

# Smiths News

Strong results, debt falling rapidly

Preliminary results

Industrial support services

8 November 2021

**Price** 40p  
**Market cap** £99m

Net debt (£m) at 31 August 2021 53.2  
Shares in issue 247.7m  
Free float 100%  
Code SNWS  
Primary exchange LSE  
Secondary exchange N/A

## Share price performance



## 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

Q1 trading update January 2022

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Management delivered on promises again as Smiths News produced a strong set of FY21 results. Operating profit increased nearly 13% and net debt fell to £53m (1.2x net debt:EBITDA versus c 2.0x in August 2020). Underlying market conditions are normalising and the company has adopted new sustainability targets, which is encouraging. We have raised our forecasts to reflect better-than-expected trading while acknowledging that inflationary pressures exist in the market. On the back of the upgrade, we have increased our valuation from 77.4p/share to 81.5p/share, twice the current share price.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
08/20	1,164.5	28.2	10.4	0.0	3.8	0.0
08/21	1,109.6	35.4	12.8	1.5	3.1	3.8
08/22e	1,065.2	30.1	10.0	2.3	4.0	5.8
08/23e	1,022.6	32.3	10.3	2.3	3.9	5.8

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

## Full-year operating profit up 13%, debt cut by a third

FY21 revenue came in at £1.1bn, down 4.7%, while adjusted EBITDA increased by 9% to £42.6m. Reported PBT grew 10.8% to £30.9m and reported EPS increased 11.3% to 10.8p/share, c 7% ahead of consensus. Free cash flow more than doubled to £24m and net debt fell from £79.7m to £53.2m, partially helped by timing effects. Smiths News declared a final dividend for the year of 1p/share making a total of 1.5p/share for the year, implying a dividend that was more than 7x covered by earnings.

## H2 recovery and efficiencies drove profits

The 4.7% decline in FY revenue was in line with the historical trend of -3% to -5%, although H1 was down 11.5% and H2 was up 2.9% versus a COVID-19 affected period, the latter benefitting from one-off sales, notably of Euro 2020 stickers and Pokemon trading cards. Newspaper revenue declined 4.3% (H1 down 8.8%, H2 up 0.6%) but stabilised more quickly than magazines as buyers shifted to local stores. Magazine revenues dipped 4.2% (H1 down 14.9%, H2 up 9.4%). The principal driver of the profit improvement was the Smiths News network efficiency programme that generated savings of £5m versus a net margin reduction of £2.2m.

## Valuation: Raised from 77.4p to 81.5p

We have increased our valuation of Smiths News from 77.4p to 81.5p/share based on a discounted cash flow (DCF) model, as we have rolled over the year end and raised estimates. Given the predictable and consistent cash flow of the core business, we believe this is a reasonable methodology to adopt. It also reflects the current strategy, which is to generate cash, pay down debt and return surplus cash to shareholders via dividends and 'special' payments. In absolute terms, Smiths News trades on a P/E of 4.0x in FY22e, with a yield of 5.8% and the prospect of 'special' dividends to bolster the yield as debt falls. In our experience, when 'safe' dividend yields exceed P/Es in absolute terms, it highlights a value opportunity.

## Summary of full year results and implications

Despite the ongoing COVID-19 related disruption and declining markets, Smiths News delivered a strong set of results with operating profit increasing by nearly 13%. Underlying market conditions are returning to normalised activity levels with some further recovery expected as the commuter and travel sectors fully reopen. In line with current trends Smiths News has adopted sustainability targets largely designed to reduce its carbon footprint, which is very positive. Finally, we have raised our forecasts to reflect better-than-expected trading while acknowledging that inflationary pressures exist in the market. On the back of the upgrade, we have increased our valuation from 77p to 81.5p/share.

### Revenue decline in line, but operating profit up 12.8%

The year to end August was clearly hampered by COVID-19 restrictions and comparisons with 2020 half years are also quite 'noisy' as H120 was largely unaffected by the pandemic, but H2 was severely affected. Therefore, it is not particularly surprising that H1 revenue fell 11.5% to £551.6m, but that H2 grew 3.1% to £558m. The full year decline of 4.7% was within the average annual decline of 3–5%.

