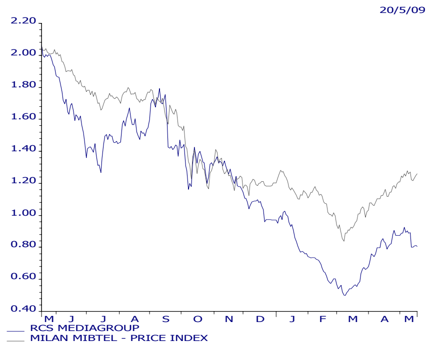
Rcs Mediagroup

MEDIOBANCA SECURITIES

20 May 2009 | **Media** | **Change in Recommendation**

Price: € 0.83 **Target price: € 1.65**

Outperform (from Neutral)



Source: DATASTREAM

	2007	2008	2009E	2010E	2011E
EPS Adj. (€)	0.20	0.08	-0.12	0.09	0.14
DPS (€)	0.11	0.00	0.00	0.00	0.07
BVPS (€)	1.72	1.49	1.34	1.40	1.51
EV/Ebitda(x)	10.8	9.5	24.9	6.4	4.6
P/E adj (x)	18.9	22.8	nm	8.9	5.9
Div.Yield(%)	2.8	0.0	0.0	0.0	8.7
FCF Yield(%)	6.9	5.5	3.7	9.0	16.0

Source: Mediobanca Securities

Wind of change

Market Data

Market Cap (€ m)	608
Shares Out. (m)	762
Main Shareholder	Shareholder pact 63.5%
Free Float (%)	36%
52 week range (€)	2.0625-0.5
Rel Perf vs Mibtel (%)	
-1m	-11.3%
-3m	12.4%
-12m	-22.1%
21dd Avg. Vol. ('000)	461
Reuters/Bloomberg	RCSM.MI /RCS IM

Key Financial Data - 2008 (€m)

Turnover	2,674
EBITDA	266
EBIT	137
Net Profit	26
Shareholders' Funds	1,133
Net Debt (-) Cash (+)	-1,147
Gearing %	94.2%

€200m saving plan approved by BoD

In the light of the significant drop in Group advertising revenues and given the extremely low visibility ahead, the BoD approved a series of measures with the aim of obtaining a €200m cut in costs – equal to 8% on total 2008 Group costs – within 24 months. More in detail: i) 40/45% savings related to cost of goods sold; 25/30% linked to G&A; 10/15% production costs; 10/15% revenues (in our view the increase in cover price for both Corriere della Sera & El Mundo in 2010). The full recovery is expected to be reached within 24 months: RCS expects to save additional €130m in 2009 and €70m at steady state.

Feasible plan, €300m EBITDA to be reached within 2011

After the release of poor first quarter results, we are changing our estimates for FY 2009, assuming an advertising drop of 18% YoY for Italian newspapers, 20% for Italian magazines and 25% for Spanish newspapers. We have tried to figure out the impact of the recovery plan division by division, in order to better understand what could be the impact of these savings in the medium/long term. In 2009 RCS could be able to save €130m costs (€39m savings in H2 '08 and €30m savings already achieved in Q1 '09): however we are more cautious than the company: in our view the full impact of plan could be reached by 2011. The company will have to sustain a huge amount (€120m) of one-off items on 2009.

From Neutral to Outperform, new TP at €1.65 per share (from €0.93)

We continue to believe that a target price based on an average of DCF analysis, peers and SOP analysis still represent the best way to provide a fair valuation (multiples should eye on 2011). Moreover: i) figures are quite conservative at top-line level; ii) the high level of debt doesn't represent an issue; iii) the approved recovery plan represents a radical change in the shareholders' approach to the company. Our new target price, based on an average of these methods, stands at €1.65 per share (from €0.93). Given the strong upside potential we move from Neutral to Outperform.

