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Weekly Credit Brief Feb 19 - Feb 25 2019

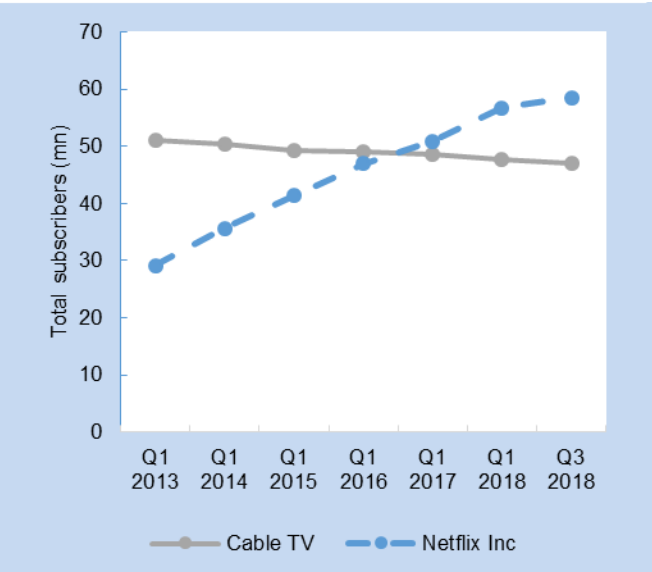
US cable TV firms face increasing challenges from Netflix

By Anthony Prayugo

In recent years, US cable TV firms are increasingly being challenged by Netflix, a company that provides streaming service that allows customers to watch films and television programs on internet connected devices. After reaching its peak in 2000, US cable TV firms' subscribers have slowly declined over the years. In the first quarter of 2017, Netflix's US subscriber base finally overtook cable TV's base (see Figure 1a), boasting around 50.85mn subscribers as compared to the approximately 48.61mn that US cable TV firms had.

Many customers are leaving their cable TV subscription and switching to Netflix for both convenience and affordability. Despite the relatively flat wage growth in the US, prices for cable TV subscription has grown around 74% since 2000. Today, an average cable TV bundle could cost a customer around USD 105 per month, much higher than Netflix's basic plan that cost user USD 7.99 monthly. From 2013, Netflix also produced many critically acclaimed original TV shows which further enticed customers to leave cable TV for Netflix.

As Netflix received a steady influx of new subscribers over these past few years, its revenue grew on average, 30.3% every year since 2015. On the other hand, Comcast Corporation, US largest cable TV firm by subscribers' number, saw its cable revenue increased 5.7% each year during the same period. Netflix's operating margin also had an increasing trend during the last 4 years while Comcast and Charter's virtually remained unchanged (see Figure 1b). Comcast and Charter currently dominate the cable TV sector by having around 80% of the total cable TV subscribers in US. The robust outlook on both Netflix's revenue and profitability cemented investors' bullish view on its stock, driving its market capitalization upwards by more than 17x from USD 9.2bn in January 31, 2013 to USD 158.5bn in February 22, 2019.



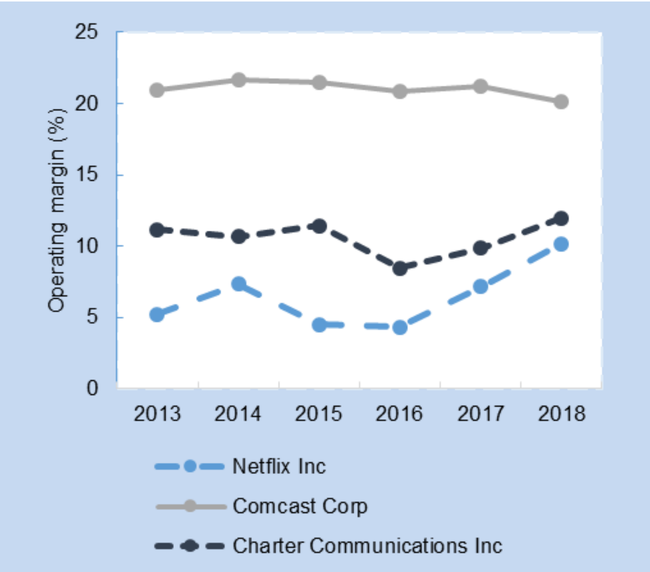


Figure 1a (LHS): Paid cable TV and Netflix number of US subscribers. Figure 1b (RHS): Operating margin for large cable TV firms and Netflix. Source: *Bloomberg, Statista.*

As of the end of 2018, Netflix was also the least leveraged among Comcast and Charter when measured by its Net Debt / Equity ratio. Furthermore, by having the lowest Net Debt/ EBIT among the 2 cable TV firms, Netflix has the highest debt servicing ability among its peers.

