ALIGN
RESEARCH

# Zinc Media

23rd November 2017

## Factual TV production specialist set to become a "super-indie"

**Zinc Media is an AIM listed TV production and multimedia communications content business which is focusing on becoming one of the UK's leading independent factual TV producers.**

### Re-structured and re-focused

Over the past two years Zinc has restructured its operations via the appointment of a new senior management team, closure of loss making publishing operations and restructuring of debt. The corporate strategy is now focused upon growing the business, organically and by acquisition, into one of the UK's leading independent factual TV producers.

### Consolidation under way via two complementary acquisitions

In line with its strategy to consolidate the fragmented UK TV production industry, Zinc completed the reverse takeover of Reef Television in July 2015. This was followed in November 2017 by the acquisition of Tern Television Productions. Based in Scotland & Northern Ireland, Tern is expected to benefit from growth in regional programming, with the deal forecast to be earnings enhancing in FY2018.

### Results for 2017 highlight the benefits of the restructure and point towards strong growth in 2018

For FY2017 the company achieved profitability at the EBITDA level on an annual basis for the first time since 2010. **With the order book being 76% higher in the TV division compared to the end of 2016, significantly increased profits are expected in FY2018.**

### Transaction based valuation multiple suggests minimum upside of 60%

Based on recent industry transactions we set an end 2019 fair value price target of 1.32p per share, 60% higher than the current price. We see this as a base case scenario, with potential for further value to be derived. **We therefore initiate coverage of Zinc Media with a Conviction Buy stance and a 1.32p price target.**

*Table: Financial overview. Source: Company & Align Research*

| Year to end June | 2016A | 2017A | 2018E | 2019E |
|---|---|---|---|---|
| Revenues (£m) | 22.62 | 19.76 | 31.05 | 34.68 |
| EBITDA (£m) | (0.43) | 0.44 | 1.20 | 1.80 |
| EPS (p) | (0.91) | (0.01) | 0.004 | 0.065 |

*This investment may not be suitable for your personal circumstances. If you are in any doubt as to its suitability you should seek professional advice. This note does not constitute advice and your capital is at risk. This is a marketing communication and cannot be considered independent research.*

## CONVICTION BUY – Price Target 1.32p

**Key data**

| | |
|---|---|
| EPIC | ZIN |
| Share price | 0.825p |
| 52 week high/low | 1.78p/0.68p |
| Listing | AIM |
| Shares in issue | 1,359,586,281 |
| Market Cap | £11.22m |
| Sector | Media |

**12 month share price chart**


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**IMPORTANT:** Zinc Media is a research client of Align Research. Align Research owns shares in Zinc Media. For full disclaimer & risk warning information please refer to the last page of this document.

## Corporate Background

Zinc Media has its origins in media business Ten Alps. Founded in 1999, the company listed on AIM in 2001 following the reverse takeover of Osprey Communications.

Driven by a total of 17 acquisitions up until March 2008, the business built up a sizeable operation in the areas of TV production, online and print media, with revenues peaking at £81.4 million that financial year. However, Ten Alps was then hit by a mix of issues following its record annual performance, including the advertising downturn caused by the 2008/09 recession, cancellation of contracts, asset impairments and debt concerns.

**The business as it is today, which has been streamlined into the three divisions of TV Production, Digital Communications and Publishing, is the result of several years of various restructuring activities which were finally completed in the last financial year. The primary focus of the business today and its future growth strategy is upon TV Production, which drives the majority of the group's revenue.**

Shaping the current operations was the July 2015 reverse takeover of TV production business Reef Television. This was the first step in a new strategy to focus the group on consolidating the fragmented UK independent factual TV production sector, which was further advanced by the recent acquisition of Tern Television (see page 10). At the same time as the Reef acquisition a £4.5 million placing was completed at 2p per share, along with a 10 for 1 share consolidation and debt waiver, repayment and conversion into equity and preference shares, resulting in a reduction of long-term debt obligations from £9.06 million to £2 million.

A number of board changes have also taken place in the past two years. In October 2015 CFO Nitil Patel resigned and was replaced by David Galan in January 2016. Further, CEO Mark Wood resigned with immediate effect in July 2016. The CEO position was not directly replaced, with David Galan taking on the role of Chief Operating Officer and Chairman Peter Bertram taking on additional responsibilities.

**Under the new senior management team a number of other notable changes have taken place.**

During 2016 the decision was made to exit certain loss making publishing operations rather than invest further cash and management time into turning them around. In June 2016 the niche publisher and event organiser Grove House Publishing was disposed of and in August London based publishing business, Ten Alps Media Limited, which had been loss making for a number of years, was placed into creditors' voluntary liquidation. Also, the business activities of the remaining publishing unit - Ten Alps Communications Limited were restructured, with many unprofitable contract publishing activities and owned titles terminated and closed down. **The remaining publishing operations are now trading profitably and based in a separate office in Macclesfield with a standalone management team.**

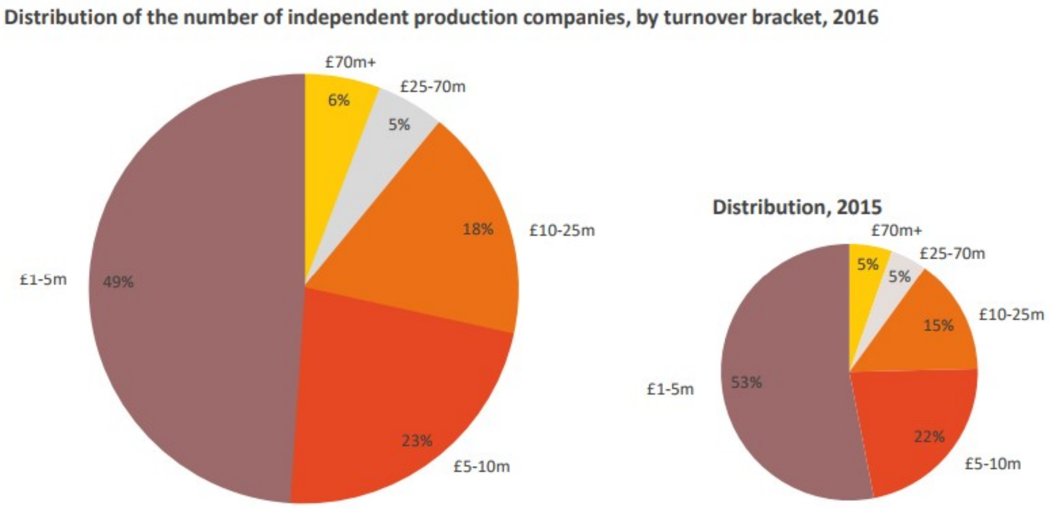
In November 2016 a further placing of £837,836 was completed at 0.75p per share, with the proceeds used to fund cash consideration due to the Reef vendors and for working capital purposes. At the same time, **Zinc restructured the repayment dates on all of its short and long-term debt, with a repayment of both principal and interest now due on 31st December 2020.** Also, in November 2016, to reflect the newly refocused business, the company changed its name from Ten Alps to Zinc Media.

