Smiths News

Preliminary results

Better FY22 than expected; 10% dividend yield

Industrial support services

24 November 2022

Smiths News' FY22 results were strong, with revenue and profit ahead of market expectations. Continuing adjusted PBT increased by 0.6% to £31.1m as financing costs reduced and net debt fell to £14.2m. Management was successful in mitigating inflation and controlling costs within budget. FY23 has started well, with uplifts in one-shot revenues and ancillary income. However, we have upgraded our forecasts, and an increase in the discount rate has driven a decrease in our DCF valuation from 94p to 89p. Smiths News trades on an FY23e P/E of 3.8x with a 10% yield, which we believe is attractive for a company with such cash-generative characteristics.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
08/21	1,109.6	31.9	11.3	1.5	3.7	3.7
08/22	1,089.3	32.3	11.7	4.2	3.6	10.1
08/23e	1,056.6	33.1	11.0	4.2	3.8	10.1
08/24e	1,024.9	33.5	10.8	4.2	3.9	10.1

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Results exceed estimates, debt cut by over two-thirds

FY22 revenue reduced by 1.8% y-o-y to £1.1bn as lower volumes were offset by cover price increases. Adjusted EBITDA (pre IFRS 16) edged down 4.5% to £40.7m, but was still higher than previous guidance. Adjusted operating profit stood at £38.1m, while adjusted PBT increased by 0.6% to £31.1m as financing costs declined with falling debt. Adjusted EPS was flat at 10.8p. The company declared a total dividend of 4.15p (more than twice covered). FY22 net debt fell from £53.2m to £14.2m, partially aided by one-off income. We have revised our estimates and increased our FY23 total adjusted operating profit forecast by 5.9% to £38.1m.

Positive outlook despite declining markets

Since the period end, Smiths News has announced that it has signed a new long-term newspaper distribution deal with Associated Newspapers until 2029. This agreement covers all the group's existing territories with Associated Newspapers. It is the first of the major newspaper contract renewals and followed the signing of new five-year magazine distribution deals with Frontline and Seymour. Collectively, these three long-term contracts account for 35% of Smiths News' revenue and are a clear industry endorsement of the future of newspaper and magazine categories.

Valuation: Modest downgrade from 94p to 89p

Our DCF valuation of Smith News has fallen from 94p/share to 89p/share, as an increase in our forecasts is offset by the higher risk-free rate (up from 1.9% to 4%). The upside to our valuation reflects the company's current strategy, which is to generate cash, pay down debt and return surplus cash to shareholders via dividends and 'special' payments. Smiths News trades on a P/E of 3.8x in FY23e, with a yield of 10.1% and the prospect of 'special' dividends to bolster the yield as debt falls. In our experience, when 'safe' dividend yields exceed P/E ratios in absolute terms, it indicates a value opportunity.

Price	**41.7p**
Market cap	**£103m**

Net debt (£m) at end FY22	14.2
Shares in issue	248
Free float	96.7%
Code	SNWS
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	21.9	34.5	19.1
Rel (local)	12.9	34.8	20.4
52-week high/low		42p	28p

Business description

Smiths News is the UK's largest newspaper and magazine distributor with a c 55% market share covering 24,000 retailers in England and Wales. It has a range of long-term exclusive distribution contracts with major publishers, supplying a mix of supermarkets and independent retailers.

