Reach: Decreasing liabilities will boost cash flows

Company:	Reach (RCH LN)	**Market Cap:**	£250mio
Industry:	Media/Newspaper	**Net Cash:**	£43.8mio + £69.1mio pension deficit
Country:	UK	**Revenue:**	£600mio
Date:	16th September 2022	**Net Income:**	£50mio (8.3%)
Dividend:	£23.6mio (9.5%)	**Free Cash Flow:**	£23mio (3.8%)
Entry:	£273mio	**Target Market Cap:**	£400mio

The UK newspaper landscape

The UK newspaper landscape can be divided between national and regional papers and between conventional and tabloid style journalism. Reach is focused on tabloid style journalism with both, regional and national papers as well as websites & newsletters. The industry has seen a bounce in 2021 amidst strengthening advertising yields, high digital viewership and a stronger focus on regional titles due to lockdowns and Covid-19. This recovery has, however, quickly stalled and is now in clear decline with y-o-y circulation of regional titles dropping by double digit percentages[1]. Despite this rapid boom bust cycle with Reach losing over 80% market capitalization in just one year, there are signs that a turnaround could evolve from here…

[1] https://pressgazette.co.uk/regional-abcs-2022/

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UK's largest newspapers

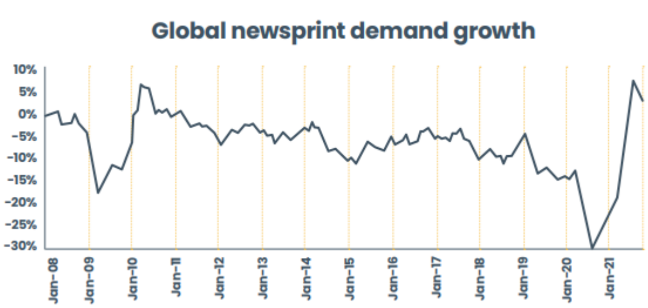
Newspaper	Owner	Circulation per day	Conventional & National	Tabloid & National	Regional
The Times, The Sun	News UK	1,600,000*	x	x	
Financial Times	Nikkei	105,748	x		
Daily Telegraph	Telegraph Media	300,000*	x		
Daily Mail, Metro, i	DMG Media	978,313		x	x
Daily Mirror, Express, Star, Record & Regionals	Reach	733,285		x	x
The Guardian, The Observer	GMG	235,000*		x	
The Independent, Evening Standard	Lebedev, Abuljadayel, Shaw	600,000*		x	x
City AM	City AM ltd	36,640			x
The Herald, Northern Echo etc.	Newsquest media group/Gannett	728,571*			x
The Courier, Aberdeen Journals	DC Thomson	50,000*			x
The Scotsman, Yorkshire Post etc.	JPI Media	-			x

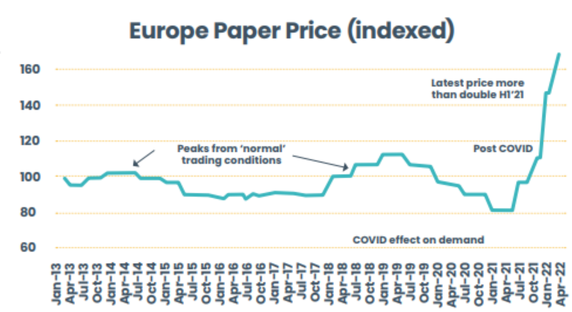
Source: Abc.org, Google, *not accurate

Why did Reach's valuation drop by 80% in 1 year?

The decline of Reach's market capitalization can be summarized as follows: A decline in advertising yields partly caused by the Ukraine war, the general decline in newspaper circulation, the rise in energy costs that caused paper prices to climb parabolic and rising staff costs that has led to strikes. Reach has described these struggles in the following charts:

Reach's troubles





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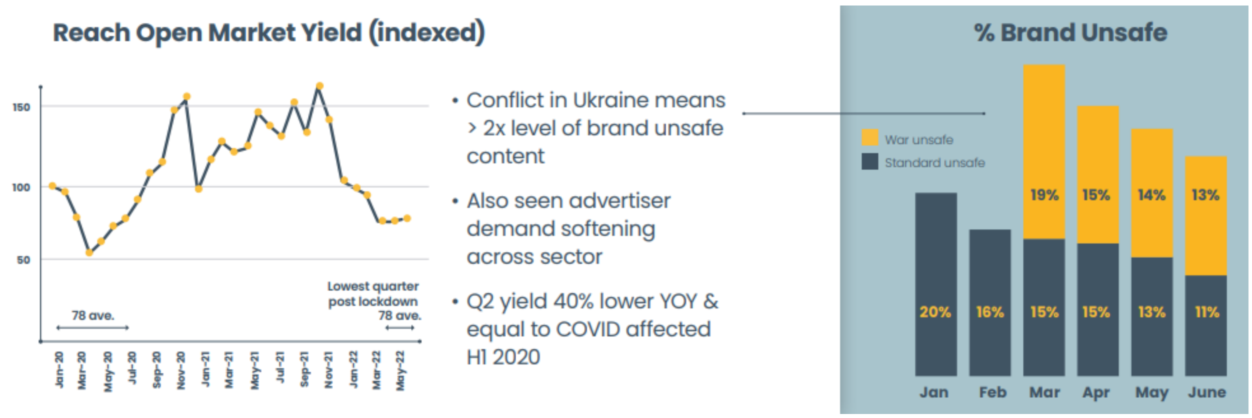

Source: Reach H1 22 presentation

The near term outlook

Last week a number of events unfolded that made a turnaround of Reach possible. First of all, the UK government pledged to cap energy bills for businesses to levels equivalent to that of households. This could help in bringing printing costs as well as paper prices down. Then, the Queen's death, as tragic as it was, led to a declaration of one week of mourning and has stopped a planned 3-day strike of 25% of Reach's workforce – this gives management time to renegotiate and also comes after more clarity on energy costs for households, which should ultimately put a cap on the cost of living crisis. Furthermore, the Queen's death has caused a massive demand in newspaper print. When I walked in to Waitrose on Saturday morning I saw people buying 3-4 newspaper at a time – I began to have £ signs in my eyes. Reach has guided for a stronger H2 amid the implementation of price hikes in newsprint. And while the recession risk remains, the football world cup in Qatar should drive increasing advertising demand.

The turnaround

The key about understanding Reach's low P/E valuation is their liabilities. Over the last few years Reach had to pay around £50mio in annual pension contributions. Due to the rise in discount rates and still anchored inflation expectations, the pension deficit declined to only £69.1mio with around £32mio due in H2 22. This means by next year, Reach will likely achieve a pension surplus, especially as they consider hedging and de-risking their liabilities. Another drag on cash flows has been around £17mio annual payments due to the acquisition of Express & Star. Next year will be the last payment of £7mio & possibly

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the last ~£37mio pension deficit payment, which would then leave cash flows improved by a whopping £72.2mio from 2024 onwards. This compares to current free cash flows of £23mio (i.e. potential £95mio free cash flow from 2024) and an enterprise value of just £200mio!

Reach's liabilities

Year	Pension deficit (£ mio)	Express & Star deferred payment (£ mio)
2019	48.9	-
2020	53.9	18.9
2021	64.7	16
2022	55.1	17.1
2023	37	7
2024	-	-

Source: Reach annual reports

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