Despite the falling revenues year-on-year, strength can be noted in the reported gross and operating margins. The former rose 30bp y-o-y to 6.6% which is in line with both FY19 and H120, both pre COVID-19. In fact, the gross margin in H221 was higher still at 6.8%, due largely to the partworks contribution. This will drop away in the current year but is likely to contribute in FY23, which will include partworks revenue from both the football World Cup in Dubai and the UEFA Nations League finals the following summer.

**Exhibit 1: Summary of reported full year results**

(£m)	2019	H120	H220	2020	H121	H221	2021
Total revenue	1,303.5	623.1	541.4	1,164.5	551.6	558.0	1,109.6
% change	-	-	-	(10.7%)	(11.5%)	3.1%	(4.7%)
Cost of goods sold	(1,217.5)	(581.7)	(509.7)	(1,091.4)	(515.9)	(520.3)	(1,036.2)
% change	-	-	-	(10.4%)	(11.3%)	2.1%	(5.1%)
Gross profit	86.0	41.4	31.7	73.1	35.7	37.7	73.4
Gross margin	6.6%	6.6%	5.9%	6.3%	6.5%	6.8%	6.6%
Total admin expenses	(42.9)	(21.7)	(16.4)	(38.1)	(16.9)	(17.0)	(33.9)
% change	-	-	-	(11.2%)	(22.1%)	(3.7%)	(11.0%)
Income from JV	0.5	0.2	(0.1)	0.1	0.1	0.0	0.1
Total adjusted operating profit	43.6	19.9	15.2	35.1	18.9	20.7	39.6
% change	-	-	-	(19.5%)	(5.0%)	36.2%	12.8%
<b>Total adjusted operating profit margin</b>	<b>3.3%</b>	<b>3.2%</b>	<b>2.8%</b>	<b>3.0%</b>	<b>3.4%</b>	<b>3.7%</b>	<b>3.6%</b>

Source: Company data, Edison Investment Research

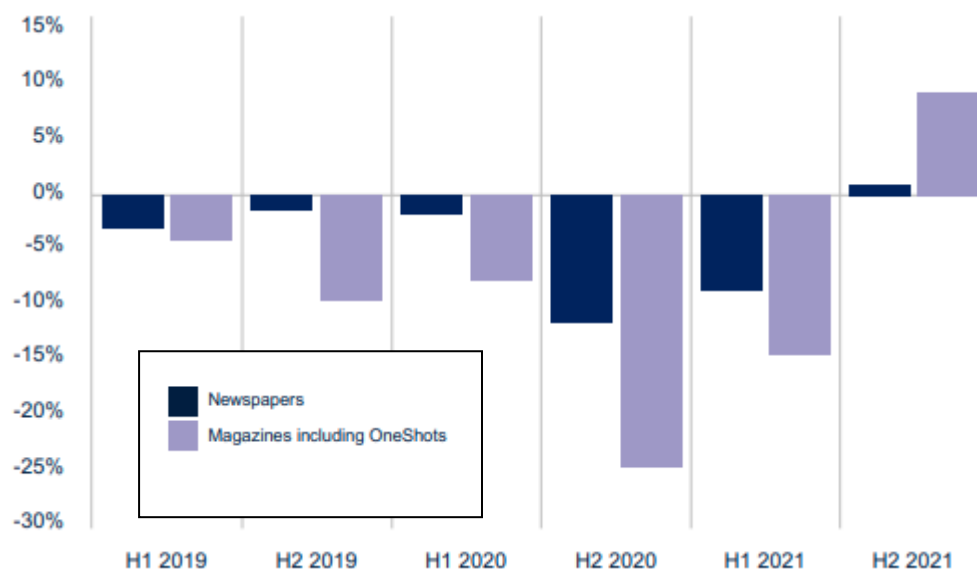
Administration costs were kept under control, assisted by the reduced headcount following the disposal of Tuffnells. This resulted in an adjusted operating margin that was up 60bp versus 2020 and 30bp versus 2019, to 3.6%. We estimate that the contribution to profits from partworks was c £1m for the full year, though most of this fell into H2.