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Contents

Q1 09 weak as expected

First-quarter results came out in line with our estimates:

- ✓ Q1 09 revenues were €515m, -18% YoY, and in line with our estimates. Advertising revenues were extremely weak, both in Italy (-23% YoY for Newspapers and -28% for Magazines) and Spain (where Unidad Editorial suffered a -34% YoY decrease);
- ✓ On the other hand, books confirmed their resilience, with Italian fiction posting 5% YoY growth, while Spanish circulation revenues rose by 6% YoY following the increase in the cover price of El Mundo introduced in December 2008;
- ✓ Q1 09 EBITDA was negative to the tune of €12m, in line with MB's estimate of a €13m loss and vs. the figure of €14m achieved in Q1 08: note that these results are already reflecting the impact of savings put in place by the company, totalling €10m in the Italian newspapers division, and the group's workforce has been significantly cut in the last 12 months;
- ✓ As a consequence, EBIT and net profit were extremely negative;
- ✓ Net debt as of 31 March 2009 came out at €1,118m, an improvement of €28m vs. €1,147m at year-end 2008, impacted by: i) debt of €39m related to the disposal of Spanish printing activities now available for sale; ii) a cash-in of €17m from the disposal of the Spanish building in Madrid.

RCS: Q1 09 results vs. MB estimates

	Q1 09e	Q1 08	*YoY ch.*	Q1 09a	*Diff. % A/E*
Revenues	**514.9**	**625.5**	*-17.7%*	**504.3**	*2.1%*
EBITDA	**-11.6**	**14.2**	*nm*	**-12.7**	*-8.4%*
margin	*-2.3%*	*2.3%*		*-2.5%*	
EBIT	**-35.6**	**-10.1**	*nm*	**-39.6**	*-10.0%*
margin	*-6.9%*	*-1.6%*		*-7.8%*	
Pre-tax	**-51.6**	**-31.3**	*nm*	**-51.6**	*0.1%*
margin	*-10.0%*	*-5.0%*		*-10.2%*	
Net Profit	**-40.7**	**-18.6**	*nm*	**-46.4**	*-12.2%*

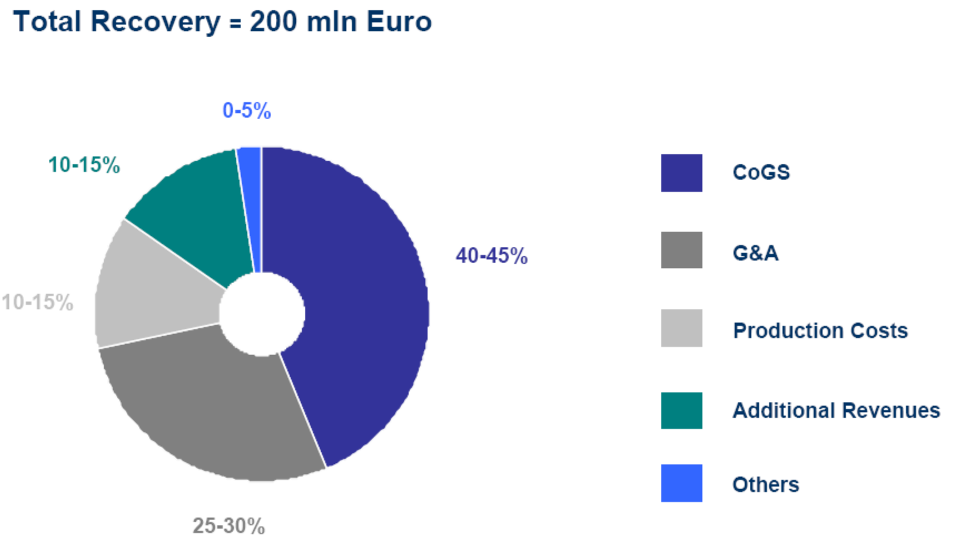
Source: Mediobanca Securities, company data

€200m savings plan approved by the board

In light of the significant drop in group advertising revenues and the extremely low visibility, the board has approved a series of measures to cut costs by €200m – equal to 8% of total group costs in 2008 – within 24 months. The plan will involve all the business units (with the exception of Dada). More specifically:

- ✓ 40/45% should be cost savings related to cost of goods sold: labor costs (the new national collective work contract for journalism was signed on 5 May), printing, foliation, paper weight, compensation to external agencies;
- ✓ 25/30% linked to G&A (labor cost in particular);
- ✓ 10/15% should involve production costs (i.e. transportation costs);
- ✓ 10/15% should be represented by additional revenues: above all, in our view the increase in cover price for both Corriere della Sera & El Mundo in 2010. Note that RCS did the last cover price increase for Corriere in August 2005. Moreover starting from December 2008 the cover price of Spanish daily El Mundo was moved to €1.10 (from €1.00).

