TV2 Media Csoport Zrt.
Hungary, Media

BB- STABLE

Corporate profile

TV2 Media Csoport Zrt. is a Hungarian media company (broadcast, digital, content) founded in 1997. The group employs approximately 350 people and its headquarters are located in Budapest. The group provides a large variety of programmes and operates a portfolio which includes TV2 and its 13 sister channels. TV2 is aired throughout Hungary. The group's annual sales amount to HUF 40bn derived from three main sources of income. Advertising, accounting for roughly 50% of revenues, consists of the sale of spot advertising slots on TV2 (12 minutes per hour) through an in-house sales department and a partnership with Atmedia (the leading marketing and communications company in Hungary). Distribution, generating 40% of turnover, includes fees paid by various customers (cable and telecommunication companies) to broadcast the TV2 portfolio. The third segment includes other activities which encompass sponsoring (non-spot) as well as online operations and TV shopping. The group's strategy is to develop and consolidate its market leader position in Hungary while entering in a cost control phase.

Key metrics

			Scope estimates	
Scope credit ratios	**2017**	**2018**	**2019E**	**2020E**
EBITDA/interest cover (x)	8.2x	11.4x	9.9x	16.3x
Scope-adjusted debt (SaD)/EBITDA	1.4x	1.3x	1.5x	1.5x
Scope-adjusted FFO/SaD	63%	69%	62%	62%
FOCF/SaD	(-) FOCF	7%	6%	(-) FOCF

Rating rationale

Scope has assigned a first-time issuer credit rating of BB- with a Stable Outlook to Hungary-based TV2 Media Csoport Zrt. Senior unsecured debt has been rated at B+. The credit rating mainly reflects

TV2's historical leading market position in the Hungarian broadcasted television industry, solid profitability (EBITDA margin) and low leverage. The rating is held back by the company's rather weak customer and geographical diversification.

TV2's issuer rating is largely supported by the group's leading position in Hungary as a television broadcaster. TV2 has managed to become the country's primary audiovisual company. This is thanks to a material expansion of its channel offer, combined with a surge in its audience ratings, overtaking main competitor RTL, driving increased advertising revenues. In 2018, TV2's market share in the spot advertising segment stood at 37%, generating HUF 20.0bn in a concentrated market. We view positively the ongoing cost control policy. This has allowed the company to attain strong operating profitability above 30%, which it is expected to maintain in the coming years. We expect the group to use the issuance of a HUF 30bn Hungarian National Bank (MNB) bond with ten years maturity, under the MNB Bond Funding for Growth Scheme, to refinance its total debt in order to lower financial costs. The issuance should also allow TV2 to finance its strategy of producing and broadcasting more local productions and series to strengthen its leading position in Hungary. The company's creditworthiness is further supported by adequate liquidity, low leverage and good cash flow generation.

Ratings & Outlook

Corporate ratings	BB-/Stable
Senior unsecured rating	B+

Analysts

Thomas Langlet
+33 1 82882-355
t.langlet@scoperatings.com

Related Methodology

Corporate Rating Methodology

Scope Ratings GmbH

1 Cour du Havre
F-75008 Paris

Phone +33 1 8288 5557

Headquarters

Lennéstraße 5
10785 Berlin

Tel. +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

The ratings are constrained by the limited overall size of the market in which TV2 operates. The group also has concentration issues regarding its footprint and customer portfolio (especially in its distribution segment). We view negatively TV2's volatile profitability, which is sensitive to recurring negotiations with content producers, and reduced visibility on future advertising revenues. TV2's digital offer and its monetisation remain limited, although the group expects to develop its online platform in the foreseeable future. Finally, the rating is lowered by TV2's financial policy considered as aggressive since the company is expected to double its gross debt while refinancing a shareholder loan by an unsecured senior bond.