### Underlying markets bouncing back post COVID-19

As already mentioned, revenues fell by 4.7%, in line with trends. However, magazine sales in particular, which are a smaller part of the revenue base but a higher margin activity, bounced back strongly in H2 versus easier comparatives, boosted by sales of one-shot titles, including stickers and albums relating to the Euros and Pokemon.

Newspaper sales were also affected of course, but some of the demand shifted to local vendors which meant that distribution volumes needed to be redirected. There is some optimism that overall sales can rebound in the current year as travel and commuting normalise.

**Exhibit 2: Sales performance of newspapers and magazines**



Source: Smiths News

## New ESG-based sustainability targets

Following a period of consultation, Smiths News has introduced a new ESG sustainability framework based on the principals of the UN Sustainable Development Goals and the introduction of structured disclosures-based reporting promoted by the Global Reporting Initiative. The outcome of the consultation is the introduction of five pillars of focus for activity which are: Governance, Environment, People, Community and Responsible Partnership.

In addition to the five areas of focus it has committed to the following ambitions:

- The migration of its subcontracted delivery service partners to sustainably fuelled vehicles by 2035 through the installation of supporting infrastructure at its sites by 2030.
- The migration of the company's car fleet to sustainably fuelled/hybrid vehicles by 2025 and of its heavy goods vehicles to decarbonised technology by 2030.
- All new warehouse locations to be net carbon neutral and current sites to be net carbon neutral by 2030.
- All gas and electricity to be sourced from 100% green/renewable sources by 2024.
- A colleague engagement score of 70% or greater each year and an improving trend of relevant 'promoters' within the underlying metrics.
- A material improvement in the ethnic and gender diversity of the leadership population.
- At least one board member from a minority group and at least two female members by 2026.

## Revised forecasts: PBT raised 3% and 11% in FY22e and FY23e

Revenue for 2021 was c £15m ahead of our expectations thus increasing the base for future years and hence the modest increase in forecast revenue. In FY23e there is also an increased element of partworks as both the 2022 World Cup and the UEFA Nations League finals fall into the period. This feeds the 1.2% increase in EBITDA (reported, pre IFRS) in 2022e to £38.8m. In 2023e the larger increase reflects our previously over-conservative assumptions.

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. Smiths News is of course no stranger to cutting costs which it will continue to pursue through routing efficiencies and other initiatives, but the company estimates that the costs could amount to c £2m at the EBITDA level.

Therefore, we have increased PBT (reported, pre-exceptional) by 3% and 11% respectively in FY22e and FY23e, though both figures are below the FY21 figure reported of £30.6m.

### Exhibit 3: Forecast revisions

Year end August (£m)		2021	2022e			2023e		
			Old	New	% chg	Old	New	% chg
Revenue		1,109.6	1,050.8	1,065.2	1.4%	998.3	1,022.6	2.4%
YoY % change		-	(5.3%)	(4.0%)	-	(5.0%)	(4.0%)	-
EBITDA - Edison basis		48.4	39.2	41.1	4.7%	36.4	41.9	15.1%
y-o-y % change		-	(19.0%)	(15.2%)	-	(7.1%)	2.0%	-
EBITDA - Reported pre IFRS 16		42.6	38.3	38.8	1.2%	35.5	39.6	11.5%
y-o-y % change		-	(10.1%)	(9.0%)	-	(7.3%)	2.2%	-
Normalised operating profit		44.1	34.6	36.6	5.7%	33.8	37.3	10.4%
y-o-y % change		-	(21.5%)	(17.1%)	-	(2.3%)	2.0%	-
PBT (Reported, pre-exceptionals)		30.6	27.2	28.1	3.2%	27.3	30.3	11.0%
y-o-y % change		-	(11.1%)	(8.2%)	-	0.3%	7.9%	-
EPS - Diluted, normalised (p)		12.2	9.0	9.9	9.8%	8.6	10.2	19.0%
y-o-y % change		-	(26.3%)	(19.0%)	-	(4.4%)	3.6%	-
DPS (p)		1.5	2.3	2.3	0.0%	2.3	2.3	0.0%
y-o-y % change		-	53.3%	53.3%	-	0.0%	0.0%	-
Net debt (pre IFRS 16)		(53.2)	(40.6)	(27.9)	(31.2%)	(26.1)	(10.1)	(61.1%)
y-o-y % change		-	(23.7%)	(47.5%)	-	(35.8%)	(63.7%)	-

Source: Company data, Edison Investment Research

Net debt for FY21 came in c £7m better than we estimated at £53.2m and we have modelled in the receipt of £6.5m of deferred consideration now received from the disposal of Tuffnells, hence the c £13m improvement in FY net debt in 2022e. This implies that Smiths News' net debt:EBITDA ratio is estimated to be 0.7x at the end FY22e, falling to 0.25x at the end of the following year.