## Current Strategy

Zinc Media's current strategy is focused on growing the business into one of the UK's leading independent factual TV producers via both organic and acquisitive means. **The medium-term ambition is to scale up the business and explore a potential exit around 2020.**

On the acquisitions side the company is looking to take advantage of opportunities to consolidate the fragmented independent TV production market and build itself up into a "super-indie". Giving a broad view of the acquisition opportunities available to Zinc, the 2017 *Production 100* report from specialist industry publication Televisual highlights 100 independent UK TV producers, across all genres, with annual revenues ranging from £197.1 million to £2.8 million.

The chart below, from the 2017 industry *Census* put together by Oliver & Ohlbaum for trade body PACT, also highlights the fragmented nature of the industry. It shows the distribution of 137 UK independent production companies by revenue bracket, with the market being characterised by having many small producers and fewer larger groups. In addition to the companies considered, the report estimates there are c.300 small producers with an annual turnover of less than £1 million.




*Source: Broadcast, Pact UK Television Production Census 2017, Oliver & Ohlbaum analysis*

**The industry is seeing a trend towards consolidation, with studios looking towards building scale and creative breadth in order to capitalise on opportunities in the UK and in the increasingly lucrative international markets (see Market Overview section below).** Regulator Ofcom's 2015 report into the TV production industry suggest that in 2001 there were over 500 UK TV producers, most of them being small producers (revenues of <£10 million). By 2014 Ofcom suggests there were only 230 small producers with at least one programme broadcast by the BBC, ITV or Channels 4 & 5.

Alongside the acquisition strategy Zinc is looking to grow organically by producing higher revenue programmes. This involves focussing on securing larger budgets for higher quality productions and longer running series which have the capacity to deliver strong royalties through international distribution. This will be balanced by producing a mix of fast turnaround 'one-offs' that drive smaller short-term revenues and help to smooth out troughs in income.

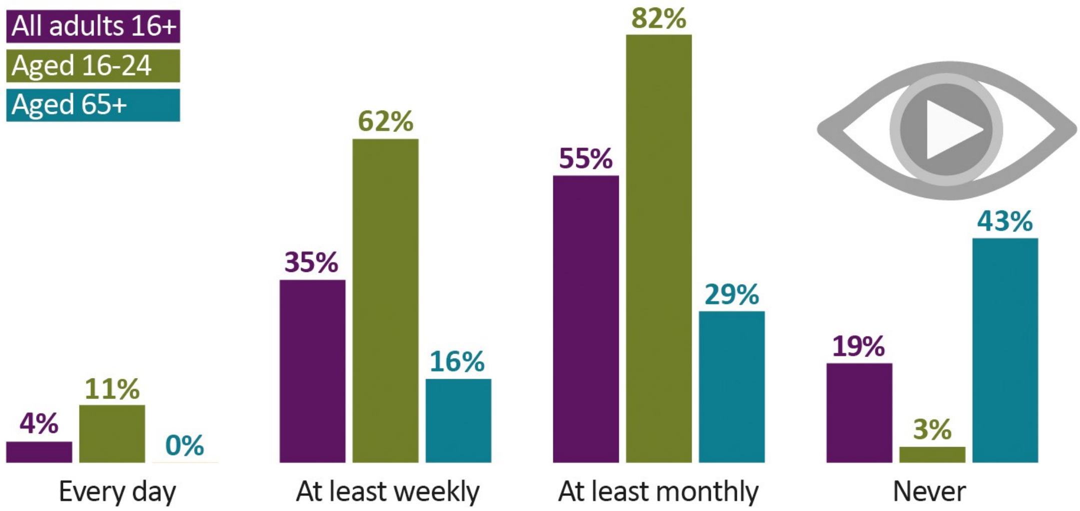
Zinc also intends to recruit more executive talent to push new ideas and expand its traditional content into new factual genres and formats. To that effect, in the last financial year Roy Ackerman was hired as Director of International and Managing Director of subsidiary Films of Record and Emma Hindley appointed as Creative Director of Brook Lapping.

## TV Production Market Overview

According to PwC's *Global Entertainment & Media Outlook 2016–2020,* the global TV market is set to grow total revenues to $325 billion by 2020, up from just under $290 million in 2016. Although PwC expects the majority of revenues ($288 billion) to come from traditional broadcast TV ("linear") in 2020, the fastest growth is expected to come from areas including video-on-demand, streaming and interactive (also known as "non-linear"). These are forecast by PwC to grow by a CAGR of 11.5% up until 2020, compared with just 1.7% for traditional broadcast.

The high growth in demand for non-linear services has been driven over the past decade or so by technology and changing viewing habits, with TV consumers moving away from watching live broadcast TV and towards on-demand services such as the *BBC iPlayer* and subscription services such as *Netflix* and *Amazon Prime*. The rapid growth in connected devices such as smartphones and tablets has been a key factor in this shift and helped to boost demand for high quality on-demand TV content.

Not only are consumers shifting their viewing habits, they are also consuming more content. For example, the rise of on-demand services has increased the phenomenon of "binge watching", where viewers watch multiple episodes, typically of the same TV show, in one go. According to Ofcom's *Communications Market Report 2017*, 79% of adults now watch multiple episodes of their favourite shows in a single sitting. This is a particularly popular habit amongst the 16-24 age demographic, with 82% binge watching at least monthly and 62% at least weekly.



*Binge watching demographic survey statistics: Source: Ofcom Communications Market Report 2017*

To satisfy this increase in consumer demand, new international TV platforms such as Netflix and Amazon have begun commissioning their own programmes, including a number of high profile, big-budget series. Across the industry, recent drama series such as *Versailles*, *House of Cards* and *The Night Manager* were reported to have production costs between £2.5 million and £5 million per hour. Netflix itself, which currently has c.104 million paid subscribers, recently suggested alongside its Q3 2017 earnings announcement that it would spend between $7 billion and $8 billion on content in 2018, up from c.$6 billion this year, with 25% committed to original programming.

In the UK, the 2017 PACT Census suggests that total UK producer revenues were £2.586 billion in 2016, down 2.9% compared to 2015 mainly as UK primary commissions fell from £1.55 billion to £1.503 billion. However, reflecting the trends mentioned above, revenue from international primary commissions rose from £430 million in 2015 to £468 million in 2016, driven largely by commissions from digital services. According to PACT, international TV revenues rose by a CAGR of 13.2% during 2010-2016, compared to a CAGR of just 1.6% in UK TV revenues.

## Operations

Operating through three divisions, Zinc Media is a TV and multimedia content producer and is one of the UK's leading independent TV production companies, specialising in non-scripted factual programming. Following the recent restructuring the group now consists of three divisions, **TV Production, Digital Communications** (which are strategically housed together in the same London office) and, based in Macclesfield, **Publishing**.

### Television Production

The core of the business is the television production division, which made up 77% of total revenues in the last financial year. It comprises six award winning and critically acclaimed television production companies, Blakeway, Blakeway North, Brook Lapping, Films of Record, Reef Television and Tern Television (discussed on page 10), which produce television and radio programmes for the majority of broadcasters in the UK and a number of key international broadcasters.