Outlook

The Outlook is Stable and incorporates our expectation of stable credit metrics, with net debt/EBITDA below 2.0x and an EBITDA interest coverage of above 7x. The Outlook also includes the expectation that liquidity (currently viewed as adequate) will not deteriorate. Our Outlook is based on annual capex spending (including organic expansion and acquisition capex) of around HUF 43bn for the 2019-2021 period and an EBITDA margin ranging between 29%-34%.

A positive rating action is likely if free operating cash flow (FOCF)/Scope-adjusted debt (SaD) increases above 5% on sustained basis. A negative rating action could be required if SaD/EBITDA rises above 2x on a sustained basis for the next few years.

Rating for unsecured debt

We expect a 'below average recovery' for current and future senior unsecured debt. Such recovery expectations translate into a B+ rating for the senior unsecured category (one notch lower than the issuer rating). Our expectations are based on a distressed enterprise value under the assumption of a going concern of around HUF 10.7bn at the end of 2021, including a 10% reduction for administrative claims in a liquidation scenario. Existing debt positions are senior unsecured and are all expected to be refinanced by the planned MNB bond (expected issuance of HUF 30bn).

Rating drivers

Positive rating drivers	Negative rating drivers
• Historical television broadcaster in Hungary with leading position in a concentrated market • Recent channel portfolio expansion allowing growth and consolidation of market share • Strong EBITDA margin (above 30% at YE 2018) despite high volatility and low revenue visibility	• Lagging behind with regard to digital offer and online monetisation • Weak geographical diversification coupled with strong customer concentration • Capital-intensive business model due to recurring license acquisitions and content production despite improving cash flow generation

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Increase in FOCF/SaD above 5% on sustained basis	• Rise in SaD/EBITDA above 2x on a sustained basis

Financial overview

			Scope estimates	
Scope credit ratios	**2017**	**2018**	**2019E**	**2020E**
EBITDA/interest cover (x)	8.2x	11.4x	9.9x	16.3x
Scope-adjusted debt (SaD)/EBITDA	1.4x	1.3x	1.5x	1.5x
Scope-adjusted funds from operations/SaD	63%	69%	62%	62%
Free operating cash flow/SaD	(-) FOCF	7%	6%	(-) FOCF
Scope-adjusted EBITDA in HUF m	**2017**	**2018**	**2019E**	**2020E**
EBITDA	10,564.1	12,334.4	11,631.1	13,579.7
Operating lease payments in respective year	0	0	0	0
Other	0	0	0	0
Scope-adjusted EBITDA	10,564.1	12,334.4	11,631.1	13,579.7
Scope-adjusted funds from operations in HUF m	**2017**	**2018**	**2019E**	**2020E**
EBITDA	10,564.1	12,334.4	11,631.1	13,579.7
less: (net) cash interest as per cash flow statement	-1,281.5	-1,078.4	-1,176.9	-830.9
less: cash tax paid as per cash flow statement	0.0	0.0	-4.2	-127.3
add: depreciation component, operating leases	0	0	0	0
Scope-adjusted funds from operations	9,493.2	11,179.0	10,449.9	12,621.5
Scope-adjusted debt in EUR m	**2017**	**2018**	**2019E**	**2020E**
Reported gross financial debt	13,332	13,510	15,003	30,000
less: hybrid bonds	0	0	0	0
less: cash and cash equivalents	-3,656.8	-2,984.0	-3,786.0	-11,523.8
add: cash not accessible	0	0	0	0
add: pension adjustment	0	0	0	0
add: operating lease obligations	0	0	0	0
Other	2,642	2,867	2,867	940
Scope-adjusted debt	14,959.3	16,260.6	16,952.3	20,356.4

