fatPROPHETS™ 1300 881 177

STV Group 30/01/2014 FAT-UK-522

STVG GBP £3.20 Special HIGH B

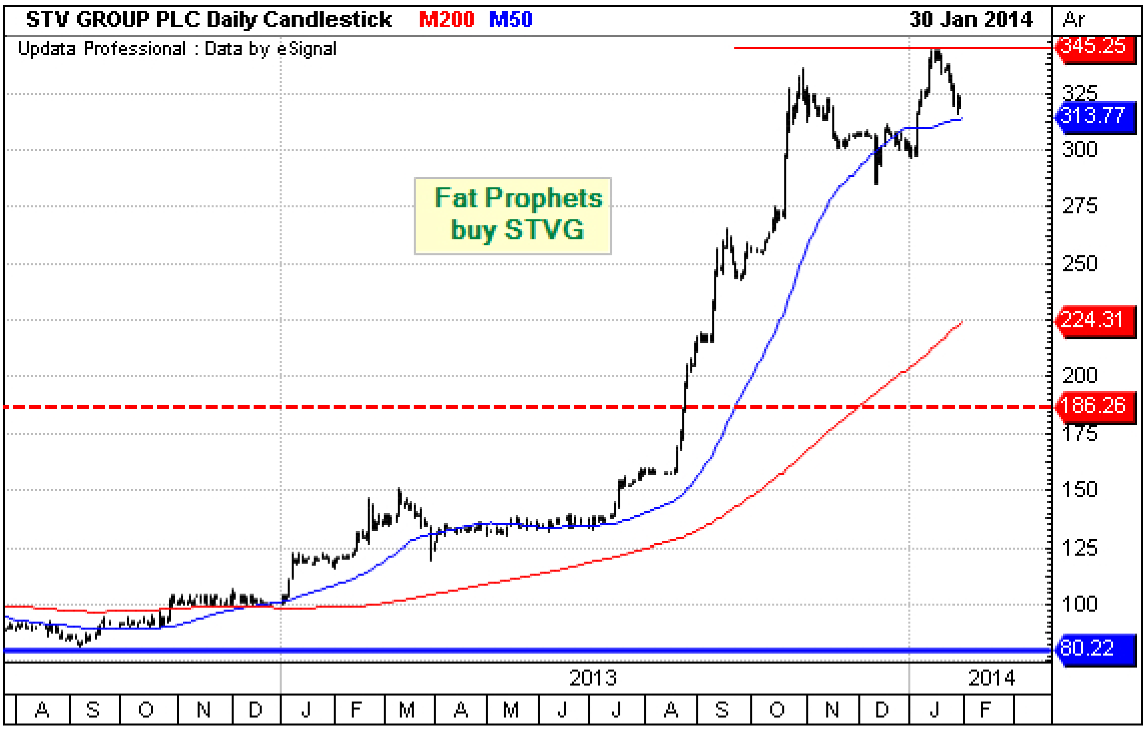
A sharper picture

A few weeks ago we highlighted STV Group (LSE, STVG) as a ‘traffic light’ recommendation. The company is a leading media brand in Scotland with around 4 million viewers via Channel 3 and a further 3.2 million unique users via digital services.

We believe that the company is ideally positioned to an improvement in advertising revenues which is being witnessed across the media industry. Burgeoning digital revenues and offshore distribution deals provide another plank for significant earnings growth.

Two weeks ago we held off pushing the buy button following the shares strong run. The recent market pullback has, in our view, opened up a reasonable opportunity to gain exposure.

STV remains modestly priced at 10 times times current year expected earnings (to 31 December 2013) and 8.9 times earnings for the following year. We are therefore recommending the shares as a buy around current levels.



Background

As a reminder STV group is a Scottish media company which was originally formed as Scottish Television. The business has undergone a number of transformational changes over the years through acquisitions and divestments. A rapidly changing industry landscape has also seen regular speculation that the group could be a bid target or will make further acquisitions itself.

Acquisitions over the years included the purchase of two newspapers in Glasgow in 1996 which were subsequently sold. This is as STV has looked to focus on television and media assets which is a good move, in our view, given current ad trends.

Today STV is structured into two primary businesses:

On the **consumer side** STV reaches over 4 million viewers (around 92% of the regional audience) each month, broadcasting 'ITV' favourites such as Emmerdale Coronation Street, The X Factor and Britain's Got Talent. The company's digital business incorporates Scotland's most popular commercial media website, stv.tv (also home to the on-demand STV Player).

STV Productions meanwhile is one of the UK's leading content businesses, with a strong track record of delivering successful programmes. Efforts include producing Catchphrase and Fake Reaction for ITV1 and ITV2, and The Poison Tree for ITV1.

Management and Financials

Part of the attraction of STV are the many changes that have been ushered in under the stewardship of CEO Rob Woodward in recent years. A major restructuring has included the sale of non-core and poorly performing assets, and a rebranding to focus on television.

The success of these decisions has enabled a refocussed STV to reap the full benefits of the industry rebound in advertising spend. This is reflected in the company's August half year results and October trading update.

An interim statement showed that STV was on track for a period of 'strong progress' with advertising revenues continuing to track higher. The company reported that national advertising revenues were in line up 6% which was in line with expectations. Regional airtime revenues were up 4% and by the end of November were 5% ahead.