	Netflix Inc	Comcast Corp	Charter Communications
Net Debt / Equity (%)	125.33	146.21	163.25
Net Debt / EBIT (X)	4.09	5.68	13.84

Table 1: 12 months ending financial figures for Netflix Inc, Comcast Corp, and Charter Communications as of 12/31/2018. *Source: Bloomberg*

Figures 2a and 2b below illustrate the term structure of the NUS-CRI Forward 1-year Probability of Default (Forward PD) for the 2 current largest publicly listed US cable TV firms and Netflix. The Forward 1-year PD can be interpreted similar to a forward interest rate and it computes the credit risk of a company in a future period. For instance, the 9-month Forward 1-year PD is the probability that the firm defaults during the period from 9 months onwards to 1 year plus 9 months, conditional on the firm surviving the first 9 months. The Forward PD for Netflix showed a higher credit risk in January 2013 compared with Comcast and Charter, but the improvement in subscription rates and profitability over the years resulted in a lower risk profile in February 2019 as shown in Figure 2b.

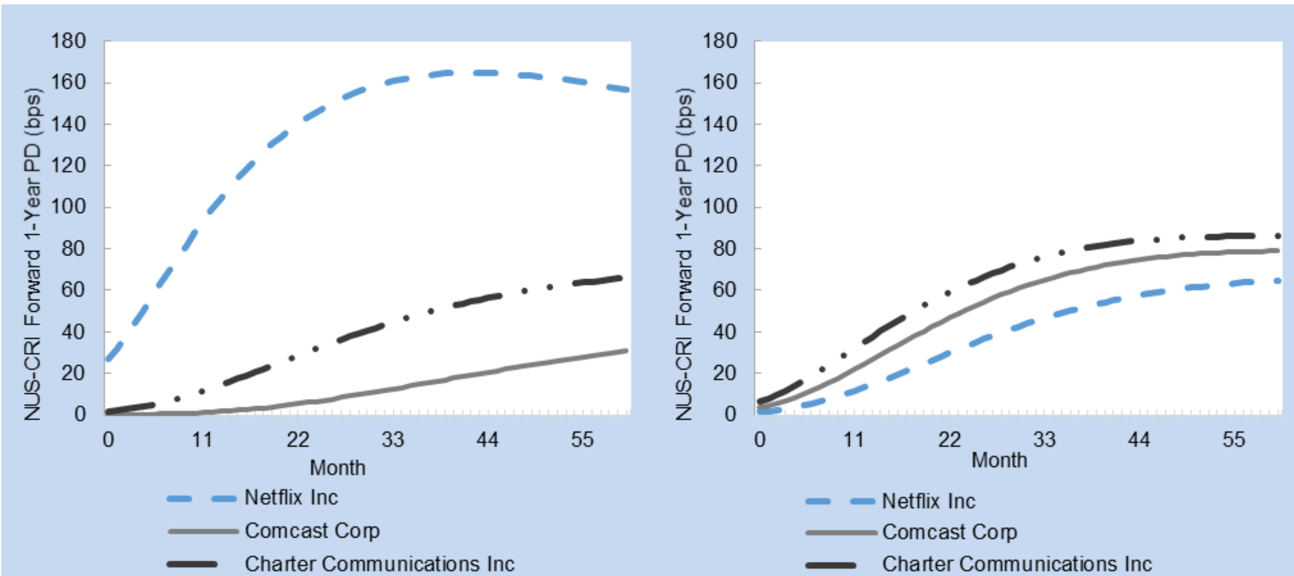


Figure 2a & 2b: NUS-CRI Forward 1-year PD term structure for Comcast Corp, Charter Communications, and Netflix on January 31, 2013 (LHS) & February 22, 2019 (RHS). *Source: NUS-CRI*

Currently, large entertainment corporations with huge movie libraries such as Disney and Warner Bros are preparing to launch their own stand-alone streaming service, making it even more imperative for cable TV firms to innovate or collaborate with streaming providers in order to stay relevant. While traditional cable TV firms could previously rely on their live sport channels to retain customers, the competition that it will face from new streaming providers in this segment further compounds their inability to keep customers. So long as Netflix and other streaming providers are able to provide their customers with satisfactory services and price themselves below cable TV subscription rates, cable TV firms will have every reason to fear that the current trend of losing subscribers and stagnant profitability will continue to persist in the future.