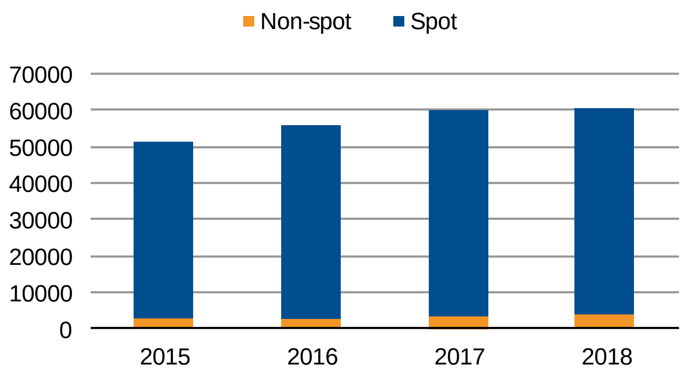
Business risk profile

Market leader in small, concentrated Hungarian TV industry

In 2018, the television advertising market in Hungary spanned 77 channels (including 14 belonging to the TV2 group) and generated HUF 60.7bn, increasing by 1% YoY. Spot advertising accounted for 94% of this revenue while non-spot advertising (sponsoring for example) constituted the remaining 6%. In 2018, TV2's market share stood at 37% with its advertising segment (spot only) generating HUF 20.0bn. This was driven by the duopoly which the TV2 and RTL Hungary groups have established. The two groups have, by far, the two highest GRP (gross rating points, a ratio measuring the size of an audience) of around 600,000 per year, In contrast, the third player (AMC) trails at 150,000 GRP. Most TV campaigns are GRP based (with value measured in terms of rating delivery) but there are still campaigns with fxed-price spots.

The non-spot market has exhibited the fastest growth over the past couple of years. Its share in the television advertising market has grown from 4.4% in 2016 to 6.2% in 2018. TV2 is the clear leader in this sub-market, with a 70% market share dominated by sponsorship and mini-programme revenues where the content is important.

Figure 1: TV advertising market in Hungary (HUF m)

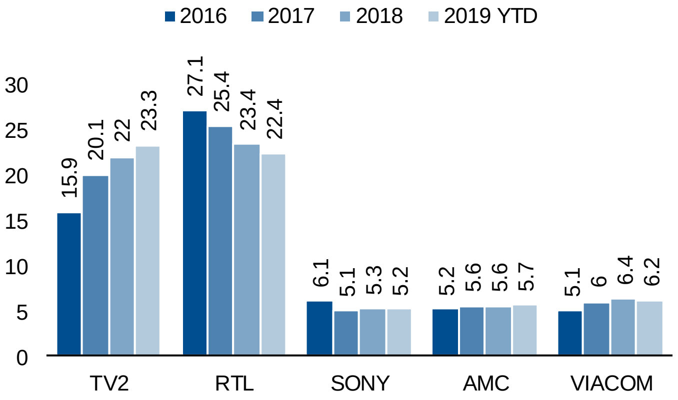


Source : EY, Meme

TV2 is market leader in the distribution market, ahead of RTL group

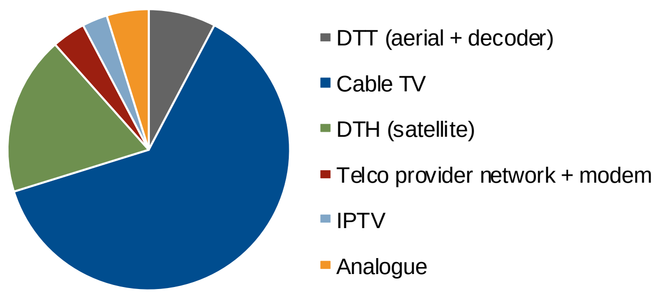
The second main source of income for TV2 is the distribution of its channel portfolio through various platforms: DTH (direct to home), DTT (digital terrestrial television), IPTV (internet protocol television), cable and OTT (over the top) thanks to clients including telecommunications and cable TV companies. In Hungary, most television is watched via cable networks using a decoder or a direct connection to a TV set (65%) or a DTH/satellite dish (23%). In comparison, the EU28 favours DTT (35%, aerial and decoder), cable (31%) and DTH (20%). Over the past year, TV2 has managed to become the most broadcasted group in Hungary ahead of RTL. It has increased the share of views of its portfolio by seven points, reaching 23.4% for viewers in both the 18-59 and 4+ age groups.

