17 December 2021 Corporates

German media sector faces extra credit risk as Covid-19 speeds up industry's digital make-over

Analyst
Dörte Mählmann
d.maehlmann@scopehamburg.com

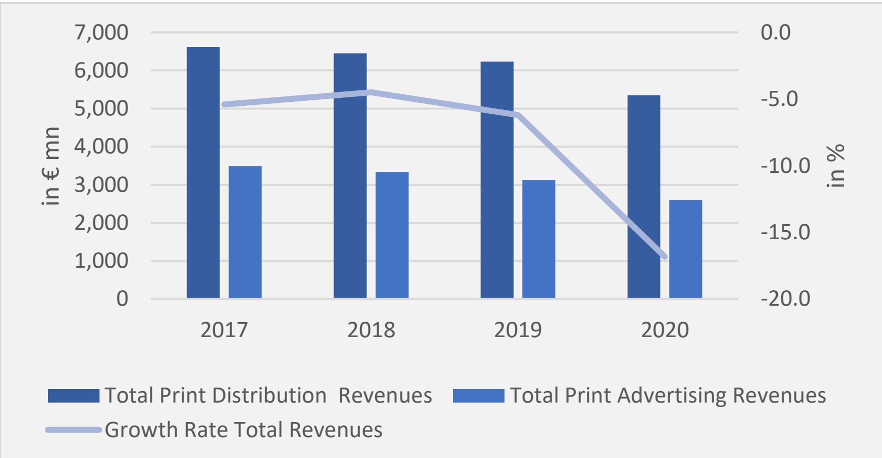
Editor
Matthew Curtin
m.curtin@scopegroup.com

The Covid-19 pandemic has accelerated the change of consumer habits and the digitalisation of media consumption, with consequences for the credit outlook for the traditional media sector – not least in Germany. Advertising budgets are increasingly shifting from traditional media channels to the large digital platforms in Europe's biggest economy. Some traditional subsectors have recorded a sharp decrease of revenues. To explore new areas of growth in this disruptive landscape, traditional media companies are shifting gears strategically, visible in increased M&A activity and growing capital-spending requirements, representing a degree of additional credit risk.

The fast-growing use of mobile devices has increased the popularity of digital media channels (new media) and changed the competitive landscape during the past two decades. These structural challenges that traditional media companies had already been facing for a long time were reinforced by the Covid-19 pandemic and the diverse restrictions for consumers.

German consumer print magazines and newspapers, one of the largest markets for printed matters in Europe, have experienced a severe drop in advertising income. Revenues from print magazines and newspapers declined by 14.1% in 2020 while advertising revenues developed worse with an annual reduction of 16.8% over the same period. Such steep revenue declines from print represent a new stage in the transformation of the media ecosystem that had already displayed structural shifts away from print publications before the pandemic.

Fig 1: Decrease of Print Revenue Streams (Germany)



Sources: Statista, PwC :"German Entertainment and Media Outlook 2021-2025" p.152f., Scope Hamburg.

Large tech-companies – the dominant competitors

The digital transformation led to new market entrants and dominant digital competitors such as Alphabet Inc., owner of Google, and Meta Platforms Inc., owner of Facebook, disrupting the traditional media industry by creating new distribution channels and offering their users or subscribers content for free.

Scope Hamburg GmbH
Ferdinandstraße 29-33
20095 Hamburg

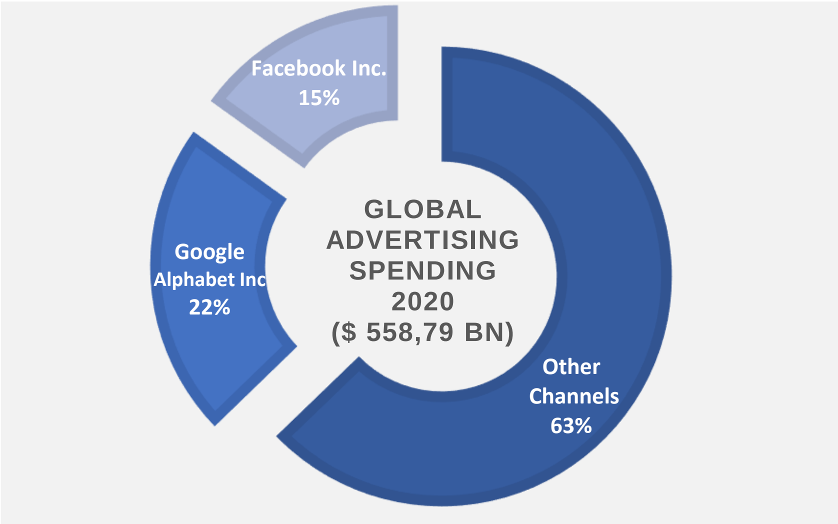
Phone: +49 (0) 40/60 77 81 200
Fax: +49 (0) 40/60 77 81 249

info@scopehamburg.com
www.scopehamburg.com

Online advertising with high growth rates

Following the increasing digital media consumption, advertising budgets were shifted to online channels during the past two decades. This accelerated in 2020 when digital advertising grew by 10.7 %[1] with the dominant platforms turning out to be the main beneficiaries. The dominance of the large tech companies is illustrated by their increasing share of global advertising budgets: Google (Alphabet Inc.) and Facebook Inc. (since October 2021 renamed as Meta Platforms Inc.) collected in 2020 around 37 % of the global advertising budgets:

