STV Group

05/07/2018 **FAT-UK-740**

STVG

GBP £4.21 Spec. **MED.** **SH**

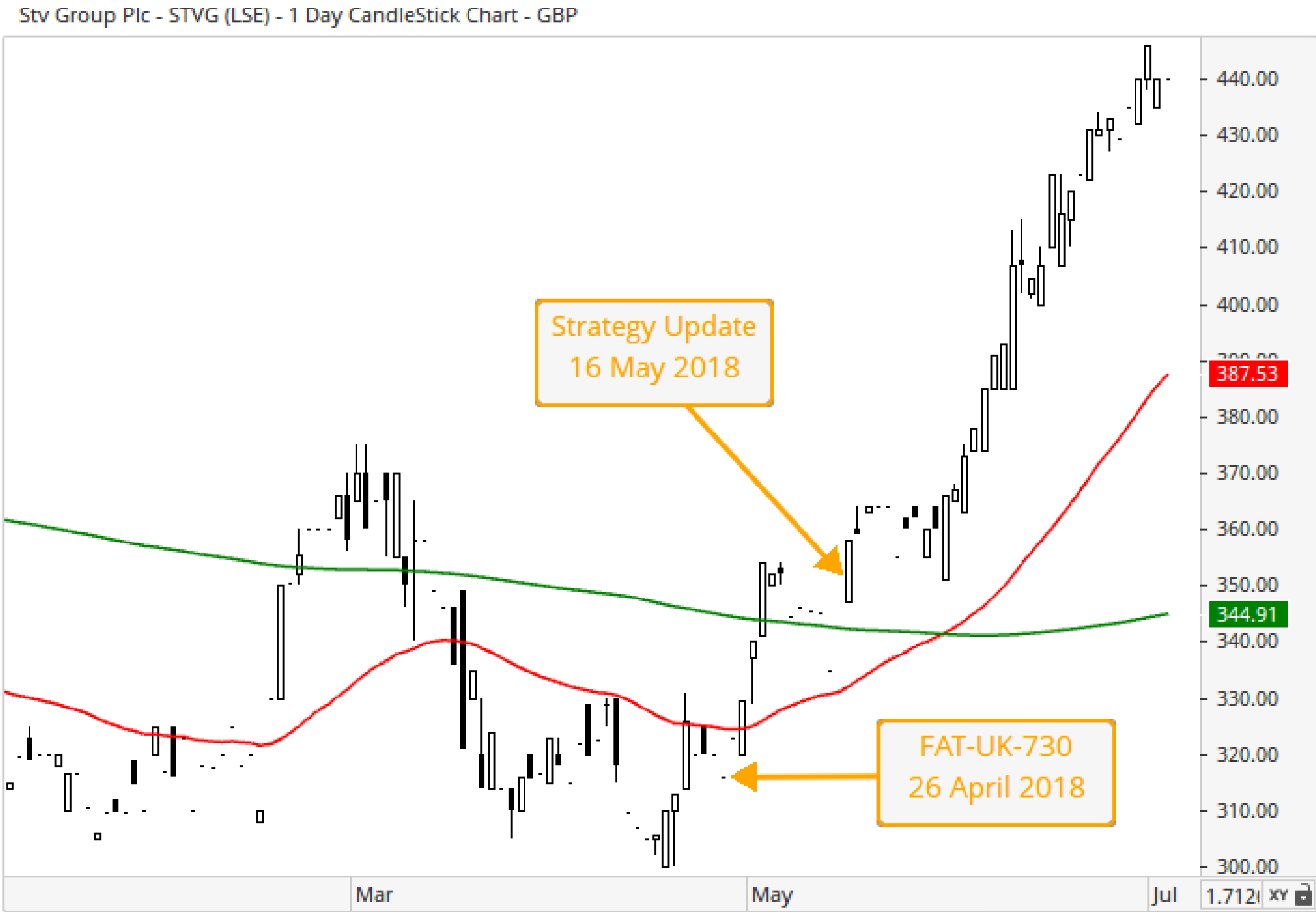
Fat Prophets take some Profits

Scotland-based integrated producer-broadcaster, **STV Group** (LSE.STVG) recently announced a Strategy Update in responses to the changing dynamics of the Entertainment Production industry, which has seen significant disruption from the likes of Netflix while consumers are shifting towards more digital content. In light of this shift and prudent response, the market has pushed the company's shares up and we believe it a prudent time to take some profits. We recommend Members **Sell Half** their holdings.

Updates and Recommendation

Since our last update in April (FAT-UK-730), the company has provided a couple of updates. The first of which was a regular trading update released the same day as our research note. In it, the company noted that business performance was off to a strong start in 2018 with production revenues up over 30% year-on-year and no doubt a side effect of more commissions that started in the period.