Credit News

Debt is roaring back in China

Feb 24. Despite the government's deleveraging campaign and the trade war in 2018, China's leverage indicators have been surprisingly strong in 2019 as new yuan loans, shadow financing, trust and wealth-management products and margin debt in China's stock market have surged. President Xi Jinping signaled a greater emphasis on growth, saying that healthy economic development is the foundation for risk prevention. Meanwhile, Chinese regulators are now allowing credit to flow back into the private sector without returning to the old ways of rapid and unsustainable credit growth. While the "re-leveraging" activity may increase concerns about China's financial stability, investors have so far cheered the prospect of easier credit conditions. (Bloomberg)

Surprise China bond default is new source of worry for investors

Feb 23. Qinghai Provincial Investment Group Co, a Chinese aluminum producer has failed to pay its Feb 22 coupon triggering concerns that other local government financing vehicles might follow suit. Analysts say that the default pose a systemic risk to the onshore bond market as the Chinese government has been supporting the sector. Defaults in China's onshore market has quadrupled to USD 18bn but unlike the recent Qinghai default, many of the previous defaulted issuers were private enterprises. (Bloomberg)

Credit rating agencies turn attention to ESG risk

Feb 23. Credit rating agencies may consider environmental, social and governance (ESG) principles when evaluating the credit quality of issuers in future. Investors have asked the rating agencies to clarify how ESG factors would affect their rating methodologies as there has been a greater demand for methodology transparency. Regulators are also studying the extent to how sustainability factors impact credit ratings and have asked the agencies to provide a clear explanation of their new ratings framework by the middle of this year. (FT)

Singapore banks enjoyed higher interest margins in 2018, but voice uncertainty for year ahead

Feb 22. Despite higher net interest margins (NIM) and lower non-performing loan (NPL) ratios, Singapore banks see challenges in the year ahead as global uncertainties continue. DBS Group sees the highest increase in NIM as it rises to 1.85% as compared to OCBC at 1.7% and UOB at 1.82%. All three banks either improve or maintain their NPL ratio at 1.5%. The management of the local banks expect income growth and continued NIM improvement in the coming quarters as they continue to build deeper customer relationships and invest in their capabilities. OCBC group CEO Samuel Tsien expects the global economic growth to slow amid concerns of geopolitical tensions, weaker market sentiment and rising policy risks. (Business Times)

Search for yield draws US life insurers to risky places

Feb 21. Insurance companies such as AIG and MetLife have increasingly moved into riskier assets since the financial crisis as they search for higher yields. A wave of corporate downgrades have also lead to lesser higher-rated bonds. Fitch examined the books of 42 large US life insurance companies and found that holdings of BBB rated bonds, last notch above junk, have increased from 25% before the financial crisis to 34% as of Q3 2018. Insurers have also increased their exposures to less liquid assets such as private placements which are bonds or stocks sold directly to investors. However, some market observers downplay the risks as they find that insurers tend to have strong liquidity position and their overall portfolio is much more diversified as compared to the past. (FT)

FDIC warns failure-free bank sector is 'not the new normal' (FT)

Investors gorge on corporate bonds after Fed 'capitulation' (FT)

Realty cash crunch is risk for struggling India shadow banks (Bloomberg)

Regulatory Updates

ECB loans ripe for rethink as officials mull slowdown response

Feb 24. European Central Bank officials are considering whether their response to the region's economic slowdown should include an update to its targeted lending program, known as TLTROs with less than two weeks before the Governing Council meeting. ECB has used various longer-term funding measures to support banks and boost lending. Economists think that policy makers should also think about creating a facility that offers regular longer-term funding of at least two years, as funds of less than one-year maturity do not count in certain regulatory calculations. Currently, the longest regular liquidity operations of the ECB are three months. The discussions by ECB officials are taking place amid deteriorating growth, with increasing risks from the US-European trade war and a messy Brexit. (Bloomberg)

Loans to NBFCs become costlier as RBI tightens norms

Feb 23. The Reserve Bank of India (RBI) has tightened risk-weight norms for loans to non-bank financial companies (NBFCs) as NBFCs and housing finance companies face financing and liquidity pressures. A loan to an NBFC which owes banks INR 2bn or more and is un-rated will attract a risk weight of 150%. At the same time, NBFCs are also losing access to funding from mutual funds as the volume dipped 20% from its peak. NBFCs' borrowing cost remain higher than in August 2018 before the liquidity crisis erupted. Separately, RBI also harmonized and reduced the different categories of NBFCs based on the principle of regulation by activity rather than by entity. (Financial Express)

A rate hike next year may be appropriate: Australia central bank head (Business Times)

RBNZ proposes raising top banks' capital ratio to 16 percent, open to rate cut (Reuters)

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