Ten Network 10/06/2014 **FAT-AUS-676**

TEN AUD $0.285 Spec. **HIGH** B

A starter for Ten

To say that shareholders in Ten Network Holdings (ASX, TEN) have endured something of a rollercoaster ride over the past decade, is being overly kind. The company's share price has been in serial decline since late 2004, losing more than 90% of its value in the process. Some respite for shareholders did come in 2009 but was to prove only fleeting.

Ten, like many other industry participants has struggled with the structural headwinds facing the media industry in Australia (and witnessed globally), and has also arguably been somewhat sluggish in reacting, exacerbating what was already a difficult situation.

To characterise a company as a 'turnaround' situation is relatively simplistic, when significant shareholder value has been lost on the back of a collapse in earnings and severe revenue pressure. However in Ten's case we believe there are legitimate reasons to believe that we may have 'seen the 'bottom'. Recent half year results were not as bad as feared, and remedial action through substantial cost cutting looks set to lay the foundation for earnings returning to the black over the medium term.

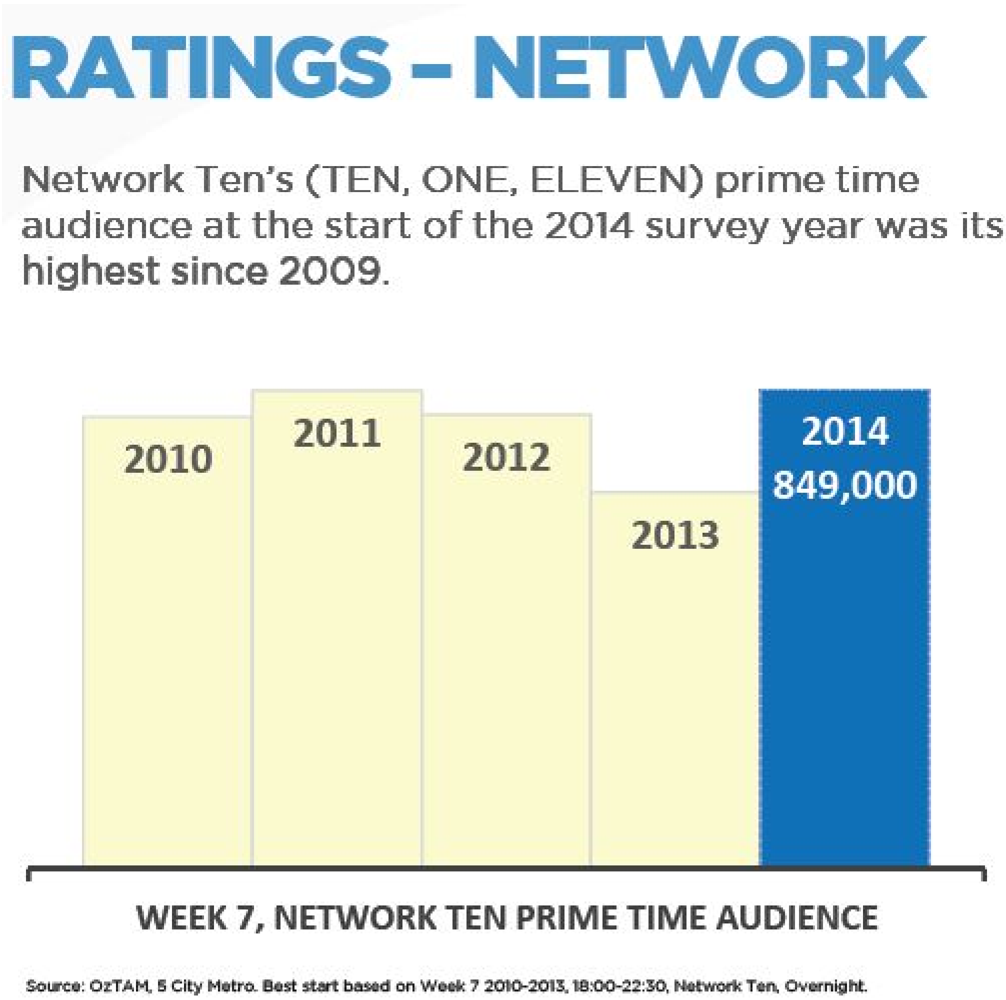
Meanwhile, whilst not a primary basis for this recommendation, we also believe that Ten may prove an attractive target as consolidation within the media sector steps up a gear, facilitated by imminent regulatory changes.