Aside from that though, the second, and more important development in our view, is the update on the company's Strategy Review commenced by CEO Simon Pitts after taking office from Rob Woodward in January; this was released 16 May 2018. The chart below shows the price impact following the announcement of the disclosures:



Considering that 2017 was a difficult year for the company and the industry as a whole, especially in the wake of disruptors like Netflix, these updates and shift in strategy are what we believe to be the necessary reprieve the company needed. The market, likewise, responded in kind with the shares taking off since then.

In light of these developments, we believe it is prudent for Members to take some profits while sentiment is positive. Though we do admit that **we like the direction the company is taking**, and **valuations are reasonable as well**, we do note that a fundamental shift in strategy will incur costs and take some time to bear fruit while the share run up has been quite steep as the chart above illustrates. Thus we believe that the opportunity is here for the taking and recommend a **Sell Half** rating on STV Group.

Strategy Update

As noted above, the company released a strategy update 16 May 2018 and highlighted 3 strategic objectives on how management intends to transform the company by FY2020. The strategies are listed below:

To implement the vision we will focus on 3 strategic objectives

1. **Maximise the value of our broadcast business by delivering high quality, cost-effective news and entertainment**

2. **Drive digital growth by creating an *STV for everyone***

3. **Build a world class independent production business**

Source: 16 May 2018 Company Presentation

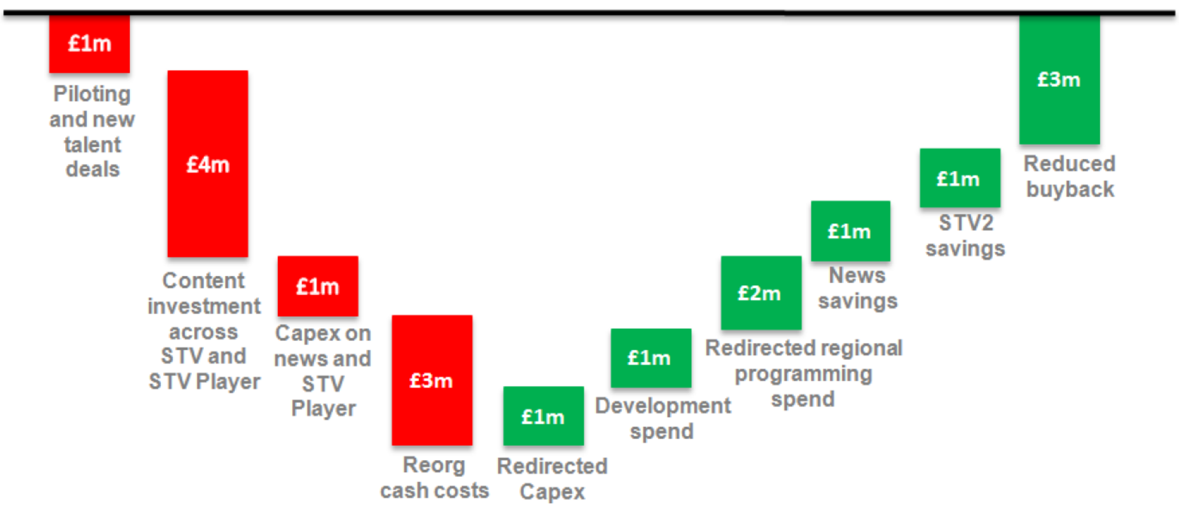
The shift can be summarised as a plan to "focus the organisation on content and digital to deliver long-term growth". This is mainly due to the fact that, under its current circumstance, the company lacks a differentiation factor compared to competitors like BBC Scotland, which also happen to have deeper pockets (15x the budget), while simultaneously lacking the culture that pushes for creativity and risk-taking.

Under the new management, this will lead to the closure of STV2, freeing up headcount by 59 and selling the TV assets to That's Media, a local news channel which broadcasts on Freeview all to deliver cost savings of circa £2 million per annum. The company will then increase investments in the main STV channel, which already has a lead in local news while ramping up digital investments to strengthen STV Player.

That aside, the company is streamlining its Production business and will rebrand to focus more on consistent and "market-relevant" content to strengthen its brand instead of having a mix or more random content it has been spewing out over the years.

All said, this will entail significant upfront costs, but management has noted that the cost savings generated from lopping off STV2 and some other changes will be sufficient to pay for the strategic shift. This is illustrated in the graphic below:

