	4.4	4.8	2.8	2.9

Table 1: Financial Data for AMC Entertainment Holdings. *Source: Bloomberg*

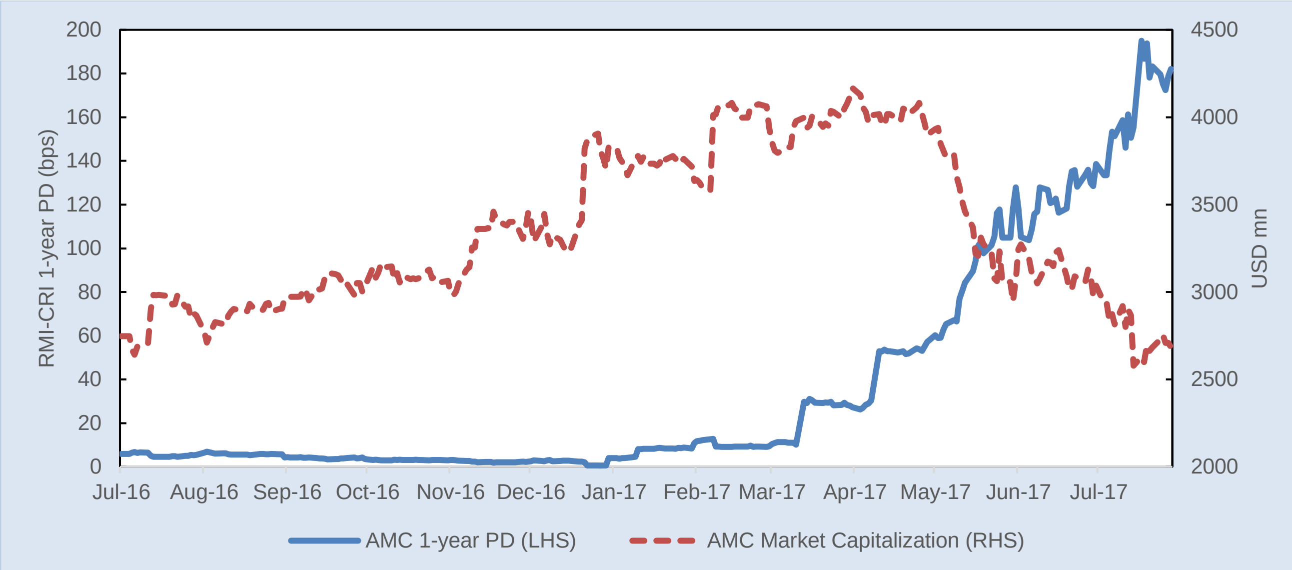

Figure 1: RMI-CRI 1-year PD (LHS) and market capitalization (RHS) for AMC Entertainment Holdings *Source: RMI-CRI, Bloomberg*

Its major shareholder, Wanda, is also embroiled in a crackdown from the Chinese government related to its overseas investments. AMC's purchases of Sweden's Nordic Cinema Group Holding AB and US Carmike Cinemas Inc. have been highlighted as deals that have flouted Chinese rules, according to people familiar with the matter. The Chinese government plans to cut off some funding to Wanda after breaching restrictions on overseas investments. Even though AMC has clarified that it used its resources to finance these transactions, analysts have cut AMC's price target reflecting the risk that it may not have a financing partner going forward.

In order to compete and provide a better movie experience, AMC is rejuvenating its cinema offerings such as introducing recliner seats, enhancing food and beverage offerings and expanding to premium large format experiences to boost its margins. However, these investments come at a cost as the capital expenditure is projected to be USD 700 - 750mn for 2017 as compared to USD 421mn in 2016. The expected capital expenditure also constitutes more than 10% of its projected 2017 revenue potentially leading to lower free cash flow.

Faced with new entrants and disruptions in this mature industry, the leveraged position of AMC put itself in a tight spot. Fortunately, AMC has diversified globally and has undertaken investments to improve its cinema offerings, which might help relieve some negative impact of the headwinds.