Strong brand presence is also enabling STV to command robust margins as the industry recovers.

The company's digital business is also performing exceedingly well with revenues here set to be up by around 21% by the end of November on the same period the year before.

The 'STV player' has also been a key driver of traffic with one million streams a month, and is being used by 70 percent of the broadcast audience. Digital margins are also notably strong at around 34%.

The productions business was also performing solidly, commissioning a new quiz show, The Lie, co-produced with GroupM Entertainment for Irish broadcaster, TV3. Management are also actively looking to generate offshore growth opportunities and recently signed up a new international partnership with Red Arrow Entertainment Group, incorporating co-investment, co-development and worldwide distribution.

STV is set to report full year results next month, and we expect this to build on the progress seen at the half year. STV reported a 5% gain in pre-tax profit to £6.7 million for the six months ended June 30th 2013. Operating profit was up 1% to £8.2 million, while revenue surged 8% to £51.2 million. Underpinning the result was an 84% gain in production revenues and 19% uptick in digital turnover.

Financial Highlights	H1 2013	H1 2012	Year on year
Revenue	**£51.2m**	£47.6m	**+8%**
EBITDA (pre exceptionals)	**£9.3m**	£9.3m	**No change**
Operating profit*	**£8.2m**	£8.1m	**+1%**
Pre-tax profit*	**£6.7m**	£6.4m	**+5%**
EPS**	**14.3p**	13.6p	**+5%**
Statutory EPS	**13.2p**	2.7p	**+389%**
Net debt	**£43.4m**	£55.9m	**-22%**

Balance Sheet

STV does have a relatively high level of debt which is not a good position for a cyclical business. However, we are encouraged that it is trending down. The company reported that net debt was down 22% at the half year to £43.4 million and is on track to fall below 2 times EBITDA by the end of the year.

Stock overhang

One uncertainty that has been removed is the overhang of a stake in STV held by ITV. In December last year the latter sold its 6.79 percent legacy stake.

The deal rules out any prospect of ITV making a play for the rest of STV. Meanwhile STV and ITV have also patched up their commercial differences.

From a charting perspective STVG has been in a strong uptrend over the past 18 months. Given the stellar rise we have not been surprised to see a pullback recently, but we expect support to kick in around 300p (a psychologically important level). Such a correction will ultimately be healthy in our view, and reinforce the longer term uptrend.

Summary and Recommendation

We believe that STV Group is well leveraged to the improvement in advertising revenues which is being witnessed across the industry.

We are also encouraged that the company's main exposure is TV, as opposed to radio (such as in UTV Media's case), where the advertising rebound has continued to lag. The company is also leveraged to the transition to internet advertising through its digital businesses. TV advertising is far from dead though, and we expect an ongoing recovery here to drive earnings growth at STV in the medium term.

From a valuation perspective STV is modestly priced at 10 times forecast earnings for the year ended 31 December 2013 and 8.9 times the following year's earnings.

We believe the recent pullback in the share price opens up a reasonable entry point. We recommend STV Group as a buy to Members around current levels.

Goldbridges Global Resources, Google (Alphabet), Grainger, Gulf Keystone Petroleum, Highland Gold Mining, HSBC,ICICI Bank, Ironveld, iShares Physical Metals, J Sainsbury, JKX Oil & Gas, John Wood Group, Kazakhmys, Legal & General, Lloyds, Low and Bonar, Market Vectors Junior Gold Miners, Market Vectors Oil Services, Market Vectors Vietnam, Marstons, Medusa Mining, Mitchells & Butlers, Mitsubishi Tokyo Financial, Mitsubishi UFJ, National Grid, Nippon Telegraph and Telephone, Panasonic, Paragon Group of Companies, Petra Diamonds, Petrofac, Petropavlovsk, PICC Property & Casualty, PPHE Hotel Group, Randgold Resources, Rank Group, Reckitt Benckiser, Royal Dutch Shell, Solgold, Sony Corporation, Standard Chartered, STV Group, Sylvania Platinum, Tata Motors, Tencent, Tertiary Minerals, Teva Pharamaceutical, Toyota Motor, Tullow Oil, Unilever, Vedanta Resources, Vodafone, Walt Disney, Zillow.

Snapshot STVG

STV Group

Latest Closing Price: £3.20

STV group is a Scottish media company which was originally formed as Scottish Television. The business has undergone a number of transformational changes over the years through acquisitions and divestments. And a rapidly changing industry landscape has also seen the regularly seen the company involved in corporate activity speculation, either as the acquirer or target.

Acquisitions over the years included the purchase of two newspapers in Glasgow in 1996, which were subsequently sold as the group looked to focus on television and media assets, a decision which looks to have been well founded given current ad trends.

A key deal involved the acquisition of Grampian, the ITV license holder for Northern Scotland, in 1997. Scottish Television (which owns the license for Central Scotland) and Grampian merged brands in 2006 to form STV. And after selling off print based and radio assets, the name change also reflected management intention to focus back on core TV assets.

Market Capitalisation:£125m

	FY1	FY2
Price to Earnings	8.95	7.95
Dividend Yield (%)	0.7	1.0
EV/EBITDA	6.73	