Recovery plan at a glance

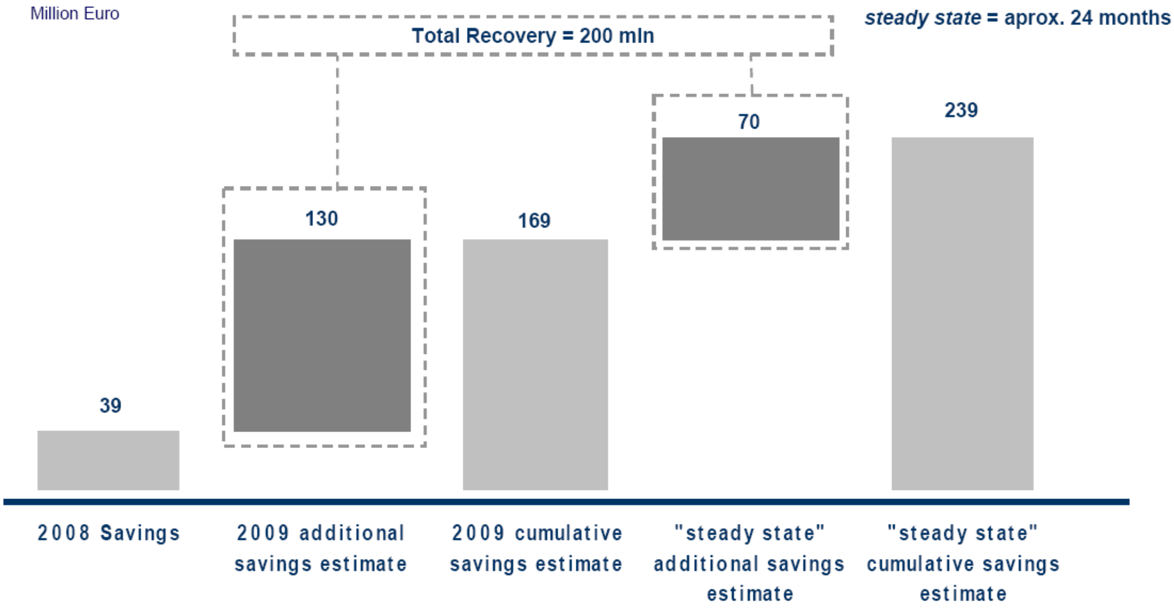


Source: Mediobanca Securities, company data

The market was expecting a strong recovery plan to be disclosed by the company, but the announced measures are above our expectations. Furthermore, RCS stated that:

- ✓ The full recovery is expected to be reached within 24 months: after having posted €39m saving in 2008, management expects to save additional €130m in 2009 and the remaining €70m at steady state;
- ✓ 2009 figures will be negatively impacted by extraordinary costs related to the action plan: considering that in 2008 €23m non-recurring costs were sustained for the first tranche of 'savings', we could assume additional €120/130m to be sustained in 2009 in order to support the new measures.

Recovery plan: timing



Source: Mediobanca Securities, company data

Finally, Riccardo Stilli, CFO of RCS MediaGroup since January 2005, was appointed Deputy General Manager: we like this move, since we recognise his in-dept knowledge of the group together with his strong commitment to cost controls. Moreover, as Mr. Stilli was involved in preparing the recovery plan, we believe that these additional powers will ensure he is better able to support the ongoing process.

Estimates revision

Step 1) another (the last?) cut in estimates

After the release of poor first-quarter results, we are changing our estimates for RCS for FY 2009, assuming a drop in advertising revenues of 18% YoY for Italian newspapers, 20% for Italian magazines and 25% for Spanish newspapers: note that these assumptions could in our view be extremely conservative, since we are assuming a double-digit drop for both Italy and Spain in the last quarter, which already posted significant declines in the last quarter of 2008: 14% YoY for Italian newspapers, 10% for Italian magazines and 25% for Spanish newspapers.
We also became more conservative on books (particularly in the partworks division) and the new media field (Dada – we published an update report on 30 April – and Digicast).
All in all, our new estimates deliver a 5% YoY drop at top-line level, while if we do not consider any cost savings, we would cut our FY 2009 EBITDA forecast by 35%, to €143m.