Credit News

Singapore-dollar bond market still robust despite Nam Cheong default

Jul 28. Singapore dollar bond prices remain strong despite the SGD 365mn default by Nam Cheong, another offshore support vessel-focused group that has become insolvent. The default on Nam Cheong means 13 Singapore dollar bond issues worth SGD 2.5bn have gotten into trouble since 2015. Nevertheless, investors are unfazed because the liquidity has been improving and the debt woes of the oil and gas and offshore sectors are by now well documented. Nam Cheong's default has not rattled the market as much as it was within investors' expectations. (Business Times)

Santander cuts back lending amid Bank of England concern over personal debt

Jul 28. In response to Bank of England warnings about reckless lending and complacency over mounting consumer debt, Santander UK reduced its mortgage lending and its loans for car purchase. The bank's total mortgage lending fell by GBP 1bn to GBP 11.6bn in the first half of 2017 compared with 2016. The action was reflected in Santander's pledge not to make further rate cuts to its hugely popular 123 account. Net consumer finance lending, which covers car loans and credit cards, fell to GBP 97mn from GBP 266mn. Nathan Bostock, Santander UK chief executive, mentioned that the risks of car loans are nothing to be worried about since, compared to the GBP 1.3tn mortgage market, the unsecured lending market is valued at only GBP 60bn to GBP 70bn. Also, non-performing loans stood at just 0.48% of the unsecured book of lending and mortgage arrears remained low. (The Guardian)

Noble Group default risk flares as warning deepens crisis

Jul 27. Noble Group's crisis escalated as Moody's flagged an elevated risk of default after the embattled Hong Kong-based commodity trader warned of a quarterly loss of as much as USD 1.8bn and announced more asset sales. Noble Group has been under siege for more than two years, marked by vast losses, mounting concern it will default and accusations it inflated the value of some contracts, which it has denied. Although the company said, it would dispose of its oil-liquids business to help address its short-term liquidity, Moody's is concerned that the resultant substantial reduction in its scale and global reach could challenge its ability to reshape its business model and generate profit and cash flow to service the remaining debts. (Bloomberg)

Percentage of SME debt paid on time at 2-year low

Jul 27. According to credit information company DP Information Group (DP Info), the percentage of debt held by Singapore small and medium-sized enterprises (SMEs) that was paid on time fell to 37% - the lowest in two years - in the second quarter of this year. However, the percentage of debts unpaid after 90 days remained at 14%. DP Info concludes that this reveals SMEs are taking longer to pay a debt, rather than experiencing an inability to make payment. It might be likely that SMEs are holding on cash to fund growth and inventory. It may have an impact on the overall cash-flow position of the SME community as the creditor company may also slow down its payment to companies it owes money to if the phenomenon continues for several quarters. (Straits Times)

Seadrill says likely to file for bankruptcy

Jul 27. Filing for Chapter 11 bankruptcy seems inevitable for Seadrill as it delayed the restructuring of USD 14bn in debt and liabilities once again. The deadline for Seadrill's comprehensive restructuring plan has been extended to September 12 after the company reached an agreement with its bank group. Stakeholders of Seadrill consist of more than 40 banks along with bondholders and several rig-building yards. The restructuring plan will involve heavy losses and impairments to bondholders and other stakeholders, while shareholders are likely to receive a minimal recovery for their shares. Seadrill had previously issued a warning in April that the value of its shares would almost be wiped out and potential bankruptcy proceedings will affect its bonds. (Straits Times)

Pimco pulls in USD 50bn active cash as investors drawn to new star (FT)

Sembcorp Marine Q2 profit halves to SGD 5.6mn (Business Times)

OCBC shares hit record as return to equity climbs to highest in 2 years (Straits Times)

Regulatory Updates

Independent directors have no impact on banks' risk-taking

Jul 31. A major study has found that the post-crisis push to hire additional independent directors has no impact on institutions' risk-taking. Banks still have identical risk of failure and risk of major losses regardless of the proportion of independent directors on their boards. The opinion of the Basel Committee on Banking Supervision (BCBS) on appointing certain numbers of independent directors to carry out effective oversight was questioned by experts in risk management consulting. They believe that the number of independent directors appointed does not really matter as long as the banking regulation is perfectly organized and systematical. These experts also noted that the key to risk management ultimately boils down to establishing sound corporate and risk culture, which is the responsibility of all board directors and not just independent directors alone. (FT)

Mnuchin heaps pressure on Congress before September 29 debt deadline

Jul 29. The US Treasury Secretary, Steven Mnuchin, is putting more pressure on lawmakers to raise the government's borrowing limit to avoid a debt default. Mnuchin estimated the government will not have enough cash flow to pay its bills by September 29 and urged lawmakers to raise the limit before Congress's summer recess. The previous political showdown on debt ceiling in 2011 saw US on the brink of default and led to a downgrade of the country's credit rating. The Congressional Budget Office expects the Treasury to fund the government through early to mid-October and the Treasury has been employing special accounting maneuvers since March to stay under the current borrowing limit. Meanwhile, the suspension of investments in federal pension plans will continue as a temporary measure to stay under the debt cap. (Bloomberg)

China insurance regulator vows stricter supervision (Xinhua)

China's top banking regulator to enhance risk control (China Daily)

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