Media & Entertainment
United Kingdom
Update

# ITV plc

## Ratings

| Security Class | |
|---|---|
| **Foreign Currency** | |
| Long-Term IDR | BB |
| Senior Unsecured | BB |

## Outlook

| | |
|---|---|
| Foreign-Currency Long-Term IDR | Stable |

## Financial Data

**ITV plc**

| | Dec 09 | Dec 08 |
|---|---|---|
| Revenue (GBPm) | 1,879 | 2,029 |
| Operating EBITDA (GBPm) | 240 | 247 |
| Op. EBITDA/revenue (%) | 12.8 | 12.2 |
| Cash flow from operations (GBPm) | 306 | 131 |
| Free cash flow (GBPm) | 189 | -85 |
| FFO gross interest cover (x) | 2.9 | 2.5 |
| Total debt (GBPm) | 1,218 | 1,376 |
| Net debt (GBPm) | 796 | 930 |
| Net debt / EBITDA (x) | 3.3 | 3.8 |
| Total adjusted net debt/op. EBITDAR (x) | 3.6 | 4.1 |
| Adj. leverage/FFO (x) | 4.2 | 4.8 |
| Adj. net leverage/FFO (x) | 2.9 | 3.4 |

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## Related Research

**Applicable Criteria**
- *Rating European TV Companies (March 2010)*
- *Corporate Rating Methodology (November 2009)*

**Other Research**
- *ITV plc (February 2010)*
- *European Media Outlook 2010 (December 2009)*

## Rating Rationale

- Fitch Ratings' upgrade on 6 August 2010 of ITV plc's (ITV) Long-Term IDR and Senior Unsecured ratings to 'BB' from 'BB-' reflects an improved financial position and credit metrics after a better-than-expected H110 performance, as well as medium-term clarity on funding of its pension liability.
- ITV has outperformed the competition in a rising market, leading to net TV advertising revenue increasing by 18% year-on-year (yoy) in H110, and with management expecting a further 15% yoy increase in Q310. This should help reduce leverage to 2x by end-2010 from 3.6x at end-2009, on a lease-adjusted net debt/EBITDA basis.
- Cyclical exposure to the UK economy remains a significant risk for ITV. A sharp drop in TV advertising revenue in a "double-dip" scenario could exert pressure on profitability. However, Fitch's analysis shows that in this scenario, ITV's lease-adjusted net debt/EBITDA would not breach 3x, and would therefore remain significantly below the levels of 2008 and 2009.
- Structural changes in the media industry remain a concern even without the risk of the UK falling back into recession. The continued growth of the internet, digitalisation of content, and the change in consumer viewing patterns, have had a significant impact on content creation, content aggregation and distribution. These factors could erode ITV's ability to reach a large UK audience for advertisers, and therefore have a negative impact on long-term revenue and profitability. Management is embarking on a five-year plan to transform ITV, but this process is unlikely to show results in the short term.
- There is clarity regarding ITV's cash contributions to its pension scheme until 2014, following agreement with the trustees of its pension scheme over the company's plan to use SDN, ITV's wholly-owned digital terrestrial television multiplex operator, to provide asset-backing to the pension scheme over the long term. Fitch believes that these pension deficit payments are unlikely to change following the next actuarial pension valuation due to take place in 2011.

## What Could Trigger a Rating Action?

- Upward rating action would depend on significant progress in management's efforts to address the long-term structural challenges ITV is facing, as well as continued reduction in leverage. Fitch believes that funds from operations (FFO)-adjusted net leverage could be approaching 2x by end-2012 (compared with 2.9x at end-2009).
- Leverage higher than 3x lease-adjusted net debt/EBITDA, due to cyclical effects from a double-dip scenario, could lead to negative rating action, given ITV's current strategic position in a competitive UK TV market.

## Liquidity and Debt Structure

Liquidity is stronger following improved profitability and positive changes to the debt maturity profile over the course of 2009. The company has no credit facilities, but ended H110 with GBP686m of cash and cash equivalents. ITV bought back GBP70m of debt in H110, and the only repayment due before 2013 is GBP10m.

