Progressive EQUITY RESEARCH

STV GROUP
MEDIA

5 September 2023

STVG.L

194p

Market Cap: £91.8m

SHARE PRICE (p)

12m high/low	315p/193p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (debt)/cash	£(32.0)m *(at 06/07/23)*
Enterprise value	£123.8m
Index/market	LSE
Next news	Prelims, March
Shares in issue (m)	47.3
Chairman	Paul Reynolds
CEO	Simon Pitts
CFO	Lindsay Dixon

COMPANY DESCRIPTION

STV is a leading TV broadcaster, streamer and programme producer, based in Glasgow.

www.stvplc.tv

STV GROUP IS A RESEARCH CLIENT OF PROGRESSIVE

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Strategic progress in tough ad markets

STV's H1 results confirm a picture of continuing uncertainty in the UK economy and advertising markets (albeit Q3 should be positive due to sporting events), driving a reduction of 8%-9% to FY EPS estimates. As market leader though, STV is very well placed to benefit when the ad market recovers, with every 1% of advertising uplift having a material positive impact on EPS. STV also continues to make vigorous progress in its diversification strategy. Growth in both Digital and Studios businesses (forecasts unchanged, now 69% of profits) should also drive future growth for the group.

- **H1 results.** Group H1 operating profit fell 33% to £8.0m, with weak ad markets in Broadcast and cost inflation (both previously flagged) more than offsetting good growth in both Digital and Studios. H1 EPS fell 26% but the dividend was maintained, and both leverage and dividend cover remain very comfortable, in our view.
- **Strategic progress evident.** In our view, current weakness and cost inflation in the UK economy are obscuring a very strong strategic change story, with STV diversifying into growth markets (Digital and Studios) at pace. A recent streaming agreement with ITV has led to Cost Per Thousand pricing in Digital jumping 55% in H1. Studios remains on track for a break-out year, even in tougher commissioning markets (LFL revenues up six-fold in the last three years to £50m+, with another £20m from the recent transformational acquisition of Greenbird). We now forecast these two divisions to generate 69% of group profits this year.
- **Forecasts.** Continued economic pressures result in us shaving our TAR expectation for FY23E (from -7% YOY to -8%). With continuing cost pressure, this drops through to a cut of 8%-9% to EPS estimates. However, our forecasts for strong growth in Digital and Studios remain unchanged.
- **Remains soundly positioned**. Even with the impact of the Greenbird acquisition, we estimate ND/EBITDA of 0.9x for end-FY23, with solid dividend cover of 2.9x. Our dividend forecasts are unchanged. Valuation remains undemanding at 5.9x EPS for FY23E / 5.9% dividend yield, in what is a cyclically challenging year.

FYE DEC (£M)	2021	2022	2023E	2024E	2025E
Revenue	144.5	137.8	179.4	191.1	200.3
Adj EBITDA	31.0	31.4	30.4	34.4	37.3
Fully Adj PBT	23.6	24.1	21.3	24.8	27.7
Fully Adj Dil EPS (p)	43.8	40.4	32.8	37.3	42.9
EV/Sales (x)	0.9x	0.9x	0.7x	0.6x	0.6x
EV/EBITDA (x)	4.0x	3.9x	4.1x	3.6x	3.3x
PER (x)	4.4x	4.8x	5.9x	5.2x	4.5x

Source: Company Information and Progressive Equity Research estimates.

Interim profits down, as anticipated

Although overall profits declined driven by the Broadcast division, both the Digital and Studios divisions performed strongly, highlighting the benefits of the increasing diversification of the group.

Overall revenues grew strongly (+21%), driven by stand-out strength in Studios. However, adjusted group operating profit fell to £8.0m from £11.9m. This was consistent with STV's previous cautious guidance, indicating tough advertising markets, inflationary pressures, and challenging comps in H1 22. Adjusted EPS fell 26% and the dividend was maintained at 3.9p, as shown in the table below.

TAR (total advertising revenues) declined 14% in the period, comprising -19% for national broadcast, -14% for regional, and +7% (our estimate) for digital.

Net debt remains broadly flat with the end-FY22 position at £16.3m. The group saw a partial unwind of the previous working capital position in the period, as two major drama series were part-delivered to customers.