We are therefore recommending Ten as a speculative buy at current levels. Members should note this this recommendation carries a high degree of risk.

Half Year Results

Half year results for the six months to 28th February 2014 were released by the company in early April, with the market already braced for a poor showing. In the end the top line result was reasonably positive, with television earnings before interest, tax, depreciation and amortisation coming in at $10.1 million.

Television revenues (with main channels being TEN, ELEVEN and ONE) overall increased 4.4% to $315.0 million as industry spend ticked up, but also outpaced market growth of 3.1% as the company recorded its best start to a year ratings wise since 2009. Viewers were attracted by the company's investment in the 'Big Bash' T20 cricket tournament and the Sochi Winter Olympics.



Source: Half Year results presentation

However a recovering top line was not enough to cover increasing television costs which rose 14.3 per cent to $304.9 million. As a result the company recorded a net loss after tax of $8.0 million, and an underlying loss of $4.8 million. Mind you, the first half bottom line was small beer compared to the net loss of $243.3 million reported in the previous corresponding period which saw non- recurring charges of $244.8 million as the company underwent a restructuring and wrote down the value of TV licenses.

FY14 H1 INCOME STATEMENT

FY14 H1 Group Results ($m)	2014	2013	Fav / (Unf)
Television Revenue	315.0	301.7	4.4%
Television Expenses	304.9	266.8	(14.3%)
Television EBITDA	**10.1**	**34.9**	**(71.2%)**
Outdoor EBITDA	-	-	-
Group EBITDA	**10.1**	**34.9**	**(71.2%)**
Depreciation & Amortisation	7.5	7.8	4.1%
EBIT	**2.6**	**27.1**	**(90.4%)**
Net Interest Expense	7.8	11.3	31.8%
PROFIT BEFORE TAX, NRI & DISCONTINUED OPERATIONS	**(5.2)**	**15.8**	**(132.7%)**
Non Recurring Items	-	(304.0)	
Discontinued Operations	-	(7.1)	
(LOSS)/PROFIT BEFORE TAX	**(5.2)**	**(295.3)**	**98.3%**
Tax Revenue/(Expense) - Normal	0.4	(5.4)	107.5%
Tax effect of NRI's/Discontinued Operations	-	61.0	(100.0%)
(LOSS)/PROFIT AFTER TAX	**(4.8)**	**(239.7)**	**98.0%**
Non-controlling interest	3.2	3.6	9.3%
NET (LOSS)/PROFIT AFTER TAX ATTRIBUTABLE TO MEMBERS	**(8.0)**	**(243.3)**	**96.7%**
Underlying Net (Loss) / Profit After Tax Attributable to Members	*(8.0)*	*6.8*	*(217.4%)*

Onerous contract provisions of $8.5m (2013: $9.9m) for Television and $6.6m (2013: $5.8m) for Outdoor have been released during the period.
The information contained on this page may not necessarily be in statutory format. A full reconciliation of EBIT is provide in Appendix 4D for the half year ended 28 February 2014.

Source: Half Year results presentation

Ten has clearly come a long way in getting back towards profitability but still has further to go, and we believe some decisive steps have been taken here by boss Hamish McLennan.

TV companies necessarily need to invest in content to maintain and boost ratings, but also have to do so on an economic basis to conserve programming profitability. It seems Ten did so with mixed results, with the Big Bash investment proving a ‘break even’ investment although the company doubled its money on the Winter Olympics, generating around $30 million.

Nonetheless it is encouraging that Ten seems to be gaining a greater share of the industry pie, recording market share of 24.2% in February 2014, the highest since March 2013. The trick will now be to maintain momentum post one-off big events, and to do so through ‘economical investment’. This is particularly while the general advertising market remains somewhat tepid and the outlook for 2014 subdued. Recent stats had Ten at less than 20% revenue share in April though, increasing the need for action on the costs front.

As history has shown, costs need to have intense focus when earnings are under pressure, and we are encouraged by moves the company is making here. Ten recently axed its underperforming breakfast program ‘Wake Up’ and its early, morning and late news bulletins, with 150 jobs going, to reduce costs.