There are some outstanding potential receipts including an £8m pension surplus, a further £4.25m of deferred consideration for Tuffnells that may be received in the current year and the final deferred consideration of £4.25m due in May 2023 that would reduce the net debt further on the assumption that these were all received as planned. We have not factored these receipts into forecasts. If received it would imply a net debt:EBITDA ratio of 0.3x at the end of the current year and a net cash position by the end of 2023 which could have implications for the current £6m pa dividend payment limits for the next two financial years.

## Revised estimates implies increase in valuation to 81.5p/share

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 c 3–4%;
- **constant operating margins of 3.3%**, a reflection of cost base action;
- **a terminal growth rate of -5% pa**; and

- a **WACC of 7.5%**, reflecting the cost of equity of 7.5% as the company would be debt free quite early in the modelling period. WACC is increased from 6.5% to reflect the faster paydown of debt.

Plugging these assumptions into our DCF model gives a valuation of 81.5p, up from 77.4p principally as we have rolled over the year end and raised estimates as described earlier.

The sensitivity table below describes how the valuation fluctuates with differing terminal value (TV) growth rates and WACCs. The current share price of c 40p is discounting a TV decline of 10% and a WACC of 15%, both roughly double the rates assumed in our base case scenario.

**Exhibit 16: Smiths News DCF value per share (p)**

		Terminal growth rate (%)				
		0.0%	-2.5%	-5.0%	-7.5%	-10.0%
WACC (%)	8.0%	97.8	85.3	77.5	72.3	68.4
	7.5%	105.0	90.4	<b>81.5</b>	75.7	71.4
	7.0%	113.2	96.0	85.9	79.3	74.6
	6.5%	122.6	102.2	90.7	83.2	78.0
	6.0%	133.6	109.2	95.8	87.4	81.6