For clarification, this was an organic performance in the period, with the recent significant acquisition of Greenbird Media not consolidated into the results until 6 July this year.

STV Group – Interim Results Summary, 2023

6mth to Jun **£m unless stated**	**2022**	**2023**	**Change** **%**
Broadcast	46.0	38.0	-17%
Digital	9.2	10.1	10%
Studios	6.9	27.2	294%
Group revenues	62.1	75.3	21%
Broadcast	10.7	4.9	-54%
Digital	4.0	5.0	25%
Studios	-1.0	0.1	-110%
Central	-1.8	-2.0	11%
Total Divisional Profit	11.9	8.0	-33%
Share of associate profits	0.0	-0.1	
Net interest	-0.7	-1.0	
Profit before tax (adjusted)	11.2	6.9	-38%
ETR %	20%	1%	
Minorities	0.1	0.0	
Ave # shares (FD) m	46.6	47.3	
EPS p (adj, FD)	19.5	14.4	-26%
DPS p	3.9	3.9	0%

Source: STV/Progressive Equity Research estimates

Digital – revenues +10%, OP up from £4.0m to £5.0m

Even in a tough ad market, digital revenues grew by a creditable 10% in H1, with a surprise improvement in the operating margin from 43% to 50%. This reflected ongoing structural growth in the digital market plus specific benefits from (a) the streaming partnership with ITV struck in December 2022 (transferring national digital ad sales to ITV, joining the Planet V programmatic platform, and adding new ITV digital content to the STV Player) and (b) the success of the addition of *Brookside* content to the platform (now up to 8m streams!).

Aided by these factors, viewing on STV Player increased 25% in the period, and advertising yield (cost per thousand) jumped 55%. Total VOD ad revenues increased by a very healthy but lower rate of +14%, pointing to a significant drop in the number of ads per hour on the STV Player. We view all these initial metrics as highly encouraging, implying an improved user experience (less advertising) at the same time as good continued overall revenue growth.

Studios – revenues almost quadrupled, OP up from -£1.0m to +£0.1m

The Studios business is always somewhat lumpy, depending on the timing of programme deliveries, and this H1 saw (as expected) a reversal from a relatively quiet H1 22 to a bumper delivery period in H1 23. In particular, STV part-delivered episodes from its two high-end dramas in the period (*Screw* season 2 for the BBC, and *Criminal Record* for Apple TV+). As a result, divisional revenues jumped from £7m to £27m, driving double-digit revenue growth for the group as a whole.

The division moved from loss to modest profit in H1. The group is guiding to a broadly similar revenue performance (pre-Greenbird) but with stronger profitability in H2, reflecting the phasing of profit recognition and secondary rights sales.

H2 will benefit additionally from the early-July strategic acquisition of Greenbird, which has lifted the scale and profitability of STV's content business. Even in a tougher climate for new programme commissions (reflecting economic pressures on broadcasters and streamers), Greenbird itself is continuing to win new commissions (seven since the announcement of the acquisition), and STV confirmed that the underlying Studios division remains on track to hit its previously-increased target of £50m+ revenue for FY23 (£70m+ including the maiden six-month contribution from Greenbird).

Broadcast – revenues -17%, OP down from £10.7m to £4.9m

STV continues to perform resiliently in audience terms (peak-time viewing share up one percent to 22.5%, highest lead versus BBC for 15 years). However, in addition to ongoing structural pressures, the weak UK economy drove a 19% decline in national advertising revenues. In addition, cost inflation absorbed some of the natural 'buffer' that STV normally enjoys in tough markets courtesy of its long-term supply agreement with ITV. As a result, profits halved, with the H1 operating margin falling to 13% from 23%.

Regional advertising fared somewhat less badly, declining 14% in H1. Within this, Government advertising fell c.55%, reflecting an absence of Covid-related advertising since Q1 22. SME advertising was altogether more resilient, down just 2%, supported by continuing take-up of STV Growth Fund offers (180 further deals in H1, including 70% of 2022 clients rebooking).

Outlook: positive TAR expected for Q3

As expected, STV is indicating a substantially better TAR performance in Q3, up 3%-5% compared with the 14% decline in H1, supported by major sporting events (women's football World Cup and men's rugby World Cup). July TAR was +1%, August +4%, and September is expected to be up 5%-7%. Q4 should also benefit from the men's rugby World Cup, although this will be offset by the absence of men's football World Cup revenues, which boosted Q4 22.