Fig 2: Share of Global Advertising Spending



Sources: VDZ, Statista, Scope Hamburg

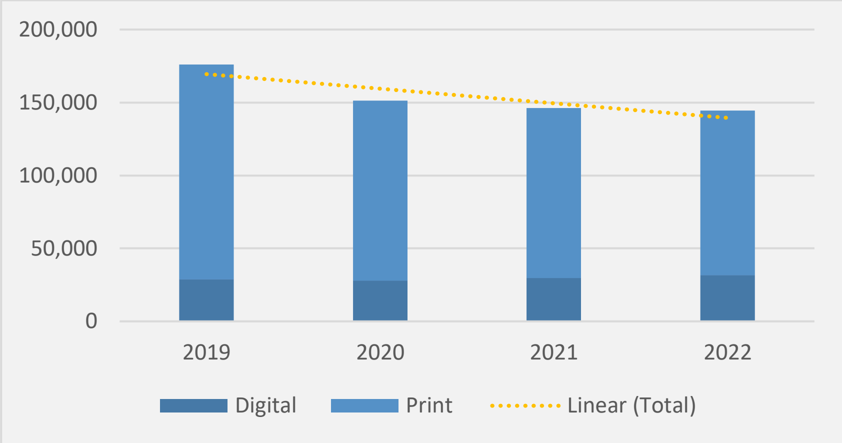
Acceleration of digital transformation and diversification

New growth perspectives needed

According to a survey of the Association of German Magazine Publishers (VDZ) in 2021, the majority of the consumer magazine publishers expects another decrease of the distribution revenues by 3.8% and of the print advertising revenues of 7.5% in 2021. We expect that the decline of the traditional revenue streams will still weigh down on the operating cashflows of the magazine publishing industry in the medium-term and will continue to force companies to accelerate the digital transformation. The industry has been creating digital products such as e-papers, paid content offerings, podcasts and online advertising concepts. However, the pure technical digitalisation of traditional business lines will not compensate the decreasing total revenues from legacy business in the medium-term due to fast-changing media consumption habits of consumers and the growing competition in the new media landscape.

[1] Source: German Advertising Federation (ZAW)

Fig 3: Global Revenues of Newspapers and Magazines (€ mn)



Sources: Statista, Scope Hamburg

M&A Deals at large to accelerate growth

Strategic shift toward greater diversification

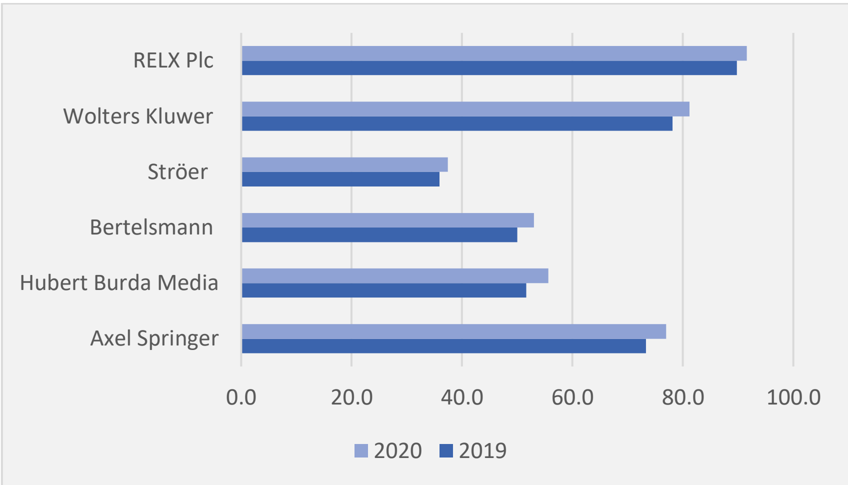
To speed up their digital transformation and participate in new digital trends and technologies major publishing companies have built up portfolios with diversified digital assets in recent years – increasingly through mergers and acquisitions.

In November 2020 the Bertelsmann Group and its subsidiary Penguin Random House announced to acquire Simon & Schuster for USD 2.2bn. Another example is the strategic expansion of Axel Springer SE with the acquisition of the majority stake in the newsletter publisher Morning Brew in October 2020. This was followed by the largest acquisition in the history of the Axel Springer SE in August 2021 when it took full control of the US publisher Politico.

The strategic shift in the media industry is reflected in the increasing share of digital revenues in recent years.