The changes suggest to us that management are firmly intent on getting earnings back into the black and that there is no room for historic loyalties. A leaner cost base will also provide Ten with more leverage to an eventual recovery in the TV advertising market, and also any further inroads into ratings. The latter could see a gain from the Glasgow Commonwealth Games coverage as well as new landmark content deals.

Digital Opportunities

Ten has been slow in addressing opportunities in digital but at least looks to be getting further down the road. The company launched its ‘tenplay’ website and app last September. Content here has expanded whilst partnerships have also been agreed with Microsoft Xbox and Google Android. This initiative has come ‘better late than never’ and a focus on digital will also help restore earnings positivity over the medium term.

Balance Sheet

Given the earnings pressure that Ten has been under it is no surprise that the company's balance sheet has come in for some attention. At the half year end net debt came in at $35.9 million which was an increase of $8 million on the year before. Interest cover however is still sound at 2.22 times.

The company however has sufficient liquidity, having used 'only' $55 million of a $200 million debt facility approved in February. The facility is guaranteed by major shareholders Lachlan Murdoch, Bruce Gordon and James Packer.

DEBT STRUCTURE

	Facility ($m)	Maturity	Feb 2014 ($m)	Aug 2013 ($m)	Feb 2013 ($m)
AUD $150m USPP	-	Dec-15	-	150	150
Domestic Facility	200	Dec-17	55	-	-
Total			**55**	**150**	**150**
Cash at Bank			(20)	(122)	(149)
Net Debt			**36**	**28**	**1**
Debt Service Ratio			3.27x	3.59x	2.48x
Net Debt Service Ratio			2.12x	0.66x	0.02x
Interest Cover Ratio			2.22x	4.39x	3.22x

The information contained on this page may not necessarily be in statutory format. Refer to the Appendix 4D for the half year ended 28 February 2014 for statutory format.

Source: Half Year results presentation

At current rates of cash burn Ten could end up using this facility in the next few years, however that is presuming there is not a material improvement in any of the advertising markets, Ten's share thereof, or the company's cost base. The company is certainly taking action to address the latter, whilst we also believe that a cyclical turnaround in ad spend is on the horizon as confidence improves.

M&A potential

A sense that the media industry is back on the up can also be seen in the increasing number of M&A deals in the sector. Recent tie ups include Viacom's purchase of Channel 5 while AT&T is buying DirecTV in the US.

Ten is certainly not in a position to play the suitor at this juncture, but could well find itself receiving attention. Recent months have seen speculation that a major US free to air TV network has made the trip down under to explore 'options' which extend beyond programming deals. Britain's ITV is also said to have been in talks about a 'strategic investment'.

As we have stated in our initiation on Prime Media, there are changes afoot which will see reforms on media ownership. This could open up the door to more industry consolidation, which may involve Ten. One tie up in such an event could involve Newscorp with Ten's former chairman, and still significant shareholder, Lachlan

Murdoch (co-Chairman of News Corp) likely to be a key deal broker. He stepped down as Chairman of Ten in March and maintains an 8.8% share-holding.

Another possibility is a combination with fellow sector battler Fairfax Media. Gina Rinehart, a director of and key stakeholder in Ten, also has a 14.9% holding in Fairfax, and could be a proponent for a tie up.

Turning to the charts, we see that on the five year above, the downward trend has been broken, with the past 18 months being about the stock bottoming out, testing support at 20/25 cents. The recent uptrend (refer the daily chart) is now encountering resistance, but this now looks set to break through to retest 35/36 cents.

Summary

We believe that the Ten has many of the hallmarks of a compelling turnaround story. We believe the low point for earnings has been passed with costs being taken out of the business, increasing leverage to a recovery in industry revenues over the medium term.

The shares are not without risk with the company still making losses and the near term landscape far from assured. However comfort is provided by the debt headroom that the company has, and the fact that the prospect of industry consolidation is likely to maintain tension in the share price.

We are therefore recommending Ten as a High Risk buy at current levels for Members with a medium to longer term investment horizon.

Disclosure: Ten Network Holdings is held in the Fat Prophets Concentrated Australian Share and Small/Mid-Cap Models.

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Snapshot TEN

Ten Network

Latest Closing Price: $0.285

Ten Network Holdings Limited operates commercial television stations through five capital cities in Australia know as the Ten Network. The Company broadcasts and produces television shows, movies, news and sporting events. The Company also provides outdoor advertising services.

Market Capitalisation:$750m

	FY1	FY2
Price to Book	0.90	0.88