Digital remains on track to hit the longstanding group target of £20m of revenues in FY23, despite the weaker economy, but supported by the recent ITV deal.

Studios similarly remains on track for its long-expected bumper year, both underlying (£50m+ revenues) and including Greenbird (£70m+ revenues and £6-6.5m OP), despite the tougher recent climate noted for new programme commissions.

At group level, STV expects total revenue growth of at least 25% for FY23, but a fall in operating profits driven by linear ad decline in broadcast and cost inflation (part-offset by £2.5m of cost mitigations and strong profit growth in Digital and Studios).

Forecasts: 8%-9% EPS reductions

Our previous forecasts had factored in a gradual easing of cyclical pressures through FY23, which is not yet evident. Although the TAR guidance of +3%-5% in Q3 is in line with our estimates, H1 TAR was slightly weaker than we had forecast, and we have shaved our Q4 expectation.

As a result, we now factor in a TAR decline of 8.0% for FY23 (versus -7.0% previously). For FY24E we continue to assume a +6.5% bounceback, contingent on (a) modest economic growth YOY, (b) a stronger year for sports events due to UEFA men's football and (c) a 1% boost derived from the ITV streaming deal.

Overall, this drives EPS reductions of -9% in FY23E, -8% in FY24E and -9% in FY25E, as shown in the table below. Given comfortable levels of leverage and dividend cover, our dividend estimates remain unchanged. Our YOY growth expectations for FY24E and FY25E remain substantially unchanged, forecasting a recovery to EPS growth of 14% in FY24E and 15% in FY25E.

STV Group – Changes to estimates (interims 2023)

	FY23E			FY24E		
£m unless stated	**Old**	**New**	**Change (%)**	**Old**	**New**	**Change (%)**
Revenue	181.4	179.4	-1.1%	193.4	191.1	-1.2%
Adj EBITDA	31.9	30.4	-4.7%	36.6	34.4	-5.9%
Adj Operating Profit	25.5	24.0	-5.9%	30.1	28.0	-6.9%
Adj PBT	23.5	21.3	-9.4%	27.1	24.8	-8.4%
Fully adj Dil EPS (p)	36.2	32.8	-9.3%	40.7	37.3	-8.2%
DPS (p)	11.3	11.3	0.0%	12.0	12.0	0.0%

Source: Progressive Equity Research estimates

Financial: guiding to ND/EBITDA <1x by year-end

Net debt (excluding finance leases) of £16.3m at end-H1 was broadly unchanged from the end-FY22 position of £15.1m. The group saw a partial unwinding of the significant working capital position built up in H2 22 (reflecting the two major drama series in production at the time), with total WC reducing by c.£4m on our estimates. However, this was offset by an exceptional cash outflow of £2.8m (relating to setting up the new digital streaming arrangements with ITV), as well as the lower profits in the period.

As previously indicated, net debt increased further just after the half-year end with the acquisition of Greenbird. STV has indicated an initial net debt figure post-Greenbird of c.£32m, which includes c.£6m of cash balances within the Greenbird entities (not wholly owned, hence consolidated on STV's balance sheet but not fully available to STV). Reflecting usual seasonal H2 strength in cash flows, STV expects net debt to have reduced by year-end, with ND/EBITDA of around 1x for the year still at the low end of the company's internal target of 1-1.5x (and well below the covenant level of <3x).

We estimate a net debt position of £26m by end-FY23E, with ND/EBITDA of 0.9x. This excludes finance lease debt, in accordance with STV's covenants.

Exceptional Items

Adjusted profits in H1 exclude an exceptional charge of £2.8m. These relate to set-up and tech costs connected with the ITV streaming agreement. A moderate amount of further exceptionals is expected in H2, mainly relating to Greenbird acquisition and integration costs.

Pension deficit position reduces to £55m

STV's longstanding DB pension deficit reduced in the period to £55.0m from £63.1m on an accounting basis, with the effect of a rising discount rate more than offsetting a reduction in asset value. The group continues to make deficit payments of around £10m pa, in accordance with a plan targeted to eliminate the deficit by 2030.