## Peer Group

| Issuer | Country |
|---|---|
| **BBB+** | |
| Bertelsmann | Germany |
| BSkyB | United Kingdom |

## Issuer Rating History

| Date | LT IDR (FC) | Outlook/ Watch |
|---|---|---|
| 6 Aug 10 | BB | Stable |
| 3 Mar 10 | BB- | Stable |
| 7 Aug 09 | BB- | Negative |
| 4 Mar 09 | BB- | Negative |
| 28 Oct 08 | BB+ | Stable |
| 6 Aug 08 | BBB- | Negative |
| 22 Feb 08 | BBB- | Stable |
| 15 Mar 07 | BBB- | Stable |
| 20 Nov 06 | BBB- | Stable |
| 21 Jun 06 | BBB- | Stable |
| 8 Mar 06 | BBB | Negative |
| 7 Feb 06 | BBB | Stable |
| 6 Dec 05 | BBB | Stable |
| 12 Jul 05 | BBB | Stable |
| 3 Mar 04 | BBB | Stable |

## Snapshot Profile: Major Issuer-Specific Rating Factors and Trends

| Rating Factor | Status[a] | Trend |
|---|---|---|
| Operations | Average | Improving |
| Market Position | Average | Neutral |
| Finances | Weak | Improving |
| Governance | Average | Neutral |
| Geography | Average | Neutral |

[a] Relative to European media

# Immediate Peer Group – Comparative Analysis

## Sector Characteristics

### *Operating Risks*

The media industry has been undergoing significant structural change. The explosive growth of the internet, digitalisation of content, and changes in consumer viewing patterns, have had a significant impact on the areas of content creation, aggregation, and distribution. These structural changes are having a varying impact on different segments — with consumer publishing, directories, and ad-funded television likely to experience the worst of the dislocation.

### *Financial Risks*

Advertising revenue is highly cyclical, with limited visibility. Companies with a large exposure to advertising have high operating leverage, but sluggish revenue development means that profit growth still depends on further cost-cutting efforts. Efforts to diversify revenue streams away from advertising may carry additional financial costs and increase execution risk.

### Peer Group Analysis

| Latest quarterly results | Bertelsmann 'BBB+'/Stable | BSkyB 'BBB+'/Stable | ITV 'BB'/Stable | TF1 Not rated | Prosieben Not rated |
|---|---|---|---|---|---|
| LTM Revenue (EURm) | 15,459 | 7,094 | 2,348 | 2,519 | 2,859 |
| LTM Revenue change (YoY, %) | -3.4 | 10.3 | 2.6 | 6.2 | 0.5 |
| LTM Operating margin (%) | 10.3 | 14.5 | 16.4 | 6.7 | 24.9 |
| Net debt / LTM EBITDA (x) | 2.7 | 0.9 | 1.7 | 0.4 | 4.1 |

Note: Based on 2Q10 results except Bertelsmann which is based on 1Q10. Source: Fitch, Companies

## Key Credit Characteristics

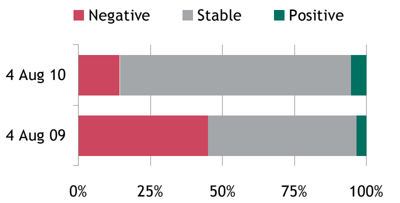
Fitch is concerned about the long-term structural challenges facing commercial broadcasters. A sustained economic recovery, and the ability to mitigate the impact of structural changes, would lead to more solid credit profiles.

## Overview of Companies

- **Bertelsmann AG** (Bertelsmann, 'BBB+'/Stable) — large media conglomerate based in Germany that owns RTL (TV broadcaster), Random House (book publisher), Gruner & Jahr (magazines) and Arvato (media outsourcing, services and print). Less than 30% of revenue is derived from advertising. Cost-cutting efforts in 2008 and 2009 have helped protect margins during the downturn. Management's commitment to reducing leverage is a key factor contributing to the rating.
- **British Sky Broadcasting Group plc (Sky)** (BSkyB, 'BBB+'/Stable) — leading pay-TV operator in the UK. A limited reliance on advertising revenue means that BSkyB, with its increasing free cash flow (FCF) and strong liquidity, has a credit profile which is stronger than the average in the media sector.
- **ITV** ('BB'/Stable) — leading commercial broadcaster in the UK, which faces strong competition from BSkyB and the state-funded BBC, and structural threats from the internet and interactive TV. Recovery in the UK TV advertising market, and efficient cost control, has led to a healthier financial position. Addressing long-term structural issues is key to further positive rating action.
- **TF1** (not rated) — leading commercial broadcaster in France, owned by Bouygues SA ('BBB+'/Negative), and facing competition from strong internet protocol TV (IPTV) and interactive TV distributed over fixed broadband services.
- **Prosieben** (not rated) — second-largest broadcasting group in Europe, operating 20 free TV channels supported by advertising revenue in 12 countries. Free-to-air TV in German-speaking countries accounts for 60% of group revenue.