#### Blakeway Productions

blakeway

Bought by the group in May 2004, Blakeway has over two decades' experience in making films for television and cinema, specialising in history, wildlife, arts and current affairs. Clients include major UK and international broadcasters including the BBC, Channel 4, ITV, FIVE, HBO, PBS, Discovery, NHK, Arte and National Geographic. In addition to film-making, the company also has an award-winning radio production arm and has a regional arm based in Manchester, Blakeway North.

Recent productions include *7 Days That Shook the Windsors* for Channel 5, *Dispatches Undercover: Britain's Cheap Clothes* for Channel 4 and *9/11: Truth, Lies and Conspiracies* for ITV. Blakeway has won awards in every major television award ceremony including the BAFTAs, Griersons, Royal Television society awards and Emmys. Blakeway North recently received a BAFTA nomination in the factual category of the 2017 Children's Awards for its documentary *Born to Vlog*, which was made for CBBC. This is the sixth time that a Zinc Media company has been recognised by BAFTA in the last three years.

**Blakeway North**

Blakeway North is an award-winning regional production company, based in Manchester, specialising in factual programming. Voted Prolific North's Independent Production Company of the Year, Blakeway North works with all the major British broadcasters and have a well-earned reputation for warm, intelligent, relatable programming.

Blakeway North is known for access-driven factual documentaries. By instigating and maintaining strong relationships with individuals and institutions, it tells emotionally engaging, human stories with integrity. It often delivers programmes that are both critically acclaimed and audience-friendly, often winning bumper ratings.

Blakeway North has had particular success with long running series such as Bargain Loving Brits in the Sun, which is in production for a third series for Channel 5. Recently Blakeway North were double winners at the RTS North West Awards. 'My Life – Born to Vlog' won the award for Best Children's Programme for School Age category whilst 'Kicked Out - From Care to Chaos' won the award for Best Current Affairs Programme.

**Brook Lapping**

Brook Lapping is a specialist in producing documentaries and is especially well known for its series on international politics. Acquired in November 2002, it has made definitive series on British political leaders, including Margaret Thatcher and Tony Blair, and has run *Question Time* for BBC1 and *A Week in Politics* for Channel 4. Four part series, *Inside Obama's White House,* made for BBC2, received a 2017 BAFTA nomination. Brook Lapping has also made a number of award-winning radio features for BBC Radio 4.

**Films of Record**

Founded in 1979 by Roger Graef OBE, and part of the group since its acquisition in August 2008, Films of Record specialises in producing high-quality factual programming for all the major broadcasters. Genres include observational documentaries on social issues, criminal justice, business, current affairs and science. Recent commissions include *Panorama: The Spy in the IRA* for the BBC, *Passions: Gary Kemp on Mick Ronson* for Sky Arts and *The Billion Pound Flower Market* for Channel 4. In 2016 the company was nominated for six BAFTA awards, winning Best Factual Series for *The Murder Detectives.*

**Reef Television**

Acquired in July 2015 for an initial £2 million plus up to £3 million in potential earn-outs, Reef Television is a specialist factual production company with an in-house post production department which has made hundreds of hours of both peak time and daytime broadcast factual programmes for clients including the BBC, Channel 4, Discovery, ITV, Channel 5 and UKTV.

Founded in 2003 by former BBC and Talkback Productions producer Richard Farmbrough, the company has produced multiple landmark music films for BBC Two including the Emmy-nominated *Messiah at the Foundling Hospital* and *Leningrad and the Orchestra That Defied Hitler*. It has produced multiple series of *Penelope Keith's Hidden Villages* and *Selling Houses With Amanda Lamb* for Channel 4, *Paul Hollywood's City Bakes* for Food Network, along with BBC Daytime's hit antiques show *Put Your Money Where Your Mouth Is.*

To date, the business exceeded expectations in the first financial year since acquisition but, despite operating profitably, did not quite reach the target set for the second year of the three year earn-out. However, increased profitability is expected in the current financial year, which should see earn-out payments due.

## Digital Communications

Zinc Communicate, the digital communications division, specialises in designing, creating and executing communications strategies and behaviour change programmes, campaigns and resources for blue-chip companies, charities and government departments. The aim is for these programmes to engage, educate and activate wider audiences, and to push clients' branded content and storytelling through digital communications and short-form film. The division made 13% of total group revenues in the last financial year.

A selection of blue-chip clients in the division include the likes of AstraZeneca, National Grid, The BMW Group, Vodafone and Thames Water. A key contract is with Transport for London (TfL) where Zinc Communicate has created The Children's Traffic Club, a programme aimed at improving road safety via a range of fun multi-media activities targeted at young children and parents. The programme has reached over 85% of pre-school children living in Greater London and in October this year Zinc Communicate was awarded a one year extension to the contract, beginning 1st April 2018.

Showing wider industry recognition, Zinc Communicate recently won gold, silver and bronze awards for Best Drama, Best Health & Safety Film, Best Direction and Best Training Film at the EVCOM Screen Awards 2017. It also won a bronze award for Best Drama for *Get Real with Money*, a series of films on money management for Nationwide Building Society.

## Publishing

Following the recent restructuring, the remaining publishing operations made up 10% of total group revenues in the last financial year. The remaining unit, Ten Alps Communications, based in Macclesfield, mainly publishes homeowner-planning guidelines for local authorities across the UK under a five year contract with the Local Authority Building Control (LABC) and sells trader advertising in those guidelines.

The division recently completed the third year of the contract with LABC, with the focus being on transitioning from print products to e-books and digital through the 'Home & Build' website, a nationwide directory of trusted and council endorsed tradespeople. Additional revenue streams include the production of short films for local authorities to use to raise awareness around building control and planning permission issues.

In terms of the wider group strategy the division is seen as non-core however, small scale growth opportunities have been identified. For example, in the last financial year the business was awarded a contract by the Royal Institute of British Architects to publish certain annual directories and a deal to sell trader advertising and provide content to the Planning Portal, a joint-venture between the Department for Communities & Local Government and a private company focused on providing an online planning and building regulations information portal.

## Tern Television Productions Acquisition

In line with its new strategy, on 25th October Zinc Media announced the acquisition of regional television production company **Tern Television Productions** for a total consideration of up to £5.45 million. In conjunction, a placing to raise just over £3.5 million before expenses was announced, with the deal completed on 14th November following a General Meeting to approve certain resolutions related to the fundraise.


**Tern Operations**

Founded in 1988 Tern is a profitable independent TV production company specialising in factual TV production across the areas of documentary, specialist factual and popular factual. The company has its key production bases in Glasgow, Aberdeen and Belfast and typically produces over sixty hours of TV content annually for a range of UK broadcasters including the BBC, ITV, Channel 4 and Sky One, as well as international broadcasters including Discovery, PBS and National Geographic Channels.

Some recent productions include; *Best Laid Plans*, ten hour-long episodes for Channel 4 which follows two families renovating their homes; *How to Stay Well*, four half hour episodes for Channel 4 revealing the tips and tricks we all need to stay fit and well; and *Air Ambulance ER*, six 60 minute episodes for Sky One which tells the stories of the men and women who save lives daily as they take A&E to the roadside.