Increasing share of digital revenues

Fig 4: Share of Digital Revenues (in %)



Source: Scope Hamburg Research; Publications by companies and Scope Hamburg estimates.

Transformation projects and new alliances

Operational shift in focus: efficiency, technical skills

The strategic shift is accompanied by an operational transformation. The decrease of traditional revenue streams requires tight cost management and the enhancement of operational efficiency. Although the Covid-19 pandemic has increased the pressure on publishers' traditional revenue models, it has also increased the demand for quality journalism. However, for many publishers the costly production of high-quality content is difficult to scale due to lower reach compared with large platforms.

Newsroom transformation

In addition, media companies need to build up new technologies and technical skills of their employees across the traditional business lines. The transformation of the newsroom set-up is necessary to break down the walls between the editorial and technological functions within and across media channels.

New alliances

Encumbent media companies are striking up new alliances to take advantage of synergies in the new disruptive competitive landscape. These new partnerships are reflected in different marketing alliances to sell advertising concepts as well as in content alliances across media sub-segments.

Digital Services Act to limit the dominance of gatekeepers?

Evolving regulatory framework

The increasing dominance of some major digital platforms and gatekeepers has attracted the attention of the regulators. The proposal for the Digital Services Act (DSA) by the European Commission to the European Parliament and Council in December 2020 aims to create more regulation in the digital markets in Europe. However, data and privacy protection became more complex for all market participants and may have a negative impact on the generation of online advertising revenues.

We expect the digital transformation of the media industry and the fragmentation of media consumption to continue. New technical possibilities, such as higher data speeds and more sophisticated mobile devices, will further accelerate the mobile media consumption. The pressure on market participants to adapt to this will remain high.

High funding needs challenge credit outlook

Increasing leverage and volatile credit metrics …

The expansion of the traditional media companies into new segments is accompanied by high funding needs. The increasing financial debt weighs on the credit risk assessments of media companies since the cash flows of the legacy business are gradually declining and the cash flows generated by new segments are less predictable.

… adversely affect credit risk assessments

The speed of this development has been accelerated by the fast-changing media consumption habits and will continue to be high. We expect an ongoing market consolidation and volatile credit metrics which will negatively affect credit risk assessments and external funding for media companies with a still strong focus on traditional business lines.

This publication does not constitute a rating action for any of the companies mentioned

Scope Ratings GmbH and Scope Ratings UK Limited apply the same methodologies/models and key rating assumptions for their credit rating services while Scope Hamburg GmbH's methodologies/models and key rating assumptions are different from those of Scope Ratings GmbH and Scope Ratings UK Limited

Disclaimer

CREDIT RATINGS ISSUED BY SHG ARE SHG'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND SHG'S PUBLICATIONS MAY INCLUDE SHG'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. SHG DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND, IN THE CASE OF ISSUANCE-LEVEL CREDIT RATINGS, ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND SHG'S OPINIONS INCLUDED IN SHG'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. CREDIT RATINGS AND SHG'S PUBLICATIONS ARE NEITHER A PROSPECTUS NOR A SUBSTITUTE FOR INFORMATION ASSEMBLED AND PRESENTED BY COMPANIES OR ISSUERS FOR INVESTORS REGARDING THE PURCHASE OF A SECURITY OR FOR ASSESSING THE CREDITWORTHINESS OF A RATED ENTITY. CREDIT RATINGS AND SHG'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR SHG'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. SHG ISSUES ITS CREDIT RATINGS AND PUBLISHES ITS PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, CONDUCT ITS OWN INDEPENDENT ANALYSES, CREDIT ASSESSMENTS AND OTHER VERIFICATIONS AND EVALUATIONS OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

SHG'S CREDIT RATINGS AND SHG'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE SHG'S CREDIT RATINGS OR SHG'S PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT SHG'S PRIOR WRITTEN CONSENT.

All information contained herein is obtained by SHG from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. SHG adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources SHG considers to be reliable including, when appropriate, independent third-party sources. However, SHG is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the SHG publications.

Please note that summaries of contracts, laws and other documents contained in any SHG publication, rating report or other materials cannot replace careful study of the relevant complete texts.

SHG and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if SHG or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by SHG. The limitations do not apply to the extent that fraud, intent or any other type of liability cannot be excluded and/or limited under applicable law.

SHG and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, on the part of, or any contingency within or beyond the control of, SHG or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information. The limitations do not apply to the extent that fraud, intent or any other type of liability cannot be excluded and/or limited under applicable law.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY SHG IN ANY FORM OR MANNER WHATSOEVER.

The dissemination and use of an SHG rating report may be prohibited by law in certain jurisdictions. Any persons who come into the possession of such information should inquire about and comply with any prohibitions that may be in place. SHG assumes no liability of any kind with respect to such dissemination and use of any rating in any jurisdiction whatsoever.

Scope Hamburg GmbH