### Distribution of Sector Outlooks

Directional Outlooks and Rating Watches




Fitch's expectations are based on the agency's internally-produced, conservative rating case forecasts. They do not represent the forecasts of rated issuers individually or in aggregate. Key Fitch forecast assumptions include:

- good revenue growth in 2010, driven by continued recovery in UK TV advertising market;
- subdued revenue growth in 2011 but no economic "double dip" expected;
- continued cost-control, with limited investments over the medium-term;
- unchanged CRR regulatory framework.

### Definitions

- Leverage: Gross debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock divided by FFO plus gross interest paid plus preferred dividends plus rental expense.
- Interest Cover: FFO plus gross interest paid plus preferred dividends divided by gross interest paid plus preferred dividends.
- FCF/Revenues: FCF after dividends divided by revenues.
- FFO Profitability: FFO divided by revenues.
- For further discussion of the interpretation of the tables and graphs in this report, see Fitch's "*Interpreting the New EMEA and Asia-Pacific Credit Update Format*", dated 25 November 2009 and available at www.fitchratings.com.

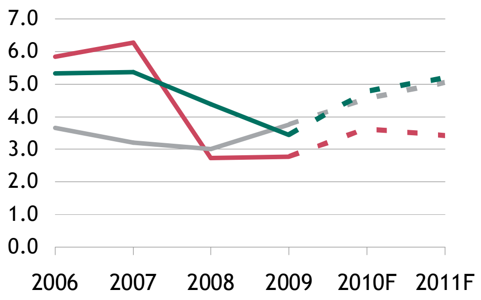
ITV plc —— Media & Entertainment Median —— Developed BB Cat Median —— Source: Company data; Fitch.

### Leverage

including Fitch expectations


### Interest Cover

including Fitch expectations



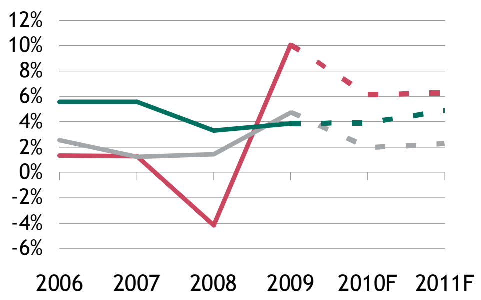

### Debt Maturities and Liquidity at June 2010*

| Debt maturities | (GBPm) |
|---|---|
| 2H10 | 0 |
| 2011 | 11 |
| 2012 | 0 |
| 2013 | 160 |
| After 2013 | 905 |
| **Cash and equivalents** | 686 |
| **Undrawn Committed Facilities** | 0 |

* £138m nominal value of 4.5% March 2019 gilts secured against drawing of £200m 2019 loan facility has been excluded from cash but netted off against 2019 debt. Debt excludes GBP64m of finances leases and -GBP17m amortised cost adjustment.

