

BRUNSWICK GROUP

Moderator: Adam Crozier
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Operator: This is conference # 17121472

Operator: Good day. My name is (Brandon) and I will be your conference operator today. And I would like to welcome you to the ITV Q3 trading update conference call.

At this time, all participants are in a listen-only mode. There will be a presentation followed by a question and answer session, during which, if you wish to ask a question, you will need to press "star," "one" on your telephone. Please be advised that this conference is being recorded today, November 10, 2016.

I would now like to hand the conference over to your speaker today, Mr. Adam Crozier.

Adam Crozier: Morning, everyone. Thank you very much for taking the time to come on the call this morning.

We thought it would be helpful to have a call today. You don't need me to remind you that there's quite a lot going on in the world right now and we certainly live in interesting times. And we thought it might be helpful, even though we (wouldn't) normally have a call, to have one this morning just to give you a bit of color around the results and also give you a chance to ask any questions that you have.

Just a few words from me before we throw it open to Q&A. As you can see from the release, our strategy of rebalancing and strengthening ITV continues to deliver with total external revenue up 5 percent in the first nine months, even with ITV NAR down 1 percent.

Studios delivered double-digit revenue growth, up 18 percent, mainly, as you know, driven by our acquisitions. And we've got a really good, strong pipeline of new and returning dramas, including, Victoria, Poldark, Cold Feet, Harlots, The Good Witch. And we sold over 64 (mats) globally this year, including, This Time Next Year, The Voice, Five Gold Rings, Pawn Stars and Love Island.

We've delivered good organic growth in the UK, but the performance of ITV America in 2016 has been impacted by the lumpy nature of the business, with some programs, such as Texas Rising and Best Time Ever, not returning in 2016, and others, such as Hell's Kitchen, moving to 2017 for two series.

We remain very confident in the outlook for ITV Studios, with the drama slate, I think, healthier than it's been for a long time. Because of this strong slate and the high level of commissions and recommissions that we've secured, we will deliver a return to good organic revenue growth in 2017.

However, with the increased investment in our scripted content, which we think is the right thing for the business, and the lumpiness caused by the timing of some of our key shows, such as The Voice of China, ITV Studio's profits in 2017 are likely to be broadly in line year on year.

Onscreen and online, we continue to perform strongly. Our share of viewing on the main channel at the end of the nine-month period was up 3 percent and flat for the ITV Family, even after a summer of Olympics and Paralympics, with a good performance across all the key genres of dramas, entertainment, the soaps and sport.

With the continued success of ITV Hub, viewing of our shows online was up 49 percent, which has driven continued strong growth in online, and pay and interactive revenues, which are up 22 percent.

Over recent weeks, I think you can see the political and economic uncertainty has increased, particularly with the debate over a hard or soft Brexit. And we are currently seeing more cautious behavior by advertisers, and, as a result, ITV ad revenue's forecast to be down 7 percent in quarter 4, and down around 3 percent across the full year.

Despite the caution, I think you could also see from the release that the rate of decline in ITV advertising appears to be easing over quarter 4, with October down 11 percent, November down 6 percent and December down 4 percent. And we're certainly not seeing campaigns pulled or cancelled. However, as we look across the advertising categories, we are seeing some decline across the majority of the key categories.

I'm sure one of the questions you will have is, what is our view of the outlook into 2017? But, as ever, we only have limited visibility. However, what we can say is that our strong onscreen performance and continued ability to deliver mass audiences across all the key demographics gives us confidence that, based on the deals we have already done, we will also outperform our estimate of the TV ad market in both 2016 and 2017.

ITV is now a much more balanced and resilient business, and so even against the current uncertain economic backdrop, we expect earnings to be broadly in line with 2015, driven by growth in our high margin, online pay and interactive business, and in our Studios business in the UK and internationally.