Televisual Media's 2017 annual TV industry survey put Tern as number 29 in the Top True Independents league table and at number 7 in the Genre Ratings: Specialist Factual list. Broadcast's 2017 survey showed Tern at number 14 in the Regional Indies. Tern has also won numerous awards for its programming, including BAFTAs, Prix Italia, Royal Television Society awards and a Cine Golden Eagle.

In the year to 31st March 2017 Tern made revenues of £5.34 million, up from £4.4 million in 2016, with a pre-tax profit of £0.30 million. **The deal is expected to be earnings enhancing in the current financial year and all of Tern's management team intend to stay with the company following completion.**

The acquisition is in line with Zinc Media's strategy to consolidate the fragmented independent TV production industry business and brings with it a number of complementary factors. In particular, being based in Scotland and Northern Ireland, Zinc expects Tern to benefit from broadcasters such as the BBC and Channel 4 investing more in regional programming, as well as from their regional programming quotas. The BBC for example intends to invest £20 million in new TV channel, BBC Scotland, to be broadcast from Autumn 2018 and to invest a further £20 million in increased network production from Scotland. The deal also broaden's Zinc's creative capabilities into additional factual genres such as adventure, gardening and religious programming.

Consideration for the deal amounted to an initial payment of £2.35 million in cash (£1.25 million plus £1.1 million for surplus cash in the business) and £0.75 million by the issue of new Zinc Media shares at a price of 0.8p per share - equal to the average closing price over the five dealing days prior to the date of the general meeting held on 13th November. A maximum earn-out payment of up to £2.35 million will also be paid based on performance over the next three years, with up to 50% able to be satisfied by the issue of new shares at the company's option.

**Placing & Preference Share Conversion**

Alongside the acquisition Zinc Media raised just over £3.5 million by placing 389,603,280 new shares at a price of 0.9p with both new and certain existing shareholders. The net proceeds of the placing, estimated at £3.15 million, will mainly be used to finance the initial cash consideration due for Tern and to provide additional growth capital for the enlarged business. **The placing was contributed to by several board members including Peter Bertram, David Galan and Nicholas Taylor and also by well known entrepreneur Luke Johnson. The placing was over-subscribed and brought several new institutional investors onto the share register.**

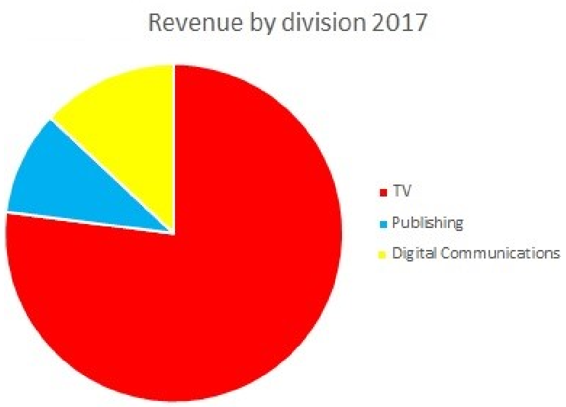
In conjunction with the placing, major shareholders Herald Investment Trust and John Booth & related parties agreed to convert preference shares and related accrued dividends, amounting to £303,374, into ordinary shares in Zinc Media at 0.9p per share so that their combined current holding of c.40% was maintained. On completion of all the above transactions, along with a share based payment for advisor fees, the number of shares in issue increased from 619,775,478 to 1,359,586,281.

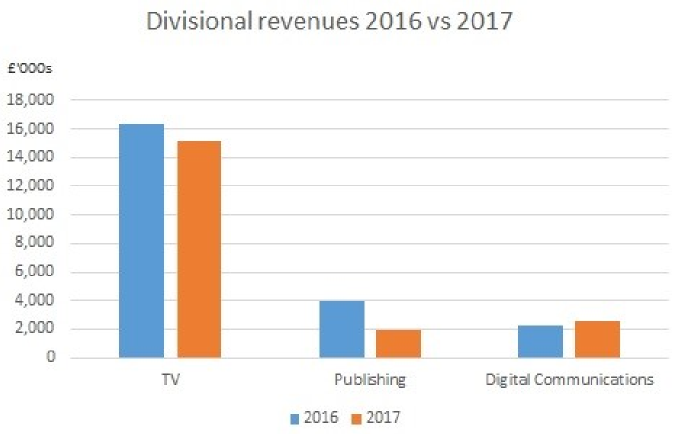
## Financials

The financial year to 30th June 2017 marked the completion of the restructuring activities carried out over the previous 24 months, with profitability achieved on an annual basis for the first time since 2010. The return to profitability for the period is, in our view, a clear endorsement of the company's new direction and talent of the management team.

### Revenues

Total group revenues from continuing operations were down from £22.62 million to £19.76 million for the period. The fall was largely due to a £2.04 million fall in sales in the Publishing division (to £1.96 million) following the remaining Macclesfield publishing unit withdrawing from the majority of its titles to focus on the LABC contract. In addition, revenues fell by £1.16 million in the TV Production division to £15.17 million, mainly as Reef had a less active year compared to what was considered an exceptional performance in 2016. Offsetting these falls, Zinc Communicate saw revenues up by 16% at £2.57 million.




### Profits

Despite the fall in revenues, gross profits were almost flat, slipping by just £0.08 million to £6.31 million as margins rose from 28.3% to 31.9%. This reflected the restructuring activities undertaken, in particular the exit from unprofitable publishing operations.

At the operating level each division traded profitably, with total operating expenses remaining constant at c.30% of revenues. The previous year's loss of £0.43 million was turned into an adjusted EBITDA (earnings before interest, tax, depreciation, amortisation and exceptional items) profit of £0.44 million, with the main contributors being Publishing, which turned a £0.64 million loss into a £0.28 million profit, and Central & Plc, where costs fell by £0.25 million. Digital Communications saw EBITDA profits up by 64% to £0.31 million, however there was a 51% fall in TV Production profits largely due to the revenue fall at Reef.

| £'000 | TV | | Publishing | | Digital Communications | | Central & Plc | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **2017** | 2016 | **2017** | 2016 | **2017** | 2016 | **2017** | 2016 | **2017** | 2016 |
| Revenue | **15,167** | 16,330 | **1,961** | 4,002 | **2,566** | 2,212 | **62** | 78 | **19,756** | 22,622 |
| Adjusted EBITDA | **406** | 822 | **276** | -643 | **314** | 191 | **-552** | -803 | **444** | -433 |

*Table: Divisional revenue and operating profit performance 2016 vs 2017. Source: Company accounts*

On a statutory basis Zinc Media reported a net loss for the year from continuing operations of £72,000, a complete turnaround from the previous year's loss of £3.7 million. Other key P&L items in the year included £0.52 million of depreciation & amortisation and £41,000 of net exceptional items. These exceptional items included a £1 million impairment in the carrying value of goodwill applied to Reef, offset by adding back £1.3 million for a change in the fair value of contingent consideration due for the business. A tax credit of £0.25 million was also booked in due to movements in deferred taxation.