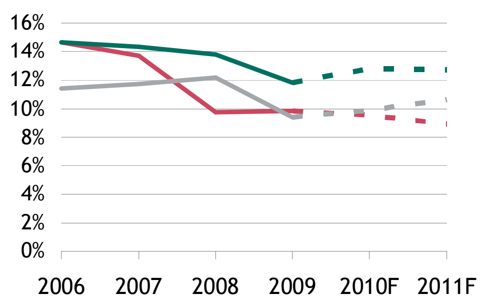
### FCF/Revenues

including Fitch expectations



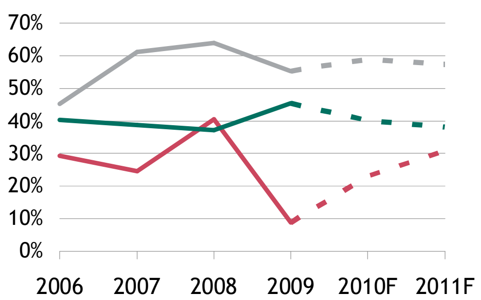

### FFO Profitability

including Fitch expectations

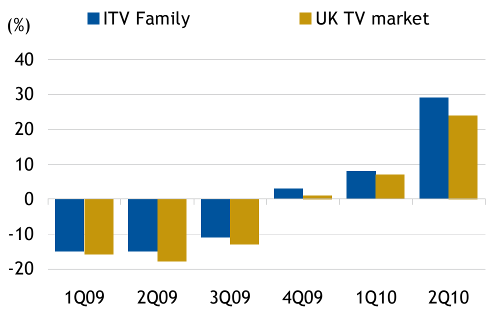



### Capex/CFO

including Fitch expectations




### Net Advertising Revenue Growth

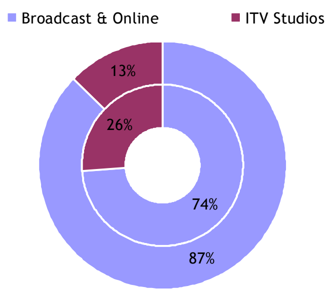



Source: ITV

### 1H10 Segmental Split

Outer Ring: Revenue

Inner Ring: EBITA bef exceptionals



## FINANCIAL SUMMARY - ITV plc

| | 31 Dec 2009 GBPm Original | 31 Dec 2008 GBPm Original | 31 Dec 2007 GBPm Original | 31 Dec 2006 GBPm Original | 31 Dec 2005 GBPm Original |
|---|---|---|---|---|---|
| **Profitability** | | | | | |
| Revenue | 1,879 | 2,029 | 2,082 | 2,181 | 2,177 |
| Revenue Growth (%) | (7.39) | (2.55) | (4.54) | - | - |
| Operating EBIT | 143 | 145 | 247 | 299 | 358 |
| Operating EBITDA | 240 | 247 | 346 | 407 | 494 |
| Operating EBITDA Margin (%) | 12.77 | 12.17 | 16.62 | 18.66 | 22.69 |
| FFO Return on Adjusted Capital (%) | 18.46 | 16.05 | 7.69 | 8.06 | 6.67 |
| Free Cash Flow Margin (%) | 10.06 | (4.19) | 1.30 | 1.33 | 2.07 |
| **Coverages (x)** | | | | | |
| FFO Gross Interest Coverage | 2.54 | 2.92 | 3.69 | 5.62 | 6.11 |
| Operating EBITDA/Gross Interest Expense | 2.31 | 2.17 | 6.41 | 6.17 | 9.15 |
| FFO Fixed Charge Coverage (inc. Rents) | 2.38 | 2.62 | 3.28 | 4.63 | 4.73 |
| FCF Debt-Service Coverage | 2.40 | 0.05 | 0.96 | 0.18 | 1.02 |
| Cash Flow from Operations/Capital Expenditures | 11.33 | 2.47 | 4.08 | 3.41 | 4.89 |
| **Debt Leverage of Cash Flow (x)** | | | | | |
| Total Debt with Equity Credit/Operating EBITDA | 5.08 | 5.57 | 3.66 | 4.16 | 2.32 |
| Total Debt Less Unrestricted Cash/Operating EBITDA | 3.32 | 3.77 | 2.42 | 2.14 | 1.19 |
| **Debt Leverage Including Rentals (x)** | | | | | |
| Rental Expense | 14 | 19 | 19 | 19 | 17 |
| Gross Lease Adjusted Debt/Operating EBITDAR | 5.24 | 5.74 | 3.88 | 4.34 | 2.50 |
| Gross Lease Adjusted Debt/FFO+Int+Rentals | 4.17 | 4.78 | 3.46 | 4.54 | 4.30 |
| FCF/Lease Adjusted Debt (%) | 14.21 | (5.56) | 1.90 | 1.57 | 3.52 |
| **Debt Leverage Including Leases and Pension Adjustment (x)** | | | | | |
| Pension and Lease Adjusted Debt /EBITDAR + Pension Cost | 6.30 | 5.96 | 3.87 | 4.56 | 3.08 |
| **Liquidity** | | | | | |
| (Free Cash Flow+Available Cash+Committed Facils)/(ST Debt + Interest) (%) | 473.64 | 99.72 | 327.34 | 157.96 | 677.53 |
| **Balance Sheet Summary** | | | | | |
| Cash and Equivalents (Unrestricted) | 422 | 446 | 428 | 824 | 558 |
| Restricted Cash and Equivalents | 160 | 170 | 170 | 137 | 105 |
| Short-Term Debt | 9 | 259 | 33 | 471 | 43 |
| Long-Term Senior Debt | 1,209 | 1,117 | 1,233 | 1,224 | 1,101 |
| Subordinated Debt | 0 | 0 | 0 | 0 | 0 |
| Equity Credit | 0 | 0 | 0 | 0 | 0 |
| Total Debt with Equity Credit | 1,218 | 1,376 | 1,266 | 1,695 | 1,144 |
| Off-Balance-Sheet Debt | 112 | 152 | 152 | 152 | 136 |
| Lease-Adjusted Debt | 1,330 | 1,528 | 1,418 | 1,847 | 1,280 |
| Fitch- identified Pension Deficit | 314 | 129 | 53 | 199 | 372 |
| Pension Adjusted Debt | 1,644 | 1,657 | 1,471 | 2,046 | 1,652 |
| **Cash Flow Summary** | | | | | |
| Operating EBITDA | 240 | 247 | 346 | 407 | 494 |
| Gross Cash Interest Expense | (120) | (103) | (106) | (69) | (46) |
| Cash Tax | 41 | 43 | 18 | (50) | (120) |
| Associate Dividends | 0 | 0 | 1 | 3 | 5 |
| Other Items before FFO (incl. interest receivable) | 24 | 11 | 26 | 28 | (98) |
| **Funds from Operations** | **185** | **198** | **285** | **319** | **235** |
| Change in Working Capital | 121 | (67) | (44) | (36) | (10) |
| **Cash Flow from Operations** | **306** | **131** | **241** | **283** | **225** |
| Total Non-Operating/Non-Recurring Cash Flow | (63) | (40) | (31) | (35) | (28) |
| Capital Expenditures | (27) | (53) | (59) | (83) | (46) |
| Dividends Paid | (27) | (123) | (124) | (136) | (106) |
| **Free Cash Flow** | **189** | **(85)** | **27** | **29** | **45** |
| Net (Acquisitions)/Divestitures | (48) | 20 | 60 | 195 | (233) |
| Net Equity Proceeds/(Buyback) | (3) | 0 | (11) | (282) | 8 |
| Other Cash Flow Items | (4) | (27) | (43) | (227) | (19) |
| Total Change in Net Debt | 134 | (92) | 33 | (285) | (199) |
| **Working Capital** | | | | | |
| Accounts Receivable Days | 66.92 | 60.44 | 62.76 | 52.88 | 48.79 |
| Inventory Days | 100.66 | 105.69 | 92.51 | 81.07 | 81.98 |
| Accounts Payable Days | 25.94 | 32.77 | 40.37 | 35.29 | 35.89 |