We continue our tight control on costs and just to reassure you, we're on track to deliver the GBP25 million of overhead savings in 2017 that we announced at the interims. And due to the absence of a major sporting event next year, the NPB will be around GBP25 million lower in 2017 (sic), whilst, very importantly, still maintaining the strength and depth of the schedule.

We remain committed to our strategy and we see clear opportunities to continue to invest, both organically and through acquisitions. And the strength of our balance sheet and underlying cash flows allows us to do this whilst, at the same time, delivering sustainable returns to our shareholders.

So hopefully that's a quick and helpful summary. And both Ian and I are both now happy to take any questions that you may have. Thank you.

Operator: (Operator Instructions). Lisa Yang.

Lisa Yang: I have a few questions if I may. I know the visibility is quite short but you still expect to outperform the overall TV market for 2017. So maybe could you share with us what are your internal thinking about 2017 for the market? And how do you expect to outperform that despite the lack of sports events?

Secondly is on Studios. So you expect to return to good organic growth next year. So just wondering what kind of range of growth you're thinking about. And given the nine months this year already trading at minus 9 percent, what do you think for the shape of organic growth for 2016?

And lastly is on the use of cash. So we see recently you tried to buy Entertainment One, it didn't happen. So does it mean you're more keen to do M&A rather than paying a special dividend? Any comment there would be helpful. Thank you.

Adam Crozier: I'll take them in the order that you asked them if that's OK with you. Just looking at advertising, I think in terms of the categories in the first nine months, that didn't perform as well. It was really what had happened in the earlier part of the year. It was really based around retail, finance, food and telecom, as we said at the half year.

In quarter 4 I think a number of the key categories are down a small bit to some extent. There are some that are up. Ironically digital advertising from people like Amazon, Netflix, and Facebook, rightly recognizing the power of television advertising which I think is good. I think we've been clear throughout the year that we expected to outperform the market this year. And I think we will do that.

Looking forward into next year, what do we base our belief on? One is that we actually have done virtually all our deals with the major buying agencies. And we know through that that we will outperform the market. Plus, we have a very strong slate of shows for next year, some great dramas, and some

fantastic big entertainment shows, new ones like The Voice and The Voice Kids.

But also we have things like the horseracing, which, as we said at the time that we won it, will bring in genuine incremental revenue, because that revenue actually follows the sport in terms of whichever channel it's on. So I think we can genuinely, confidently, say that we will outperform the market.

In terms of the organic growth in Studios. Yes, at the nine months, I think organic growth was down 9 percent. Actually, when you look at that, that's around GBP60 million, which is almost entirely made up of three things. One is Hell's Kitchen, which is actually moving into next year and coming back as a double run. And the other two are that Texas Rising and This Time Next Year, both again in America, are not returning. So it's really explained by large by three shows.

But if we look to next year we do, I think, genuinely have the strongest lineup of new and returning scripted shows that we've had for a long time. A number of our formats are doing extremely well. Probably the highest level of commissions and recommissions we've had for a very long time at this stage of the year. So I think we're in very good shape. And we're confident in delivering good revenue growth in Studios.

Yes, we think the profits next year will be broadly flat for the reasons we explained. But we do think it is the right thing to do to invest in our Studios business, particularly in scripted. And because of that very strong slate and the demand from broadcasters for those ideas, I don't think we would be doing the right thing for the business if we didn't continue to invest in that long-term success. So I think that's absolutely the right thing for us to do there.

In terms of cash which was your final question, look, I think we've been very clear that we will continue to look to drive organic growth. We have a good, strong M&A pipeline. We didn't do E1 as you know. And I think for us, that was about looking at an idea. Normally that wouldn't have been public. But unfortunately it leaked.

But in any event, we will continue to show discipline around anything that we look at. And we are very clear about the value we attach to businesses we look at. We couldn't agree that with them. And, therefore, we declined, and we moved on. I think it's important we do show that discipline.