**Balance sheet**

Shareholder equity rose from £1.65 million to £3 million at the period end mainly due to an increase in the share premium account following the fundraising of £0.84 million in November 16, along with other share issues during the year and a £0.94 million transfer. The major balance sheet items included £5.91 million of goodwill and intangibles, cash of £2.97 million, £3.38 million of borrowings (making for net debt of £0.4 million) and £2.91 million of preference shares. The preference shares are classified as equity rather than debt, with interest being rolled up and added to other payables.

Trade receivables fell from £2.34 million during the year to £1.33 million due to the change in the business mix towards TV Production where cash collection from the company's range of blue-chip customers is faster than in Publishing which is characterised by many small clients – broadcasters also tend to make pre-payments for commissions, thus improving working capital. Total payables fell from £8.28 million to £5.48 million following a £0.78 million fall in trade creditors, £1 million being paid as deferred consideration for Reef and lower levels of social security and taxes owed. Current assets exceeded current liabilities 1.17 times at the period end. In non-current liabilities, along with all borrowings, is £0.7 million as an estimation of the further earn-out due to be paid to the Reef vendors.

**Cash flow**

Cash fell from £3.54 million to £2.97 million over 12 months, with a net £1.31 million being used in operations. This reflected a £2 million fall in trade and other payables and the subtraction of a £1.18 million gain realised on the revaluation of the Reef deferred contingent consideration. These were offset by the adding back of £1.52 million of depreciation, amortisation and impairment of intangibles, along with a £0.42 million fall in trade and other receivables. Other major cashflow items included a £0.5 million expense on acquisitions, a net £0.8 million inflow from share issues and a £0.43 million inflow from borrowings received.

## Outlook

Zinc was positive on the outlook for FY2018, in particular highlighting a strong order book in the TV division which was 76% higher at the year-end compared to 12 months previously. The current TV commissioned order book stood at £8 million, representing c.35% of budgeted TV revenues for the full year. Notably, Blakeway North has been seeing further benefits of regional quotas and has 79% of its FY2018 budget commissioned. The Digital and Publishing divisions continue to trade in line with management expectations. In addition, with a strong TV development slate and multiple programme ideas being at an advanced stage with commissioners, the company has confidence in the outlook for the full year, with significantly increased profits expected in FY2018.

## Management

**Peter Bertram - Chairman**

Peter is currently Senior Independent Non-Executive Director of Microgen plc. He was previously Chairman of Alphameric plc, AttentiV Systems Group plc and Phoenix IT Group plc and also a Non-Executive Director of Anite plc and Psion plc. Peter was Chief Executive of Azlan Group plc from 1998 until its takeover in 2003. He is a fellow of the Institute of Chartered Accountants in England and Wales.

**David Galan - Chief Operating and Financial Officer**

David joined Zinc Media Group in January 2016 as CFO before taking on additional responsibilities and a dual role as COO following the departure of the CEO. After qualifying as a chartered accountant with Arthur Andersen in London, he went on to work in investment banking with Teather & Greenwood, specialising in corporate finance and small cap IPOs. Since 2004, David has board level experience across several industries, including the manufacturing industry and the early stage technology sector. During 2015, he held an interim senior role with Casual Dining Group, the owner and operator of Cafe Rouge, Bella Italia and Belgo restaurant brands, where he managed the integration of the acquisitions of Las Iguanas and La Tasca.

**Jonathan Goodwin - Non-Executive Director**

Jonathan Goodwin founded Lepe Partners in 2011. Lepe Partners is a merchant bank created to help entrepreneurs and CEOs in the media, consumer and internet sectors grow their businesses. Prior to founding Lepe, Jonathan was CEO and Co-founder of LongAcre Partners, where he built the company into Europe's leading mid-market media corporate finance house prior to selling it to Jeffries in 2007. In 2006, Jonathan created the Founders Forum, an entrepreneurs' event held annually in London, New York, Brazil and India. In 2009, Jonathan also Co-founded PROfounders Capital, an early stage fund backed by entrepreneurs for digital entrepreneurs. Previously, Jonathan focused on the media sector at Apax Partners and later joined the MBI team of Talk Radio, backed by News Corporation and Liberty Media.

**Nicholas Taylor - Non-Executive Director**

Nicholas has extensive experience of working with growing organisations, principally in the TMT sector. He has worked as a consultant and in-house and has held senior positions in both private and public businesses and in the not for profit sector. His involvement in the media industry started over 20 years ago when he was Head of Finance at Brighter Pictures (now Remarkable Television, part of Endemol Shine) and encompasses film and television; production, post-production and special effects; factual and entertainment. Between 2011 and 2013 he was Managing Director of The Imaginarium Studios. He is also non-executive director of Maintel Holdings Plc and non-executive chairman of Focus 4 U Ltd.

## Key Risks

### Reliance on key customers

Zinc Media is one of many UK based TV producers which rely upon a relatively small number of customers / broadcasters to earn commissions and royalty income for their programming. According to the 2017 PACT Census, the four main terrestrial networks (BBC, ITV, Channel 4 and Channel 5 and subsidiaries) accounted for an estimated 82% of UK primary commission spend in 2016. As such, the company and the industry as a whole is exposed to budget cuts amongst these broadcasters. However, the number of customers has increased over the past few years, with notable growth being seen in international markets.

Zinc Media mitigates against the key customer risk by focusing on growing in international markets, with the company now being a preferred supplier to certain key international broadcasters such as National Geographic. Zinc also looks to maintain good relations with clients and enhance the quality of its creative output to mitigate the risk.

### Cyclical nature of the TV production industry

On an annual basis, Zinc Media's TV operations are typically second half weighted (January to June). However, a more prominent cyclical risk is the TV production industry's exposure to wider economic trends, especially trends in the advertising industry upon which broadcasters rely for their income. Should the advertising industry go through a downturn broadcasters may reduce budgets, thus reducing the potential for new commissions. Zinc Media seeks to reduce this risk as above, by maintaining good relations with clients, with the increased focus on international markets reducing exposure to a downturn in the UK.

### Changes in the popularity of factual content

The TV industry sees different factual genres come in and out of favour with commissioners. To mitigate this risk the company ensures that it has the creative capability to produce programmes across a diversified mix of factual genres, as evidenced by the acquisition of Tern. Further acquisitions may also add new areas of expertise to the company's operations.

### Acquisition risk

By embarking on an acquisitive growth strategy Zinc Media runs the risk of failing to integrate new companies successfully, with there being no assurance that any expected benefits, including synergies and cost savings, will be realised. In addition, time spent on searching for, acquiring and integrating acquisitions may divert management's attention from the day-to-day operations of the business. These risks are mitigated to some extent by the company applying strict financial criteria to any potential acquisition and deals typically being structured with earn-out payments being set over a number of years in order to align future payments with performance.

### Creative and people risks

The key driver of organic growth is the company's ability to attract and retain commercial and creative talent in order to generate business. To mitigate this risk key staff are incentivised through a mixture of sales commissions, profit related bonuses and participation in employee share incentive plans. However, should Zinc be unable to attract new employees or retain existing employees this could have a material adverse effect on its ability to grow or maintain its business.