## Appendix 1 : ITV - Sector credit factors

| | Sector Risk Profile | Company-Specific Traits | | | | Financial Profile (historical where relevant and forecast, mid-points) | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | Market share and competitive intensity | Advertising reliant? | Control of quality content | Geographic diversification and absolute scale | FFO adj. leverage (x) | FFO adj. net leverage (x) | FFO int. cover (x) | Op. EBITDAR margin (%) | Pre-div. FCF/sales (%) |
| BBB | • Dominant pay-TV companies<br>• Dominant terrestrial broadcasters | • Strong position reflected in small number of major competitors (2 to 3)<br>• Stable or growing share of TV viewers | • Little reliance on ad-funded revenue<br>• Ad-funded pricing power is strong | • Ownership of in-house leading content production<br>• Market-leading aggregation of must-have content | • Strong market positions in a number of markets to benefit from programming efficiency or ad growth | 2.5 | 2 | 7 | 20-45 | 11 |
| BB | • Weaker terrestrial broadcasters<br>• Smaller pay-TV companies | • Medium market position, with lower or declining share of TV audience<br>• Presence of non-ad-funded competition | • Stronger reliance on ad-funded medium and weaker ad-funded pricing power | • Less own-produced content<br>• More reliant on acquired programming | • Less geographic diversity but some scale, ie audience delivery (but not dominant) | 3 | 2.5 | 6 | 15-20 | 8 |
| B | | • Weaker or small player in highly competitive market | • Solely reliant on ad-funded revenue and weak ad spend markets | • Do not control own content | • Single geography; small companies with no diversification | 4.5 | 4 | <5 | <15 | <8 |

General:
- Reliance on cyclical ad-funded TV spend
- Importance of TV for ad spend in each market?
- Growing demand for entertainment?
- Technology distribution risk and fragmentation of delivery
- Regulated licences and cross-ownership of media
- Largely fixed operating costs
- Potential licensing barriers to entry

This diagram shows indicative features observed for rated issuers in developed markets. Ratio levels refer to the midpoint of a through the cycle range, and as a result actual observations are likely to vary from these. Weighting of factors will vary substantially based over time for a given issuer, and between issuers based on relative significance determined by the rating committee. Factors give a high level overview as a convenience for rating users, and are neither exhaustive in scope nor uniformly applicable. These may vary for a given rating category, notably in emerging markets, and where group linkages constrain or enhance a rating level.

For more details, please see sector criteria report, Rating European TV Companies, published on 12 March 2010.