We'll continue to look at M&A as we've said before. And to maintain that flexibility going forward of wanting to invest in the business, both organically and through M&A, and of course balance that with rewarding shareholders. And we'll do that as we have done over the previous few years when we come to the end of this year.

Lisa Yang: Great, thank you very much.

Operator: Laurie Davison, Deutsche Bank.

Laurie Davison: On Studios, first question just a clarification on the third quarter. Could you just give us a third quarter organic? And you mentioned that for next year you're feeling more confident, or we should see a return to growth. You start to include some of the acquisitions next year in your organic numbers. You've held them for over two years. So how much of an effect is that going to have next year?

And then lastly, just on the dividend. Consensus has in around a 9p extraordinary dividend for this year, and 10p for next year. How do you feel about that market expectation? Thanks.

Ian Griffiths: The quarter 3 for Studios, as Adam outlined, Laurie, was largely impacted by the US factors. Best Time Ever was a remake of Saturday Night Takeaway, which went out in the US primarily in September. Hell's Kitchen is something that happens across the year. And Texas Rising also has primarily a Q3 impact.

And the thing about the Studios business, as we've talked before, is the lumpiness is largely caused by, to a large extent, caused by broadcasters frequently changing their minds about when they want shows, as well as which shows they want. Quite frequently shows move from month to month or, in some cases, quarter to quarter. So there's always a lot of volatility

around the business. It's about the quality of the pipeline and the recommission rates. And hopefully from what you've heard from Adam, that the outlook going into 2017 is very good.

Going back to Lisa's point about the phasing of things next year, which quarter these things come into, we couldn't give you a firm steer on that now. But we know we've got them contracted and we know they'll be delivered in 2017 at some point and that's always the case.

In terms of the organic, we can have this debate whether this is a good way of looking at it or not. Our definition of organic excludes currency and excludes businesses we've not owned for two financial years. And that means things like Talpa, Twofour, Mammoth, Cats on the Roof, businesses we acquired last year or invested in last year are excluded from our current definition of organic. But because it changes every year, next year the whole business is organic. And that's how we look at things.

In terms of day-to-day management of the Studios business, we don't differentiate between organic and acquired businesses; we invest behind the best ideas and the best talents. And this year, the business is delivering exactly what we said it would right from the start. We said from day one that 2016 we'd deliver double-digit revenue and profit growth. We've reiterated that guidance today.

The shape of how it's delivered is slightly different from what we expected. The acquisitions have done better. The organic, on our definition, is slightly worse. Next year, we won't have that definition because it's the same business. So I think that's how we tend to look at things. We look at the whole business in the round and is the whole business healthy. And that's important and is that driving value going forward.

As far as the exceptionals are concerned, again touching on what Adam said, in terms of what Lisa said, we'll do what we normally do when we get to the end of the year. We'll look at the investment requirements for the organic business, the key business, the business we have today. We'll look at the M&A pipeline. We'll look at how we're trading. And if there's genuine surplus

we will, as we have done historically, do the right thing for shareholders and move that forward.

Based on what we've said and the earnings we'll have, there's still going to be significant headroom against our net debt targets. So it's nice looking into 2017 knowing you've got a lot of flexibility on the balance sheet. And I think that's a good place to be.

Adam Crozier: I would just add one thing to what Ian said. As we've said many times, not really, at our end anyway, are we differentiating between organic and acquisitions. It's about investing in the studios in wherever we think we can get the returns.

So part of the investment going into next year that we talked about is for more scripted teams and pods working in the US, for more pilots, for more writers. That's because we think there are good talented people there that we want to take on as part of the organization. And if that's the right thing to do at that stage, that's what we'll do. If it's a smaller talent-led M&A deal, we'll do that.

But we don't really, at our end, differentiate between those two things because, in effect, to us they're just investing in growing our content business and making sure that the right creative people are working with ITV; and that when we've got opportunities with broadcasters and a chance to do work for them, we seize that opportunity.