## Forecasts

We initiate coverage of Zinc Media with forecasts for the 2018 and 2019 financial years. Our forecasts begin at the divisional level and are summarised in the table below.

| | TV Production | | Publishing | | Communications | |
|---|---|---|---|---|---|---|
| | 2018 | 2019 | 2018 | 2019 | 2018 | 2019 |
| **Revenues** | 26,257,000 | 29,580,000 | 2,088,500 | 2,100,000 | 2,704,000 | 3,000,000 |
| **COGS** | -20,360,200 | -22,888,200 | -1,175,000 | -1,175,000 | -1,014,000 | -1,300,000 |
| **Gross profit** | 5,896,800 | 6,691,800 | 913,500 | 925,000 | 1,690,000 | 1,700,000 |
| **Admin expenses** | -4,621,200 | -4,835,200 | -699,900 | -699,900 | -1,406,500 | -1,406,500 |
| **EBITDA** | **1,275,600** | **1,856,600** | **213,600** | **225,100** | **283,500** | **293,500** |

| | 2018 | 2019 | 2018 | 2019 | 2018 | 2019 |
|---|---|---|---|---|---|---|
| **Revenue growth** | 73.12% | 12.66% | 6.50% | 0.55% | 5.38% | 10.95% |
| **EBITDA growth** | 214.19% | 45.55% | -22.61% | 5.38% | -9.71% | 3.53% |
| **Gross margin** | 22.46% | 22.62% | 43.74% | 44.05% | 62.50% | 56.67% |
| **EBITDA margin** | 4.86% | 6.28% | 10.23% | 10.72% | 10.48% | 9.78% |

*Zinc Media divisional forecasts 2018 & 2019. Source: Align Research*

For 2018 we forecast that the combined **TV Production** businesses will be the main driver of growth, with Tern making a maiden 7 month contribution to the division and the rest of the TV business benefitting from the current strong order book. We forecast overall revenues in TV Production to grow by 73.1% to £26.26 million, with EBITDA more than trebling from £0.41 million to £1.28 million as operational gearing kicks in. In 2019 we forecast more modest revenue growth in TV, up by 12.7% to £29.58 million, with EBITDA growth of 45.6% to £1.86 million as admin expenses remain broadly stable.

In **Publishing** and **Communications** we expect more modest revenue growth for both years, with each division making a useful contribution to profits on EBITDA margins of c.10%.

We forecast at the group level by adding together our divisional forecasts, with total revenues expected to be up by 57.2% at £31.05 million for 2018. In 2019 this rises by 11.7% to £34.68 million. **Adding in Central & Plc costs gives total group EBITDA of £1.2 million for 2018, an almost trebling of the 2017 figures, rising to £1.8 million for 2019.**

| | Central | | Total | |
|---|---|---|---|---|
| | 2018 | 2019 | 2018 | 2019 |
| **Revenues** | 0 | 0 | 31,049,500 | 34,680,000 |
| **COGS** | 0 | 0 | -22,549,200 | -25,363,200 |
| **Gross profit** | 0 | 0 | 8,500,300 | 9,316,800 |
| **Admin expenses** | -571,700 | -571,700 | -7,299,300 | -7,513,300 |
| **EBITDA** | **-571,700** | **-571,700** | **1,201,000** | **1,803,500** |

*Zinc Media group forecasts 2018 & 2019. Source: Align Research*

For the remainder of the P&L statement, we assume depreciation of £100,000 for both 2018 and 2019 – we assume no capex in either years as the company is capex light and recently invested in editing suites which should be sufficient for the next few years. Amortisation is forecast at £421,000 and £621,000 for 2018 and 2019 respectively

In 2018 we allocate £0.35 million of placing expenses and £30,000 of share based payments to exceptional items and in 2019 there is a £0.2 million exceptional gain on a reduction in deferred consideration due to the Reef vendors (see below).

For interest costs we assume a charge of 4.5% per annum on outstanding borrowings of £2.53 million and an 8% charge on the remaining £834,000 of borrowings, which we assume are paid in cash. There is also a 4.5% interest charge on outstanding preference shares, which is rolled up and added to other payables on the balance sheet. We assume zero tax in 2018 due to historic losses which can be utilised within the group, with a 15% charge for 2019.

For 2018 we expect a statutory net profit of £43,063, rising to £0.9 million for 2019. Respective earnings per share are 0.004p and 0.0647p. Our full P&L forecasts are presented in the table below.

**Table: P&L forecasts**

| £ | **2016A** | **2017A** | **2018E** | **2019E** |
|---|---|---|---|---|
| **Revenue** | 22,622,000 | 19,756,000 | 31,049,500 | 34,680,000 |
| Cost of sales | -16,228,000 | -13,447,000 | -22,549,200 | -25,363,200 |
| **Gross Profit** | **6,394,000** | **6,309,000** | **8,500,300** | **9,316,800** |
| Operating expenses | -6,827,000 | -5,865,000 | -7,299,300 | -7,513,300 |
| **Adjusted EBITDA** | **-433,000** | **444,000** | **1,201,000** | **1,803,500** |
| Depreciation and amortisation | -3,275,000 | -517,000 | -521,000 | -721,000 |
| Exceptional items | -44,000 | 41,000 | -380,000 | 200,000 |
| **Operating profit (loss)** | **-3,752,000** | **-32,000** | **300,000** | **1,282,500** |
| Finance costs | -183,000 | -293,000 | -256,937 | -223,827 |
| Finance income | 279,000 | 0 | 0 | 0 |
| **Profit (loss) before tax** | **-3,656,000** | **-325,000** | **43,063** | **1,058,673** |
| Taxation | -54,000 | 253,000 | 0 | -158,801 |
| **Total profit (loss) for the year** | **-3,710,000** | **-72,000** | **43,063** | **899,872** |
| Loss from discontinued operations | -2,661,000 | -37,000 | 0 | 0 |
| **Total profit (loss) for the year** | **-6,371,000** | **-109,000** | **43,063** | **899,872** |
| | | | | |
| **Basic earnings per share (p)** | -1.57 | -0.02 | 0.0040 | 0.0647 |
| **Diluted earnings per share (p)** | -1.57 | -0.02 | 0.0039 | 0.0642 |
| | | | | |
| Weighted number of shares | 406,760,864 | 544,171,445 | 1,083,930,749 | 1,390,532,732 |
| Share options | 0 | 11,330,279 | 11,330,279 | 11,330,279 |
| Weighted plus dilutive | 406,760,864 | 555,501,724 | 1,095,261,028 | 1,401,863,011 |

## Cash flow

**We expect Zinc Media to be strongly cash generative over the two years of our forecast horizon.** In 2018 favourable working capital movements should be a major contributor to cash flow, with the adding back of non-cash charges taking net cash flow from operations to £1.75 million. Overall, we forecast total cash to grow by £4 million over the year to just under £7 million, with the operating cash flow being added to by the November placing proceeds, less the net cash consideration paid for Tern. **By the end of 2019 we expect total cash to grow to just under £8 million.**