RCS: new estimates exl. recovery plan

	FY 09E new	FY 09E old	*Diff. %*	FY 10E	*Diff. %*
Newspapers Italy	625.7	657.5	*-4.8%*	622.0	*-0.6%*
Unidad Editorial	546.4	575.6	*-5.1%*	539.6	*-1.3%*
Magazines	281.3	298.1	*-5.6%*	288.2	*2.5%*
Books	623.4	647.4	*-3.7%*	630.3	*1.1%*
Advertising	504.9	567.8	*-11.1%*	515.4	*2.1%*
Digicast	27.8	33.8	*-17.7%*	28.6	*3.0%*
Dada	168.9	191.2	*-11.7%*	177.1	*4.9%*
Revenues	**2375.4**	**2510.9**	***-5.4%***	**2389.1**	***0.6%***
Newspapers Italy	37.5	71.0	*-47.1%*	49.8	*32.5%*
Unidad Editorial	27.3	60.4	*-54.8%*	40.5	*48.1%*
Magazines	8.4	11.9	*-29.1%*	14.4	*70.8%*
Books	53.0	55.0	*-3.7%*	56.7	*7.1%*
Advertising	-2.5	-2.8	*-9.8%*	2.6	*nm*
Digicast	8.3	11.8	*-29.3%*	8.6	*3.0%*
Dada	25.0	31.0	*-19.4%*	28.0	*12.0%*
EBITDA	**143.1**	**222.3**	***-35.6%***	**186.5**	***30.3%***

Source: Mediobanca Securities

Step 2) factoring the impact of recovery plan

We have tried to assess the impact of the recovery plan by division, in order to better understand the affect of these savings in the medium/long term. To summarise our assumptions:

We are assuming that RCS should be able to reduce costs by €130m in 2009, and this amount – in line with company indications – seems achievable to us in light of the €39m savings posted in the second half of 2008 and the €30m savings achieved in the first quarter of 2009;

We are more cautious than the company in our 2010 forecasts, giving a 50% probability to its estimated cuts of €70m, which in our view could be fully reached by 2011;

All in all, as we have already anticipated, we believe that the company will have to sustain a huge amount of one-off items on 2009: considering that in 2008 these totalled €23m, we consider it a fair assumption that €120m will be posted (according to IAS requirements) above the EBITDA line. Net of one-off impact, EBITDA 2009 should point at €188m.

In our view, RCS should be able to reach its EBITDA target of €300m in FY 2011, with a margin above 12.5%: note that our scenario for the following years reflects flattish growth for advertising, but after the strong drop posted in 2008 and 2009, a greater recovery cannot be ruled out. Following the strong cost reductions put in place, this could have a significant impact on margins.

RCS: new estimates with recovery plan

	FY 09E 'recovered'	FY 09E 'no rec.'	*Diff. %*	FY 10E 'recovered'	FY 10E 'no rec.'	*Diff. %*	FY 11E 'recovered'	*YoY %*
Revenues	**2375.4**	**2375.4**	***0.0%***	**2395.9**	**2395.9**	***0.0%***	**2423.1**	***1.1%***
Newspapers Italy	15.6	37.5	*-58.3%*	74.6	49.8	*50.0%*	86.3	*15.7%*
Unidad Editorial	12.0	27.3	*-56.0%*	65.6	40.5	*62.0%*	108.2	*65.0%*
Magazines	8.4	8.4	*0.0%*	17.3	14.4	*20.0%*	17.4	*0.9%*
Books	28.1	53.0	*-47.1%*	63.0	56.7	*11.1%*	64.1	*1.7%*
Advertising	-15.1	-2.5	*nm*	2.6	2.6	*0.0%*	5.3	*ns*
Digicast	8.3	8.3	*0.0%*	8.6	8.6	*0.0%*	9.5	*10.0%*
Dada	25.0	25.0	*0.0%*	28.0	28.0	*0.0%*	30.1	*7.5%*
EBITDA	**68.3**	**143.1**	***-52.2%***	**245.7**	**186.5**	***31.7%***	**306.9**	***24.9%***
margin	*2.9%*	*6.0%*		*10.3%*	*7.8%*		*12.7%*	
EBIT	**-44.3**	**30.4**	***nm***	**135.3**	**76.1**	***77.7%***	**198.7**	***46.9%***
margin	*4.5%*	*4.5%*		*4.5%*	*4.5%*		*4.5%*	
Pre-tax	**-85.8**	**-8.5**	***nm***	**98.3**	**40.1**	***145.0%***	**168.2**	***71.2%***
margin	*2.3%*	*2.3%*		*2.3%*	*2.3%*		*2.3%*	
Net Profit	**-111.8**	**-4.8**	***nm***	**46.1**	**14.1**	***227.5%***	**80.8**	***75.4%***