Rapid strategic progress

Despite the profits drop in H1, we view the delivery of strong revenue growth (+21%) as an indicator of the continuing vigorous strategic development at STV. We would further highlight the following:

- Diversification towards digital and content continues apace. Helped by the Greenbird acquisition and the current weakness in broadcast, we expect the group to comfortably beat its longstanding strategic target of over 50% of profits from outside broadcast by end-2023 – we estimate 69% for the year.
- The Greenbird acquisition, which transforms the scale, breadth, and profitability of STV's content business, looks to be bedding in well, and is already winning further new programme commissions despite a slowing market.
- Similarly, the underlying Studios division ex-Greenbird remains on track to deliver break-out results despite the tougher market.
- The performance in Digital is looking even more impressive as the benefits of the ITV deal filter in. Overall revenues are still growing nicely in a tough market, and the sharp uplift in CPTs, accompanied by a reduction in total ad volumes around the programming, augurs well for sustainable digital growth.
- Underlying regional advertising continues to outperform national significantly, looking through the drag from a cessation of Government Covid spending, and helped by the ongoing STV Growth Fund initiative.
- Financially the group remains in a comfortable position post the Greenbird acquisition, in terms of financial leverage and pension repayments. Despite the EPS reductions, we remain comfortable with our dividend forecasts.

With FY23 representing the target year for the group's longstanding strategic forecasts, we expect the group to set updated strategic targets in due course. These should provide a good steer on how much further STV believes it can develop its digital and content businesses over the next few years.

Comparison with ITV

Finally, we note that STV's H1 profit performance (OP-33%) is notably more resilient than that at peer ITV (OP-52% YOY in the same period). This is despite a slightly less severe economic effect for ITV (H1 TAR -11% versus -14% for STV).

The slightly less severe TAR decline for ITV reflects both the benefit of ITV's family of channels (ITV2 with *Love Island* etc.) compared with only ITV1 content for STV's terrestrial business, as well as the recent heavy investment and marketing in ITVX (relaunched in December 2022, driving H1 digital ad growth of 26% for ITV versus 10% for STV).

However, the more resilient profit performance for STV versus ITV reflects some key differences between the two quoted groups, which we highlighted in our initiation report (*STV Group – Towards streaming and content*, 7 February 2023).

- **Digital investment.** STV has been investing steadily in rolling out the STV Player and adding digital content over a number of years, and the business continues to grow nicely and profitably even in a tough current ad market. ITV profits, in contrast, are impacted by recent heavy investment in the digital platform to migrate it beyond being largely a catch-up/live digital platform to a full streaming/content platform.

- **Cost variability in STV broadcast.** Reflecting STV's long-term supply agreement with ITV, around 60% of STV's broadcast division costs are variable with ad revenues. This provides some natural mitigation to costs in tough ad periods such as the current one.

As STV continues to diversify further towards digital and content, we would expect the overall profit resilience in tough economic times to continue to improve.

Financial Summary: STV Group

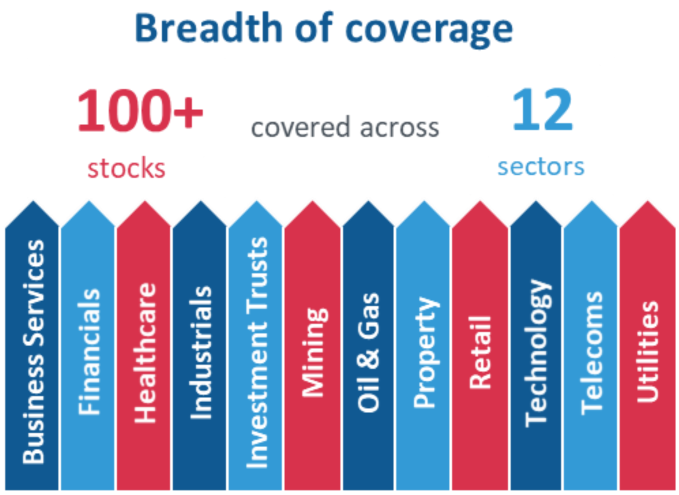
Year end: December (£m unless shown)