Figure 2: Market share of distributed channels (18-59 years of age)



Source : TV2, Nielsen Audience Measurement

Figure 3: Means of receiving TV in Hungary



Source: European Commission (TNS opinion)

Weak geographical and product diversification mitigated by channel portfolio

Besides its historical television channel TV2, the group owns 13 other channels showing children's programmes (Kiwi), news, sport (football from the Spanish Liga, Champions leagues and Premier league as well as MotoGP and the NHL), movies (from Universal, Fox and Paramount) and game shows, targeting a wide range of viewers. However, product diversification is limited since the company is not involved in any other type of media such as print media or radio.

The TV2 group generates 96% of its turnover in Hungary with the remaining share related to the broadcasting of its channels abroad, including the UK.

Concentration of distribution segment

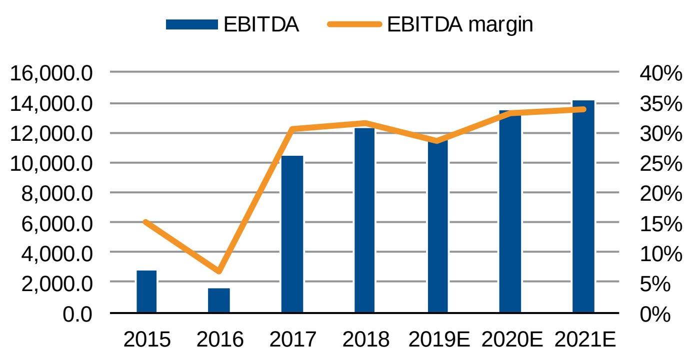
TV2 derives 84% of its revenues in the distribution segment from its major customers implying a strong concentration. These players have more than 200,000 subscribers each. 11% of distribution revenues is generated by a second group of medium size operators. The remaining smaller operators have a high risk of being acquired by cable players as consolidation of the market is still ongoing.

Regarding the advertising segment, TV2 has outsourced its GRP sales to Atmedia, the leading sales house in Hungary for television advertisements.

Recovering profitability forecasted to improve due to new cost controls

Between 2015-2018, TV2 managed to materially improve its profitability thanks to a surge in the advertising segment and the distribution division (due to the increase in the number of channels from four in 2015 to 12 in 2018). This trend has been combined with operating expenses levelling off in 2017 and 2018 after the company had to grow its cost base due to the rapid expansion of its portfolio.

Figure 4: TV2 EBITDA (HUF m) and EBITDA margin



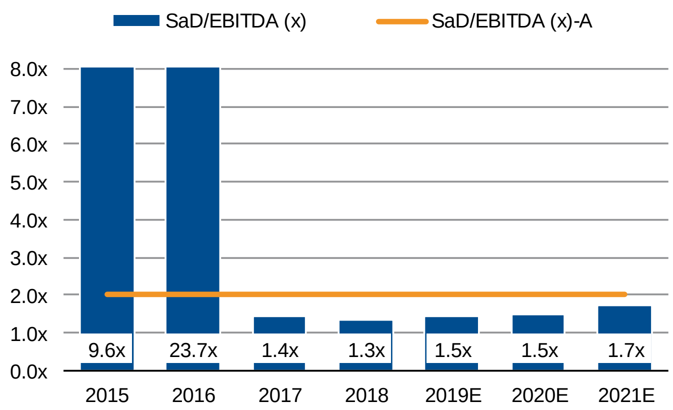
Source : TV2, Scope

Financial risk profile

Our main assumptions for TV2 projections are as follows:

- Revenue increases in 2019, 2020 and 2021 by 3.8%, 3.1% and 1.3% respectively due to: i) a potential decrease in government spending following budget reduction policy (decrease of EU funding); ii) a lower than expected increase in distribution revenues (no new channels launched in 2020)
- An increasing EBITDA margin between 2020 and 2021 due to a stabilised cost base following contract renegotiations with content providers and better management of distribution costs
- Decrease in interest costs assuming HUF 14bn of total debt refinanced thanks to the HUF 30bn MNB bond issuance with 2.5% coupon in 2020 (vs 8% interest previously paid for refinanced debt)
- Net capex between 2020-2021 in line with 2018, in addition to HUF 16m financed by remaining part of the MNB bond and HUF 1bn in maintenance capex per annum
- No dividend pay-out, no change in provisions, no pensions, no operating leases, no restricted cash

Figure 5: Leverage – 2015 to 2021E



Source: TV2, Scope

Good interest expense coverage remaining above 7x after the bond issuance.

TV2's growing EBITDA interest expense cover reached 7x in 2017. This high coverage is due to the shareholder loan granted by Magyar Broadcasting Co Zrt. (a direct shareholder in TV2) with capitalised interest accounting for 43% of total gross debt in 2018. The remaining part of the HUF 7.5bn in outstanding debt is an MKB Bank loan, which pays 8% interest.

We anticipate that debt protection will improve to 17.1x by 2021. This is due to a significant change in TV2's future debt position, with the new HUF 30bn bond issued in 2020 under the MNB scheme with a fixed coupon rate of 2.5% used to refinance the total debt outstanding. No penalties are expected for the early repayment of the MKB loan, which matures in 2025.

Cash flow generation not expected to cover recurring capex from 2020 on.

In the past, TV2's operating cash flow generation has been insufficient to cover its capex. Working capital was negative at the end of 2017 and 2018 because of a higher number of days of sale outstanding (from 57 days to 102 days). This is a consequence of the company's turnover growing by 152% in four years, with more distribution clients implying longer payment delays. We expect FOCF/SaD to remain negative in 2020 and 2021 because of a combination of two factors: i) the negative impact from working capital consumption: we expect this to continue but to a lower extent; and ii) large capex used to fund the production of new shows and local programmes.

Leverage is expected to increase to 1.7x by 2021 from 1.3x in 2018

Since 2017, the company's consolidated leverage measured by SaD/EBITDA and funds from operations (FFO)/SaD has been low due to the recurring high level of cash balance.

We forecast that TV2 will become be slightly more leveraged, with net debt surging between 2018 and 2021 from HUF 16.2bn to HUF 24.2bn. This is because of the issuance of the HUF 30bn MNB bond, a larger debt amount than before the refinancing, coupled with the full use of the proceeds to fund the capex plan.

Adequate liquidity supported by unrestricted cash balance and no short-term borrowings

TV2's liquidity is adequate based on our expectation that sources of liquidity will exceed uses by about 3x in the next 12 months, following constantly good liquidity for the past two years. Internal liquidity is not a concern since the company did not book any short-term loans in 2018. The only upcoming liquidity requirements are the off-balance sheet financial guarantees regarding license fee payments.

	2015	2016	2017	2018	2019E	2020E	2021E
Short-term debt (t)	475.8	7,298.0	1,205.3	0.0	1,927.3	899.6	40.5
Unrestricted cash (t)	1,124.1	1,750.9	3,656.8	2,984.0	3,786.0	11,523.8	5,840.4
Open committed credit lines (t)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Free operating cash flow (t+1)	-13,306.3	-5,460.0	1,124.9	1,050.5	-5,539.7	-3,996.7	-3,996.7
Liquidity (internal)	-25.6x	-0.5x	4.0x	>100.0x	-0.9x	8.4x	45.5x

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

1 Cour du Havre
F-75008 Paris

Phone +33 1 8288 5557

London

Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 20 3457 0444

Madrid

Paseo de la Castellana 95
Edificio Torre Europa
E-28046 Madrid

Phone +34 914 186 973

Milan

Via Paleocapa 7
IT-20121 Milan

Phone +39 02 30315 814

Oslo

Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

info@scoperatings.com
www.scoperatings.com

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