Laurie Davison: Understood. That's very clear, thanks. Just one follow up, on the horse racing you mentioned and the advertising for next year, there's some speculation that there could be a tighter regulatory stance on pre-watershed advertising around gambling. Would that potentially impact any of your horse racing impact for next year and the comments you gave about outperforming the market? Thanks.

Adam Crozier: This has been a slightly strange one, to be perfectly honest. When this first came out, I don't think either we or Sky or frankly most of that industry could find where it had emanated from. So it was slightly odd. And we've subsequently discovered it's tagged on the end of a review for completeness.

But, actually, this whole thing was reviewed by the CAP and BCAP in 2014. And it was very clearly found that there was very little evidence that gambling advertising has an impact on young people. And, more importantly, that all the right protections in terms of the marketplace in the UK are very much already in place.

Remember, it's currently only allowed around sporting events. And it's pretty strictly controlled. So I think the evidence is clear. It's part of an overall look. But, in any event, it's such an important part of the whole horse racing industry, I personally think it's extremely unlikely. But I think, obviously, we've got to make sure we get all of the facts across. But that's not just a case of ITV doing that. That's for everyone in the industry to do that.

Ian Griffiths: And just on a slightly more positive note around advertising in general, we've been very encouraged by the response from the market for advertising around the horse racing. And that, to a large extent, goes to what Adam was saying about our confidence in 2017 about being able to outperform the market. The demand and response from the industry has been really encouraging, so that's good.

Adam Crozier: And most of that is presold for the year which, again, is very helpful.

Laurie Davison: That's great, thanks ever so much.

Operator: Tamsin Garrity, Jefferies.

Tamsin Garrity: Looking through the mix shift that we're seeing going into next year, are you seeing any change in behavior from the advertisers or any new advertisers entering the market? So post-Brexit, are we seeing a change in behavior?

And then looking at the Studios business, you've made it very clear, given the flexibility on the balance sheet that you could make some acquisitions. But might we be moving, given the uncertainty in the ad market, more towards the smaller acquisitions or taking stakes in businesses, as you had done previously in a more uncertain outlook? Or might we also see some larger acquisitions? Thank you.

Adam Crozier: So advertisers first, I think the honest answer is we're not really seeing any change in behavior. I think the things that were there, which is a bit of a recalibration back towards the importance of television advertising is still very much there, both here in the UK and in other major markets.

You'll have seen the recent announcement, for example, from Facebook about their overestimation of the advertising impacts that they've been delivering. So I think all that has fueled that recognition of the power of TV and probably just as importantly, the fact that the television measurement system is very much a trusted system, where advertisers know what it is they're getting in return for the very large investments they're making.

And I think digital advertising generally has got some work to do to get its house in order including, no doubt, at some point, actually bringing in independent measurements of the impacts they're delivering. You can't really in this day and age, be marking your own homework, let's put it that way.

If you look at advertising in the UK, I think the categories that were down, for reasons that are pretty well trailed, like finance, an industry that's got its own issues, and supermarkets, where they're obviously under real pricing pressure, I think those have continued to have a difficult time, although we are seeing some stirring in the supermarket side, which, again, is not surprising in the run-up to Christmas. All the categories down but nobody really changing their behavior, just being a bit cautious and holding back a little bit in the short term.

In terms of areas picking up, still very much, for example, the whole digital side of things, ranging from clients such as Just Eat, in that sort of area, through to, as I just mentioned earlier, people like Amazon, Netflix, Facebook; again, ironically, backing up the power of television advertising, even for those digital brands.

So no real change in behavior, genuinely no canceling of any campaign. And I think, to some extent, the back end of quarter 3, beginning of quarter 4 is living in the aftermath of the decisions that were taken immediately post-

Brexit, where everyone, bit of uncertainty, immediately jumped in. So I think all to be expected.