Next events

AGM and trading update	January 2023
Interims	May 2023

Analysts

Andy Murphy	+44 (0)20 3077 5700
Natalya Davies	+44 (0)20 3077 5700

industrials@edisongroup.com

Edison profile page

Smiths News is a research client of Edison Investment Research Limited

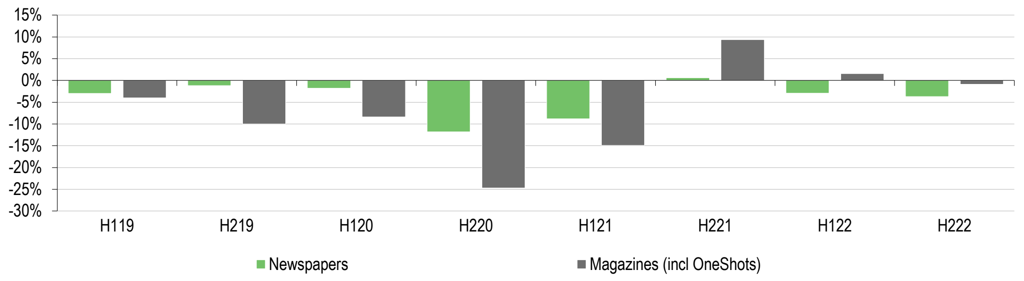
Resilient business model in challenging times

Despite ongoing market headwinds, Smiths News reported resilient FY22 results, with revenues down 1.8%, below the average pre-COVID annual decline (2015–20) of 3–5%. Adjusted operating profit dropped marginally by 3.8%, which excludes provisioning of £4.4m to cover bad debt risk following the collapse of McColl's. In addition to the progressive actions taken by management, a rise in high-margin, one-shot and collectable sales helped offset inflationary pressures, with revenues in these categories up 43% y-o-y. The company has seen continued demand in these categories so far in Q123, which is encouraging. We have raised our forecasts to reflect better than expected trading while acknowledging that inflationary pressures exist in the market. However, on the back of increasing the applied risk-free rate, we have decreased our valuation from 94p to 89p, which is still over 100% upside to the current share price.

Revenue and operating profit ahead of expectations for FY22

FY22 revenue of £1,089.3m represented a decline of only 1.8% y-o-y, lower than the historical pre-COVID-19 trend, with an even split between interim periods: H1 (£544.8m) and H2 (£544.5m) were down 1.2% and 2.4% y-o-y respectively. FY22 saw a strong performance from one-shot releases (+43% revenue increase y-o-y), mainly owing to Premier League football and Pokémon trading cards. Daily newspapers (-2%), and weekly (-3%) and monthly (-2%) magazines outperformed historical trends, as shown in Exhibit 1, but these robust figures were offset by a 9% decline in Sunday newspapers, where price rises were largely absent. The Dawson Media Direct (DMD) airline segment of the business saw a 27% rise in revenue to £4.2m, benefiting from normalised travel post-COVID and additional newspaper and magazine supply to Emirates and Thai Airways seen in H2.

Exhibit 1: Revenue performance of newspapers and magazines



Source: Smiths News, Edison Investment Research

Strength can be noted in the adjusted gross (6.7%) and operating margins (3.5%). The former rose 10bp y-o-y and is larger than the pre-COVID 2019 margin of 6.6%. In 2023 we will likely see increased one-shot revenue from the funeral of Queen Elizabeth II, the FIFA World Cup in Qatar, the coronation of King Charles III and the UEFA Nations League finals. A net debt reduction of 73% to £14.2m at YE22 presents a net debt:EBITDA ratio of 0.3x, comfortably below the company's main leverage covenant limit of 2.75x; one-off income including the pension surplus (£8.1m) and the final settlement of Tuffnells deferred consideration (£14m) were both used to pay down debt. With rising interest rates and inflationary headwinds, lower debt levels will bolster the group's financial position on account of the consequential lower interest charges.

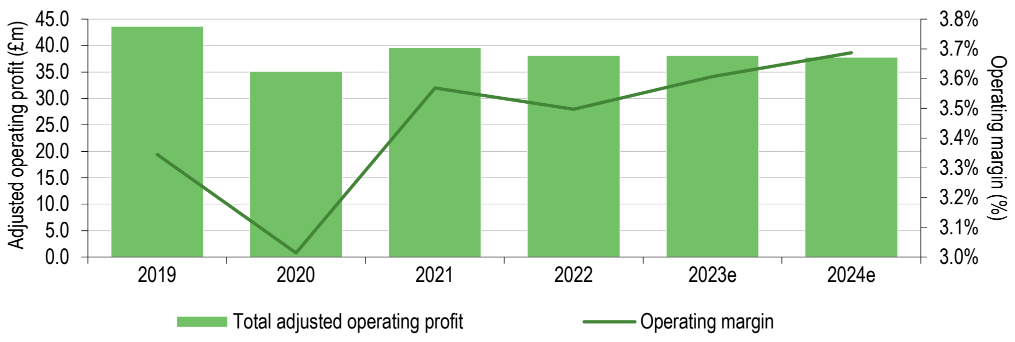
Exhibit 2: Summary of reported full-year results