**Table: Cash flow forecasts**

| | 2016A | 2017A | 2018E | 2019E |
|---|---|---|---|---|
| **CASH FLOW FROM OPERATIONS** | | | | |
| Loss/profit for the year | -6,371,000 | -109,000 | 43,063 | 899,872 |
| **Adjustments for:** | | | | |
| Taxation | 192,000 | -253,000 | 0 | 158,801 |
| Depreciation | 94,000 | 96,000 | 100,000 | 100,000 |
| Amortisation and impairment of intangibles | 4,806,000 | 1,421,000 | 421,000 | 621,000 |
| Finance costs | 183,000 | 293,000 | 256,937 | 223,827 |
| Finance income | -279,000 | 0 | 0 | 0 |
| Share based payment charge | 0 | 98,000 | 30,000 | 0 |
| Gain on revaluation of deferred consideration | 0 | -1,177,000 | 0 | -200,000 |
| Gain on disposal of assets | -40,000 | -43,000 | 0 | 0 |
| (Increase) / decrease in inventories | 780,000 | -6,000 | -13,524 | -1,220 |
| Decrease / (increase) in trade and other receivables | 1,080,000 | 415,000 | -1,615,000 | -566,507 |
| (Decrease) / increase in trade and other payables | -3,713,000 | -1,998,000 | 2,710,000 | 930,940 |
| **CASH FlOW FROM (USED) IN OPERATIONS** | **-3,268,000** | **-1,263,000** | **1,932,476** | **2,166,713** |
| Finance costs | -75,000 | 1,000 | -181,785 | -181,785 |
| Tax paid | -40,000 | -46,000 | 0 | -158,801 |
| **NET CASH FROM OPERATIONS** | **-3,383,000** | **-1,308,000** | **1,750,691** | **1,826,127** |
| **CASH FLOW FROM INVESTING** | | | | |
| Disposal of subsidiary undertakings | 19,000 | 5,000 | 0 | 0 |
| Acquisition of subsidiary undertakings | 0 | -500,000 | -1,250,000 | -812,500 |
| Purchase of property, plant and equipment | -89,000 | -69,000 | 0 | 0 |
| Proceeds of sale of property, plant and equipment | 40,000 | 0 | 0 | 0 |
| Disposal / (investment) in associate | -100,000 | 100,000 | 0 | 0 |
| **NET CASH FROM INVESTING** | **-130,000** | **-464,000** | **-1,250,000** | **-812,500** |
| **CASH FLOW FROM FINANCING** | | | | |
| Issue of ordinary share capital and preference shares | 4,495,000 | 801,000 | 3,506,430 | 0 |
| Borrowings repaid | -116,000 | 0 | 0 | 0 |
| Borrowings received | 750,000 | 433,000 | 0 | 0 |
| **NET CASH FROM FINANCING** | **5,129,000** | **1,234,000** | **3,506,430** | **0** |
| Net (decrease) / increase in cash and cash equivalents | 1,616,000 | -538,000 | 4,007,121 | 1,013,627 |
| Translation differences | 7,000 | -26,000 | 0 | 0 |
| Cash and cash equivalents at beginning of year | 1,914,000 | 3,537,000 | 2,973,000 | 6,980,121 |
| **Cash and cash equivalents at the end of the year** | **3,537,000** | **2,973,000** | **6,980,121** | **7,993,748** |

**Balance sheet**

On the balance sheet we account for the corporate activity completed around the Tern acquisition in 2018. For working capital, inventories are expected to grow in line with revenue growth in the publishing business. Trade creditors and debtors grow at 50% in 2018 and in line with revenue growth in 2019.

We assume that in November 2019 a £0.5 million earn-out payment is due to the Reef vendors. This is paid half in cash and half in shares, we assume for modelling purposes that the shares are issued at the current price of 0.825p. The remaining £0.2 million earn-out liability is thus removed from goodwill and added to the P&L statement as an exceptional gain. At the same time, we assume a £0.75 million earn-out will be due for Tern, payable 75% in cash and 25% in shares (at 0.825p).

Net assets are forecast to close 2018 at £7.63 million, rising to £8.97 million in 2019.

**Table: Balance sheet**

| | 2016A | 2017A | 2018E | 2019E |
|---|---|---|---|---|
| **ASSETS** | | | | |
| **Non-current** | | | | |
| Goodwill and intangibles | 7,330,000 | 5,909,000 | 8,738,000 | 8,117,000 |
| Investment in associate | 100,000 | 0 | 0 | 0 |
| PPE | 212,000 | 231,000 | 131,000 | 31,000 |
| **Total non-current assets** | **7,642,000** | **6,140,000** | **8,869,000** | **8,148,000** |
| | | | | |
| **Current assets** | | | | |
| Inventories | 202,000 | 208,000 | 221,524 | 222,743 |
| Trade receivables | 2,341,000 | 1,326,000 | 1,989,000 | 2,221,566 |
| Other receivables | 1,357,000 | 1,904,000 | 2,856,000 | 3,189,941 |
| Assets held for sale | 147,000 | 0 | 0 | 0 |
| Cash and cash equivalents | 3,537,000 | 2,973,000 | 6,980,121 | 7,993,748 |
| **Total current assets** | **7,584,000** | **6,411,000** | **12,046,645** | **13,627,999** |
| | | | | |
| **TOTAL ASSETS** | **15,226,000** | **12,551,000** | **20,915,645** | **21,775,999** |
| | | | | |
| **LIABILITIES** | | | | |
| **Non-current** | | | | |
| Borrowings | 2,007,000 | 3,375,000 | 3,375,000 | 3,375,000 |
| Deferred consideration | 2,000,000 | 700,000 | 1,950,000 | 500,000 |
| **Total non-current liabilities** | **4,007,000** | **4,075,000** | **5,325,000** | **3,875,000** |
| | | | | |
| **Current liabilities** | | | | |
| Trade payables | 1,987,000 | 1,205,000 | 1,807,500 | 2,018,844 |
| Other payables | 6,295,000 | 4,275,000 | 6,154,278 | 6,915,916 |
| Liabilities held for sale | 159,000 | 0 | 0 | 0 |
| Current tax liabilities | 89,000 | 0 | 0 | 0 |
| Deferred tax | 263,000 | 0 | 0 | 0 |
| Borrowings | 774,000 | 0 | 0 | 0 |
| **Total current liabilities** | **9,567,000** | **5,480,000** | **7,961,778** | **8,934,760** |
| | | | | |
| **TOTAL LIABILITIES** | **13,574,000** | **9,555,000** | **13,286,778** | **12,809,760** |

| | | | | |
|---|---|---|---|---|
| **EQUITY** | | | | |
| Called up share capital | 5,925,000 | 5,926,000 | 5,927,850 | 5,927,982 |
| Share premium account | 22,671,000 | 25,013,000 | 31,575,698 | 32,013,065 |
| Share based payment reserve | 0 | 47,000 | 47,000 | 47,000 |
| Merger reserve | 696,000 | 27,000 | 27,000 | 27,000 |
| Preference shares | 2,909,000 | 2,909,000 | 934,256 | 934,256 |
| Retained earnings | -30,549,000 | -30,926,000 | -30,882,937 | -29,983,065 |
| **TOTAL EQUITY** | **1,652,000** | **2,996,000** | **7,628,866** | **8,966,239** |
| | | | | |
| **NET ASSETS** | **1,652,000** | **2,996,000** | **7,628,866** | **8,966,239** |

## Valuation

We choose to set our base case valuation for Zinc Media on the basis of multiples being paid in recent TV production industry transactions. In particular, we focus on the Enterprise Value to EBITDA (EV/EBITDA) multiple as it is upon this measure which deals in the sector tend to be based. It should be noted however that certain deals, particularly with large US acquirers, are based on a multiple of revenue and should Zinc Media achieve this type of valuation the scope for a significantly higher valuation is possible. With Zinc Media's strategy to try and move the business towards long running and higher budget series, particularly for the large US broadcasters and platforms, this may be the ambition.