In terms of Studios and acquisitions, your second question, again I think the easiest way to put it is that I think we always have done -- virtually every acquisition we've done in the most derisked way we could for the Company. And I think we will continue to do that because we believe, when we're doing acquisitions, in aligning our interests with those of the company that we're acquiring.

I think that's been a really good model for us. I don't think that matters really whether it's a small acquisition, a medium-sized one, or a larger one, we will always look to try and do that. There's a healthy pipeline of things we're looking for. And as I said before, we haven't made any secret of the fact that if the right acquisition is there, the right quality, and the right price, and we think they are people we can and should be working with, then we will look at it seriously.

Tamsin Garrity: Thank you.

Adam Crozier: Probably time for one more question.

Operator: John Karidis, Haitong Securities.

John Karidis: I've got two questions, please. The first one is could you please reflect on the cost, and the drivers of the cost, of producing scripted content, and specifically drama, over time?

Then secondly, I am trying to understand whether your appetite and motivations for more acquisitions in Studios has, or not, been affected by what's happening in your TV advertising business. Are you more keen to diversify away from advertising because of what's happening, or nothing has really changed in your motivation there? Thank you.

Adam Crozier: I'll take them in reverse order, so I'll start with the second question, if that's OK. I think right from the time that we started on this strategy a few years ago, which we, Ian and I, and the Company and the Board remain absolutely

committed to was to, over time, rebalance ITV away from the high reliance on television advertising that it had, into other revenue streams, specifically content and online digital and pay.

Secondly, to rebalance ITV away from its, at the time, almost entire focus on the UK, so much more international. I think leave it for all of you to decide, but I think we've had some really good success in driving both of those factors. And that continues to be the strategy, so there's no change in that.

That's not impacted by, frankly, any -- I get why it's very important to all the commentators, but in the grand scheme of things, short-term shifts in advertising do not impact on the strategy that we are delivering and why that's right for the Company. In fact, arguably, they highlight why the strategy is the right strategy. I think our nine-months' revenue numbers reflect that, despite advertising being impacted, we can still grow our overall revenues. I think that's a testament to why we're doing this. So that's that one.

I think your basic question is on the cost of scripted. The absolutely honest answer is it's, as you might expect, a mixed picture. We can and do produce very good quality scripted projects that can cost as little as GBP500,000, GBP650,000 an episode. We also produce very high-end, high-quality dramas that can cost up to GBP2 million per episode. It really depends on the idea, on the script, the broadcaster you're producing it for, whether it's for one particular market, whether it's a worldwide opportunity. So it really does depend on what you're trying to do.

I think the bigger issue in scripted right now, hence, for example, us investing in people in the US over the course of the next 12 months, is the thing it gets harder to do, given the sheer demand for scripted projects from broadcasters, is that the very best people are in higher demand, whether that be writers, producers, directors, you name it.

Therefore, ensuring that you have a good creative reputation for working with these people, employing them in the right way, working with them in the right way, investing in them, giving them the right kind of work, supporting their

projects, that's actually part of developing a relationship with all of those people.

I would say that has become ever-more important over the last couple of years. When you take the US, I think the view is they have gone from, two or three years ago, having something like just over 200 scripted series on air, I think the expectation next year is there'll be around 500 scripted series on air. That's a lot of extra demand, which is good, but there hasn't necessarily been a similar increase in the number of people able to do that well. Therefore those people are more highly demanded.

John Karidis: Thank you.

Adam Crozier: OK. Can I just, on behalf of Ian and I, just thank you all for taking the time this morning. I know we don't normally do it; I hope you understand why. We just thought it was a helpful thing, given there are so many things going on at the moment, to give you a bit of color around everything.

As always, Pippa and the team and of course us, we're all around so if anyone needs to talk to us, please just let us know. But thanks again for your time; really do appreciate it. Thank you.

Operator: That does conclude our conference for today. Thank you for participating. You may all disconnect.

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