Year end 31 August (£m)	2019	H120	H220	2020	H121	H221	2021	H122	H222	2022
Total revenue	1,303.5	623.1	541.4	1,164.5	551.6	558.0	1,109.6	544.8	544.5	1,089.3
% change	-	-	-	(10.7%)	(11.5%)	3.1%	(4.7%)	(1.2%)	(2.4%)	(1.8%)
Cost of goods sold	(1,217.5)	(581.7)	(509.7)	(1,091.4)	(515.9)	(520.3)	(1,036.2)	(508.0)	(508.6)	(1,016.6)
% change	-	-	-	(10.4%)	(11.3%)	2.1%	(5.1%)	(1.5%)	(2.2%)	(1.9%)
Gross profit	86.0	41.4	31.7	73.1	35.7	37.7	73.4	36.8	35.9	72.7
Gross margin	6.6%	6.6%	5.9%	6.3%	6.5%	6.8%	6.6%	6.8%	6.6%	6.7%
Total admin expenses	(42.9)	(21.7)	(16.4)	(38.1)	(16.9)	(17.0)	(33.9)	(17.9)	(17.1)	(35.0)
% change	-	-	-	(11.2%)	(22.1%)	(3.7%)	(11.0%)	5.9%	0.6%	3.2%
Income from JV	0.5	0.2	(0.1)	0.1	0.1	0.0	0.1	0.2	0.1	0.3
Total adjusted operating profit	43.6	19.9	15.2	35.1	18.9	20.7	39.6	19.1	19.0	38.1
% change	-	-	-	(19.5%)	(5.0%)	36.2%	12.8%	1.1%	(8.2%)	(3.8%)
Total adjusted operating profit margin	3.3%	3.2%	2.8%	3.0%	3.4%	3.7%	3.6%	3.5%	3.5%	3.5%

Source: Smiths News data, Edison Investment Research

The company has demonstrated its ability to successfully mitigate inflation through tight cost control and growth of ancillary revenues; the net impact of inflation was a modest £2.1m (less than 1% of revenue). Management estimates that inflation carry through to next year will be approximately £1.5m. Since October 2021, the group has benefited from fixed energy prices lasting to 2024, which represents a relatively small part of the cost base. Management has stated that it will continue to monitor when the right time is to extend the energy agreement.

Exhibit 3: Total adjusted operating profit and operating margin, FY19–24e



Source: Smiths News reports, Edison Investment Research

Contract renewals underpin attractive valuation

The current year has started well, with contracts representing 35% of newspaper and magazine sales revenues renewed until 2029, underpinning the sustainability of the business in the long term. Since the period end, the group has announced the signing of a new newspaper distribution deal with Associated Newspapers Limited, publisher of the *Daily Mail*, *The Mail on Sunday*, *'i'* newspaper and *New Scientist*. This new agreement covers all of the group's existing territories with Associated Newspapers and represents revenue of c £155m pa at current market values.

This agreement followed the signing of new five-year magazine distribution deals with both Frontline (the UK's largest magazine distributor) and Seymour (part of Frontline Group and the UK's largest independent magazine distributor). These contracts cover all of Smiths News' current distribution territories in the UK from 2025 to 2030, representing revenue of c £180m pa at current values. The two customers account for c 50% of the UK magazine market, making the deals a key endorsement of the UK magazine market and Smiths News' position within it as the UK's foremost route to market. Other discussions with leading UK publishers are ongoing and further agreements are expected to be announced in the next few years.

