

Research Update:

U.K.-Based Broadcaster ITV Outlook Revised To Stable On Recovery Of Advertising Revenues; 'B+' Long-Term Rating Affirmed

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Overview

- U.K. broadcaster ITV PLC increased its advertising revenues in the first quarter of 2010 and the group expects further significant growth in the second quarter.
- We are revising the outlook on ITV to stable from negative.
- The stable outlook reflects our opinion that, under the current scenario of recovery in the U.K. advertising market, ITV's profitability and credit measures are likely to improve in 2010.

Rating Action

On May 27, 2010, Standard & Poor's Ratings Services revised its outlook on U.K. broadcaster ITV PLC to stable from negative. At the same time, we affirmed the 'B+' long-term and 'B' short-term corporate credit ratings on ITV.

The recovery rating of '4' on all of ITV's outstanding bonds is unchanged. The recovery rating indicates our expectation of average (30%-50%) recovery for unsecured creditors in the event of a payment default.

Rationale

The outlook revision reflects our view that ITV's credit measures will likely improve in 2010. This is based on the recent recovery in ITV's advertising revenues reported in the first quarter of 2010 and the group's anticipation of further material growth over the next quarter. Given the group's high operating leverage, we anticipate that top-line growth can rapidly translate into an improvement in profitability. This could enable the group's debt to EBITDA ratio (adjusted for operating leases and pensions and excluding any netting of excess cash) to drop below 6.0x by year-end 2010. The stable outlook also incorporates our view that the group's pension deficit will remain stable in 2010 and that there will be no significant changes to current funding assumptions.

In our opinion, the recovery in the U.K. advertising market in the fourth quarter of 2009 and the first quarter of 2010 is likely to continue over the next few quarters. ITV reported 8% growth in advertising revenues in the first quarter of 2010 and the group forecasts 22% growth for the second quarter. Given the predominance of fixed costs in the group's cost structure, we

believe that ITV's EBITDA and cash flow will directly benefit from top-line growth. As a result, we anticipate that credit metrics will improve over the course of 2010, such that adjusted debt to EBITDA will decline below 6.0x at year-end.

ITV managed to increase cash conversion in 2009: it reported unadjusted free operating cash flow (FOCF) of about £216 million in of 2009, £157 higher than 2008, due to lower capital expenditure and a focus on working capital management, which provided an exceptionally high £121 million cash inflow. ITV's discretionary cash flow (FOCF after dividends) became positive again in 2009 following the suspension of dividends based on 2009 results. ITV's cash dividends paid out in 2009 (based on a final dividend on 2008 results) were £25 million, compared with cash dividends of about £122 million in 2008.

In addition, ITV managed to reduce its pension deficit by £110 million in the second half of 2009 from the peak level of £538 million in June 2008, thanks to the successful implementation of changes to its defined benefit scheme. We believe that the group's pension deficit it is likely remain at a similar level to that reported in 2009.

Liquidity

In our view, ITV's liquidity is adequate. ITV had about £582 million of cash on Dec. 31, 2009, which covered about £9 million of short-term debt. We understand, however, that about £150 million of reported cash is restricted for financial leases, unfunded pension commitments, or is held overseas and therefore not readily accessible.

ITV was particularly active in raising new funding in 2009. In February 2009, the group drew down a £200 million loan facility maturing in March 2019, which is secured against about £138 million nominal of U.K. gilts that have the same maturity as the loan. ITV also drew down a £125 million covenant free loan in March 2009, with a maturity of May 2013, and in May 2009 completed a £100 million bond issue, which was a tap of the existing £325 million October 2015 bond and resulted in net proceeds of £58 million.

In June 2009, under the terms of an exchange offer, ITV repaid €81 million (£69 million) of the €500 million October 2011 Eurobond and exchanged at par €188 million of the October 2011 bonds for the issuance at par of new bonds with a maturity of June 2014 and carrying a coupon of 10%.

In October 2009 ITV repaid £75 million of the £125 million covenant-free loan drawn in March, and in November issued £135 million of convertible notes due in November 2016.

Finally, ITV repurchased €146 million of the remaining October 2011 bonds and £42 million of the notes due in October 2015.

Importantly, liquidity has improved following the exchange offer, since ITV's closest debt maturity is about £10 million in October 2011 (net of

cross-currency swaps), versus about £335 million prior to the exchange offer. The next maturity after the October 2011 bond is about £110 million in early 2013. In 2009, ITV cancelled its undrawn £450 million revolving credit facility maturing in June 2011 following the risk of breaching financial covenants. In addition, we anticipate that ITV will generate positive free operating cash flow in 2010.

Recovery analysis

ITV's senior unsecured notes are rated 'B+', in line with the corporate credit rating. The recovery rating on these notes is '4', indicating our expectation of average (30%-50%) recovery for unsecured creditors in the event of a payment default.

In our hypothetical scenario, we assume default in 2013, triggered by a significant decline in ITV's revenues and profitability and its inability to repay or refinance debt maturing in 2013 (£125 million bilateral financing and £110 million notes).

We have valued ITV on a going-concern basis, given the strength of its brand, licenses, programming rights, market share, and knowhow, which might still retain some value at default. We estimate ITV's enterprise value at the hypothetical point of default at about £900 million. This represents a meaningful decline from today's value, given the likely structural and significant changes in the business prior to default.

After deducting priority liabilities, we estimate that coverage for the senior unsecured notes will be 30%-50%.

Recovery prospects for unsecured debt instruments reflect the estimated value available and accessible to creditors and are constrained by the bonds' lack of security and documentary provisions, and the likelihood that the capital structure at default might be materially different, as additional debt could be raised along the path to default with parity or priority to the rated unsecured debt instruments.

For more details, see "ITV PLC's Recovery Rating Profile," published March 10, 2009.

Outlook

The stable outlook reflects our view that, based on the current recovery in the U.K. advertising market, ITV will increase its advertising revenues in 2010. We anticipate that top-line growth will translate into higher EBITA and an improving operating margin given its relatively high operating leverage. The stable outlook also incorporates our view that ITV's adjusted gross debt to EBITDA will drop below 6.0x by year-end 2010. We also factor in our anticipation that ITV's liquidity will remain adequate and that the group will continue to successfully defend its audience and advertising market shares

over the medium term. Finally, we do not expect a significant change in the group's merger and acquisition activity that could affect its liquidity position or a change in ITV's dividend policy as a result of the new management.

We could lower the ratings if ITV were unable to reduce adjusted debt to EBITDA to about 6.0x, from the 7.1x at year-end 2009, and if the group were unable to maintain positive free cash flow generation. We could revise the outlook to positive or raise the rating in the event of a material improvement of the group's operating performance and credit measures arising from substantially better-than-expected advertising and economic conditions in the U.K.

Related Criteria And Research

- Principles Of Corporate And Government Ratings, June 26, 2007
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
ITV PLC Carlton Communications Ltd. Corporate Credit Rating	B+/Stable/B	B+/Negative/B

Ratings Affirmed

ITV PLC Senior Unsecured* Recovery Rating	B+ 4
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*Guaranteed by Carlton Communications Ltd.

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