Source: Mediobanca Securities

Huge leverage? Not an issue

As we already underlined in our previous report on the stock, RCS' net debt to EBITDA ratio is likely to reach extremely high levels by the end of the year. We estimate that RCS could reach a net debt position of €1.03bn in FY 2009 vs. €1.15bn as of December 2008. We believe there is no risk on debt repayment, considering that:

- ✓ RCS does not have any covenant on its debt;
- ✓ the first significant deadline will be in 2013, and the company already has credit lines totalling more than €2.1bn;
- ✓ As detailed in the company's annual report, more than the 75% of total debt is at variable interest rates, with a very limited spread (lower than 50 bps): for this reason, we expect RCS to benefit from current market conditions;
- ✓ Note too that the last AGM did not renew the Board of Directors' authorisation regarding the capital increase increase.

Having said that, we believe that the company still has some minor assets that it could sell off: i) RCS has a 34.5% stake in IGP Decaux, an Italian player in outdoor advertising (which we value at €39m in our SOP); iii) RCS has a 10% stake in Poligrafici (€5m at current market prices), but does not have any members on the board, and launched local editions of Corriere della Sera in Bologna and Florence.

RCS could withdraw from Partworks (revenues of €186m in FY 2008), since the business does not offer any synergies with the remainder of the books' segment and has low profitability. Since the business is affected by a structural decline, in our view the best solution could be an agreement with a player in the sector that would lead to significant economies of scale: for example, the De Agostini group recently announced significant cost-cutting initiatives to combat the weakness of this business.

Valuation

Over the past three months, RCS shares have performed worse than its market peers, posting a 2% decline compared to a 16% growth for the sector. Moreover, relative to the market RCS posted an increase of 10%.

Media sector: stock market performance

NAME	1Y	6M	3M	1M
GRUPPO EDIT.L'ESPRESSO	-50%	-9%	34%	27%
MONDADORI EDITORE	-46%	17%	5%	15%
RCS MEDIAGROUP	**-62%**	**-37%**	**26%**	**-2%**
CLASS EDITORI	-45%	-5%	10%	-3%
TRINITY MIRROR	0%	0%	0%	0%
PEARSON	-72%	123%	60%	10%
PROMOTORA DE INFMCS	1%	17%	8%	2%
VOCENTO	-74%	8%	65%	34%
LAGARDERE GROUPE	-56%	0%	28%	18%
REED ELSEVIER	-50%	-14%	-19%	-4%
WOLTERS KLUWER	-21%	-3%	-1%	1%
CAIRO COMMUNICATION	-24%	-3%	7%	6%
IL SOLE 24 ORE	-46%	-15%	5%	7%

Source: Mediobanca Securities, Datastream

In the light of the recovery plan presented to the market, we would like to change our valuation approach to the stock:

- ✓ We continue to believe that a target price based on an average of DCF analysis, peers' and SOP analysis still represent the best way to provide an update valuation;
- ✓ Being RCS involved in a medium-term restructuring program, we believe that multiples should eye on 2011, i.e. the year in which according to our estimates the impact will reach the steady state (since we are more conservative than the guidance presented by the company).

Having said that, and adding that:

- ✓ in our view our figures are quite conservative at top-line level (the implied drop in advertising for the last quarter of 2009 is still double-digit notwithstanding the easy-comparison with an extremely weak Q4 08 for both Italy and Spain;
- ✓ the high level of debt doesn't represent an issue;
- ✓ the approved recovery plan represents a radical change in the shareholders' approach to the company;
- ✓ being the profitability of RCS far from the one of its 'best-in-class' peers, in our view the €200m savings approved are more than visible.

Our target price, based on an average of these methods, stands at €1.65 per share (+78% versus our previous target). Notwithstanding we see further risk for coming months, related to the low visibility on advertising scenario, given the strong upside potential we move from Neutral to Outperform.