Despite current economic volatility and inflationary pressures, the combination of sustained margin mix and tight cost control provides confidence that the group will maintain its strong performance in FY23. The balance sheet has distributable reserves of £118.7m (FY21: £124.9m) to allow for future dividend payments.

Revised forecasts: PBT raised 5% in FY23e

Revenue for 2022 was c £12m ahead of our expectations, thus increasing the base for future years and hence the modest increase in our forecast revenue. In FY23 there is also an increased element of partworks as the funeral of Queen Elizabeth II, the World Cup in Qatar, the UEFA Nations League finals and the coronation of King Charles III fall into the period. This has led to a 5.9% increase in our FY23 total adjusted operating profit forecast to £38.1m. On the back of that, our revised FY24e adjusted operating profit has increased 8.6% to £37.8m.

We had already factored the inflationary pressures into forecasts hence we upgrade numbers rather than downgrade. These pressures include driver shortages at specific locations, higher fuel costs, contractor pressures and wage inflation. The company is no stranger to cutting costs, which it will continue to pursue through routing efficiencies and other initiatives; the overall net impact of inflation was £2.1m in 2022 and the company expects c £1.5m to roll through to next year.

We have increased PBT (reported, post-exceptionals) by 4.8% and 9.0% respectively in FY23e and FY24e, both figures above the reported £27.9m in FY22.

Exhibit 4: Forecast revisions

	2022	2023e			2024e		
		Old	New	% chg	Old	New	% chg
Revenue	1,089.3	1,044.9	1,056.6	1.1%	1,013.5	1,024.9	1.1%
Y-o-y % change	-	(3.0%)	(3.0%)	-	(3.0%)	(3.0%)	-
EBITDA - Edison basis	42.9	41.6	43.2	3.9%	40.4	42.9	6.2%
Y-o-y % change	-	(2.8%)	0.7%	-	(2.9%)	(0.7%)	-
EBITDA – reported adjusted pre IFRS 16	40.7	39.3	40.5	3.1%	38.1	40.2	5.5%
Y-o-y % change	-	(3.0%)	(0.5%)	-	(3.1%)	(0.8%)	-
Total adjusted operating profit	38.1	36.0	38.1	5.9%	34.8	37.8	8.6%
Y-o-y % change	-	(3.5%)	0.0%	-	(3.3%)	(0.8%)	-
PBT (Reported, post-exceptionals)	27.9	29.5	30.9	4.8%	28.7	31.3	9.0%
Y-o-y % change	-	14.8%	10.8%	-	(2.7%)	1.2%	-
EPS - diluted, normalised - Edison basis (p)	11.0	10.1	10.5	4.3%	9.5	10.3	8.2%
Y-o-y % change	-	(4.7%)	(4.5%)	-	(5.9%)	(2.4%)	-
DPS (p)	4.2	4.2	4.2	(0%)	4.2	4.2	(0%)
Y-o-y % change	-	0.0%	0.0%	-	0.0%	0.0%	-
Net debt (pre IFRS 16)	(14.2)	(5.1)	(2.6)	(49.3%)	(8.3)	(8.1)	(1.9%)
Y-o-y % change	-	(75.2%)	(81.8%)	-	62.7%	214.7%	-

Source: Smith News data, Edison Investment Research

Net debt for FY22 came in c 30% better than we estimated at £14.2m, as the company utilised one-off income including the pension surplus of £8.1m and the final settlement of Tuffnells deferred consideration of £14m to pay it down. We have modelled further reduction in net debt to £2.6m in 2023. This implies that Smiths News' net debt:EBITDA ratio is estimated to be 0.06x at the end FY23e, rising modesty to 0.2x at the end of the following year.

Valuation: Revised estimates offset by increased discount rate

We have retained our chosen DCF method to value Smiths News. This is because the decline in revenue is relatively constant, the reduction in the cost base is also factored into management action and it has a track record of delivering. Therefore, we believe that the profits and cash flow of the company are likely to be relatively robust and to decline only slowly over an extended period of time.