**With Zinc Media looking for its own exit in the medium-term we believe that this a relevant way to value the business and to illustrate the kind of price a potential acquirer would be willing to pay.** We also consider it to be more relevant than deriving a value from an analysis of listed peers – while there are many companies operating in the wider Media sector there are few London listed businesses whose operations are primarily focused on TV production.

One of the most prolific acquirers in the TV production sector over the past five years has been industry giant ITV, which has built up its ITV Studios business into the largest production and distribution company in the UK. The table below shows details of ten deals completed by ITV over the past five years which have been announced to the market.

| Date | Acquired business | Initial consideration | Historic EBITDA | Net debt (cash) | EV/EBITDA multiple |
|---|---|---|---|---|---|
| Apr-17 | World Productions | 8,695,652 | 910,940 | -774,661 | 8.70 |
| Jun-15 | Boom Supervisory | 55,000,000 | 6,452,000 | 23,697,000 | 12.20 |
| May-15 | Talpa Media | 500,000,000 | 61,000,000 | 0 | 8.20 |
| May-14 | Leftfield Entertainment | 450,000,000 | 38,000,000 | -5,000,000 | 11.71 |
| Feb-14 | DiGa Vision | 12,500,000 | Not revealed | 0 | 7.00* |
| Jul-13 | Big Talk | Not revealed | Not revealed | 0 | 7.00* |
| Jun-13 | Thinkfactory Media | 46,153,846 | Not revealed | 0 | 7.00* |
| May-13 | High Noon | 42,750,000 | 5,700,000 | 0 | 7.50 |
| Apr-13 | The Garden | 18,000,000 | 2,500,000 | -749,320 | 6.90 |
| Dec-12 | Gurney Productions | 65,040,650 | 10,000,000 | 0 | 6.50 |
| | | | | **AVERAGE** | **8.27** |

*Table: ITV Studios acquisitions since Dec 2012. Source Align Research. *estimate*

In compiling our analysis in the table above we have made certain assumptions given that complete deal information has not always been revealed by ITV. Firstly, if no cash/debt figure was provided for a deal, or if the figure is not publicly available, we assume it was done on a cash/debt free basis. Secondly, regarding the acquisitions of DiGa Vision, BigTalk and Thinkfactory Media, ITV commented, *"The multiple paid is similar to the range paid on our previous acquisitions"*. We assume this multiple to be 7 times EV/EBITDA given the average price paid for the previous three deals (High Noon, The Garden, Gurney Productions).

**We therefore estimate that the average EV/EBITDA multiple paid by ITV for the ten acquisitions (initial consideration only) is 8.27 times.** This seems a reasonable figure to apply to Zinc Media in our view. This is supported by major deals elsewhere in the sector, with All3Media, then the largest independent production group in the UK, being acquired by Discovery Communications and Liberty Global on a reported EV/EBITDA multiple of 8.5 times in 2014.

**Therefore, applying an EV/EBITDA multiple of 8.27 times to our 2019 numbers suggests a fair value base case target price for Zinc Media of 1.32p per share, 60% above the current price of 0.825p.**

| | |
|---|---|
| 2019 EBITDA | £1,803,500 |
| Multiple | 8.27 |
| Implied enterprise value | £14,914,945 |
| Net cash | £4,618,748 |
| Preference shares | £934,256 |
| Implied market cap end 2019 | £18,599,437 |
| Value per share (p) | 1.32 |
| Implied upside | 60% |

*Table: Zinc Media 2019 transaction multiple based valuation. Source Align Research*

**As mentioned above, we see this very much as a base case valuation for the company (should it meet our 2019 numbers) for several reasons.**

Firstly, the valuation multiple represents the price paid for the *initial* deal consideration only. With most transactions in the sector having further payments in the form of earn-outs, which in many cases can be at least equivalent to the initial consideration paid, Zinc Media shareholders could realise substantial further value in the years following completion of a takeover.

Secondly, our model does not assume that Zinc makes any more acquisitions in line with its consolidation strategy. **Should the company complete and successfully integrate additional earnings enhancing deals we expect the profit element of the equation, and therefore take out price, to be higher.**

Thirdly, with the company seeking an exit in 2020 there is an additional 12 months for further growth to be delivered over the 2019 numbers upon which our valuation is based, again giving the potential for a higher transaction value.

## Conclusion

Following a number of takeovers and de-listings amongst the UK listed TV production peer group over the past few years, Zinc Media now offers investors one of the few almost "pure play" ways to take advantage of the growth in the sector. Under the new management team the business has been successfully restructured, is well financed and has a clear strategy for growth. Risks remain over meeting our forecasts for this financial year and next, but we see a well-managed and industry recognised business here that has significant short and medium-term growth potential.

**We initiate coverage of Zinc Media with a base case target price of 1.32p and Conviction Buy stance.**

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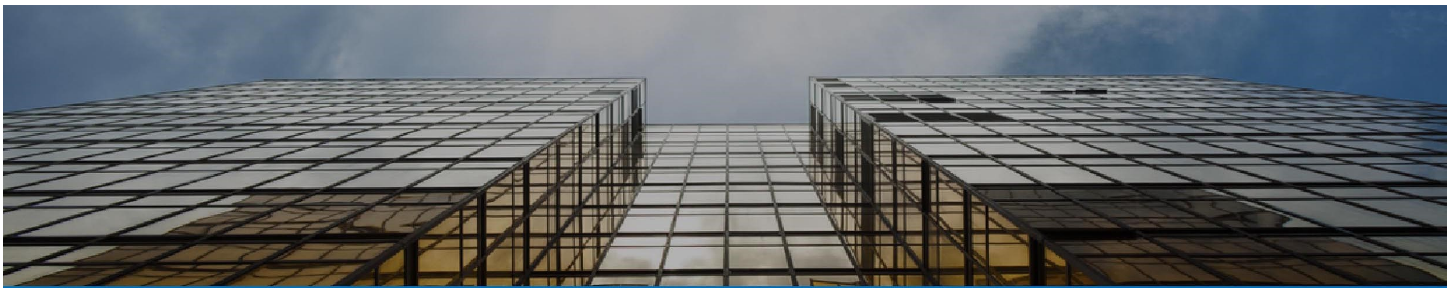

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