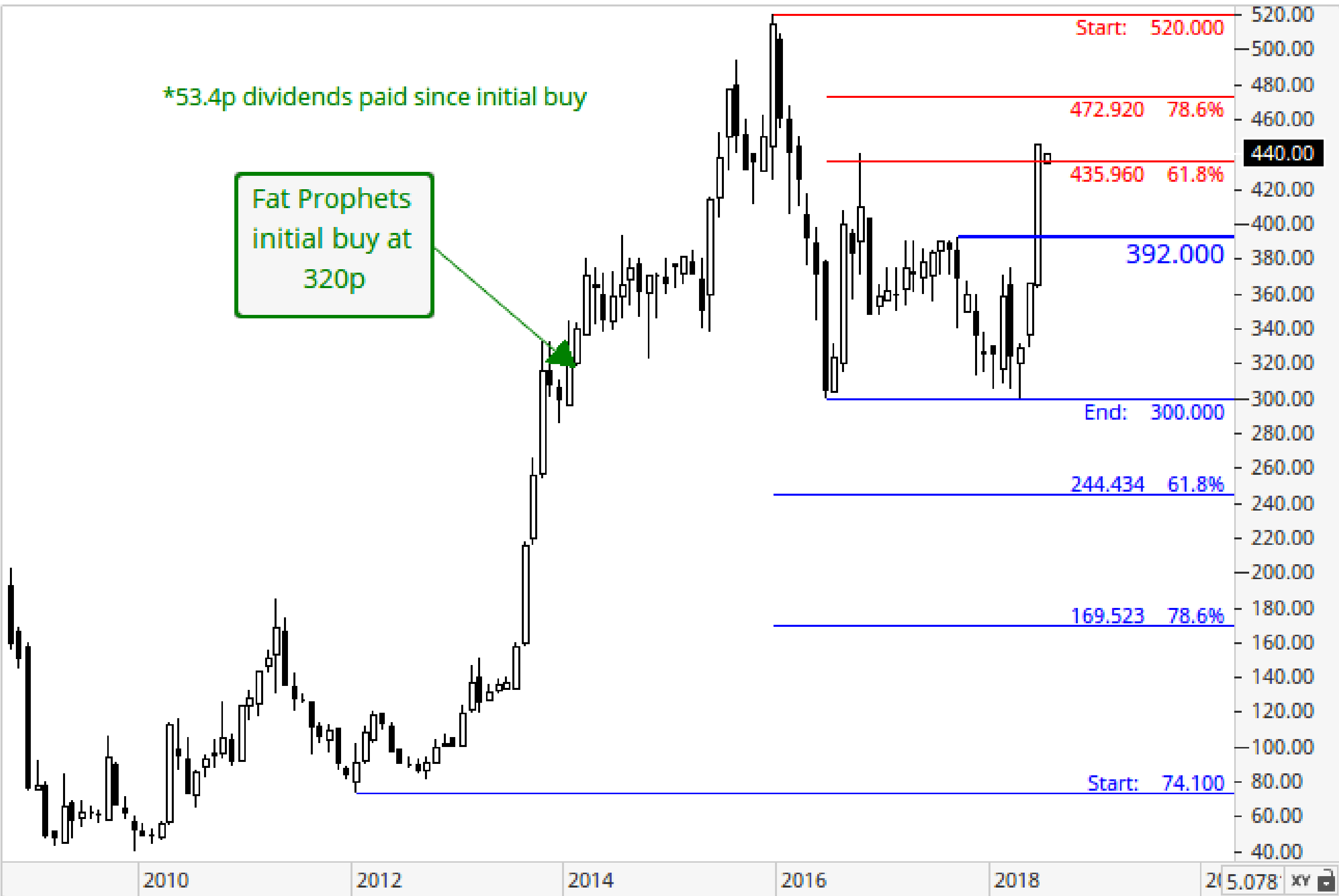
Our future investment in content will be paid for by cost savings and by capping the existing share buyback



Source: 16 May 2018 Company Presentation

Overall, we are pleased with the company's shift into a more rational approach of its business though we note that effects of this shift will be long in the making and require patience in the interim. **That said, we recognise the recent run up in share price as a prudent time for Members to take profits and trim down the risk exposure.**

Stv Group Plc - STVG (LSE) - 1 Month CandleStick Chart - GBP



Summary

Following a difficult 2017 with headwinds from intensifying competition and fewer commissions, the STV Group has made significant changes to how it approaches its business, focussing on strengthening its flagship brand while investing more towards the digital space. The company has also rationalised its Production business to deliver a more consistent and on brand content.

In light of these changes, the market has responded in kind and pushed up the share price while on a valuation front, the shares are trading at a reasonable 11.0x FY18 earnings which is expected to fall to 10.2x the following year while also offering an attractive dividend yield of 5.2%.

Stv Group Plc - STVG (LSE) - 1 Day CandleStick Chart - GBP

In light of these developments, we believe it is prudent for Members to take some profits while sentiment is positive. Though we do admit that **we like the direction the company is taking**, and **valuations are reasonable as well**, we do note that a fundamental shift in strategy will incur costs and take some time to bear fruit while the share run up has been quite steep. **Accordingly, we recommend Members take profits and sell half their shares in STV group.**

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: £4.21

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:£172.45m

	FY1	FY2
Price to Earnings	11.0	10.2
Dividend Yield (%)	5.2	4.5
EV/EBITDA	9.8	8.6