Our key assumptions include:

- **revenue declines of c 5% pa**, a combination of volume declines of 8–9% and annual price rises of 3-4%;
- **a terminal growth rate of -5% pa**; and
- **a WACC of 9.5%**, reflecting the cost of equity of 9.0% as the company moves to significantly lower levels of debt

Although we have increased forecasts marginally, the inclusion of a higher risk-free interest rate of 4% in the model (up from the previously used 1.9%) and subsequent higher WACC (9.5% versus the previous 7.5%) has resulted in a modest decrease in our valuation from 94p to 89p. The sensitivity table below shows how the valuation fluctuates with differing terminal value (TV) growth rates and WACCs. The current share price of c 42p is discounting a terminal growth rate of -10% and a WACC of 19%, both double the rates assumed in our base case scenario.

Exhibit 5: Smiths News DCF value per share (p)

		Terminal growth rate (%)				
		0.0%	**-2.5%**	**-5.0%**	**-7.5%**	**-10.0%**
WACC (%)	**10.0%**	99.0	91.3	86.0	82.3	79.5
	9.5%	104.0	95.1	89.3	85.1	82.0
	9.0%	109.5	99.3	92.8	88.1	84.7
	8.5%	115.7	103.9	96.5	91.4	87.6
	8.0%	122.6	109.0	100.5	94.8	90.6