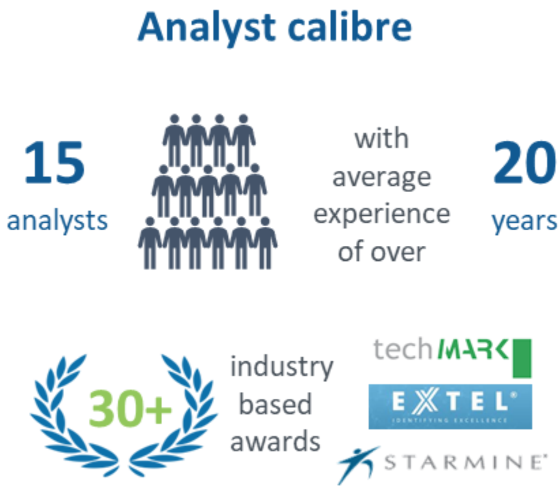
PROFIT & LOSS	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Revenue	144.5	137.8	179.4	191.1	200.3
Adj EBITDA	31.0	31.4	30.4	34.4	37.3
Adj EBIT	25.2	25.8	24.0	28.0	30.5
Reported PBT	20.1	22.2	15.5	21.5	24.4
Fully Adj PBT	23.6	24.1	21.3	24.8	27.7
NOPAT	22.1	20.4	18.6	21.4	23.7
Reported EPS (p)	41.0	36.6	25.2	36.1	41.7
Fully Adj Dil EPS (p)	43.8	40.4	32.8	37.3	42.9
Dividend per share (p)	11.0	11.3	11.3	12.0	12.8
CASH FLOW & BALANCE SHEET	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Operating cash flow	35.3	11.5	31.0	30.4	33.3
Free Cash flow	32.5	10.0	28.3	25.3	24.8
FCF per share (p)	71.4	21.9	61.9	55.2	54.0
Acquisitions	(1.6)	(3.3)	(19.0)	(2.0)	(2.0)
Disposals	5.3	0.0	0.0	0.0	0.0
Shares issued	0.0	0.0	0.0	0.0	0.0
Net cash flow	17.8	(15.4)	(11.0)	1.9	1.4
Overdrafts / borrowings	(14.4)	(26.4)	(33.4)	(33.4)	(33.4)
Cash & equivalents	14.7	11.3	7.3	9.2	10.6
Net (Debt)/Cash	0.3	(15.1)	(26.1)	(24.2)	(22.8)
NAV AND RETURNS	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Net asset value	(25.9)	(8.3)	1.3	10.0	19.5
NAV/share (p)	(55.4)	(17.7)	2.7	21.3	41.5
Net Tangible Asset Value	(27.5)	(9.5)	(15.4)	(12.5)	(10.8)
NTAV/share (p)	(58.9)	(20.3)	(32.9)	(26.6)	(23.0)
Average equity	(27.9)	(10.6)	(3.8)	5.6	14.7
Post-tax ROE (%)					
METRICS	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Revenue growth	34.9%	(4.6%)	30.2%	6.5%	4.8%
Adj EBITDA growth	30.3%	1.3%	(3.2%)	13.3%	8.2%
Adj EBIT growth	38.5%	2.4%	(7.0%)	16.8%	8.9%
Adj PBT growth	42.2%	2.1%	(11.6%)	16.5%	11.7%
Adj EPS growth	21.1%	(7.7%)	(18.7%)	13.7%	15.0%
Dividend growth	22.2%	2.7%	0.0%	6.2%	6.3%
Adj EBIT margins	17.4%	18.7%	13.4%	14.7%	15.2%
VALUATION	**2021**	**2022**	**2023E**	**2024E**	**2025E**
EV/Sales (x)	0.9	0.9	0.7	0.6	0.6
EV/EBITDA (x)	4.0	3.9	4.1	3.6	3.3
EV/NOPAT (x)	5.6	6.1	6.7	5.8	5.2
PER (x)	4.4	4.8	5.9	5.2	4.5
Dividend yield	5.7%	5.8%	5.8%	6.2%	6.6%
FCF yield	36.8%	11.3%	31.9%	28.5%	27.8%

Source: Company information and Progressive Equity Research estimates

5 September 2023

Disclaimers and Disclosures





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