RCS: new fair value

	NEW Fair value	OLD Fair value	*Diff.*
DCF	1.5	1.3	*15.4%*
SOP	1.3	0.9	*44.4%*
EV/EBITDA	1.8	0.9	*100.0%*
P/E	1.9	0.8	*137.5%*
Target price	**1.7**	**0.9**	***78.5%***

Source: Mediobanca Securities

Rcs Mediagroup

Profit & Loss account (€ m)	2007	2008	2009E	2010E
Turnover	2,728	2,674	2,375	2,396
Turnover growth %	14.6	-2.0	-11.2	0.9
EBITDA	360	266	68	246
EBITDA margin (%)	13.2	9.9	2.9	10.3
EBITDA growth (%)	29.5	-26.2	-74.3	nm
Depreciation & Amortization	-101	-129	-113	-110
EBIT	260	137	-44	135
EBIT margin (%)	9.5	5.1	nm	5.6
EBIT growth (%)	22.0	-47.1	-132.3	-405.2
Net Fin.Income (charges)	-36	-68	-42	-37
Non-Operating Items	0	0	0	0
Extraordinary Items	64	-7	0	0
Pre-tax Profit	289	63	-86	98
Tax	-62	-31	-20	-44
Tax rate (%)	21.3	49.1	nm	45.0
Minorities	-14	-6	-6	-8
Net Profit	213	26	-112	46
Net Profit growth (%)	-2.8	-88.0	n.m	-141.2
Adjusted Net Profit	156	61	-89	69
Adjusted Net Profit growth (%)	79.0	-60.9	n.m	n.m

Multiples	2007	2008	2009E	2010E
P/E Adj.	18.9	22.8	nm	8.9
P/CEPS	8.8	8.0	89.8	3.7
P/BV	2.3	1.2	0.6	0.6
EV/ Sales	1.4	0.9	0.7	0.7
EV/EBITDA	10.8	9.5	24.9	6.4
EV/EBIT	15.0	18.3	nm	11.7
EV/Cap. Employed	1.5	0.9	0.7	0.6
Yield (%)	2.8	0.0	0.0	0.0
OpFCF Yield (%)	6.9	5.5	3.7	9.0
FCF Yield (%)	5.8	2.9	0.1	10.2

Per Share Data (€)	2007	2008	2009E	2010E
EPS	0.28	0.03	-0.15	0.06
EPS growth (%)	-2.8	-88.0	n.m	n.m
EPS Adj.	0.20	0.08	-0.12	0.09
EPS Adj. growth (%)	79.0	-60.9	n.m	n.m
CEPS	0.44	0.23	0.01	0.22
BVPS	1.7	1.5	1.3	1.4
DPS Ord	0.11	0.00	0.00	0.00

Balance Sheet (€ m)	2007	2008	2009E	2010E
Working Capital	211	224	170	213
Net Fixed Assets	2,463	2,443	2,333	2,225
Total Capital Employed	2,674	2,667	2,503	2,438
Shareholders' Funds	1,307	1,133	1,021	1,067
Minorities	82	84	90	98
Provisions	319	304	301	297
Net Debt (-) Cash (+)	-966	-1,147	-1,091	-976

Key Figures & Ratios	2007	2008	2009E	2010E
Avg. N° of Shares (m)	762	762	762	762
EoP N° of Shares (m)	762	762	762	762
Avg. Market Cap. (€ m)	2,920	1,373	608	608
Adjustments (€m)	0	0	0	0
Enterprise Value (€ m)	3,886	2,520	1,699	1,584
Labour Costs/Turnover (%)	18%	20%	21%	20%
Depr.&Amort./Turnover (%)	4%	5%	5%	5%
Prod. Ratio (Turn./Op.Costs)	1.1	1.1	1.0	1.1
Gearing (Debt / Equity) (%)	70%	94%	98%	84%
EBITDA / Fin. Charges	>10	3.9	1.6	6.6
Net Debt / EBITDA	2.7	4.3	>10	4.0
Cap.Employed/Turnover (%)	98%	100%	105%	102%
Capex / Turnover (%)	4%	4%	3%	3%
Pay out (%)	37%	0%	0%	0%
ROE (%)	16%	2%	nm	4%
ROCE (%) (pre tax)	10%	5%	nm	6%
ROCE (%) (after tax)	8%	3%	nm	3%

Cash Flow Model (€ m)	2007	2008	2009E	2010E
Cash Earnings	335	173	7	164
Working Capital Needs	22	-13	54	-43
Capex (-)	-116	-114	-60	-60
Financial Investments (-)	-1,069	-112	57	57
Dividends (-)	-27	-82	0	0
Other Sources / Uses	-117	-32	-3	-4
Ch. in Net Debt (-) Cash (+)	-972	-181	55	115

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