Source: Edison Investment Research

Exhibit 6: Financial summary

£m	2019	2020	2021	2022	2023e	2024e
Year end 31 August	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT						
Revenue	1,303.5	1,164.5	1,109.6	1,089.3	1,056.6	1,024.9
Cost of Sales	(1,217.5)	(1,091.4)	(1,036.2)	(1,016.6)	(985.2)	(954.8)
Gross Profit	86.0	73.1	73.4	72.7	71.4	70.2
EBITDA – Edison basis	60.1	40.4	44.9	42.9	43.2	42.9
Normalised operating profit	44.0	35.4	40.6	39.3	39.3	39.0
Share-based payments	(0.4)	(0.3)	(1.0)	(1.2)	(1.2)	(1.2)
Total adjusted operating profit	43.6	35.1	39.6	38.1	38.1	37.8
Amortisation of acquired intangibles	(0.1)	(0.2)	0.0	(4.4)	0.0	0.0
Exceptionals	(7.2)	(7.8)	(1.9)	(2.5)	(1.0)	(1.0)
Impairment	0.0	(6.0)	(1.6)	1.2	0.0	0.0
Other financial costs	0.0	0.9	3.5	2.5	0.0	0.0
Other	0.0	0.0	(0.3)	0.0	0.0	0.0
Reported operating profit	36.3	22.0	39.3	34.9	37.1	36.8
Net Interest	(6.0)	(7.2)	(8.7)	(7.0)	(6.2)	(5.5)
Joint ventures & associates (post tax)	0.0	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0	0.0
Profit Before Tax (norm)	38.0	28.2	31.9	32.3	33.1	33.5
Profit Before Tax (reported)	30.3	14.8	30.6	27.9	30.9	31.3
Reported tax	(8.4)	(2.8)	(4.3)	(4.5)	(6.8)	(7.8)
Profit After Tax (norm)	29.6	25.4	27.6	27.8	26.3	25.7
Profit After Tax (reported)	21.9	12.0	26.3	23.4	24.1	23.5
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0
Discontinued operations	(53.4)	(18.7)	(0.1)	0.0	0.0	0.0
Net income (normalised)	29.6	25.4	27.6	27.8	26.3	25.7
Net income (reported)	(31.5)	(6.7)	26.2	23.4	24.1	23.5
Basic average number of shares outstanding (m)	246	245	244	239	239	239
EPS - basic normalised (p)	12.01	10.39	11.33	11.66	11.03	10.76
EPS - diluted normalised (p)	11.98	10.28	10.83	11.03	10.53	10.28
EPS - basic reported (p)	(12.78)	(2.74)	10.76	9.81	10.11	9.84
Dividend (p)	1.00	0.00	1.50	4.15	4.15	4.15
Revenue growth (%)	N/A!	(10.7)	(4.7)	(1.8)	(3.0)	(3.0)
Gross Margin (%)	6.6	6.3	6.6	6.7	6.8	6.8
EBITDA Margin (%)	4.6	3.5	4.0	3.9	4.1	4.2
Normalised Operating Margin	3.4	3.0	3.7	3.6	3.7	3.8
BALANCE SHEET						
Fixed Assets	31.5	66.5	47.1	41.9	34.4	12.8
Intangible Assets	10.1	4.0	2.3	1.7	(0.9)	(3.5)
Tangible Assets	10.9	9.4	9.4	8.6	9.8	11.0
Investments & other	10.5	53.1	35.4	31.6	25.5	5.3
Current Assets	181.2	165.9	139.1	147.5	145.2	141.9
Stocks	16.2	14.1	13.2	15.6	14.8	14.3
Debtors	124.2	101.2	106.6	95.7	95.1	92.2
Cash & cash equivalents	24.0	50.6	19.3	35.3	35.3	35.3
Other	16.8	0.0	0.0	0.9	0.0	0.0
Current Liabilities	(229.7)	(283.9)	(167.5)	(157.2)	(139.5)	(111.6)
Creditors	(173.7)	(139.5)	(136.5)	(140.3)	(134.2)	(109.7)
Tax and social security	0.0	(1.7)	(0.3)	0.0	0.0	0.0
Short term borrowings	(46.1)	(130.1)	(21.2)	(8.0)	3.6	(1.9)
Other	(9.9)	(12.6)	(9.5)	(8.9)	(8.9)	0.0
Long Term Liabilities	(57.3)	(30.1)	(76.4)	(64.2)	(58.2)	(48.8)
Long term borrowings	(49.3)	0.0	(50.1)	(39.1)	(39.1)	(39.1)
Other long-term liabilities	(8.0)	(30.1)	(26.3)	(25.1)	(19.1)	(9.7)
Net Assets	(74.3)	(81.6)	(57.7)	(32.0)	(18.1)	(5.7)
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0
Shareholders' equity	(74.3)	(81.6)	(57.7)	(32.0)	(18.1)	(5.7)
CASH FLOW						
Op Cash Flow before WC and tax	60.1	40.4	44.9	42.9	43.2	42.9
Working capital	(3.9)	(5.3)	(1.8)	2.8	(4.7)	(21.2)
Exceptional & other	(7.7)	(13.4)	(1.3)	(4.4)	(2.2)	(2.2)
Tax	(2.6)	0.0	(6.3)	(5.3)	(6.8)	(7.8)
Other	(22.9)	1.7	5.9	13.8	6.9	6.9
Net operating cash flow	23.0	23.4	41.4	49.8	36.4	18.5
Capex	(8.1)	5.3	(2.4)	(1.9)	(4.2)	(4.2)
Acquisitions/disposals	0.0	(10.2)	6.5	14.0	0.0	0.0
Net interest	(5.1)	(8.0)	(9.4)	(8.0)	(4.0)	(3.3)
Equity financing	0.0	(0.7)	(2.6)	(2.6)	(0.8)	(0.8)
Dividends	0.1	(2.2)	(1.0)	(5.9)	(9.8)	(9.8)
Other	(2.8)	(15.6)	(5.9)	(6.4)	(6.0)	(6.0)
Net Cash Flow	7.1	(8.0)	26.6	39.0	11.6	(5.6)
Opening net debt/(cash)	79.3	72.1	79.7	53.2	14.2	2.6
FX	0.1	(0.1)	(0.2)	0.0	0.0	0.0
Other non-cash movements	0.0	0.5	0.1	0.0	0.0	0.0
Closing net debt/(cash)	72.1	79.7	53.2	14.2	2.6	8.1

Source: company accounts, Edison Investment Research

EDISON

General disclaimer and copyright

Australia

New Zealand

United Kingdom

United States