Source: Edison Investment Research

**Exhibit 4: Financial summary**

	£'m	2019	2020	2021e	2022e	2023e	2024e
31-August		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
<b>INCOME STATEMENT</b>							
Revenue		1,303.5	1,164.5	1,109.6	1,065.2	1,022.6	981.7
Cost of Sales		(1,217.5)	(1,091.4)	(1,036.2)	(996.6)	(954.0)	(914.2)
Gross Profit		86.0	73.1	73.4	68.6	68.6	67.5
EBITDA		60.1	40.4	48.4	41.1	41.9	41.8
Normalised operating profit		44.0	35.4	44.1	36.6	37.3	37.2
Amortisation of acquired intangibles		(0.1)	(0.2)	0.0	0.0	0.0	0.0
Exceptionals		(7.2)	(7.8)	(1.9)	(1.0)	(1.0)	(1.0)
Share-based payments		(0.4)	(0.3)	(1.0)	(1.0)	(1.0)	(1.0)
Impairment		0.0	(6.0)	(1.6)	0.0	0.0	0.0
Other		0.0	0.9	(0.3)	0.0	0.0	0.0
Reported operating profit		36.3	22.0	39.3	34.6	35.3	35.2
Net Interest		(6.0)	(7.2)	(8.7)	(6.5)	(5.0)	(3.1)
Profit Before Tax (norm)		38.0	28.2	35.4	30.1	32.3	34.1
Profit Before Tax (reported)		30.3	14.8	30.6	28.1	30.3	32.1
Reported tax		(8.4)	(2.8)	(4.3)	(5.3)	(6.7)	(8.0)
Profit After Tax (norm)		29.6	25.4	31.1	24.7	25.6	26.1
Profit After Tax (reported)		21.9	12.0	26.3	22.7	23.6	24.1
Discontinued operations		(53.4)	(18.7)	(0.1)	0.0	0.0	0.0
Net income (normalised)		29.6	25.4	31.1	24.7	25.6	26.1
Net income (reported)		(31.5)	(6.7)	26.2	22.7	23.6	24.1
Basic average number of shares outstanding (m)		246	245	244	248	248	248
EPS - basic normalised (p)		12.01	10.39	12.77	9.99	10.35	10.52
EPS - diluted normalised (p)		11.98	10.28	12.21	9.88	10.24	10.41
EPS - basic reported (p)		(12.78)	(2.74)	10.76	9.18	9.54	9.71
Dividend (p)		1.00	0.00	1.50	2.30	2.30	3.00
Revenue growth (%)	#DIV/0!		(-10.7)	(-4.7)	(-4.0)	(-4.0)	(-4.0)
Gross Margin (%)		6.6	6.3	6.6	6.4	6.7	6.9
EBITDA Margin (%)		4.6	3.5	4.4	3.9	4.1	4.3
Normalised Operating Margin		3.4	3.0	4.0	3.4	3.6	3.8
<b>BALANCE SHEET</b>							
Fixed Assets		31.5	66.5	47.1	31.6	22.4	1.7
Intangible Assets		10.1	4.0	2.3	(1.5)	(5.5)	(9.5)
Tangible Assets		10.9	9.4	9.4	4.1	5.3	6.5
Investments & other		10.5	53.1	35.4	29.0	22.6	4.7
Current Assets		181.2	165.9	139.1	134.3	129.7	125.3
Stocks		16.2	14.1	13.2	12.8	12.3	11.8
Debtors		124.2	101.2	106.6	102.3	98.2	94.2
Cash & cash equivalents		24.0	50.6	19.3	19.3	19.3	19.3
Other		16.8	0.0	0.0	0.0	0.0	0.0
Current Liabilities		(229.7)	(283.9)	(167.5)	(136.8)	(113.7)	(79.7)
Creditors		(173.7)	(139.5)	(136.5)	(131.0)	(125.8)	(120.7)
Tax and social security		0.0	(1.7)	(0.3)	(0.3)	(0.3)	(0.3)
Short term borrowings		(46.1)	(130.1)	(21.2)	4.1	21.9	40.4
Other		(9.9)	(12.6)	(9.5)	(9.5)	(9.5)	1.0
Long Term Liabilities		(57.3)	(30.1)	(76.4)	(70.4)	(64.4)	(55.4)
Long term borrowings		(49.3)	0.0	(50.1)	(50.1)	(50.1)	(50.1)
Other long term liabilities		(8.0)	(30.1)	(26.3)	(20.3)	(14.3)	(5.3)
Net Assets		(74.3)	(81.6)	(57.7)	(41.2)	(26.0)	(8.1)
Shareholders' equity		(74.3)	(81.6)	(57.7)	(41.2)	(26.0)	(8.1)
<b>CASH FLOW</b>							
Op Cash Flow before WC and tax		60.1	40.4	48.4	41.1	41.9	41.8
Working capital		(3.9)	(5.3)	(1.8)	(0.7)	(0.6)	(0.6)
Exceptional & other		(7.7)	(13.4)	(4.8)	(2.0)	(2.0)	(2.0)
Tax		(2.6)	0.0	(6.3)	(5.3)	(6.7)	(8.0)
Other		(22.9)	1.7	5.9	6.8	6.8	7.0
Net operating cash flow		23.0	23.4	41.4	39.8	39.4	38.2
Capex		(8.1)	5.3	(2.4)	(4.2)	(4.2)	(4.2)
Acquisitions/disposals		0.0	(10.2)	6.5	6.5	0.0	0.0
Net interest		(5.1)	(8.0)	(9.4)	(6.5)	(5.0)	(3.1)
Equity financing		0.0	(0.7)	(2.6)	(0.8)	(0.8)	(0.8)
Dividends		0.1	(2.2)	(1.0)	(3.6)	(5.6)	(5.6)
Other		(2.8)	(15.6)	(5.9)	(6.0)	(6.0)	(6.0)
Net Cash Flow		7.1	(8.0)	26.6	25.3	17.8	18.5
Opening net debt/(cash)		79.3	72.1	79.7	53.2	27.9	10.1
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	27.9	10.1	(8.4)

Source: Company data and Edison Investment Research

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